

L3Harris Technology (LHX)

\$228.55 (As of 02/14/20)

Price Target (6-12 Months): **\$242.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 07/04/19)

Prior Recommendation: NA

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:F

Value: D

Growth: F

Momentum: A

Summary

L3Harris ended 2019 on an impressive note, with its fourth-quarter earnings as well as revenues surpassing the respective Zacks Consensus Estimate. The company is a technology-oriented aerospace and defense player that delivers advanced defense and commercial technologies. On completion of its integration, L3Harris is expected to come up with \$18 billion in annualized revenues. In the six months since completion of the merger, L3Harris has delivered \$65 million of net synergies. Its shares have outperformed its industry in the past year. However, expanded tariff on import of aluminum may increase the input cost of aerospace and defense stocks like L3Harris. The Brexit effect may disrupt the company's supply chain. A comparative analysis of L3Harris' historical EV/EBITDA TTM ratio reflects a relatively gloomy picture,

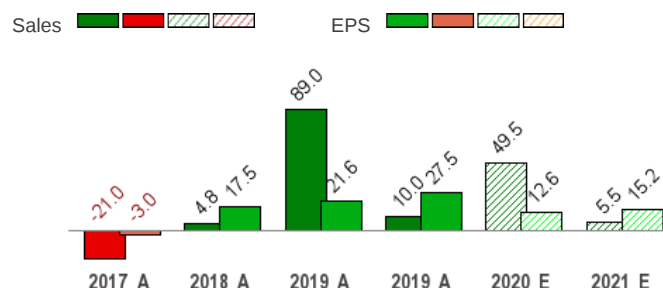
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$230.99 - \$156.90
20 Day Average Volume (sh)	1,258,726
Market Cap	\$50.5 B
YTD Price Change	15.5%
Beta	0.82
Dividend / Div Yld	\$3.00 / 1.3%
Industry	Aerospace - Defense
Zacks Industry Rank	Bottom 27% (187 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	6.1%
Last Sales Surprise	0.5%
EPS F1 Est- 4 week change	1.9%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	22.9
P/E F1	20.1
PEG F1	2.5
P/S TTM	3.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					20,280 E
2020	4,632 E	4,741 E	4,723 E	5,110 E	19,221 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					\$13.08 E
2020	\$2.57 E	\$2.77 E	\$2.79 E	\$2.88 E	\$11.35 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.

The data in the charts and tables, except sales and EPS estimates, is as of 02/14/2020. The reports text and the analyst-provided sales and EPS estimates are as of 02/17/2020.

Overview

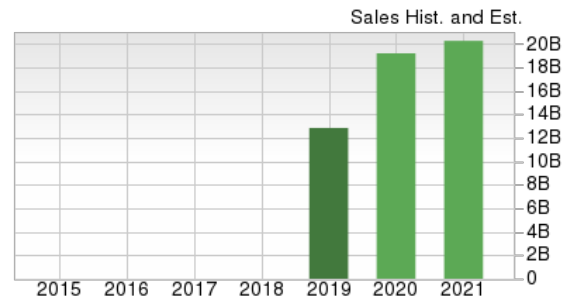
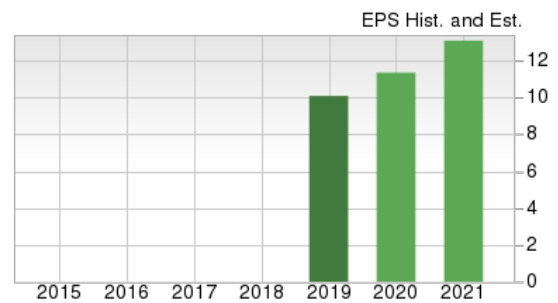
L3Harris Technologies, Inc. was formed following the merger of L3 Technologies and Harris Corporation on Jun 29, 2019. The company is a technology-oriented aerospace and defense player that delivers advanced defense and commercial technologies across air, land, sea, space and cyber domains. It currently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



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 financial position and consolidated operational strength to boost L3Harris' growth

As of Jan 3, 2020, the integration is progressing ahead of plan and in the six months since closure of the merger, L3Harris has delivered \$65 million of net synergies, 30% higher than its previous guidance. This momentum, along with a well-defined path to generate \$180 million of cumulative net savings in 2020, has made L3Harris confident. It targets \$300 million net savings, \$500 million in total, in 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, L3Harris won the certificate of airworthiness in ISR business on its fourth and final Peregrine aircraft. Notably, the company has modified G550s with next generation electronic warfare capabilities for the Royal Australian Air Force. To this end, management believes that its strong performance and customer focus positions it for continued international growth in its missionization business in 2020 and beyond. Moreover, 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, in February 2020, L3Harris announced its decision to sell its airport security business for \$1 billion to Leidos. The deal is expected to close by middle of 2020, and the net proceeds from the transaction will be used to repurchase shares and offset dilution.
- ▲ In July 2019, L3Harris's management approved a 10% increase in quarterly cash dividend rate to 75 cents per share, corresponding to an increase in the annualized rate from \$2.74 to \$3.00. This represents an increase of 15% for legacy L3 shareholders. The increase has been effective from third-quarter of 2019, and the company expects to further review its annual cash dividend rate in the first quarter of 2020, as it transitions to the calendar year financial reporting.

In addition, management approved a new \$4 billion share repurchase authorization. During the fourth quarter, L3Harris returned \$915 million to shareholders including \$750 million in share repurchases and pledges to return more than \$3.5 billion to share repurchases and dividends by the end of 2020. Such impressive capital deployment program is indicative of the combined company's financial flexibility. This commitment toward delivering value to shareholders may have boosted investors' confidence in this stock's growth potential. In the past year, L3Harris has moved up 40.8% compared with its industry's 8.2% growth.

Reasons To Sell:

- ▼ Volatility in foreign currencies is expected to occur as the United Kingdom exits from the European Union, as a result of Brexit. If the United Kingdom's membership in the European Union ends without an agreement, there could be cost escalation due to re-imposition of tariffs on trade between the United Kingdom and European Union, shipping delays because of the need for customs inspections and procedures and shortage of certain goods. The United Kingdom will also need to negotiate its own tax and trade treaties with countries all over the world, which could take years to complete. This potential scenario has the capacity to expose L3Harris to disruptions in supply chain, while the imposition of tariffs, and currency devaluation in the United Kingdom might have an adverse impact on its consolidated revenues, earnings and cash flow.
- ▼ 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.
- ▼ 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 27.94. This level lies near the high end of its past one year range. Moreover, the company's EV/EBITDA TTM ratio remained above the industry's EV/EBITDA TTM ratio of 14.53 in a year.

Effect of Brexit, impact of import tariff on aluminum and poor valuation might mar the stock's growth

Last Earnings Report

L3Harris Technologies Q4 Earnings Beat Estimates

L3Harris Technologies adjusted earnings from continuing operations in fourth-quarter 2019 came in at \$2.85 per share, which surpassed the Zacks Consensus Estimate of \$2.75. The bottom line also increased 28% from the year-ago quarter's \$2.22.

Excluding one-time items, the company reported GAAP earnings of \$1.77 per share compared with \$1.88 in the year-ago quarter.

The year-over-year uptick can be attributed to higher volumes from the L3Harris merger, strong operational performance and the integration savings gain on the sale of the Harris Night Vision business in the third quarter.

Quarter Ending **12/2019**

Report Date	Feb 04, 2020
Sales Surprise	0.47%
EPS Surprise	6.09%
Quarterly EPS	2.85
Annual EPS (TTM)	9.98

Total Revenues

In the quarter under review, the company's revenues came in at \$4,832 million, exceeding the Zacks Consensus Estimate of \$4,809 million by 0.5%. Revenues in the reported quarter were favorably impacted by strong growth across Integrated Mission Systems, Space and Airborne Systems and Communication Systems.

Segmental Performance

Integrated Mission Systems: Net sales at the segment improved 11% to \$1,471 million from the prior-year quarter's \$1,331 million, primarily driven by strength in the ISR and Electro Optical businesses.

Operating income came in at \$197 million compared with \$148 million in the year-ago quarter. Moreover, operating margin expanded 230 basis points (bps) to 13.4%.

Space and Airborne Systems: The segment recorded net sales of \$1,198 million in the fourth quarter, up 12% year over year. The upside can be attributed to the ramping up of modernization in the F-35 platform in Avionics, increased production of B-52 aircraft in Electronic Warfare, and growth in ground-based adjacencies and exquisite systems in classified areas.

Operating income increased to \$216 million from \$199 million in the year-ago quarter. Operating margin contracted 60 bps to 18%.

Communication Systems: Net sales at the segment rose 10% to \$1,119 million, led by a ramp-up in U.S. DoD modernization programs in Tactical Communications and Integrated Vision Solutions as well as increased demand from state and federal customers in Public Safety.

Operating income increased to \$259 million from \$227 million in the year-ago quarter. Operating margin expanded 80 bps to 23.1%.

Aviation Systems: Net sales at the segment improved 7% to \$1,090 million, led by growth in defense and commercial aviation products.

Financial Position

As of Jan 3, 2020, L3Harris had \$824 million in cash and cash equivalents compared with \$343 million as of Dec 28, 2018.

Long-term debt as of Jan 3, 2020, was \$6,694 million compared with \$3,411 million as of Dec 28, 2018.

Net cash inflow from operating activities amounted to \$1,655 million at the end of the fourth quarter compared with the year-ago cash inflow of \$847 million.

2020 View

As a result of strong momentum and performance in 2019, L3Harris provided the following guidance for 2020. The company expects organic revenues to grow 5-7% from combined full-year calendar 2019 revenues.

Non-GAAP earnings per share for 2020 are expected to be in the range of \$11.35-\$11.75. Operating cash flow is expected to be \$2.8-\$2.9 billion and adjusted free cash flow \$2.6-\$2.7 billion.

Operating income increased to \$162 million from \$76 million. Operating margin expanded 740 bps to 14.9%.

Valuation

L3Harris' shares are up 8% in the past six months period and up 40.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are up 7.4% and 10.3% in the past six months period, respectively. Over the past year, the Zacks sub-industry and sector are up 8.2% and 13.7%, respectively.

The S&P 500 index is up 17.2% in the past six months period and 23.5% in the past year.

The stock is currently trading at 19.42X forward 12-month earnings, which compares to 23.13X for the Zacks sub-industry, 22.12X for the Zacks sector and 19.88X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.9X and as low as 11.55X, with a 5-year median of 18.20X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$242 price target reflects 20.56X 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	19.42	23.13	22.12	19.88
	5-Year High	25.9	23.13	22.12	20.66
	5-Year Low	11.55	14.52	14.26	15.75
	5-Year Median	18.2	17.09	16.87	18.77
P/S F12M	Current	2.61	1.62	1.42	3.29
	5-Year High	6.11	1.64	1.42	3.29
	5-Year Low	1.11	0.95	0.8	2.37
	5-Year Median	2.3	1.26	1.09	2.84
EV/EBITDA TTM	Current	27.94	20.49	13.23	11.36
	5-Year High	31.28	20.49	13.24	12.85
	5-Year Low	8.96	8.3	7.28	8.47
	5-Year Median	15.98	11.56	9.98	10.7

As of 02/14/2020

Industry Analysis Zacks Industry Rank: Bottom 27% (187 out of 255)



Top Peers

Heico Corporation (HEI)	Outperform
Leidos Holdings, Inc. (LDOS)	Outperform
General Dynamics Corporation (GD)	Neutral
Lockheed Martin Corporation (LMT)	Neutral
Northrop Grumman Corporation (NOC)	Neutral
Raytheon Company (RTN)	Neutral
Transdigm Group Incorporated (TDG)	Neutral
Teledyne Technologies Incorporated (TDY)	Neutral

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	LHX Neutral	X Industry	S&P 500	LDOS Outperform	LMT Neutral	NOC Neutral
VGM Score	F	-	-	A	C	A
Market Cap	50.52 B	15.81 B	24.61 B	15.97 B	123.45 B	62.18 B
# of Analysts	8	5	13	6	9	7
Dividend Yield	1.31%	0.88%	1.78%	1.21%	2.19%	1.42%
Value Score	D	-	-	C	D	B
Cash/Price	0.02	0.04	0.04	0.04	0.01	0.04
EV/EBITDA	127.90	14.13	14.06	18.29	14.68	18.08
PEG Ratio	2.52	2.27	2.09	2.76	2.75	0.97
Price/Book (P/B)	2.20	4.62	3.29	4.91	38.93	7.05
Price/Cash Flow (P/CF)	23.79	16.75	13.65	18.03	16.65	13.45
P/E (F1)	20.14	18.94	19.21	20.70	18.13	15.99
Price/Sales (P/S)	3.93	1.39	2.70	1.48	2.06	1.84
Earnings Yield	5.06%	5.06%	5.19%	4.83%	5.52%	6.25%
Debt/Equity	0.31	0.66	0.71	1.00	3.60	1.60
Cash Flow (\$/share)	9.61	2.18	6.92	6.26	26.30	27.58
Growth Score	F	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	12.63%	13.39%	10.85%	14.25%	16.29%	23.28%
Proj. EPS Growth (F1/F0)	39.60%	13.18%	7.17%	9.04%	10.04%	9.35%
Curr. Cash Flow Growth	23.01%	4.55%	8.56%	1.52%	18.08%	2.21%
Hist. Cash Flow Growth (3-5 yrs)	7.97%	7.16%	8.36%	37.15%	9.70%	14.43%
Current Ratio	1.49	1.16	1.23	1.16	1.22	1.13
Debt/Capital	23.74%	43.17%	42.91%	49.88%	78.24%	61.48%
Net Margin	10.37%	6.17%	11.81%	6.25%	10.42%	6.64%
Return on Equity	17.71%	19.42%	16.86%	21.12%	198.95%	39.51%
Sales/Assets	0.66	0.92	0.54	1.17	1.24	0.84
Proj. Sales Growth (F1/F0)	96.83%	5.15%	3.85%	6.47%	6.09%	5.46%
Momentum Score	A	-	-	C	B	C
Daily Price Chg	0.68%	0.16%	0.06%	-0.26%	0.72%	0.80%
1 Week Price Chg	3.85%	3.70%	2.47%	9.59%	2.58%	-3.51%
4 Week Price Chg	6.62%	2.44%	0.59%	10.28%	2.85%	-3.35%
12 Week Price Chg	14.81%	9.36%	6.98%	25.27%	12.19%	6.52%
52 Week Price Chg	40.87%	29.11%	16.62%	80.99%	45.47%	32.20%
20 Day Average Volume	1,258,726	466,245	2,020,569	752,598	1,149,905	892,934
(F1) EPS Est 1 week change	0.06%	0.00%	0.00%	0.00%	0.14%	0.00%
(F1) EPS Est 4 week change	1.91%	0.00%	-0.05%	0.00%	-0.44%	0.61%
(F1) EPS Est 12 week change	2.77%	-0.44%	-0.17%	1.18%	-0.44%	0.67%
(Q1) EPS Est Mthly Chg	1.49%	-1.60%	-0.24%	0.00%	-5.15%	-1.60%

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	D
Growth Score	F
Momentum Score	A
VGM Score	F

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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