Good morning. I certainly like to welcome you to L-3’s 2015 Investor Conference. I’m going to spend just a moment going through the agenda, giving you an idea of what we’re going to do this morning.

But first, I’ve got to give you this Safe Harbor statement. I’ll give you a second to take a quick look at that. What I’d like to do is talk a little bit about the agenda and what we’re going to do this morning. Since DoD and associated agencies are a big part of our business and products and solutions for those folks are terribly important to us, the thing that really drives them and drives those needs are the geopolitical environment. So we’re going have Dick Cody give us a little overview of that.

Mike Strianese, our CEO, is going to give us a Company overview. Then we’re going to have Chris Kubasik, our COO, newest member to the executive team, give us -- have a little panel with the number of business sectors who we thought we’d go down a level this year, just give you a feel for where they stand and where the businesses is. We’ll do a break and then we have Ralph do the financials and then we’ll have Q&A and lunch, okay.

So what I’d like to do though is just spend a few minutes and give you a feel for L-3 and what its composition is today and some of the products that we build and then what we will do is have Dick follow it. (video playing)
Dick Cody - L-3 Communications Holdings, Inc. - SVP, Washington Operations

Well, good morning everybody. I have been with the Company seven years now. I think last time I briefed to you all was two years ago. And I can tell you it’s a different Company than what company I joined in all for good in terms of where we’ve reshaped the Company over time with our new strategy and we’ve mapped that strategy to the chaotic world we live in. So the story I am going to tell you here in the next 20 minutes is what the world looks like today, where we think the world is going as well as how we’ve mapped that to our customers’ needs, especially the US government, whether it be state or DHS but also clearly DoD as well as our partner nations that are all facing what I would tell you is most chaotic world we’ve seen since the 1930s and maybe even more dangerous. So these six bullets up here are what I’m going to talk about and then I’m going to walk you back to what we’ve done in the last three years in terms of executive level management and group leadership and sector leadership to fully understand the requirements and solutions that our customers need, not just US but worldwide, not just the prescribed requirements but the descriptive capabilities that they need to be able to provide for the security that they are looking for.

So L-3 was formed in 1997 and this is what the world looks like across the globe. Russia was in decline coming out of Afghanistan, you had the peace dividend, NATO was all celebrating. You had NATO enlargement coming on board. Pretty much piece broken out all over the world. And not too many things going on. You had the Balkans, you had Rwandans, Somalia, a little bit of problem with the nuclear North Korea, but basically in 1997, the world certainly was not chaotic.

Here is what the world looks like today and I don’t have a model up there, but you can see across the globe whether it’s in Europe, you’ve got a resurge of Russia, you’ve got defense budgets, you’ve got Balkan security, you’ve got failing economies, Africa has really become a basket case across the board in terms of countries failing and in terms of everything from disasters to health problems to extremism. Middle East, you know very, very well and it is not getting better. Russia in itself, I could spend an hour trying to explain to you what Putin is doing. But suffice it to say, Russia is resurgent and is causing problems across not only Europe and Pacific certainly in Middle East. And then in Asia, a long growing problem with China. They get more land grab today across the globe in the Pacific with China since we saw what Japan did back in the 1930s.

And so this is the world we live in and our southern border, we’ve got similar problems. Some of the democracies are failing. Venezuela has got some real problems. You’ve got several other countries with narco trafficking problems as well as ISIS expanding across all of -- or ISIS surrogates. So I showed this slide to you about three or four years ago. You have to understand — if you’re going to be a business like L-3, you have to understand how our customers map their strategy and their requirements. So this slide basically tells you from the 1950s to 1989 when the wall came down, this is where we send our military, the US across the globe against the spectrum of conflicts. That’s military strategy for, these are the type of things we think we need to do and they built their force around that; Army, Navy, Air Force and Marine as did our NATO allies.

And you can see during the Cold War, it was high end up here but not much here. The Wall came down, all defense budgets went south if you remember, and then here is where we are today from 1989 on and you can see the big takeaway is this is no longer just about threat, it’s about capabilities base. And each one of those starbursts represent at least 5,000 troops or air wings or navies that were deployed to deal with these spectrums of conflicts, whether it’s peacekeeping, piece engagement, rage, counterinsurgency, major theater war, general war, and then down here domestic and disaster relief and several of these deployments still have (inaudible). And so it’s putting a demand on us and on our NATO partners and that’s what’s happened in the last 23 years.

And as we go forward, if you go over to the Pentagon and take a look at their national military strategy that’s built into their national security strategy, this is what the world looks like to them. It’s not getting any better. And so now what we had to understand was they’ve got some high-end requirements, they’ve got requirements down in this area and they’ve got requirements here and it’s all going to be a balance between capabilities based and threat based, okay. And so we looked at that as a Company and said okay where do we map our capabilities and what we bring to the table. Some of it has to be fast because it’s reactionary. Some of it is long term like the third offset, which I’ll discuss in a few minutes. So what we’re seeing is a cycle of chaos now as not every 10 years some big major deployment and it’s getting compressed and certainly with Russia going into Syria, with ISIS now expanding into Libya that’s what we’re seeing.

So let me give you a little quick update on the Middle East and you can see the turmoil there. With those starbursts, this is all terrorist activity. Libya as you know the Civil War, now ISIS is going there. ISIS is spreading. If they get those oil fields, they will be able to fund themselves internationally in ways that we haven’t seen before, certainly much bigger than Al-Qaeda. And they are a team now with Boko Haram, Al-Shabaab and so this whole area is really a problem. You know what’s going on in the Middle East. You know the Turks and Iran, natural enemies because of the credit
spread to them. And then you've got Assad being backed by Iran, being backed by Lebanese Hezbollah and now of course Russia. You've got the Sunni Monarchies.

They're concerned about Assad, but you all know that Saudi Arabia is more concerned about the Shia problem down in Yemen and they are more concerned about how Iran comes out of this nuclear deal and how strong they come -- become in Iraq. I don't know if you understand that we've got Iran and Iraq helping the Iraqis, we've got NATO in there helping them and this a basket case in terms of if you are a Sunni monarchy looking to the north. And so then all the way across here you know what's going on in Afghanistan. All this has created 60 million refugees. So now, not only the military issue, but now think about the burden on all of these countries in Europe with 60 million refugees. That's more refugees than we had in World War II. So it's creating security problems, border problems and it's generating a lot more capability and requirements across the security spectrum and we've taken a hard look at what capabilities and products we can do to address this.

When you take a look at the Pacific and you start from Afghanistan and move to the east, you can see we've got five nuclear powers. And Pakistan and India, they've got their own problems internally. We know about China, they are rather stable. And you know about this guy. At the same time you've got that's Shikoku Islands and you've got the Spratly Islands and you've got China pushing out their economic zone and we're being challenged there across the board.

And of course, I think you all know that a lot of the commerce, about 80% of the commerce, flows through the Strait of Malacca, so largest Muslim population there. They've got unrest. It hasn't really manifested itself yet. But you can anticipate with ISIS growing, you can anticipate all that happen. So that's what the Middle-East and the Pacific look like. So what does that mean is we looked at it.

Well, we took a look at the international defense budgets. They are not spiking to react to the current world problems of the refugees as well as the spread of ISIS as well as what's going on in Iraq and some of these other countries, but what we are seeing in the Middle-East like Saudi Arabia and UAE their budgets, defense and security budgets have gone up. What's really interesting and that's why the third offset, which I'll get to in a minute, Russia and China get a 15% to 18% increase in their defense spending. So they are resurging and they are challenging every point of the sphere.

Asia defense market, will eclipse the European market by next year. Our NATO nations that belong to NATO are supposed to spend 2% of their GDP on defense. There is only three countries that do that of all the NATO nations. Now, we don't anticipate this is going to last, because of what's going on because of Paris and because of what's happened in Belgium, but we haven't seen the budgets yet, but we know that uptick is coming and so we postured ourselves for it.

Across the board, I showed you the full spectrum capabilities that the US military wants, we're now seeing that the other militaries that were maybe [tri-athletes or penta-athletes], now they need to be full spectrum. And so we're seeing the same demands coming now from the international against full spectrum capability like anti-access, area denial more tactical ISR, SATCOMs, lot more soldier modernization, certainly UAVs all of which are on our portfolio. So as we've mapped last two or three strategy sessions, we feel that the portfolio that we have today is really set to the geopolitical market environments that are about to emerge.

I wouldn't have a pitch without telling you about little bit what's going on in Washington. It is getting better. Speaker Ryan, his honeymoon is perhaps over, but we are going into an election year and so you are going to see much bipartisanism. Having said that, we did get the budget deal and because of what's going on in the world we've got the Defense Authorization Act. It's enacted, it got passed, a few tweaks, but when we drill down and looked at it, there is great progress on the acquisition reform. You now have the service chiefs in charge of not only the requirements but they now have, I will say, skin in the game in terms of controlling some of their outcomes on the acquisition side. Not fully vetted to where I think the Chiefs want it, but we certainly see that. That's going to smooth out the demand cycle for industry, once we get that going.

The appropriations wrap up, the December 18; the CR goes till December 11. They're going to do a seven day extension on that, but we're going to get the Approps Bill out on the 18. We've talked to both the Senate and to the House, they're just going through that, but as drilled into all the programs, our programs are very good across the board, not many surprises.
Tax extenders; I know a lot of you are concerned about that. That’s going to happen on the 18 also. We’re not going to get a permanent, like Ryan wanted to. He can’t get some of his party to do it, but we’ll get the one-year extension retroactive on R&D tax credits. And then of course, you saw the transportation bill got passed and added to the transportation bill was the extension of the EXIM Bank. So even though there is still little bit of rift between the House and Senate, as well as inside their own parties, they did get a lot of work done.

Now, here is what the budget agreement laid out. I know a lot of you have seen it, but I want to point out a couple of things. Two years ago, we laid out, I think it was Ralph or I, laid out the budget and the OCO number was marked out there for 2016, 2017 and 2018 at $30 billion. We told you then that that number was not going to hold and it certainly has it.

Right now, the revised cap is about $58 billion. If something happens in the world that thing is going to go up quick, why? That’s the fast money. That’s the money they need for readiness and we’ve paid close attention to the readiness requirements of not just DoD, but our allies and we’re poised there. But the bottom line is, they got plus $33 billion above the current BCA caps for 2016 and about plus $23 billion for 2017. That’s good news and bad news.

For DoD, it’s not enough, it’s about $15 billion less in 2017 than they wanted. Now where are they going to take that money from? They’re going to take it from the platforms. They have no place else to go because of their readiness, because of that world, I just painted to you, where they got to be able to react in several places simultaneously across the full spectrum, they’ve got to build back their readiness. And we’ve heard it from the Secretary of Defense, we’ve heard it from the Deputy Secretary and certainly the comptroller that we’re not going to take end-strength down any further because of the problems we have in the world.

And so, because of this $15 billion requirements shortfall we have, we’re going to take it from platforms. What’s that translate? Well modernization and upgrades to the current platforms they have, more readiness put back in, more simulation training, more flying our programs added back in. Now, I don’t know how -- right now, they’ve got the OCO at about $58 billion, I think it’s probably going to be higher in year of execution for 2017 and that will take some of the buy back, some of the cushion on that $15 billion, but most of its going to go to readiness.

So I told you, I talked to you about the third offset strategy is [could] probably to review for some of you that in the 1950s the first offset was really about inter-continental strike, it was about mutual assured destruction, it was about our nuclear programs as well as our ability to be able to launch them as well as defeat incoming. In the 1970s, it was about precision strike and stealth. And if you remember, those technologies, a lot of them were not used in the first Gulf War other than precision strike and little bit of stealth. Most of it, again, was ground war and the war we’re in now certainly counter-insurgency. A lot of this stuff is very, very good, but it’s not what’s going to make the difference on the ground.

So now, we’ve got a third offset strategy because of the full spectrum nature of the challenges globally for our military, as well as the others and the fact that China is almost a near-peer competitor to us on technology on the high end, that high-end spectrum of conflict, as well as Russia is moving up that chain very, very quickly. The Pentagon has got a third offset strategy that they announced. Now what I’m going to lay out for you is, when we looked at it, when Mike had his last strategy session, we looked not only at the third offset strategy, which is five, six, seven years down range, lot of it in the classified arena. We also looked at the immediate needs of this full spectrum capability and requirements that they needed.

So what we did was we put, okay, what are our core capabilities at L-3? You know them very well and Chris is going to have a panel up here after I’m done, with our experts in the sectors. They can go into it a little better and we looked at and we said okay where we do we map when the next ramp up comes, we’ve got to go put boots on the ground on which we’re doing now. By the way, don’t be confused by $200 million, it will be much more than that before it’s over with and we mapped and said okay, here is the high demand capabilities that they put in the budget as well as what they have that’s not in the budget because it didn’t make the cut, but if something goes and OCO gets pumped up again, they’re going to reach down and say, we need this now. Things like Alamo, weapon systems and stuff like that. And we mapped it against our portfolio with all of our sector and a Company presence and the check back is we do this.

Okay, so we’re trying to map the strategy, the capabilities, the requirements in the immediate term and then on the third offset for the long term and how we position the Company and position our R&D on the unclassified and classified side and you can see that we map ourselves pretty well aligned, not just with our strategy, but also with the countries now that are coming to us, whether it is Middle Eastern countries or European
countries or even in the Pacific like Australia, Singapore and other places and we’ve mapped it pretty well and they’re asking for the same type of stuff.

So what are the implications for L-3? This volatile geopolitical environment we live in could turn very, very quickly. But one aircraft shoot down in Syria between the Russians and us, you’ve already seen with the Turks. We’ve got some other terrorist attacks that could happen, we hope it doesn’t happen, but this is very volatile and it can turn very, very quickly. We are in a competitive market, highly competitive for the readiness business but that’s the first thing, all the Chief said they’re going to buy back and that money is one year money, it’s OCO money and they’ll keep pumping it in and they have to crank back up for deployments.

We’re seeing a lot of opportunities in the manned/unmanned area, port and airport securities, border security, protected comp and highly classified side comp satellites as well as some great opportunities in autonomy that our panel will talk about. Homeland Security spending, Jeh Johnson has got a pretty stable budget right now. We’ve got some issues on our southern border, some of those weapons you sold to San Bernardino. They are not sure where they came from. I have a pretty good idea. We’ll wait and see how that comes, but we’ve got some problems not with just drugs coming across our border and so that’s something that Jeh Johnson and the Customs Border Patrol going to have to deal with.

We have looked at the capabilities and requirements they need and it matches very well, certainly, with our warrior systems as well as our sensor systems. And so, again, the other implication is, as I told you, there is going to be some alterations to DoD priorities on platforms and other things in the near-term and we have taken a look at the near-term reaction that we can have leaning forward to understand what our customers need when they ask for it. So my summary is this.

I think we’re extremely well positioned with the core competence we have, understanding our customers internationally as well as our main customer the US for immediate national security threats and then in the future as I said in the third offset strategy, we’re well positioned to adapt and shift there also. We in the United States may be tired of war, but I got to tell you I’ve been over the Pentagon and other places, the world and war is not tired of us and so this is going be a long haul for us and we’ve taken a good look at it. And with that I will transition, I won’t take any questions because I don’t have to, but I’ll get them later, I’m sure. So, Michael?

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

Thank you Dick. I don’t know if that’s a good idea. You do a real nice [face plant] off of this thing. So good morning, everyone. I’d like to give a brief update on the Company and then we’ll hear from Chris and the panel, but as you know, many of you are very familiar with L-3. We enjoy leading positions in Select Aerospace & Defense markets and leading meaning products that are Number 1 or Number 2. We act as a prime contractor in the ISR systems area, aircraft sustainment, training, simulation as well as night vision and we’re a leading supplier meaning the Pentagon primes, commercial markets, international markets, electronic and communication systems.

The strengths have been having a broad and very diverse portfolio of technologies and products, different customers globally, different types of contract vehicles and just having a very diverse portfolio. Our strategic objectives, which you’ll hear all day are to continue strengthening the portfolio as I’m hoping everybody has seen we did announce the divestiture of NSS this morning. So that’s an ongoing process, but we will continue to strengthen our portfolio with the goal towards expanding operating margins along with some internal programs where we’re going to focus much more heavily on margin expansion and the return to top line growth. Hopefully, we’re at the inflection point on the budget and coupled with the geopolitical situation and the new technologies that are going to be needed to deal with the geopolitical environment, we think we’re very well positioned to do just that and return to top line growth.

In terms of the end customer sales mix. This hasn’t changed materially from last year, this year, and next year. We’re seeing the DoD portion of our end customer sales growing from 64% to 69% projected for next year. So we’ll be back to roughly the 70:30 model and the 30, that’s international and commercial 28 is roughly half and half, half international military, half commercial markets and we’re comfortable with that model. We’re used to operating in that environment. We believe it provides a good mix. The US government market as you’ve just heard from Dick is improving and the outlook has gone to favorable in our view. One, the geopolitical threats continue to escalate, the fiscal situation seems to be improving and the DoD budget growth is resuming in fiscal 2016. The Bipartisan Budget Act 2.0 reduces the sequester cuts and sets budgets. It’s a two-year deal,
which is intended to give industry as well as the war fighter and the weapons buyers some level of visibility into what the funding is likely to be so we can make more intelligent efficient decisions and we all applauded that and hope to see more multi-year budgets cut out in the future.

OCO funding has been raised however there continue to be constraints and better buying power remains as a bit of a headwind and you could start to see that there’s a view out there that defense has been under funded for years and it is impacting the readiness of our armed forces. The overall US technology advantages that we have enjoyed for years. The impact of the years of neglect seem very apparent and that was clear at the Reagan Defense forum that many of us attended. I’m sure many of you were there as to where we are. The political views seem to be changing from a policy standpoint as to what the US needs to do from a national security standpoint, given where we are in the world. So that bodes well for defense companies.

And that means that there are market share opportunities especially in the US classified area but the message there is, it’s not just relying on growth in the budget, which is going to be a slow ramp but there’s also opportunities for L-3 to take market share away, given our superior portfolio of products. And what that means is here is some select awards one, Dave Van Buren as you know joined L-3 about what three years ago now Dave with a mandate to help us grow into markets where we are not with big footprints and one of them turned out to be the classified space and not only have we accessed that market, but we’ve accessed it as a prime with multiple agencies.

So we saw about $260 million of work coming out of that area. We have a number of unmanned systems ISR type platforms here, I won’t go through everyone, which you would expect to see at L-3 but I’d mention this (inaudible) is a place where we have created a market position that we previously did not fill, where our competitor had a datalink that allowed a helicopter to communicate with A1 UAV. We developed a system. This is our folks being thought leaders as I like to call them. Looking for a better solution that would allow the operator to communicate with any unmanned system and the customer responded immediately with outfitting the fleet with L-3 datalinks. So we do protect our markets and make sure that we do have the leading products there.

EMARs is one you’ve heard of before, this is us penetrating a market that has pretty much owned by one of the primes and this is just through the L-3s capability in the space where there’s been some issues getting these platforms ready and out and customer came to us directly and asked for help on getting these platforms up and running and our people are doing just that. So I hope that these will develop into a tail given the geopolitical situation having airborne medium range surveillance systems available. It’s going to be critically important if we’re going to see more and more demand and finally, the US Coast Guard has come to L-3 for missionization of two 130J aircraft for almost $100 million and we hope this is the beginning of a long-term relationship and we can build out a largest fleet for the Coast Guard.

In terms of international and commercial opportunities. First of all, the international market as you know is large. We’ve been increasing our resources to address that market with additional personnel, additional in-country offices whether it’s the Middle East or South America even and additional selling efforts. The growth areas that we see for L-3 are in the ISR systems area and our simulation training, especially Middle East and Asia whether there are severe pilot shortages and it’s well known that they have to do a lot more in training to fill the demands that they are facing and customers are indicating that they would rather buy the training by the hour than on the simulator. I’ve said that many times over the last year, which is why we acquired the CTC business and that’s -- you can hear from Todd later on, it’s doing very, very well as expected.

Now the negative in international as you know is lumpiness meaning the predictability isn’t what we’re used to seeing in the US marketplace. It takes longer to get contracts signed, its bit of a longer sales process. Things get delayed and re-thought and re-bid and the like and we need to factor that in our plans to make sure that we’re meeting the expectations that we’re putting out there, but we do factor for the lumpiness and the lack of predictability in that space and we’re very familiar with dealing in that part, you know these parts of the world.

In commercial, that’s being driven essentially by the growth in the commercial aviation market. [Recce] aircraft deliveries in Middle East and Asia, which is pulling demand for our avionics products, whether it’s data recorders, [TCAF] systems, transponders, et cetera. Same thing with the expansion of airports, we have the security systems as you know and that’s also been a driver for us. So these are areas where L-3 leads to high margin products and I love to do more of this whole day long because it does drive the margins and the top line as well.

Here’s a handful of international and commercial wins to give you a bit of flavor for the types of things we’re doing. First of all in Australia and as well as the Middle East, that’s not on there, very small aperture terminals or VSATs, one to two meters, these are NAND portable comp systems that
are used by both special operators and traditional forces to let them have SATCOM anywhere that they are deployed, very, very simple systems to set up and carry and it’s a must have this amount of soldier.

Like the US Coast Guard, the Japanese Coast Guard is also interested in a surveillance aircraft. So L-3 was put into contract for a mission system, now it’s a little lower value, but what we’re seeing is a demand in the international space to put sophisticated sensor systems on biz jets. It’s a bit of a different model for us. This one I believe we’re teamed with the Falcon Aircraft Company in France -- Dassault thank you, got a senior moment there. And this will fuel future sales in the region, we believe. This will be a highly affordable very capable system that can be rapidly deployed. And if you think about the launch version of this plus multiple times with this system of course and this provides, not presenting that, but substantial amount of mission data.

And non-airlines in China, we've penetrated that market, very strategic for us to get into the Chinese market with our training solutions given the growth there. It’s a place you have to be if you want to grow in this space and we are there with our first big order for full-flight simulators for 787 and A320s, and we believe once they use these systems that there will be continued demand. It’s a big country, they need a lot of pilots and it’s expected to grow significantly over the next several years, next decade actually.

In the airport area, Singapore Airport has selected L-3 for the baggage screening system for Shanghai Airport, which is about a $30 million deal. We believe once that's deployed and performs that there is a longer leg there for us to get more equipment in place. And in Canada, there is a lot of naval work being done, especially when you look at Russian military in the Arctic Circle they have landed. So the Arctic offshore patrol cutter program where we’re putting onboard communications systems for -- about a $30 million program. But you could see more of that coming and that has to do with the desire to be interoperable, not only with themselves but with US and other allied countries. We do similar work in Australia and the United Kingdom and L-3 is setting the standard really for naval communications systems. We really are almost, I won’t say quite 100% market share, we have a substantial share in that market.

All right, moving on to the capital allocation, how are we looking at it. Well, first, we need to continue the investment in our organic growth which means, R&D, CapEx and things for the future. We work closely with our customers. We work closely with the folks at our workshops as to what the war fighter and the customers are going to need tomorrow and make sure we're investing in areas that turn into products for tomorrow and keep L-3 as a leader.

Also important is returning cash to shareholders that we have been focused on for years now and I'll show you how much, but it’s been an area that's important to you, relative important to us as well. Also there's a potential to reduce some debt to maintain the investment-grade rating. I am sure that will be a topic of some questions, but given the divestitures right for now as of today this is something we view as important for L-3 and where we are among our competitors, which are typically larger and our own investment grade. And when it comes down to a shootout with another contractor or something important and the government is doing a financial capability review this kind of gets the box checked for it’s all day long now, may not be true forever, but it's true for today.

And then some M&A to build up the portfolio, we had a couple of transactions this year in the $50 million to $100 million range and that's where we are comfortable right now in terms of adding capability that’s accretive to our margins, that’s accretive to our growth rates. So for R&D these are some of the areas that we've been investing in that align well with the government mission-based modeling and simulation. We actually have a facility on the West Coast that we can bring customers to. That's been very well received. Advanced apertures both for radars, low observables and conformal arrays those that you can build into a platform, so you don't even see it, it's part of the wing, it's part of the aero structure, small unmanned systems, these are systems that can be expendable. It could be a combination of ISR platform and weapons, there is a whole number of requirements here in L-3 through several acquisitions over the past few years, including Mustang Technologies a few years ago. This is one of the areas where we've secured a prime position in the best part space, which is important.

Electronic warfare continues to grow and be incredibly important and we continue to develop systems that meet the future needs for jamming capabilities, operating in GPS denied or compromised environments and there's no shortage of electronic warfare requirements for self-protection for not only aircraft but for the ships. When you hear some of the systems coming out of Russia and China that is designed to put pressure on the US force projection, there is no shortage of opportunities and solutions needed in the electronic warfare area. C4ISR, a place where L-3 leads, intelligent radars, distributed ISR and laser communications all areas where we have some investments. Autonomous system, small satellites, as
you know there is a fundamental change going on and how space assets are being viewed. It’s the large $100 million, $200 million, $300 million systems that can be shot down by some certain countries, going to a more distributed system where losing any one or two satellites doesn’t knock out the whole surveillance system seems to be the way the customers want to go. That of course comes along with ground stations which we already do; advanced sensors, which we’ve already. Make no mistake, we are interested in the payload, not necessarily the buzz, but it’s the payload where we see value in health refills that niche. So it’s an area where we continue to lead in the offerings that we have. In fact, when we met with some of these customers they were actually surprised with some of that capabilities in our freight. Why because we have previously not been at the table, because we were always teamed with the prime and kind of kept a little bit in the dark. So this is very, very fundamental for us to get a seat at the table and that was really attributable to Dave Van Buren joining L-3. So thank you, Dave.

Cash flow returning to shareholders, this is what the last there years looks like. And 2014 and 2015, yes, we’re actually giving back over 100% of our free cash flow in the form of the dividend and the share repurchase. Obviously, the cash balance is coming down a little bit but we’ve been very focused on delivering values through both the dividend which has increased every year since it started and a share repurchase plan that runs at roughly about $800 million a year. Ralph will give you the guidance and tell you what we’re thinking about for next year. But given where the share price is, we thought this is a great place to deploy our cash as we’ve heard from many of you as you do as well and we agree.

So portfolio shaping -- reshaping, we’ve had a lot of dialog on this. I’m happy to say in spite of a difficult market situation we’re very proud of L-3’s folks that spent the last several weekends working getting NSS done. So I would like say this is the theme where others at L-3 has succeed. We announced the deal this morning. And I’m pleased with the price, I am pleased with the terms as is our Board who approved it earlier, later last week rather. And we continue to focus on repositioning the portfolio.

Some of the other things that we’ve done this year that didn’t get quite attention was the divestiture of the Marine Systems International, MSI, which was a low growth, low margin business in Europe, that was basically installing [COG] software on international ships, oil service platforms, cruise ships and BSI which broadcasts sports, obviously something peripheral to L-3 sport and NSS, again low margin, low growth.

The companies we’ve acquired on the other hand having much higher margin, much higher growth. And that is the theme of the show that we will move the portfolio where we can, in areas that makes sense to just improve the overall quality of L-3. And the result is improving our top line growth profile and our margin expansion profile. And that just starts to bear itself out in the numbers. So just looking at it at very simply, I mean the red with were the divestitures, low growth, low margin and the acquisitions were either top line growth or top line end margin growth or higher margins, the blue being the sweet spot for us, both ForceX and CTC, which is the training company that we acquired over in the UK, both going to do very, very well. CTC has already been with us for over six months now and Todd will talk about it, but margins have been spectacular, growth has been great as expected. Miteq is a microwave company that will be 100% consolidated in our microwave group out in [Hapag]. And a lot of synergies from the transaction adds another product to the catalog. So it has been a high-quality catalog. L-3 has been a leader in microwave and we’re just making sure we continue to be a leader in microwave. So the goal here is positioning the Company for growth long term and we’re focusing on margin expansion, the top line in this new DoD growth environment we hope and repositioning the portfolio. As you saw the R&D, we will continue to invest to keep us in line with the priority areas and that means a lot of dialog with customers that we have regularly. We have a Washington office that really keeps their pulse -- their finger on the pulse of the Pentagon and what the trends are and what the direction is and before we undertake anything significant, we usually like to sit down with the customer community and make sure that we are all on the right page. This is something more disappointing than going through a long-term R&D effort coming out with something that nobody wants to buy and we know how that ends.

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The portfolio we will focus on areas where we have incredible discriminators and great products, leadership positions, if you will, typically one or two in our spaces with the avionics, with the night vision, look at our sensor systems, I mean, these are places where we define the market. L-3 equipment on virtually every manned and unmanned ISR platform, whether it’s data link, whether it’s a camera, whether it’s instrumentation that’s in the cockpit, I mean, these are places we’re focused on and we really like to have that one or two market position gives us a lot of flexibility in what we do in terms pricing and being able to invest in R&D to keep the growth going.

And finally, we will continue to have the market leading cash flow conversion. We’ve been always a leader in free cash flow conversion. We don’t see that changing and we will continue focusing on the disciplined capital allocation as well. So with that we are going to do something a little bit different, the set of group presidents. We have below the groups, as you know, there are sectors that focus on areas and these are some of our
more important growing sectors, the management that probably haven’t met before and Chris who we’re delighted has joined L-3, myself and the Board are thrilled as is Chris. I want to have not only the best-performing portfolio, but I want to have the best regarded management team in this space and we’re well on our way. Chris?

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

All right, I’ll give the guys a few minutes to come on up. First of all, good morning to everyone and it’s great to see so many familiar faces. And as Mike said, I’m truly excited to be part of the L-3 team. Let me just remind you, especially with the announced divestiture of NSS, we have three segments. And they’re run by our three Group Presidents that are here today. Let me just ask them to stand up and you’ll get an opportunity to talk to them at break at lunch.

Far right, here we have Mark Von Schwarz, who runs Aerospace; Steve Kantor, with electronics and to your far right is John Mega for communications. So what this chart shows you is we have 12 sectors as Mike said and we randomly selected six. They happen to represent about 60% of our revenue and more than 70% of our income and we’ll have a dialog today about growth, we’ll talk about margins and a little bit about strategy, so I think we have an hour to go through this. And I’m just going to leave that chart up so you can see who they are. And maybe, we can maybe raise the lights just a little bit here so everybody can stay awake and get a better view.

But let’s just start with some simple introductions and we’ll start with Todd. We can go right down the line maybe tell us a little bit about yourself, your sector and just to have a little fun maybe tell us what your favorite app is. I see a lot of iPhones out there, taking pictures. So we appreciate that and if you guys know what an app is, tell us what you use. Todd?

Todd Gautier - L-3 Communications Holdings, Inc. - President of Precision Engagement Sector

Thanks, Chris. My name is Todd Gautier, I’m the President of the Precision Engagement Training Sector. I am in my 15th year at L-3. Before that I was a strike pilot in Navy for 15 years, a commercial airline pilot in United Airlines and then a consultant in the defense industry. Favorite app probably Strava, the competitive cycling app, so you can compete against the world, pretty unique.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay. Kris?

Kris Ganase - L-3 Communications Holdings, Inc. - President of L-3 Aviation Products & Security

Good morning. My name is Kris Ganase. I was born in Trinidad, raised in Kenya, educated in the UK, got an engineering degree in air transport engineering, worked in France for 15 years and joined L-3 15 years ago. My favorite app is iTranslate, that’s the one way you speak and it translates to you, so now I speak Chinese.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Really good. Todd, I’m sorry, Jeff.

Jeff Miller - L-3 Communications Holdings, Inc. - President, Integrated Sensor Systems Sector

Good morning. I’m Jeff Miller from Integrated Sensor Systems. Try and hit on three things of ISS today, really focused on delivering confidence, which I’ll come back and talk about a high margin business with potential for growth, so I will try and hit on today. I’ve been with the Company now for about 18 months, a great start, glad to be here. That was after 21 years at Raytheon and seven years at Teledyne.
As I said to Todd earlier you got to go first, so he stole my favorite app which is also Strava, biking does that to you. So I had to go to my default, which is I do start every morning with the app and I don't particularly like the app, but I start every morning with the New York Times crossword puzzles. So I will leave that as my second best.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay, Bruce, who is still celebrating that Dallas Cowboy victory over my Washington Redskins in a sleeper. So Bruce?

Bruce Trego - L-3 Communications Holdings, Inc. - President, ISR Systems sector

Good morning. I'm Bruce Trego with the ISR Systems Sector. Been with L-3 for 12 years, been with the ISR Systems Sector companies that comprise that sector for a total of 41 years. When I look at the favorite app out there, it would have to be Waze for me, which is the social networking traffic app that lets you know when there are accidents and police on your path. So that's kind of my favorite app.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay, Andy?

Andy Ivers - L-3 Communications Holdings, Inc. - President, Broadband Communications Sector

Good morning. Andy Ivers, I am with the Broadband Communications Sector. I've been with L-3 for 10 years. I am also a veteran of Raytheon from years past. We do predominantly datalink and satellite communications systems. I've been involved in communications pretty much my whole career. I have probably the Status app to be favored. I am total e-mail junky and I left my phone at the table there, so if I start twitching uncontrollably it will be withdrawn. So I am a good app fan.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay, go ahead Dave.

Dave Micha - L-3 Communications Holdings, Inc. - President, Advanced Communications

Good morning. My name is Dave Micha. I'm the President of the Advanced Communications Sector. We do everything from making advanced communications, C4ISR systems to low observable antennas. I've been in the industry for 32 years in a number of functions, but primarily program management and I've been with L-3 since the day it was formed, which I'm very proud of. And my favorite app is something called the Animals by Fisher-Price which I use to entertain my new 5-month old grandson Max.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay. Well, let's get started. The first set of questions will deal with top line growth. And I think we all know when a long-cycle business, you can grow the top line by investing in R&D, you can also move into adjacent markets and international markets. And sometimes we're fortunate enough just to be in markets that are growing themselves and of course M&A activity is a fourth option. So with that as a backdrop, why don't we start with R&D and some of the investments we've been making and maybe Dave you can tell us what you guys have been focused on.
Dave Micha - L-3 Communications Holdings, Inc. - President, Advanced Communications

Sure Chris, thank you. So one of the areas my sector identified a number of years ago was to grow in the integrated communications area in the Maritime domain. And when I speak of Maritime, I’m talking about surface vessels and submarine platforms and when I speak of integrated communications, what we’re looking at and what we identified as a growing market is the ability to integrate interior voice communications and data systems, onboard ships, exterior communication systems were ships talk off ship, meaning ship to satellite, ship to shore, ship to other ships and then all the data networks on board these vessels, including classified and unclassified.

And what we try to do is bring together a solution that would provide integrated communications. Our first target market was the US Coast Guard because we knew they were going through a major re-capitalization program and we determined that if we could gain a strong foothold in the US Coast Guard with our integrated communications solutions, we’d have a great opportunity to penetrate international navies as well.

And the reason is, if you think of international navies they are more in line with the size and flexibility and scalability of our coast guard than they actually are of US Navy. The US Coast Guard in fact is the seventh largest navy in the world. So over the years, we’ve invested a number of key technologies that allowed us to penetrate the coast guard and this includes automation, software and technology that allows these ships to reduce the manning on these platforms.

The single biggest cost to any ship is the people on the platform. So this automation software that we have invented has allowed us to automate functions and reduce manning. We’ve also spent significant money on working such things as situational awareness and fusion so that we can bring a common operating picture to the commanders on the ships.

And finally, we’ve invested in cyber technology and cyber compliance. The cyber threat for the communications and data networks on these platforms is very significant. So those three things together really allowed us to penetrate the US Coast Guard and we’ve won positions on the National Security Cutter where L-3 provides all the communication systems on all eight of them and we’re hoping Congress authorizes the 9th this year.

We have platform positions on the Fast Response Cutter, all 58 of those systems and we’re going to be generating revenue over the next decade on the Fast Response Cutter and the biggest and largest program the Coast Guard is doing, which is called the OPC, the Offshore Patrol Cutter. We are on both of the primary teams to provide the C4ISR solution, which to this audience means about a $500 million opportunity to L-3 in the next couple of years, which will be won in the next couple of years and then we’ll be doing those platforms for the next decade or so.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Great Dave, and then I guess, when our customers are getting secured communications and more productivity, the response has been pretty positive.

Dave Micha - L-3 Communications Holdings, Inc. - President, Advanced Communications

Absolutely, I mean everybody sees the cyber threat out there and what security means to all of us and we have been a leading provider of that in L-3 for many, many decades. The government looks to us to provide that capability and then, yes that’s really critical to our solutions.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Great. Bruce, one of the first things, my first week on the job, Ralph came down and gave me a whole set of financials and I happen to notice your R&D expenditures were increasing pretty substantially. Can you tell us what you were spending that money on?
Bruce Trego - L-3 Communications Holdings, Inc. - President, ISR Systems sector

Yes. Chris, we’ve increased our R&D investments about 3X in the past seven years. We’ve done that primarily in two areas, one of them being the airframe related aspects itself. Our customers have told us they want more utility from their platforms. They can no longer afford a dedicated platform for every type of intelligence they want to collect. So we’ve invested in basically, making sure that our utility on the platform is interchangeable.

We can basically put different [RDMs] on, different sensors on, different racks inside the aircraft. So, we’ve made a significant investment in that. That’s what we call our Rapid Aircraft Payload Deployment System. The other part that we’ve invested heavily in of course is bring in the ISR business. It’s a rapidly changing world out there, the threats evolve very quickly, especially in the communications side and so we’ve invested in staying ahead of that curve.

Basically every two years there’s a new cycle out there, so we’ve got software trying to always match ahead of the customer’s requirement to come in and tell us what he needs, we don’t do the whole job, we do just enough of the job to show him we’re the right contractor to do that work. So that’s where our money has been spent.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Great. And then we’re spending, as you know, a little more than 2% of our revenue in R&D and I think that’s one of our differentiators as we’re creating some new products and enhancing the existing portfolio and we’ll talk more about that. If we ought to switch to international, I know that’s a growth area with some potential for L-3 and Andy, tell us what you guys are working on?

Andy Ivers - L-3 Communications Holdings, Inc. - President, Broadband Communications Sector

Thanks, Chris. So out in Salt Lake City in Comm Systems-West, which is where I keep my flag, we have traditionally done a lot of work in the data link area and we are on pretty much all of the US platforms providing secured data links for both Command and Control and ISR dissemination. As we’ve been involved in international conflicts, we’ve all seen that no nation really goes to war alone anymore. It’s all about coalitions, it’s about partnerships and so as we put assets in the theater, particularly airborne assets, what we’re seeing is, demand for our products on the ground side, where we won’t be able to disseminate data that we’ve collected in our airborne assets and share it with our coalition partners.

That’s developing a pull for us, for our products, our Rover products and some of our ground-based systems. We are looking at, I think fairly significant growth in that area over the next, probably three to five years. As Mr. Strianese pointed out during his briefing that international business tends to be a little bit lumpy and so the orders are imminent and then they move out a little bit and then they pull in a little bit but we are looking for good growth in that area.

The other place we’re seeing growth and that will come internationally is in the Rotary Wing space. Mr. Strianese also talked a little bit about Manned-Unmanned Teaming. So we’re seeing that hardware going into the US inventory, but those requirements are also coming out with a requirement for us to provide FMS capability. So we see a good opportunity there. The Manned-Unmanned Teaming will be about 850 aircraft domestically, but it’ll be another 600 aircraft internationally. So we think that program will have tremendous legs for us probably for the next eight to ten years. So that’s little bit about international growth from us.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay, appreciate it. Mike showed a chart, the pie chart that show we have a pretty good presence in commercial and a lot of that is tied to the commercial aviation. So I think we all know that passenger traffic is up, new aircraft orders are up and with that Kris, maybe you can talk a little bit about your sector and how we’re positioned to growth?
Kris Ganase - L-3 Communications Holdings, Inc. - President of L-3 Aviation Products & Security

Okay, thank you. First of all, just describe briefly what my sector does. It's really two businesses, aviation and security. In the aviation world we provide everything from cockpit displays, cockpit instruments SATCOMs, black boxes which are in fact orange, anti-collision systems, et cetera. We supply to all types of aircraft from the smallest Cessnas to the high, large transport aircraft like VH-VAT from helicopters to the F-35. So wide range of products, a wide range of customers. We've been called the Home Depot of Avionics.

On the security side of my business. I guess you've all done this. So you all know we make the Checkpoint Systems at airports not just here in the US, but across the world, but we also have check baggage systems, we have carry-on baggage systems and we have mine detection systems. Our customers in that field are again, airports all over the world, internationally, domestically, as well. We have about 300 people located internationally. So that's what my sector does.

The market for us, the military aviation market is quite stable. As Mike and Chris mentioned, the commercial aviation market is showing significant growth for us. Two weeks ago, I have to announce that passenger growth is up 7.5% in October year-over-year. So what that means is that the airlines are flying more passengers, they're making more money. If they make more money they invest more. So that's a good sign for us.

Another positive sign is, two weeks ago, Airbus announced the increase in the production rates on the A320 to 60 aircraft a month. Couple of years ago, it was 50 aircraft a month. Airbus got to 60 aircraft a month, Boeing will go to 60 aircraft a month. So very, very strong production rates in aviation. So all in all, the commercial aviation market is the market you want to be in.

On the security side, I don't need to remind you, [John and Todd] did of the kind of world that we're living in today. We have seen an increased demand in our security products, especially from Middle East and in Europe we've had several countries recently come to us and ask us to accelerate deliveries of our products. Up until recently we seeing a roughly 6% growth year-over-year. And that was before Paris; that was before the Russian aircraft and before San Bernardino. So I think in my area, we are in two very, very solid growing markets.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

And on those security products, who are the ultimate customers as we all stand in line waiting to go through those machines?

Kris Ganase - L-3 Communications Holdings, Inc. - President of L-3 Aviation Products & Security

Well, it's all over the world. It's mainly airports for us, but also ports and borders, nuclear power plants. We recently booked an order for that. So it's a wide range of customers all over the world.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay, thanks. I've been here about a month and a couple of weeks ago I was over in the UK with Mike reviewing a variety of our businesses and I had the pleasure of visiting our pilot training business that Todd overseas. So Todd with this increase in aviation, I know there is a pilot shortage potential, how are we positioned and what is your outlook going forward?

Todd Gautier - L-3 Communications Holdings, Inc. - President of Precision Engagement Sector

Like Chris was saying, the commercial aviation market is going through a phase -- the beginning of a phase of unprecedented growth for the next two decades. That's leading to a massive requirement for air crews. They're projecting over 533,000 new pilots will be required to fly the commercial airlines globally. This coupled with the retirements in the first world countries, the developed countries like in the US and Europe, the majority of the air crews will be retiring in the next decade, followed by a change in business models. The major airlines are all now being forced to compete with low cost carriers and changing their use of capital and structures of their business. And many of them are looking at outsourcing their entire training programs to other industries to more effectively deploy their assets and have cash-in in more effective ways.
This already had an impact on our commercial training business within L-3. In 2015 alone, our training revenues are up 40% year-over-year. Our after-market support revenues are up 38% year-over-year and if I look at my device sales, which really is not necessarily training side, but it is a tool up training, we've sold over 100% more devices than our prior year and we expect to sell a few more this year as well. It's been a very strong year for us.

Looking in where we are positioned in the market; with Link UK and our recent acquisition CTC we are strongly in a number two position in the marketplace. We look at how we've done that and the strategy we didn't just arrive here. We acquired Link UK three years ago. As the market has evolved, we've acquired CTC and it now gives us a complete portfolio that we're allowed and we're able to train the entire continuum of commercial aviation. We sell devices and we have the capability to outsource an entire major airlines training requirements and deliver them air crews. As we do today internationally, we take an individual who has never flown before, and 18 months later they're flying in the right-hand seat of a wide body aircraft for the first time.

It is growing and that is going to become the norm that airlines are going to be looking to find cadets and pilots going forward. The market is looking for an alternative to the main competitor and really the only competitor out there that offers a complete portfolio of training. They are hungry for it. They've been forced to deal with a certain type of business model for a long time and I can assure you that what we're hearing globally from our customers, as well as their customers. They're excited about what we're offering.

We differentiate ourselves significantly from the alternatives. The quality of our systems are by far the highest. You can ask air crews across the world, the quality of our training and the pilots we put out, they're better, they're safer and are more professional. These things are going to drive our growth going forward. I can assure you that we're positioned for that growth and it's our intent in the future to be the number one commercial airline training company in the world.

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**Chris Kubasik** - L-3 Communications Holdings, Inc. - President & COO
And we just recently opened a new training center in Thailand, right?

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**Todd Gautier** - L-3 Communications Holdings, Inc. - President of Precision Engagement Sector
It's been open for quite a while. We've been expanding all of our training -- L-3 has been fantastic the last two years. We've made significant investments, increasing the number of devices that we're utilizing for aircraft training, hence that 40% year-over-year increase and we are asset-limited right now. We run our devices 24 hours a day, seven days a week, 365 days a year. Every hour is utilized for training or scheduled maintenance.

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**Chris Kubasik** - L-3 Communications Holdings, Inc. - President & COO
Okay. Jeff, we talked about the M&A and Mike mentioned, we did some portfolio shaping, I think a few of those fell under your responsibility. Can you talk about that as part of our growth strategy.

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**Jeff Miller** - L-3 Communications Holdings, Inc. - President, Integrated Sensor Systems Sector
Sure, I'd be glad to. We did have a busy year this year with two different divestitures and one acquisition. But to put that in context, that really started with our growth strategy. I think most people know that during the deployment years. Sensors in particular saw a tremendous run up and as that came down we saw those sales drop and we've effectively been able to stop that decline and flatten out the sales, but there is tremendous opportunities for growth in the sensor area.

And for us to be able to realize that opportunity, it is key that we sharpen our investment focus and look at our capital deployment to make sure we can go to capture those opportunities. That's really what started our look at the portfolio analysis. When we did that, we saw two companies...
in the portfolio both good companies, good people building good products, but low margins and capital intensive that really didn’t align with our overall strategy. And in both of those cases, we were able to find buyers resulted in what we consider to be win-win-win scenarios.

We're stronger now that our portfolio is sharper. The employees are now aligned with a company where their strategies do align better and the new companies that made the acquisitions are glad to have them. So very successful in those divestitures and that really is our aim to make sure everybody is taken care of when we do that.

On the acquisition side, I'll go back to my first comment about ISS. We all talked about the sensors, when we talked about ourselves, what we talk about is, we deliver confidence. No one really cares that we have a sensor on the plane, what they care about is, all those sensors ultimately provide a user real-time data where they have to make a decision and most of those decisions are life and death kinds of decisions that are critical and we've got to give them the confidence that they're making the right decision.

So one of the things we look at is how do we better take our sensor data and turn that into actionable information for our users. Looking at that, there was a company we’d worked with for quite a while, ForceX in Nashville, Tennessee. A great group of people, our culture is aligned well, very customer focused, and that’s what they do. They build software that really takes our sensor information and present it to a user in a way where they can make real time decisions.

It’s been a great acquisition for us. We closed out in October. Things have gone extremely well from the feedback from our customers, feedback from the employee and how rapidly we’re moving forward with them. So that part of portfolio shaping has really helped us quite a bit this year. ForceX has almost no capital investment, as Mike showed earlier, a high margin business. So it really effectively helped us position for growth and take a near-term improvement in our margin. So very happy what we’ve been able to do this year.

**Chris Kubasik** - L-3 Communications Holdings, Inc. - President & COO

Okay, thanks Jeff. So just to wrap up on the growth. Clearly, it’s a long-cycle business, we’re taking a long-term view and Ralph will show you some numbers after the break, but we believe we’re well positioned to grow especially in the 2017 and beyond time with this focus on the international the long-term investments we’ve made in R&D and then be in the commercial markets which we just covered are growing quite well.

I will say that we’re not just going to grow the top line for top line sake, those will be good business that we’re going to bid, negotiate and execute upon and that’s consistent with our stated strategy. So let's talk about margins, it seems to be a topic that everybody is very interested and something that when Mike and I talked about joining L-3, he asked that I spend a fair amount of my time focusing on margin improvements and obviously it starts with negotiating and executing on your contract. There is cost cutting, there is creative business models, just to name a few and I thought we’d like to hear from these gentlemen as to what they are doing and maybe Andy, you can get us started.

**Andy Ivers** - L-3 Communications Holdings, Inc. - President, Broadband Communications Sector

Okay. Thank you, Chris. Obviously the first element of improving your margins is flawless execution. Out at Salt Lake City we have gone through a relatively lumpy period with our ERP transition. We came online with SAP a few years ago and I’m pleased to report that we’ve reached a place where our implementation is now stable and working well for us. We’ve seen a big uptick in margins this year, over 200 basis points in that business and we’ve seen our on-time delivery return to the levels where we really want it to be. So in terms of basic margin improvement, we focused on blocking and tackling and execution and we'll continue to do that.

In any business of any size, you're never happy with the execution. There is always an opportunity to get the program completed earlier, bring it in for lower cost and we work on that a lot. But beyond that, we’re looking at different business models. So we’re actively looking at and we have some [pursuits] outstanding and opportunities where we’re licensing software. So instead of being in the business where we build hardware and ship the hardware and make a margin on the hardware, we’re actually looking at some of our partners that we would normally sell product to and exploring opportunities to design and license software to them.
It's a model that, quite honestly, Qualcomm adopted and when I was in San Diego, we used at our smaller Linkabit division. We're taking it forward today out in Salt Lake City with some of our data link products and it really gives us the opportunity to generate significantly higher margins on those sales than we would generate if we were doing a traditional cost-plus fixed fee or fixed price contract with the government.

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**Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO**

So the customers on the software licensing, are they the primes or the end user? How is that structured?

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**Andy Ivers - L-3 Communications Holdings, Inc. - President, Broadband Communications Sector**

So typically, we end up licensing it to one of the primes or one of the equipment manufacturers. So we'll license the designed to them. It allows them to shorten up their development cycle, get product into the market faster and for us, we eliminate a lot of the selling cost. We sell the software to the prime, he then goes out and does the end user marketing for us. And once a month, we open an envelope we get the checks and it's pretty much a win-win for everybody involved. They reduce their development costs, they license the software from us and get the products to the market faster and serve the warfighter.

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**Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO**

Great. Todd maybe you can elaborate on the business system comment that Andy made and your thoughts on systems and anything else that's going to drive margins.

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**Todd Gautier - L-3 Communications Holdings, Inc. - President of Precision Engagement Sector**

On the precision engagement training sector, we utilized as before, strategic and very disciplined initiatives to drive our business to achieve our goals. It's worked very successfully over the last few years. Our margins have been rising and they're going to continue to rise. This year alone, the margins in our business are up 150 basis points. The first is policy deployment. It's really a business management system. All of our businesses utilize it. It ties our strategic objectives to individual performance improvements in processes and initiatives that every business that we have to do to achieve our overall strategy. That coupled with lean, which is a methodology of driving efficiencies throughout the business, not just in your production processes but in everything. Those coupled allow us to drive cost out of our business year-over-year as well as be more efficient achieving our strategic objectives, which drive our top line growth, which being in the high-margin business or higher margin businesses, top line growth is really where we're driving the margin improvement.

The others are our market position. We didn't wake up today and find ourselves in high growth, higher margin businesses. It's a process that's been ongoing for years. It's a never ending process of shaping the business and ensuring that we're going after the places where the money is. Our eight businesses today actually came from 18 businesses that we've consolidated over the last several years to arrive where we are focused in both precision engagement and the training business, both of them are both high growth and high margin.

Mix is something we manage continually. We'd like to be out of the lower margin products. We'd like to be in fixed price high margin. Our goal is to drive ourselves more and more out of our development contracts into production contracts. That's where the margins are going to improve, and when you see the benefit for some of the years of the plotting through some of those cost plus development contracts we've been living in and as well on the training side, we've moved away from just building devices, which historically is what Link UK is done and even we've done on the military side and that's why we acquired CTC.

We're moving into training. Training is where the margins are, it's where the growth is going to occur in the industry and as you can see it's been driving our business forward. The last is M&A. We know where the markets are, we know where the money is and we know where the customer is going to be going. There are target companies out there that we can go and acquire that are higher margin businesses that allow us to effectively
consolidate them, reap the synergies, and the cash rewards from that and grow our business both on the top line and achieve higher margins and that's how we've been doing it, and that's how we're going to continue to do it.

**Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO**

So even though the airlines are profitable and generating cash, are they more inclined to enter into a power by the hour training contract as compared to deploying their own capital or what are you seeing when you talk to the airlines?

**Todd Gautier - L-3 Communications Holdings, Inc. - President of Precision Engagement Sector**

When I flew with United, although it was a different time, training commenced basically during the day and trainers are available 24 hours a day. So a lot of major airlines are finding that they don't utilize their assets and their systems full time and to compete more effectively with low cost airlines, they have to get a better utilization rate or a lower cost per hour. That's why many of them are looking at outsourcing their training and it's basically becomes a fee for service or a power by the hour model, but in most cases they sign up to a commitments of hours 4,000, 5,000, 6,000 hours a year, which provides a very secure base to allow us to forecast more effectively.

**Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO**

Okay. Before going to Dave, Todd reminded me, you talked about having some development programs, which I think we all appreciate in the lifecycle of a business are going to have some cost plus development programs that are lower margin before you evolve into production and then ultimately into international sales, so I have looked at the portfolio again where we're not satisfied with our margins, but we do have a nice mix of new business existing production in international and I think that's the sign of a healthy corporation and that's how Mike and I and the team are going to manage the portfolio. So maybe Dave, you can talk about what you're doing on margin enhancement.

**Dave Micha - L-3 Communications Holdings, Inc. - President, Advanced Communications**

Sure, Chris. I'll start by saying our sector had a very strong year in margins and I fully expect that to continue but it doesn't happen by circumstance or magic, it happens by focused discipline to running programs and in my sector, one of the things that a lot of us face is all the businesses we're in are very competitive. So frankly, raising your price isn't a way to improve margins. What we have to do and what we have done is focus on operational excellence.

And the things we work on, there's a couple of basic blocking and tackling things we do to execute our programs. So it starts with strong management on programs. I grew up in this industry as a program manager and I know that if you don't have a strong program manager leading your programs, it's not going to be easy to be successful. So we put a premium on having strong program managers. In fact, we had a number of our program managers this year certified to be [PMP] certified by an outside organization to make sure they were fully capable of running these complex programs.

We focus on risk management, risk mitigation, earned value management all the things you need to do to successfully run a program. Another area that we focus on is sub-contract management. We deal with a lot of third-party partners. You have to manage your sub-contractors as effectively as you manage your own program. And finally, strong contracts management. When you negotiate these very complex terms and conditions with the government or international countries, you have to make sure that the terms and conditions are something that are amenable to both parties but something that is realizable. Very important you have strong contracts people in your organization.

And then finally, we review our programs on a regular basis. In my communication systems east division in Camden, New Jersey, I personally review every program with an EAC over $1 million every month to make sure those programs are staying on track. I think management has to be completely aware of what's going on in the programs. The second area that we focus on is something called manufacturability and design for test. When you develop a product, you have to make sure that when we produce it at the end of the day, we can easily test it, we can easily build it, and we can
do it in the most cost-effective way possible. That all starts in the design phase of those programs. So we put a premium on that. We put a premium on automated testing of our equipment to reduce man-hours and we use the best design tools in the industry to make sure we can effectively keep the cost as low as possible on these programs.

And then the last thing is in terms of overall business units, we’re constantly focused on overhead management whether it’s putting LED lights in our facility to drive down our electric bills, restructuring our facilities, or even outsourcing work that other people can do more effectively than us, we’re constantly focused on overhead management and all this together has really helped us improve our margins. We try to focus on programs where customers want to pay for L-3’s value and not commoditize us and not pay for the things we bring. So those are the kind of things we do from a margin standpoint.

**Chris Kubasik** - L-3 Communications Holdings, Inc. - President & COO

So Dave, I'm going to ask you on a sub-contract management and supplier, our DoD customers adopted a kind of an LPTA thinking that, that gets you the best value for the fewest dollars. When you look at selecting a supplier or a subcontractor, what types of things do you consider, I mean are you adopting that LPTA mindset or looking at other alternatives?

**Dave Micha** - L-3 Communications Holdings, Inc. - President, Advanced Communications

Really were not. What we try to do with our sub-contractors is, we try to develop our partner relationship with them. I have a very famous saying around the plant, we try to make our sub-contractors partners and not vendors. Vendors make hot dogs. We want our sub-contractors to really partner with us and we try to treat them as partners. We want them to make money. We need to reasonably manage them and we try to pick-out the people who year-after-year perform. Some of these things are very complex, but we really focus on finding the best of breed and really treating them like partners in terms of the way we operate.

**Chris Kubasik** - L-3 Communications Holdings, Inc. - President & COO

Okay, thanks. Jeff, how about integrated sensor systems. What are you doing there in your margins?

**Jeff Miller** - L-3 Communications Holdings, Inc. - President, Integrated Sensor Systems Sector

Well, it's hard, won't repeat everything that Dave said but definitely agree that the operational excellence is key and a big focus of ours and we combine that with our business model, which in several of our divisions is bit more of a commercial model than the straight DoD model that's put us in a position where we do enjoy higher than average margins in the sector already, but clearly not satisfied with that and we're really looking at three things, some of which you've heard from others that help drive our margin up.

We've seen a nice uptick this year and these activities are positioning us well to see another uptick next year. The first of those is what I talked about earlier. That's portfolio management. The actions we took this year and we're looking at additional opportunities for next year drove some improvement this year. Next year, we'll see the full-year benefit of those activities, which is part of what helps us grow the margin next year. The second which is a bit broader is what we refer to as L-3 excellence. L-3 excellence is a process we developed within the sector but it relies on lean and fixing the principles and strategic goal deployment.

We've been running that program now for several years and we've seen significant improvement year-over-year now for three years in a row of driving margin to the bottom line results by further deploying this L-3 excellence program. We're also now seeing other sectors pick that up. Chris may or may not talk about it but Chris's sector is using it now as well as some of the other sectors that aren't represented on the stage today. That's been a key for us. The other thing we're really focused on is because we do enjoy higher margins than the average and I think Chris will probably say some of the same, top line growth for us even at the current margins helps the Company grow its bottom line.
So we're really focused on growth, you probably hear that in everything I talk about today. We have opportunities for growth. Some of those more near-term opportunities are international. We've seen some nice takeaways from some of our most direct competitors this year in the international market and I mentioned earlier, sharpening our investment focus which over the long-term, I think will help us continue to grow that top line. So those three things are really what we're focused on.

**Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO**

Okay. Bruce, came all the way from Texas and we all know things are bigger in Texas. So how big are those margins and how are you going to get them bigger?

**Bruce Trego - L-3 Communications Holdings, Inc. - President, ISR Systems sector**

Well, those margins have been very good this year. As Mike stated earlier, we had three international programs that delivered in the same year. Again that's a factor of the international business and you're not sure when it's going to come or but when it does, it may all result in the same year delivery. In one case, we delivered six months early back to the customer. That's very important in the ISR domain because these are low density high demand assets meaning there's few of them and they're in high demand across the world.

So our customers need that early delivery. That didn't happen by accident. Seven years ago, we set off to organize the Company to be able to predictably deliver on time or ahead of schedule and within our budgets. Obviously a lot of these contracts are fixed price and in those cases if you deliver early, it is truly time is money. So you save significant costs by delivering early. What we did seven years ago was we organized our Company so that we have a chief of operations who oversees everything associated with delivering mission systems and aircraft early.

Basically, the staff for the manufacturing operations, the hangar dock and line operations are program managers. They've been in the program organization. They deliver aircraft. They understand risk management. They understand what good looks like to the customer and they're committed to doing that. I think the final proof of that is this is our third consecutive year that all aircraft from mission integration division have been on time or early. So that's a record we're very proud of.

**Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO**

And we make more money when we deliver early I hope?

**Bruce Trego - L-3 Communications Holdings, Inc. - President, ISR Systems sector**

We make, yes, very good money when we deliver early and we have very happy customers. In this business our customers with those limited number of assets can't afford to have them sitting in depot or in modification. They've got to be out there in the field. They've got to be carrying the war fighters to where the need is greatest. So he will come back and he will recognize that a premium is justified when you do that sort of performance.

**Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO**

Okay, thank you for that and Kris, how about aviation products and security, what's your focus there on margins?

**Kris Ganase - L-3 Communications Holdings, Inc. - President of L-3 Aviation Products & Security**

So as, Jeff just mention them. The margins in my sector are significantly higher than the L-3 average. So again, our focus is growth because the more I grow, the benefit it does for L-3's margin, but that doesn't mean we can't do better. We can always do better and especially in my world,
the commercial aviation world, the commercial security world, the price pressure is continuous. So taking cost out of our business is part of our DNA. We are focused on a variety of areas, Jeff mentioned L-3 excellence and I adapted what he is doing in his sector why reinvent the wheel when someone is doing a great job there. So we are implementing that.

Other areas we focus on, we tend to invest a lot in new products. What's critical for us is the design to cost and the design for manufacturability. So when we introduce these new products into the marketplace, we hit the cost target from the get-go and that helps our margins in the long-term. Other things that we're doing is product line rationalization. The last couple of years, we've divested three product lines that had low margins, were more towards the end of their life. So we we've divested those. We have a couple more in work right now.

And just like Todd, we have embarked on a review of all our divisions. We recently announced about a month or so ago that we were consolidating two of our divisions to improve efficiencies and [again] to take out cost. We will continue to do that and look at opportunities wherever it makes sense. Another thing we're doing is we're implementing an ERP system, a common ERP system across several divisions. That again is going to help improve efficiencies and probably the other thing just like Andy mentioned was software.

So margins are not just about taking costs out, it's about getting price up. We have focused our portfolio more and more on software, sales software upgrade sales. An example, we have about 15,000 transponders out there that need to be upgraded due to mandate. That's a software upgrade. So customers, they go on to our website, they download the software and they send us the check. So from a margin perspective, it doesn't get better than that. So in a nutshell as a summary, in my sector, you can expect our margins to continue to grow.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Well, great. Hopefully you get the sense of the commitment of not only these gentleman that the whole Company to focus on margin improvement. As I said, that's one of my top priorities and it's a lot easier to say you want to improve your margins than to do it. It's not easy but it's clearly a focus and I can assure you there's no sacred cows, we're going to look at profits, we're going to look at systems, we're going to look at people. We're going to look at the organization structure and we're going to do whatever it takes to continue the margin improvement that we've seen over the past years and to get more in line with some of our peers. So, I think we have time for maybe one last round of questions based on my short time here, I've understood that we call international opportunities lumpy, which is an interesting adjective. So Bruce you know you kind of alluded to that, like how big is the lump and which way is it headed?

Bruce Trego - L-3 Communications Holdings, Inc. - President, ISR Systems sector

It is lumpy. We continue to have some international programs that we're executing on. We will have one of those complete next year. It won't be of a magnitude obviously of having three compete, but we do feel good but that one program delivering in 2016. We have another program that will deliver in 2017. We have a program that's progressing through the acquisition process that's further out in time. Delivery will start in the 2020 timeframe possibly 2019 and progress through several years. In addition, we have several international customers due to the coalition situation of having to fight their own wars now, that are now in discussions with us, but again those are very preliminary. We won't see the results of those for some time, but we feel very good internationally with our position there.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

And I think we all know the hard part of closing these international sales is there's so many different entities involved, some you can control and most you can't and one of those deals with getting export licenses and the [ITAR] challenges. I've recently with Curtis reviewed our internal process that L-3 and I think we've seen significant improvements where maybe we're down to less than five days from one of our Company's request in export license or [ITAR] clearance, but how do you see this playing into our growth strategy and what are some of the challenges or opportunities you've noticed in this arena?
Bruce Trego - L-3 Communications Holdings, Inc. - President, ISR Systems sector

We are seeing the situation improve in ITAR, we’re not quite where we want to be yet, not as quick yet. We hear that from our international customers. I expect that to improve as time goes by because obviously there’s a lot of pressure with our coalition partners now having to meet the needs to fight their own battles. So I expect that to continue to improve in the future.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay. Kris, we talked a lot about the kind of near-term 2015, 2016, but why don’t we take a further look and maybe go out five or ten years. How do you see your business position then and what are some of the strategies we’re focused on?

Kris Ganase - L-3 Communications Holdings, Inc. - President of L-3 Aviation Products & Security

Well, as I mentioned, I’m fortunate to be in two growing markets. We differentiate ourselves with our customers through our technology, our customer intimacy but most of all through our agility. And our strategy essentially is to continue to invest introducing one or two new product or systems into the marketplace every year and if you do that in a growing market, then growth is inevitable.

Just to give you a few examples of some of the things you can expect to see. There’s a mandate in Europe. There’s a mandate in the USA, if 2020 and several other countries that every aircraft flying in the air space has to have an upgraded transponder, what we call a next-gen or [ADS-BL] transponder. Today, L-3 is the only company in the world that can meet that requirement for all aircraft types from your smallest general aviation aircraft up to the large air transport aircraft and we have product available and being delivered today.

So do the math, every aircraft has to be equipped, we have the products. So as long as we maintain our customer presence, our quality, our agility, growth will come. Another area is everybody in this room has a phone. You like to use it, you like to be connected. When you are in an aircraft, you want to be connected as well. Just take a flight today. So, connectivity on aircraft is a huge growing market for us. We recently was selected by Iridium as one of four suppliers to provide SATCOM terminals on the next-generation constellation such as Iridium. So again, our focus will be of course in cockpit but that again is a huge market. It’s growing and there’s a lot of demand for that.

On the security side, again we are investing and have invested in new products. We just recently announced and launched and delivered our first generation of carry-on baggage checkpoint systems. When you go through an airport today you have to take out the liquids and your laptop, well with this system, you don’t. It’s an automated system, it does the selection, it’s much more seamless, its throughput is much better and passengers love it because the queues are shortened. So that’s an example of where we’ve invested, introducing new products. It’s a new area for us. We’re not in that area and growth will come from there.

We have the next generation check baggage system, 1,800 bags an hour, significantly more speed, more throughput, more reliability, lower cost. So again these are the things that we’re doing to invest in growth. So when I look out, let’s say 5 to 10 years time our internal target is to double the size of the business within 10 years. What does that mean for you, it means growth at higher margins.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

So these are new products is this something that we decided to invest in or is it more of a customer demand? How that come about because none of us like taking out laptops and liquids?

Kris Ganase - L-3 Communications Holdings, Inc. - President of L-3 Aviation Products & Security

No, a lot of our business is build and they will come. So it’s a risk, we invest, we target, we look for specific markets and we go after them. You can say the next-gen 2020 mandate is not a big risk because we know every aircraft has to have a transponder. So we invest in those areas. So it’s targeted investments.
Very good. Well, Todd, I have been asking a lot of training questions, but you also have the precision engagement divisions as well. And we heard earlier today about A2/AD and the third offset and maybe you can talk a little bit about those and how we’re positioned to take advantage of those initiatives?

Todd Gautier - L-3 Communications Holdings, Inc. - President of Precision Engagement Sector

I'm sure everybody in here probably knows what A2/AD is and the third offset, real simple terms, anti-access/area denials way that the threat countries prevent us from utilizing our superior weapon systems to project power. They have long range surface to air missiles, long range air and surface to surface missiles to shoot the ships, anti-submarine warfare systems to prevent submarines from getting close. So we're forced to standoff hundreds and thousands of miles in some cases to be effective. And if you look at the, F-18, the F-15 and F-16 some of the traditional weapon systems we have, it does not allow us to be successful in the mission because of that the US has come up with our strategy to counter that. That's just called the third offset. And basically the strategy is to change the way the game is played.

We're not going to confront the A2/AD necessarily head on. We'll just play a different game. They are playing horse, we're playing pig. We win when we hit three shots. So it's a different way of thinking. It's a change in the paradigm, if you will.

L-3 as a whole, not just my business, is extremely well positioned. The communication systems guys are deep in the heart of this. The integrated sensor systems folks are deep in the heart of this. The EW platforms are deep in the heart of this. But specifically within our sector the precision engagement training sector we have unmanned systems business that builds small unmanned systems, we have a radar business that builds very unique, affordable next generation radar systems, and we have some businesses that are steeped in the guidance navigation and control business designed to allow us to effectively navigate in contested environments. Basically when GPS is denied or degraded we still have to be able to fly systems whether it would be weapon systems, aircraft or sensor systems, to where they need to get to and it's their goal to prevent that from happening.

I wish that we could talk more about these systems because the nature of A2/AD it's leading edge, it's next generation technology that they are employing as are our counters to their system. So you're not going to read much about it. You're not going to see a lot of announcements but what you probably will see or you will see are increasing top line growth in the areas where we're focused on this as well as margin improvement. It’s very important and critical I think for our national security, but it is also a very large growth area for L-3 as a whole.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

We'll it's going to be hard to ask a follow-up question after that disclaimer. So we will move on to Jeff. Jeff, I recall you said you've been here about a year and a half and I think an important part of any large corporation is its culture one of the differentiators of those entities that can work together and have the ability to better serve their customers. So based on your year and a half at L-3 and your other experiences, how have you found the internal collaboration and teamwork and the ability to work together for the good of the customer and then ultimately the financial community?

Jeff Miller - L-3 Communications Holdings, Inc. - President, Integrated Sensor Systems Sector

I think that's a great topic. Coming into the Company and spending some time here, one of the things that I really appreciate about the way L-3 is structured and the business model here is the increased focus at the division level as opposed to just an overall big single groups. That individual focus I think it gives us greater accountability at the division level, where the money is made, people are focused on it doing the right things. It builds definitely in a spreed to core. You'd see the pride in the individual division. I really like that aspect of the model. But coming in one of the things I did wonder about and perhaps some of you in the audience may wonder about as well is with that focus how do we position ourselves to compete effectively against some of the bigger primes that we go up against. And one of the things that was really pleasing coming into this
organization was to see that there is that opportunity for collaboration and honestly not see some of the [still pipe] type of thinking that you might see in a large organization.

I have seen across the board our divisions are willing to collaborate better and one of the things that I really focused on personally is trying to enable more of that. And even in a relatively short period of time I've really been impressed with what I've seen in our improvements in that area.

Probably the easiest way to reference it is some of what Todd talked about with the third offset. There are significant opportunities out there. For us in my group I would say those primarily are in space, undersea surveillance and in air dominance. There is large competitors out there, but we have technologies that can effectively compete there, but we need to do two things. One, I started earlier we are talking about sharpening our investment focus, some of that is more directing it, some of it is increasing it. So the actions we've taken over the last year and a half really positioned us not only to increase our margins as I discussed earlier but significantly increase our IRAD. So next year we will see over double-digit growth in the amount of IRAD that we are spending.

Almost all of that growth in IRAD is directed at those markets in collaborative efforts. We work extensively through our advanced programs to really look across the organization for where we can get the most collaboration. Advanced programs has greater access and what Dave (inaudible) helped with us is really helped us get that access to have a better understanding of what those opportunities are collaborating with those groups. And as Todd mentioned really across the panel here there are different areas that have the opportunity to collaborate and we're off to a very good start for doing that. That's what gives me that confidence in the longer-term growth.

Together, all those things tie back to what I originally started with. Those activities are helping us meet our objective of delivering confidence to help us grow the top line and they help us expand our margins.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Great, thank you, Jeff. And based on my short time here, I have to concur with your observation. It's a very collaborative inclusive environment and the executive teams are very welcoming and let's say, again I'm excited to be here.

So Andy when I hear of Salt Lake City, I think everybody in this industry thinks of data links and a world-class organization and a great reputation, but are you guys going to do something different or is that just a one-trick pony out there?

Andy Ivers - L-3 Communications Holdings, Inc. - President, Broadband Communications Sector

Well, thank you for the compliment on that reputation. Certainly hope we're not a one-trick pony. As we look at where the market is going, traditionally we have been in the data link business and we have data links on pretty much all of the ISR platforms that fly manned and unmanned. And I think one of the things that's unique about that is people talk about it is they are really are data links. It's been a focus on point to point and as almost anybody will tell you and certainly the younger folks and my children will tell you it's all about the network now and not about the data link. And so we're moving from really being a company focused on data links and point to point to one that's focused on how do we network these assets together, how do we provide a network solution.

We talked a little bit earlier about [MAMTX], a good example of that. How do we take a UAV that's in flight and control it either from the base station where we've traditionally controlled it or from an Apache helicopter that's in flight, utilize that asset to bring data to the operator where he needs it and he really doesn't want to worry about what data link he is using. What he really wants is access to the information to the full-motion video and how it gets to him needs to be less of concern to the individual user and more managed by the network. And so we're really focusing on developing our products in that direction. We're going to more mobile adhoc networks that form and reform as assets move close together. And far apart and that's really going to take us, I think, in a number of new directions the biggest of which is I think it affords us an opportunity to go out and touch a lot of the platforms that we're on and bring them added capability and upgrades.
In other words a discussion by General Cody earlier that as we look at the budgets the bill payers are likely going to be the platforms, and the focus is going to be on upgrades. We have a tremendous installed base and I think that affords us an opportunity to take additional capabilities, networking being one of them, into that installed base, enhance their capabilities, extend their operational life times. And we’re going to see, I think, significant growth in our business along those lines.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

And would that concept apply to the coalition partners and how they’re going to change the way we work together?

Andy Ivers - L-3 Communications Holdings, Inc. - President, Broadband Communications Sector

Yes, absolutely. Those very similar capabilities will absolutely apply to our coalition partners. They have all worked with us. They’ve seen the benefits of promotion video on the battlefield. If you think about what’s happened over the last 15 years with our ROVER products, we’ve really changed the game in terms of warfare. Operators on the ground now have an aerial picture from a UAV. They can know what’s going on behind the building before they walk around it. And that capability and the ability to have that real-time intelligence data right at the pointing end of the stick makes the operators lives a lot safer. The ability to network that information and share it on the battlefield is going to be, I think, the next big game changer.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay. And Dave why don’t I ask you the last question before I turn it back to Curtis. We hear a little bit about or a fair amount about C4ISR and maybe you can use that as a platform to pull it all together here and show how you guys are doing?

Dave Micha - L-3 Communications Holdings, Inc. - President, Advanced Communications

Sure, Chris. C4ISR is not only an exciting area for my sector but quite frankly for the entire Company. The C4ISR market domestically has been estimated to be about $4.5 billion annually with a 6% compounded annual growth rate and the international market is just as big. To follow on a few of General Cody’s comments, there is a lot of threat spots in the world and specifically the Middle East, the Pac Rim all those countries have areas of concern. And one of the things that’s going to be very important for the US is interoperability with our coalition partners around the world. And for us to be interoperable with them, we have to provide interoperable C4ISR systems, they have to be secure, they have to do all the things that allow us to fight together and that’s what we bring to the table.

Mike mentioned earlier the presence we have in naval C4ISR and it really is growing and expanding and it’s going to be revenue generating for us for a long time. Let me just give you an example of that. If you remember what I said about our presence in the US Coast Guard in terms of C4ISR, we’ve taken that internationally over the last several years. We started in small programs in New Zealand, in Malaysia and Egypt, and what that did is given us -- gave us bona fides to be a platform system integrator in the C4ISR area and allowed us to win program in Australia called LHD.

LHD is Landing Helicopter Dock. It is a 757-foot warship. It’s the biggest warship Australia has ever built. L-3 Communications provides the entire C4 system for that ship. It’s comprised, just to scale it for you, it comprised of 90 racks of communications equipment that we provide along with 2000 terminals across the ship. We integrate it, we maintain it and we’re going to be generating revenue from that program for 20 years. Because the Company did such a good job in that program this year we won the program to upgrade the entire Australian submarine fleet in the Collins submarine program. Our reputation is what’s winning us this business and the customer intimacy we have with these international customers.

Mike mentioned earlier the Canadian Arctic offshore patrol program, we won that program because of what we did in Australia. And all these coalition partners talk to each other. So C4ISR is really going to generate a lot of opportunities for us in the Maritime domain. What we’ve done in addition to that is take that same capability to land-based operations. We are looking globally at air operation centers, local emergency operation centers in the US and even places like SOCOM where they want L-3 to integrate C4ISR capability on different land vehicles they have. The reputation,
the name we have and the performance on some of these programs has really been important and frankly, I think it’s going to be one of our biggest growing areas over the next decade in L-3.

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Okay, well thank you, Dave. Let me just wrap it up. First of all, thank you gentlemen for agreeing to come up here and take the questions. We had a quick charter on yesterday, but I changed the questions for today just to make it a little more exciting. So good job by all of you and just to wrap up hopefully you’ve learned a little bit more about some of our sectors, or products, or capabilities. It is a very large and complex organization. So I hope you took away from that.

Also we are committed to investing and growing. We’re coming up with new products as you heard. We’re enhancing our existing products and we’re trying to solve our customers’ most challenging problems. I’ll say it again, margin expansion, I know is an area of focus for everyone in this room and it’s one of my top priorities and you’ve got an idea of the types of things that we’re focused on. And I think probably just as importantly you’ve got a chance to meet some of our passionate dynamic leaders and look forward to working with you gentlemen in the years ahead.

And with that Curtis, I’ll turn it back to you.

Curtis Brunson - L-3 Communications Holdings, Inc. - EVP of Corporate Strategy and Development

Okay. We'll take a break until 11:30 and we'll start up with Ralph.

Ralph D'Ambrosio - L-3 Communications Holdings, Inc. - SVP & CFO

Okay. I'm very pleased to be here again to review the Company's financial outlook and profile for you. Chris already covered the forward-looking statement caveats. So, to begin with, as we look at our financial outlook and the business outlook for 2016, next year, I would say it’s characterized by two good news items.

One, the overall situation is improving, particularly, with respect to the DoD budget and I’ll talk more about that in a couple of minutes. And secondly, Mike outlined our three main strategic objectives, which are one; strengthening the portfolio, two; expanding margins, and three; returning the top line to growth and we’re making progress on all three of those in 2016, and that’s something we expect to continue after next year as well.

And those three items are inter-related, to be sure. So with respect to the budget, after having decline for the last five years or so, the budget is growing now beginning in FY 2016, which again a couple of months ago and we expect that that will continue for the next several years. There is still some constraints that we’re dealing with on the funding side and Better Buying Power, but the Company is well accustomed to managing in the Better Buying Power environment in terms of competing and competing effectively.

We talked a little bit about the international business, how it’s lumpy and declining next year, but we expect it to be a long-term growth driver for L-3 along with our commercial business, which continues to grow. Portfolio shaping, it is an evolving and continuing process. We are pleased to announce the sale of NSS, this morning and there is more to follow after NSS.

The top line and the margin trends are improving with the top line particularly organic growth is improving, although we still expect to have a modest decline next year and I’ll talk about that momentarily. In the margins, we expect to improve in all three of our segments and we continue to expect to generate solid robust, free cash flow and to allocate our cash and capital on a disciplined basis, the way we’ve been doing.

A couple of points on the sale of NSS that we announced this morning, CACI is the buyer and we’re selling it for $550 million, which we think is an attractive valuation or f multiple. It’s being structured as a stock transaction. I will tell you that there is no tax leakage in the sale, given the high tax
basis that we have in NSS and we’re going to use those proceeds in a balanced manner and we expect the transaction to close in the first quarter of next year hopefully, in the middle part of the quarter. I’m sure you may have some more questions on that, but we’ll leave that for the Q&A.

Quick look at our sales mix by end market for next year, our business is all about our customers. Satisfying, meeting and anticipating their needs and priorities. So I always like to take a quick look at our customer base in terms of sales and as you can see, we continue to be predominantly the US military contractor with US Government sales, comprising more than 70% of our sales, we like that. We’re going to continue to be predominantly a US military contractor. And then, we have about 30% of our business between commercial and international representatives, foreign governments including foreign military sales.

The business mix, we expect we’ll continue to evolve slowly in the next few years to slightly more commercial and international, because we expect that they’re going to have a better growth rate than the DoD business, even though we expect the DoD business to start growing again in 2017. Quick look at the US DoD budgets, the budgets began to decline in FY 2011 or FY 2012, so the budget had declined about 20% since then through FY 2015 and that certainly has put a lot of pressure on our top line and although we were growing internationally, commercially, it was not enough to offset the declines in the US military business.

But with the recent bipartisan budget deal, which sets the budgets for FY 2016 and FY 2017 that gives us stability and growth there, we’ve very encouraged by it and we expect that after FY 2017, which will be dealt with the next administration, we expect to continue to see improving budgets. When you look at the growth rates in the base budget and then the total budget with the OCO, it averages out in our opinion to a 2% to 3% type growth budget for FY 2016 and FY 2017 and we expect it will continue at least that pace after FY 2017. So that’s good news for our business.

As you look at the consolidated financial guidance for next year, incidentally, all the financial information I’ll review with you today is excluding NSS. We expect that we’re going to begin to present that as a discontinued operation in the fourth quarter of 2015.

So looking at our top line, it’s about $10 billion, declining about 1.5% organically and you can see it there by the three major end markets. The US DoD business, we expect it to be flat organically, next year. And what’s happening there is that we’re experiencing the final run off of our Afghanistan OCO drawdown sales reductions, which is about $115 million or so. So if we take that away, the US business is probably growing at about 1.5% or slightly above that in 2016 and we expect that rate of growth to improve after next year.

The international business is declining next year by 15%, which is what we talked about and we previewed 2016 at the end of October. And we have three large international ISR systems contracts which are nearing completion. That was discussed today in the panel. Those sales were each with important long-term foreign government customers for L-3 and we expect that we’ll be doing more work with them in the ISR space in the future, but that goes according to their procurement cycles.

And then secondly, within the communication system segment we’re shipping a relatively large SATCOM terminal contract that we booked in April this year. It’s about $90 million in sales. We ship it all by the end of this year and while we expect follow-on business there, it doesn’t happen until the end of 2016 or early in 2017. So those are the two main items that are causing the international sales reduction next year.

In commercial business, we expect this can continue to grow in the mid-single digit range. That growth is coming mostly in the aviation side whether it’d be Avionics or simulation and training, which Todd and Kris talked about in the panel earlier today.

Margins are going to improve in all three segments by 90 basis points. That’s the beginning of margin improvement for the Company. We expect it to continue after 2016 and that translates to growth in operating income of about 7% next year. We’re going to reduce our share count again in 2016 and that’s going to translate to about 6% growth in EPS with the free cash flow of about the same or unchanged from 2015 at $810 million.

A look at our segment guidance. For next year, electronic systems growing 2% organically. That growth is being driven by sensor systems, aviation products and precision engagement and training, aerospace systems. We expect it to decline about 4%. I talked about the main reason there and that’s those international contracts. Additionally we’re having some more declines in the US Navy P-3 businesses as that continues to transition and the last of those declines we’ll experience in 2016. And then in communication systems, also declining about 4%. That’s that SATCOM terminal job that I talked about as well as we see a slowdown in next year sales in our space power device business that is used on commercial satellites.
That's going to be about a $60 million to $70 million decline and we expect that to reverse and to grow again in 2017. On the margins, improving at nice pace in all three segments, the most in aerospace systems, but honestly they have the easiest comparison there and we have the most work to do in that segment, improve the margins. I would say that electronic systems and comm systems, their margin improvement trajectory is in line with the improvement that we've articulated the last year or two for those two segments.

Free cash flow is going to be about $810 million for this year and next year. We continue to generate very robust cash flow, the conversion from earnings even if you take away the 401K match is north of 140% and that's been an enduring characteristic of L-3 and one that we expect will continue into the future. I'm not going to suggest that we can continue to convert cash flow at 145% plus, but it's certainly going to be above the 125% range into the future. As you can see, the business is low capital intensity and not a lot of investment required in working capital.

Cash sources and uses for this year and next year, we've already talked about 2015, so I'll focus on 2016 compared to our initial outlook for next year. What's changed is the -- we're now folding in the divestiture of NSS, proceeds of about $540 million and we're initially allocating $250 million of that to share repurchases, taking the share repurchases to $750 million for next year, debt repayments of about $200 million, which is roughly three times the EBITDA associated with that business and the rest is going into the cash balance. I expect that we'll probably deploy some of that $400 million next year, whether it'd be in M&A or additional share repurchases. So we definitely have some flexibility and optionality there that we'll utilize.

Moving on to the balance sheet. Key takeaways here is that we continue to finance the balance sheet and the Company very efficiently using leverage in our capital structure. The leverage levels are modestly declining as we go from 2015 to 2016 and we continue to have ample liquidity. All the actions that we're taking with respect to the portfolio clearly also improve the quality of earnings and the quality of our cash flow, which is good, positive characteristics when it comes our leverage and financing situation, which brings me to my summary.

So, again it's all about focusing on achieving our three strategic objectives, strengthening the portfolio, expanding margins and returning the top line to growth. The improving DoD budget is going to make that happen. We're expanding margins and we expect that to continue. I talked about the free cash flow and the way we're allocating it and I also just touched upon the attributes of strengthening the portfolio in terms of growth margins and quality of earnings and cash flow.

So, that covers my prepared comments, and we'll go to the Q&A now. I'm sure you have a lot of questions for us. Thanks.

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

So before we get off on Q&A, I wanted to -- most of our Board is here, let me introduce by the way, really appreciate that they all came. First of all, our Independent Lead Director Bob Millard, so he is also the Chairman of the Comp Committee; Lewis Kramer, Chairman of our Audit Committee; Tom Corcoran, who is a member of our Audit Committee; Vincent Pagano, the Chairman of the Nominating and Governance Committee; Fig Newton, member of the Comp Committee as well. I got everybody, okay we have two members that did not make the meeting but for the most part, our Board is here. So with that, you could direct questions to any of the management folks that were here. I'll try to moderate it and get the questions to the right folks. So with that, go ahead.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Yes, just -- obviously it sounds like the thing that is you most under your control in the near term is the margin and the impact on the margin, you talked about a lot. Wondered if you might help us understand the art of the possible in terms of where margins could go, can it be significantly above peer averages and how long would it take to get there? How much of that comes from portfolio versus cost versus business model change or any color around the vision would be helpful.
Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

I think it's going to be hard to handicap every element that - but let me just do it this way. First of all, with the portfolio shaping, I could get Ralph up and go into a debate, but around 10.5% to 11% before anything else and then before Chris is deployed, that, his some ideas and with our Group President, some things whether it's consolidation or supply chain issues or we just need to execute better too on some of the programs, look at how we're bidding in certain things and the like and then you have acquisitions and while there hasn't been anything transformative in acquisitions, they've been in $50 million, $100 million. We've been particularly focused on very accretive acquisitions from a margin and growth standpoint.

So when you look at the CTC business, the one from Todd, I won't give out your margin, which gives out your pricing, but I could say that it's a 150% of the margins of the Electronic Systems group. It is way out outperforming and if it is growth fixing, they'll bring the whole average up and ForceX is good job play, ForceX also is a good margin play as well and you look at that in terms of its capability. We have a huge install base of the EO/IR sensors as a market as well as new customers as well as a new corporate listen to the product that will attract more customers, this is what it can do and that -- I would look at that more of a software profit. It's not really a high cost to product so that is very margin accretive too. So it will be a blend obviously of shaping plus some accretive M&A that's accretive with margin plus, (inaudible) on some of your thoughts, so you got a mic.

Unidentified Company Representative

Yes, I got a mic. Well yes, to answer your question, the first step would be to get equal to the peers and that's going to be a journey that will take couple of years, I would imagine and then once we get there, we'll look at trying to outperform the peers. But I'm a big believer and Mike is as well on ROIC. So I don't want to be singularly narrowed on focused on margins. Ultimately, in my opinion, how we get more cash and clearly, margin enhancement gets us cash top line, improvement gets us cash and the balanced portfolio and I made the comments on the panel, any business is going to have development programs, which are traditionally dilutive to your average margins until they mature into production and then international and I believe that's a sign of a healthy Company. None of us are satisfied where we are. We know we can do better and step one will be to catch the peers and then step two will be to beat them. So we'll be sure to let you know as we make progress.

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

And I'll add a comment though. We still are more focusing on the program execution because we can do without the negative margins events that gone though that. We know that. So more focus from our people on performing to what they're bidding and will go a long way. So with that, you have improvement up there for next year and we're looking for improved up there for next year and we're looking for healthy improvement to 2017 as well. That's what we're working towards and again I'd like to be able to get up here and say we have industry competing margins, not only cash conversion, that's kind of goal that we like today. So I think Howard is next, Howard you're next and then I'll get back to Rob over there.

Howard Rubel - Jefferies LLC - Analyst

Thank you very much, Mike. There is a lot of change in technology that's happened, I mean lot of manned platforms and you are a part of it, you also have a very strong manned ISR platform business in Greenville and elsewhere, how do you manage that transition? How do you make sure that you can take that trend that's changed and take the skills and technology of those people and be there for the next wave of change?

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

Okay, regarding (multiple speakers)
Howard Rubel - Jefferies LLC - Analyst

Well the RC-135s for example and there are 707 platforms and at some points they're just not going to be there anymore and so either you're going to have either business jet platforms or you're going to have Global Hawk in some cases, an unmanned one and you're not really there for that. So how do you make sure that what you can say or if you can even say anything, how do you cope with that change?

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

I'll start (inaudible) that's an area (inaudible) with his background, but we've been playing in all facets, whether it's on the manned, the large manned, the national consultation is like (inaudible) though a biz-jet which is likely to happen. Also, we're 737 type of aircraft and the improved fighters, the primes the owning the whole thing and the mission system, but I like to say -- I can't say to you, I believe we do it better than anybody and pretty much proven by things we've delivered and our legacy is spectacular.

Unidentified Company Representative

I can tell you that the mission equipment, we do very, very well on, independent with the platform, that's number one. Number two, we're currently working on transition from historical platforms to the next generation platforms. One of those elements is the fact that we teamed with Northrop Grumman on the JSTARS program and our aerospace systems area, utilizing communication equipments as well as our mission integration capabilities down in Greenville.

So on the manned side, we're working on that. On the unmanned side, almost all of that activity is in a classified domain. What I can say again, that our subsystems proliferate those programs and we are in the processes as Todd said, of developing new platforms for that next generation and they are linked up with the third offset strategy and the LRRDP, the Long Range Research & Development Plan.

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

Okay, Rob had one here and we'll be at the (inaudible)

Unidentified Audience Member

So two quick things, first one, Chris, back to you. Do you have a plan, a specific plan that you've had time to lay out yet on how you're going to approach this. Is there a review and a period, are you going to tackle it across the board or is it kind of one thing at a time. How do we -- is there a way to measure what's gone on?

Chris Kubasik - L-3 Communications Holdings, Inc. - President & COO

Alright, what I've been-- it's been 30 days, so I have been meeting with the Group presidents, you saw some of the sector Presidents, I've been meeting with the functional leads, I mean maybe it was just the way that schedule line for the first guys I happen to meet with was our CTO because I want to understand how much we were spending in R&D on generally predisposed to growing and that's the mindset that Mike and the Board and the leadership team has. So working with these guys on how to grow the top line is first and foremost, while also challenging the cost structure.

So, probably throughout the first quarter, I've been to several of the sites and I'll continue to visit with those and the team has a lot of initiatives in place. There has been a lot of consolidations, you've heard about some of that. So when I came onboard, Mike used the phrase that I'm here to help accelerate things. So strategically, we're making changes. You saw evidence of that. Recently, we've announced some new things we're doing operationally. It's all about accelerating, getting the margins up, getting the top line growth back and it's a team effort and that's what I'm here to do, but I would say throughout the quarter by the end of March, April, I have my own thoughts that I'll share with Mike, but we talk multiple times a day as there is no gap or difference in what we're ultimately trying to do.
Unidentified Audience Member

Yes, thank you for that. The other question Mike and Ralph is on the debt retirement for next year and the thought process that you went through to do that, instead of either buying back more stock or doing something else with that particular $200 million, I understand that investment-grade rating is part of the calculus here, but why?

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

Well, many of the competitors that we face or the larger primes are on some of these big platforms and when you go through the acquisition process, the bidding, there are financial capabilities reviews and having that check box that we’re investment-grade has been easy enough for us to maintain and it have a second round of questions because we don’t have that box checked anymore, to the extent that it’s not really hurting our financial performance.

But it’s something that our mind is open for the future on it. We need to re-evaluate it. I know there is not a huge difference in borrowing costs between where we are and if we were non investment grade. For now, where it has the potential to impact the business if you will, just because of our competitive environment and the access to capital markets if we want to move quickly to should there be some M&A in the future for us, it’s something, it’s a nice to have, I would tell you, it’s not necessarily a must have and given our cash generation now and what we’re projecting in the future. I think we should have sufficient cash flow to satisfy the appetite for share repurchases and we will continue on that path.

So just it will take a little longer to get down to like, those two shares, one that you own and one that Howard owns. But we got it. Let just say also on the margin plant, you know, over the years we did a lot of acquisitions, smaller ones, which created a company that was very entrepreneurial, but not the most efficient in terms of structure. Lot of small $50 million and $100 million business is all over the place, one with a President and a CEO. Well, that’s another way we’re looking at bringing things together, whether it’s regionally or by business line, more back office consolidation, I mean, there is a lot of harvesting that could be done in that area. We don’t want to break the businesses and the process though. So it needs a little bit of a delicate touch, but that’s an area that’s kind of ripe right now. Okay. Rich Safran up there. Go, ahead, Rich.

Richard Safran - Buckingham Research - Analyst

Just a quick one on the international business. Do you see the trends more FMS, more direct as you’re looking forward, also maybe if you could comment on where you’re seeing the most growth in what product areas and geographically?

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

Yes, well, I will answer a part of and I am going to get Dave to help on this. The Mid East and Asia seems to be the biggest growers. And for us in our ISR systems area, just given the global situation, everyone is keeping an eye on their borders and what’s going on, night vision as well which grew a remarkable deep through DoD and state have given us the export credentials that we need to export certain versions of our night vision equipment. The SATCOM products have been sold recently in the Emirates and in Australia, were the two big sales, but there is demand all over the place where there is any possible deployment. And the airport products, both the security products, avionics getting into China, getting into other markets for any of our equipment because we have the best -- viewed as the best in the world in our collision avoidance with our black boxes, the TCAS system, the airport security things. Do you want to talk to this FMS issue versus the direct or anything else?

David Van Buren - L-3 Communications Holdings, Inc. - SVP, Business Strategy

You might have seen a couple of weeks ago in Defense News that the Secretary of the Air Force taking leadership and trying to accelerate the FMS process. We laud that her leadership for doing that, but I will tell you that, especially in the Middle East, there is a stronger movement toward direct commercial sales. Perhaps some of that is the timeliness required where those countries are fighting conflict or whatever, but a movement more to DCS.
So the speed and time to market, trying to get our products out there augment what Mike mentioned, which was the change in the 20 or so classifications, night vision being a big one of those with regard to the government now getting into a faster releasability and exportability of many of the products.

Unidentified Audience Member

As you look at the operating companies on the ground floor of your chart, and Todd gives this as an example because he mentioned that they were eight sub-business under Precisioning and Engagement Trainings. Are incentives financially for those businesses that they maximize their profit but that they maximize Precision and Engagement or ES or the Company? And is there a room there for improvement?

Todd Gautier - L-3 Communications Holdings, Inc. - President of Precision Engagement Sector

We’ve tried to calibrate our plans that not only recognize the business units’ performance that’s their primary objective, but to also account the contribution to the group collaboration across the company as you always get into that situation where one division is working with another who’s getting the credit for the sale and we didn’t want this incentives to collaboration. I think we’ve done a great job of breaking code on that, well these guys will shake their heads. We reward them for collaborating just as much as doing it on a standalone basis because we know to survive and to really excel as a company, we do best when we work together across the Company, we do. We absolutely don’t have the stroke pipes, and the like.

Now I mean, ultimately there are incentives in place that are based on corporate level operations, whether it’s through stock ownership, option plan for people that have (inaudible) and the like. There is also an incentive there. But it starts at the ground level obviously in the business unit. The business unit has its plan and they roll up. Steve do you want to add something to it? Steve, you have a lot of business units and you have this issue every day.

Steve Kantor - L-3 Communications Holdings, Inc. - Head of L-3 Services Group

Yes, as Mike said, we have a combination of incentives that relate to the sector and the Group and the corporation. And it’s also adjusted for the reality of the business. So there are some businesses that need more investment dollars because they have greater growth potential. Some of the panel members talked about the investments they’re making, not everybody gets the same share. So we allocate the IR&D specifically driven around growth and margin expansion. And that’s done across the groups and across the corporation.

We do a total IR&D review for the Corporation as well. So it’s managed to focus on the goals of the Corporation and flows down to the divisions ultimately, so they are incentivized to support themselves, the groups and ultimately the corporation.

Unidentified Audience Member

Again just to expand quickly on the incentive discussion and take it up to the corporate level and I don’t know maybe this is a question for Mr. Millard or the Board, again historically the compensation has been more income statement focused, PSR focused, but obviously talking more about margin you’re talking more about ROIC, you’re talking about cash. Does the higher-level executive compensation warrant changed to drive those outcomes or could it be connected without that?

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

Well, it’s reviewed annually by the compensation committee in connection with their consultants in terms of what the best measures are for us. I think that the point was well taken by the committee. It was almost clear hear that we should introduce perhaps a margin element. I can tell you being on the receiving end of it whenever we had a business plan that was set for our goals, built into that plan was an element of margin expansion. It wasn’t discreet item that was built into the underlying plan, including cash flow, including PSR.
ROIC has been a discussion for a long time. As I recall based on all the companies we looked at, it was not a prevalent measure in our space, that’s my memory, I haven't looked at it recently, but this reviewed annually, annually, based on current trends in the marketplace and the changes that we want to be more focused and give more recognition for margin expansion and top line growth.

In fact, we did introduce an element in our plan that pace of the organic growth over a certain threshold. Ralph you introduced that, so you remember the -- it was over 10% organic, it was a multiplier on bonus. Everybody is a winner every year.

**Ralph D'Ambrosio** - L-3 Communications Holdings, Inc. - SVP & CFO

It’s a kicker for organic sales growth, enhancement.

**Mike Strianese** - L-3 Communications Holdings, Inc. - Chairman & CEO

Organic sale growth, yes. The things that we need to know are important try to put something on to drive that behavior and we will continue to look at it. Do you want to say a word?

**Robert Millard** - L-3 Communications Holdings, Inc. - Director

No, I actually don’t want to say a word, but I will. I think everything Mike said is right. First of all, look what’s the objective that we’re trying to capture. We just -- because we believe the competition -- we are great believers that if you want to know how behavior on the margin works, just look at the incentive. So the incentives -- now on the other hand, the biggest incentive is stock price and pay in general. But you'll remember from the 7,000 pages of the proxy statement or so that there is a dependence on not just absolute performance but relative performance because we do look at peers and how the stock market and -- I’m sorry, how our results back up to the peers as a combination which rolls up a lot of those metrics.

As to whether or not we want to zero in some of those metrics, we are actually talking about that. I mean, we are pretty much in line with the metrics we use now in comparison with our peers which is not to say that we have to be, but margin per say is not one of them because that could motivate sort of a reversed behavior.

We get rid of all low-risk cost plus business and just go to (technical difficulty) contract. So I’m happy by the way, if you want to shoot me an e-mail to consider any metric that -- if you are honest, if anybody has any better ideas in this room about things we should consider, I'm happy to listen. We are just trying to sort of capture the best metrics that motivate value.

**Howard Rubel** - Jefferies LLC - Analyst

If you want to leave Ralph out, I have a couple of items. First, can you explain a little bit why the mix for the tender? I'll just kind of go through the couple of items, mix of the tender? I mean second, so there will be probably a charge in Q1 as a result of that. The second, maybe the overhead allocation, you talk about in the footnotes, but you are more articulate than a footnote.

And then third, there is a little bit of -- you are still distributing more cash than you actually generate. Can you sort of go through the metrics of how you think about that?

**Ralph D'Ambrosio** - L-3 Communications Holdings, Inc. - SVP & CFO

Sure. The first question was regarding the tender offer for the $300 million of debt repayment that we announced yesterday, and if you recall for the last six months or so, we've been intending to repay that amount in the fourth quarter. So we initiated it yesterday, it was delayed by the announcement or the impending announcement of the NSS sale for the advice of our attorneys.
With respect to the debt tranches that we're calling, we're going after tranches that are trading at discounts, modest discounts. First off, if we're successful there will be no charge in the quarter and we will have a more significant reduction to interest expense respectively. So we think that makes sense.

The second question was regarding the -- I think the corporate expense allocations that we've been allocating to NSS that get re-absorbed or allocated elsewhere by the remaining segments. So, I foot noted that on my segment guidance chart, but I said it's about 12 basis points on average across the three segments. So we have a very lean corporate organization, corporate staff and there is a reallocation that happens there. We're going to try to cut some of those costs, but frankly our bigger more significant cost reduction opportunities especially in the overhead costs are in the operating units. And that's something that we talked about earlier today that we're going to be focusing on reducing and improving.

The third question was your comment was that we've been returning more of our free cash flow to our shareholders in the last year or two in the form of dividends and share repurchase and how do we do that or why do we do it?

Howard Rubel - Jefferies LLC - Analyst

Yes, exactly. I mean, is there a point at which you might say that it changes a little bit and that you retain more either pay down debt or to take advantage of market opportunities elsewhere?

Ralph D'Ambrosio - L-3 Communications Holdings, Inc. - SVP & CFO

So, one, we want to provide meaningful returns for our shareholders. That's what it's all about. So we pay a cash dividend and that's something that I expect that we will continue to pay and modestly increase subject to what Mike and the Board decide, but that's the historical path that we've been on. So we should pay a dividend. We will continue to pay a modestly increasing dividend, I will go on the limb to say that.

Secondly, our stock right now is very attractive in terms of the valuation relative to the peers, regardless of what metric you look at, particularly with respect to that free cash flow metric. And when it comes to buying our stock, we're buying a business that we know very well. So we don't see a lot of risk in it. So we're very comfortable buying back our stock and frankly we like to do more of it.

We are also balancing those two with wanting to grow the Company and so we've been active in making small acquisitions and that's something that we'll continue to do. Historically, we have found that the best value creation in M&A at L-3 has come from smaller deals; one, they are less risky; two, we are usually able to structure them with a tax shield that serves to enhance the economic returns; and three, we're not buying public companies who will have boards and fiduciary duties that require control premiums and those types of premiums can take away a lot of the value creation. And we're interested in benefitting our shareholders, not the shareholders of other companies. So that's the way we think about it.

Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO

Also, Ralph, I would add that we've had the discussion about the timing and we believe from a priority standpoint getting the portfolio in order where we'd like to see it in the margins will help our multiple and that should be the first order of the day which will make M&A easier for us, if you will, in terms of value equation, get the all three multiple up first which is where we are.

It doesn't mean it will pass up something that was such a perfect fit as ForceX or CTC, we can still do those and not disrupt the applecart but in terms of anything transformative, I think we have a vision as to what the priority should be and we think kind of inverted from where we started where we were trading up in the 20%, high-20s and buying things at 12% and 15%, you get that immediate -- capitalize those earnings that are high multiples, creates a lot of value. We understand the math and everything and we are very focused on creating value through M&A, not just bulk. That's really what it's about and we are all very interested in seeing that the share price move considerably and creating values. So that's the first (inaudible) as you saw it today.
We have time for maybe one more and then we have lunch and continue the dialog over lunch I am sure. Anybody else? So we covered everybody, therefore if it is okay. You have one more?

**John Rubi - Citi - Analyst**

I'm just wondering if you could just follow-up on the comment you made about better buying power being a headwind, what elements -- [John Rubi] from Citi, what elements of better buying power are causing you some trouble and how do you expect to get over those?

**Mike Strianese - L-3 Communications Holdings, Inc. - Chairman & CEO**

Well, I don't know that we get over them because it's kind of light now, we just more or less have to get used to it. And low price technically acceptable, which is not been pleasant because you don't get paid or rewarded for having the best technical solution, you get rewarded for having a mediocre technical solution that's at a lower price. And it really is a disincentive to industry to invest and come up with the next best solution, no matter what that may be on a product standpoint or on a service standpoint or whatever. So that's one.

And in our case where we supply the platform primes if you will, since this is subject to better buying power and they're getting hit with a little bit heavier on their should cost analysis, if you will, on platforms that's turning around and pulling it right down to the supplier base through mandate. So it kind of finds its way to us one way or another.

Now we've seen of course in the industry that service margins, not just an L-3 story, it's a story that has affected the whole industry which is why you have three companies on the market at the same time because it's not fun to do those contracts at 5% and looking forward to re-compete and you are out losing your workforce that maybe now it's going to be four or three because you are in a very hyper competitive environment same people in other areas. So that's been some of the effects. Although it could be debated at the customer level whether that was the intent or not, that's certainly the effect of what's happened.

It's dislocated some businesses, of course a complete transformation into government services, federal IT space and the customers may be happy with that I guess, eventually. There will be the huge consolidation and maybe they will do better on from an overhead standpoint. But we are responding to it as best we can to live within that environment. Still have a healthy business that generates respectable margins.

All right. Well, thank you very much for joining us and please join us for lunch through the doors in back of the room and we'd be happy to continue any dialog with you.

**Operator**

And this does conclude the L-3 Investor Conference Call. You may disconnect at this time.