

## L3Harris Technology (LHX)

**\$173.67** (As of 08/07/20)

Price Target (6-12 Months): **\$186.00**

Long Term: 6-12 Months

**Zacks Recommendation:**
**Neutral**

(Since: 09/09/19)

Prior Recommendation:

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:C

Value: C

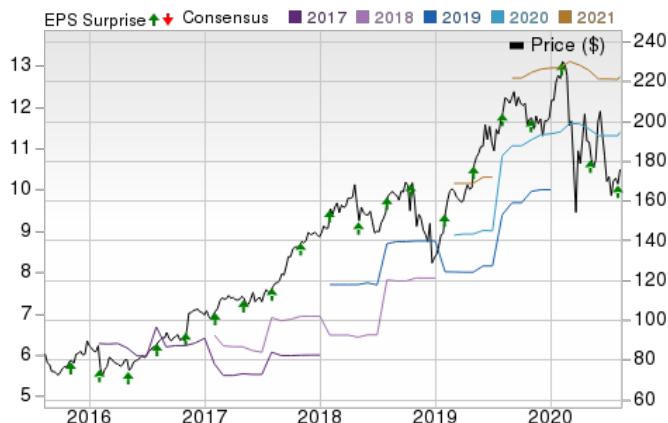
Growth: B

Momentum: D

### Summary

L3Harris second quarter of 2020 earnings surpassed the Zacks Consensus Estimate but revenues missed the mark. The company follows a disciplined divestment strategy, which is expected to boost its cash flow account. The company made net synergy savings of \$60 million in the second quarter. L3Harris delivered \$60 million of net synergies in second quarter. The company's shares have outperformed its industry in the past year. However, the expanded tariff on import of aluminum by the U.S. administration may increase the input cost of aerospace and defense stocks like L3Harris. COVID-19 and its persistent effect on the commercial aviation market are concerns for the company's commercial business. Also, the pandemic impacts are pushing up its operating expenses that might weigh on its bottom line.

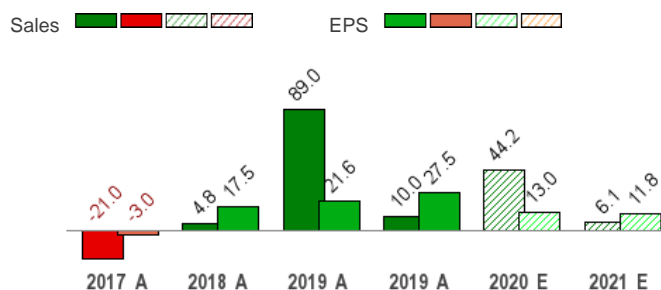
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$230.99 - \$142.01
20 Day Average Volume (sh)	1,377,243
Market Cap	\$38.0 B
YTD Price Change	-11.2%
Beta	0.71
Dividend / Div Yld	\$3.40 / 1.9%
Industry	<a href="#">Aerospace - Defense</a>
Zacks Industry Rank	Bottom 16% (211 out of 252)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	8.0%
Last Sales Surprise	-0.4%
EPS F1 Est- 4 week change	0.7%
Expected Report Date	NA
Earnings ESP	-1.1%

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	4,850 E	4,791 E	4,796 E	5,247 E	19,667 E
2020	4,626 A	4,445 A	4,525 E	4,960 E	18,540 E
2019	1,728 A	1,865 A	4,431 A	4,832 A	12,856 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$3.03 E	\$3.08 E	\$3.20 E	\$3.59 E	\$12.74 E
2020	\$2.80 A	\$2.83 A	\$2.72 E	\$3.13 E	\$11.39 E
2019	\$2.11 A	\$2.44 A	\$2.58 A	\$2.85 A	\$10.08 A

\*Quarterly figures may not add up to annual.

P/E TTM	15.9
P/E F1	15.3
PEG F1	1.9
P/S TTM	2.1

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/07/2020. The reports text is as of 08/10/2020.

## Overview

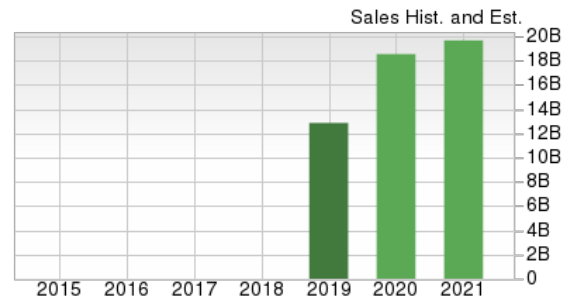
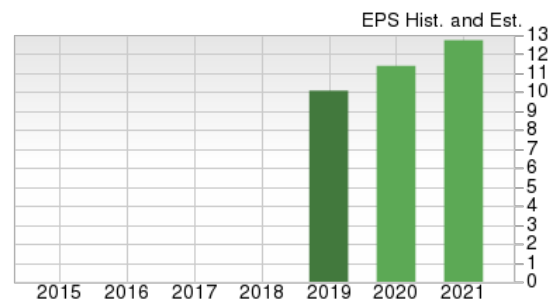
L3Harris Technologies, Inc. was formed following the merger of L3 Technologies and Harris Corporation on Jun 29, 2019. The company is a technology-oriented aerospace and defense player that delivers advanced defense and commercial technologies across air, land, sea, space and cyber domains. It currently operates through four major business segments:

**Integrated Mission Systems** provides complex ISR systems for large military platforms; advanced electro-optical and infrared, laser imaging and targeting sensor systems; and electrical and electronic systems and integration for maritime power and navigation solutions. In 2019, this segment contributed 21.8% to the company's total revenues.

**Space and Airborne Systems** provides space payloads, sensors and full-mission solutions for classified, civil and commercial customers; situational awareness, optical networks and advanced wireless solutions; avionic sensors, hardened electronics, release systems, data links and antennas supporting fixed-wing and rotary platforms; and multi-spectral situational awareness, threat warning and countermeasures capabilities for electronic warfare solutions. In 2019, this segment contributed 33.7% to the company's total revenues.

**Communication Systems** provides tactical radio communications, SATCOM terminals and battlefield management networks; broadband secured mobile networked communication equipment and integration; a full suite of helmet and weapon-mounted integrated night vision systems; and radios, applications and equipment. In 2019, this segment contributed 26% to the company's total revenues.

**Aviation Systems** provides defense aviation products such as precision engagement sensors and systems, small UAVs, antennas and arrays, RF amplifiers and microwave electron devices; commercial aviation products such as airport security and detection solutions and airborne avionics products (for example, traffic collision avoidance and flight recorders); mission communications and networking solutions. In 2019, this segment contributed 18.4% to the company's total revenues. The total revenues for 2019 consisted of \$0.09 million of corporate eliminations and \$0.1 million of other non-reportable business segments' revenues.



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## Reasons To Buy:

- ▲ The latest merger between L3 Technologies and Harris Corp has resulted in a global aerospace and defense technology innovator, which delivers end-to-end solutions to meet customers' mission-critical needs. The deal amalgamated L3 Technologies, a prime contractor in ISR systems, aircraft sustainment, communication, electronic and sensor systems, with technology company Harris Corp. The new company is expected to come up with \$18 billion in annualized revenue, on completion of the integration, with customers in over 130 countries.

Disciplined divestment strategy, solid capital deployment policy and strong cash position to boost L3Harris' growth

As of July 3, 2020, the integration is progressing ahead of plan. L3Harris made net synergy savings of \$60 million in the second quarter and \$115 million yeartodate. Offsetting COVID-19 impacts, the company currently expects to deliver \$185 million in net savings by 2020-end, up \$20 million from its prior estimate, largely driven a steady ramp in savings from the supply chain, shared services and benefits. It targets \$300 million net savings, \$500 million in total, in 2021, a year ahead of plan. We expect the merger to offer the new company improved economies of scale, considering the optimistic investment stance adopted lately by the U.S. administration in the nation's aerospace-defense industry.

- ▲ Coming to quarterly highlights, U.S. Department of Defense (DoD) tactical modernization momentum continued for L3Harris, as the company won a \$95 million award for an additional low rate production contract on the U.S. army's HMS Manpack. After completion of the operational testing early next year, management projects to clinch a full rate production award against the previously announced IDIQ of nearly \$13 billion. It also won a \$900 million contract to develop and manage simulator requirements and standards across the Air Force's training portfolio. Moreover, in July, L3Harris was selected as the prime contractor for the medium unmanned surface vehicle for the U.S. Navy. Further, the company is in the process of finalizing its position on the U.S navy's frigate program as a system integrator, with an initial 10-ship contract of over \$300 million. These awards indicate solid revenue generation prospects for this defense major over the long run.
- ▲ Post its formation, L3Harris continues to follow a disciplined divestment strategy, in line with both L3 Technologies and Harris' plans to efficiently focus on its core operations. To this end, it is imperative to mention that on Jul 31, L3Harris complete the divestment of its EOTech business for \$42 million. On May 15, the company completed the divestiture of its Applied Kilovolts and Analytical Instrumentation business for net cash proceeds of \$12 million. On May 4, L3Harris completed the sale of its airport security business for \$1 billion to Leidos Holdings. In July 2020, the company decided to divest another business from its Aviation Systems segment, which is expected to be completed by 2020-end. Such divestment strategies are expected to boost the company's cash flow account, thereby driving operations and allowing it to make notable share repurchases.
- ▲ L3Harris' cash and cash equivalents were \$1,947 million as of Jul 3, 2020, compared with \$663 million as of Apr 3, 2020. While its cash reserve improved significantly on a sequential basis, its long-term debt of \$7.1 billion remained well above the cash balance. Nevertheless, its current debt of \$668 million, as of Jul 3, 2020, remained well below its cash reserve. This reflects a strong solvency position, at least in the short term.

Moreover, the company's current ratio of 1.51, as of Jul 3, 2020, improved sequentially from 1.41. Also, this ratio being more than 1 indicates the company's ability to pay off its debt obligation. Its strong performance along with divestiture proceeds will enable it to achieve its prior commitment to return capital to shareholders in the third quarter. In the longer term, L3Harris targets to generate \$3 billion of free cash flow in 2022, driven in part by continued improvement in working capital. Such impressive financial stability may have boosted investors' confidence in this stock. In the past year, L3Harris has dropped 16.1% compared to the industry's 27.6% decline.

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## Reasons To Sell:

▼ In January 2020, the Trump administration announced plans to expand its existing tariffs on imports of steel and aluminum from Feb 8. Steel and aluminum derivatives now come under the tariff mandate. This tariff expansion is expected to deal a heavy blow to the U.S. aerospace and defense industry, which relies heavily on imported aluminum. In 2018, when the initial tariff was imposed, the AIA had expressed concern by saying that such a tariff will raise cost and disrupt the supply chain. Now that tariffs are being imposed on derivatives as well, input costs are expected to rise even more, thereby hurting the growth prospects of aerospace and defense stocks like L3Harris.

Impact of increased tariff on import of aluminum and COVID-19 impact on its commercial business might mar the stock's growth

▼ A comparative analysis of the company's historical EV/EBITDA TTM ratio reflects a relatively gloomy picture, which might be a cause for investors' concern. Evidently, the stock has a current trailing 12-month EV/EBITDA ratio of 18.64. This level lies near the high end of its past year range. Moreover, the company's EV/EBITDA TTM ratio remained above the industry's EV/EBITDA TTM ratio of 11.72 in a year.

▼ The novel coronavirus outbreak and its persistent effect on the commercial aviation market remains a cause of concern for the company's commercial business growth. Notably, the pandemic has significantly reduced demand for flight training, flight simulators and commercial avionics products in L3Harris' Commercial Aviation Solutions sector within its Aviation Systems segment. As a result, the company had to temporarily close some of its flight training facilities in Europe and several other locations. During the second quarter, L3Harris incurred \$14 million of restructuring charges, including workforce reductions and other exit costs within its Aviation Systems segment associated with the COVID-19-related downturn in Commercial Aviation Solutions.

It also recorded \$69 million of charges for impairment of goodwill and other assets and other COVID-19-related impacts, within the commercial market. With commercial training representing roughly 40% of L3Harris' total sales, the COVID-19 impacts are expected to hurt the company's results. Notably, the company expects revenues in its Commercial Aviation Solutions sector to decrease approximately \$300 million in 2020.

▼ In the wake of the ongoing pandemic, L3Harris' management is focused on mitigating the effects of COVID-19, which has required and will continue to require, a large investment of time and resources across its enterprise. While this will increase cost of operations for the company, it also will delay other value-added services or initiatives. Evidently, during the second quarter, the company witnessed a havoc 160% hike in both cost of product sales and services as well as engineering, selling and administrative expenses. Such rising expenses will weigh on its bottom line growth. Additionally, many of its employees are currently working remotely. The company fears that an extended period of remote work arrangements could strain business continuity plans, introduce operational risk, including but not limited to cyber security risks, and impair its ability to manage business.

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## Last Earnings Report

### L3Harris Technologies Beats on Q2 Earnings, Tweaks View

L3Harris Technologies second-quarter 2020 adjusted earnings came in at \$2.83 per share, which surpassed the Zacks Consensus Estimate of \$2.62 by 8%. The bottom line also increased 13% from the year-ago quarter's \$2.51.

Including one-time items, the company reported GAAP earnings of \$1.30 per share compared with \$2.21 in the year-ago quarter.

The year-over-year downside in GAAP earnings can be attributed to divestiture-related charges, COVID-19-related impacts and amortization of merger-related intangibles.

Quarter Ending 06/2020

Report Date	Jul 31, 2020
Sales Surprise	-0.36%
EPS Surprise	8.02%
Quarterly EPS	2.83
Annual EPS (TTM)	11.06

### Total Revenues

In the quarter under review, the company's revenues came in at \$4,445 million, lagging the Zacks Consensus Estimate of \$4,460 million by 0.4%. However, revenues surged 138% on a year-over-year basis, driven by post-merger inclusion of L3 operations.

### Segmental Performance

**Integrated Mission Systems:** Net sales at the segment came in at \$1,331 million. On a pro forma basis, revenues were up 7.3%, driven by growth in Electro Optical and Maritime units.

Operating income, on a pro-forma basis, came in at \$224 million compared with \$162 million in the year-ago quarter. Moreover, operating margin expanded 370 basis points (bps) to 16.8%.

**Space and Airborne Systems:** The segment recorded net sales of \$1,249 million in the second quarter, up 23% year over year. On a pro-forma basis, revenues increased 4.1% year over year driven by a ramp up in modernization on the F-35 platform in Avionics and classified growth in Intel and Cyber.

Operating income increased to \$235 million from \$228 million in the year-ago quarter. Operating margin contracted 20 bps to 18.8%.

**Communication Systems:** Net sales at the segment rose 83% to \$1,112 million. On a pro-forma basis, revenues increased 2.4% year over year due to ramp up in U.S. DoD modernization programs in Tactical Communications and Integrated Vision Systems.

Operating income increased to \$265 million from \$239 million in the year-ago quarter. Operating margin expanded 180 bps to 23.8%.

**Aviation Systems:** Net sales at the segment came in at \$800 million down 17% on a pro-forma basis, on account of COVID-19-related impacts in the commercial aviation business.

Operating income decreased to \$31 million from \$109 million. Operating margin contracted a huge 740 bps to 3.9%.

### Financial Position

As of Jul 3, 2020, L3Harris had \$1,947 million in cash and cash equivalents compared with \$824 million as of Jan 3, 2020.

Long-term debt as of Jul 3, 2020 was \$6,273 million compared with \$6,694 million as of Jan 3, 2020.

Net cash inflow from operating activities amounted to \$1,335 million at the end of second-quarter 2020 compared with the year-ago cash inflow of \$716 million.

### 2020 View

L3Harris made some changes to its 2020 guidance. The company continues to expect organic revenues to grow in the range of 3-5% and projects revenues in the range of \$18.2-\$18.6 billion. The Zacks Consensus Estimate for revenues of \$18.6 billion is in line with the higher end of the company provided range.

Adjusted earnings per share for 2020 are still projected in the range of \$11.15-\$11.55. The Zacks Consensus Estimate for earnings of \$11.28 lies below the midpoint of the company's guidance.

However, the company has decreased its GAAP EPS guidance to the range of \$6.03-\$6.43 from the previous guidance of \$6.95-\$7.35.

Operating cash flow and adjusted free cash flow are still expected in the range of \$2.8-\$2.9 billion and \$2.6-\$2.7 billion, respectively.

## Recent News

On **June 17, 2020**, L3Harris Technologies announced its new man-portable Iver4 580 unmanned undersea vehicle (UUV). The new Iver4 580 is the second vehicle in the Iver4 family of next-generation UUVs to address a wide variety of customer missions, including survey; multi-domain intelligence, surveillance and reconnaissance; anti-submarine warfare; seabed warfare and mine warfare. Built with Iver4 advanced technology, the Iver4 580 features a full suite of sensors in a portable size (5.8-inch diameter and 82-inch length) and small mission footprint for rapid deployment from any vessel.

## Valuation

L3Harris' shares are down 11.3% in the year to date period and 16.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 23.2% and 29.2% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 27.6% and the Zacks Aerospace sector witnessed a 29.2% decline.

The S&P 500 index is up 4.1% in the year to date period and 16.6% in the past year.

The stock is currently trading at 11.6X forward 12-month earnings, which compares to 21.2X for the Zacks sub-industry, 22.1X for the Zacks sector and 22.8X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.9X and as low as 18.3X, with a 5-year median of 14.4X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$186 price target reflects 12.2X earnings value.

The table below shows summary valuation data for LHX

Valuation Multiples - LHX					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.55	21.19	22.09	22.81
	5-Year High	25.9	22.54	22.09	22.81
	5-Year Low	18.25	14.52	14.17	15.25
	5-Year Median	14.39	17.75	17.24	17.55
P/S F12M	Current	1.97	1.28	1.16	3.67
	5-Year High	6.11	1.64	1.49	3.67
	5-Year Low	1.11	0.95	0.92	2.53
	5-Year Median	2.31	1.28	1.18	3.04
EV/EBITDA TTM	Current	15.63	31.66	11.53	12.89
	5-Year High	30.97	32.07	15	12.89
	5-Year Low	9.59	8.12	7.39	8.24
	5-Year Median	18.09	11.81	10.58	10.89

As of 08/07/2020

## Industry Analysis Zacks Industry Rank: Bottom 16% (211 out of 252)



## Top Peers

Company (Ticker)	Rec	Rank
General Dynamics Corporation (GD)	Neutral	3
Leidos Holdings, Inc. (LDOS)	Neutral	3
Lockheed Martin Corporation (LMT)	Neutral	3
Northrop Grumman Corporation (NOC)	Neutral	3
Transdigm Group Incorporated (TDG)	Neutral	3
Teledyne Technologies Incorporated (TDY)	Neutral	2
Textron Inc. (TXT)	Neutral	3
Heico Corporation (HEI)	Underperform	4

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	LHX	X Industry	S&P 500	LDOS	LMT	NOC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	C	-	-	A	A	A
Market Cap	37.97 B	11.26 B	23.30 B	13.25 B	107.80 B	54.89 B
# of Analysts	8	5	14	9	8	7
Dividend Yield	1.94%	0.01%	1.76%	1.46%	2.49%	1.76%
Value Score	C	-	-	B	B	B
Cash/Price	0.05	0.08	0.07	0.03	0.03	0.08
EV/EBITDA	97.23	10.68	13.32	14.06	12.89	16.20
PEG Ratio	1.96	2.31	2.94	1.61	2.31	NA
Price/Book (P/B)	1.71	3.31	3.19	3.74	28.47	5.65
Price/Cash Flow (P/CF)	18.28	10.27	12.51	13.26	14.66	11.94
P/E (F1)	15.72	15.99	22.02	17.29	15.99	14.69
Price/Sales (P/S)	2.07	1.14	2.53	1.14	1.71	1.58
Earnings Yield	6.48%	4.04%	4.37%	5.78%	6.25%	6.81%
Debt/Equity	0.32	0.95	0.77	1.32	3.22	1.61
Cash Flow (\$/share)	9.61	2.73	6.94	7.03	26.30	27.58
Growth Score	B	-	-	A	A	A
Hist. EPS Growth (3-5 yrs)	16.25%	14.53%	10.46%	14.53%	18.30%	23.60%
Proj. EPS Growth (F1/F0)	1,579.09%	1.87%	-6.80%	4.26%	9.87%	5.69%
Curr. Cash Flow Growth	23.01%	11.64%	5.39%	6.19%	18.08%	2.21%
Hist. Cash Flow Growth (3-5 yrs)	7.97%	7.38%	8.55%	6.45%	9.70%	14.43%
Current Ratio	1.51	1.33	1.33	0.89	1.31	1.35
Debt/Capital	24.07%	53.24%	44.50%	56.87%	76.28%	61.62%
Net Margin	7.21%	5.59%	10.13%	5.26%	10.25%	6.91%
Return on Equity	10.92%	10.92%	14.39%	23.81%	182.05%	40.24%
Sales/Assets	0.48	0.79	0.51	1.11	1.29	0.82
Proj. Sales Growth (F1/F0)	95.29%	0.00%	-1.51%	12.92%	8.29%	4.71%
Momentum Score	D	-	-	A	B	B
Daily Price Chg	1.13%	-0.05%	0.90%	2.42%	1.55%	0.90%
1 Week Price Chg	-1.70%	-1.88%	0.14%	4.49%	-1.87%	3.94%
4 Week Price Chg	9.91%	6.90%	8.95%	7.87%	13.43%	15.15%
12 Week Price Chg	-1.24%	15.34%	18.90%	-2.73%	8.24%	5.56%
52 Week Price Chg	-18.10%	-20.09%	1.18%	11.10%	2.24%	-10.76%
20 Day Average Volume	1,377,243	656,418	2,057,775	1,032,973	1,319,744	977,720
(F1) EPS Est 1 week change	0.95%	0.00%	0.00%	2.10%	0.00%	0.77%
(F1) EPS Est 4 week change	0.73%	0.00%	1.36%	2.97%	2.01%	1.36%
(F1) EPS Est 12 week change	0.27%	-1.22%	1.57%	3.47%	2.06%	1.43%
(Q1) EPS Est Mthly Chg	-0.82%	-1.00%	0.54%	-3.36%	-1.17%	-1.28%



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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	B
Momentum Score	D
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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