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Good morning. We're going to continue here on the aerospace and defense track. We're very grateful to have L-3 Communications here this morning. And we have Ralph D'Ambrosio, the CFO. Ralph is going to begin by making a presentation. And then, we'll have some Q&A.

So, why don't you take it away, Ralph?

Okay. Thank you, Seth. Good morning, everyone. I'm very glad to be here. I believe most of you are familiar with L-3. So, I'm going to go through my charts quickly.

We're an aerospace and defense company. We provide a wide variety of solutions to our customers.

And we're a prime contractor in about two-thirds of our business. The main areas there are intelligence, surveillance, and reconnaissance systems, including intelligence analysis; aircraft sustainment, which includes modification work as well as logistics and maintenance support; simulation training; night vision and image intensification equipment; and also enterprise and mission IT solutions, which includes cyber operations.

And the other one-third of our business, we're a broad supplier of electronic and communication systems that are used on both military and commercial platforms.

Some of the other key attributes about L-3 is that we're a broad, diverse technology company. We have a very large contract base with no meaningful concentrations in terms of our revenues. For example, our top five contracts comprise about 12% of our sales, and our top 40 contracts comprise about 33%. So, you can see that diversity in those statistics.

About 29% of our business is international and commercial. That's areas that we've been focusing on growing the last several years to offset some of the declines that we've experienced in our military business, given the reductions in the US defense budgets and other budgets around the world.

We believe we have a flexible cost structure. We're a low capital intensity business. Our CapEx is less than 2% of our sales. And that's largely because we're not a platform OEM. Most of our value add is labor-oriented, including primarily engineering and technical services.

We think we have a very efficient balance sheet, or capital structure. We're an investment-grade credit, and we intend to preserve our first-tier, investment-grade credit ratings.

And lastly, one of the enduring characteristics of L-3 is that we've continued to generate a very high earnings-to-free-cash-flow conversion ratio. It was about 140% in 2014. It will be about the same in 2015. And that's something we expect to continue into the foreseeable future.

On the next chart is a closer look at our end customer sales. I talked about the fact that we're at 29% commercial and international, and you can see how that breaks out: 15% foreign governments, which is about -- one-third of that would be FMS, or foreign military sales; the rest is direct commercial sales; 14%, commercial.
And then, you see the lion's share of our business, in that we have always been and we will continue to be predominantly a US defense contractor. It represented 66% of our sales in 2014 -- 6% of it, or approximately $750 million, was related to the Afghanistan and other OCO engagements. And when we talked about 2015, we said we expect those sales to decline about $250 million in 2015, and then to bottom in 2016 somewhere between the $300 million and $400 million range, which would be another $50 million to [$150 million] (corrected by company after the call) decline in 2016.

A couple of points on our end markets. First, the US government markets. So, the geopolitical threats that the nation is facing seem to be increasing and escalating and certainly becoming more complex, which bodes well for military spending.

And also, the country's fiscal situation has improved dramatically the last three or four years, with the deficit declining at a very meaningful pace.

The downturn in the defense budgets began in 2011, but the good news is that we're at a bottom in terms of the defense budgets, and that's with or without full sequestration. And it looks like the base budget is set to start growing again in FY16, which begins in October 1st of this year. It would grow about 1% if we have full sequester, and something better than that if we don't.

We're encouraged because Congress has taken action to reduce the first three years of sequestration -- FY13, FY14, and FY15 -- trimming those cuts by about $13 billion, or so, per year. And we expect that they'll take similar action in FY16 and beyond.

The administration earlier -- about a month ago, actually -- submitted their request for FY16, which is about $34 billion in the base budget above the BCA sequester caps, and we think that ultimately Congress will appropriate a budget somewhere between the sequester cap and the administration's request.

With that said, we continue to have very meaningful opportunities to grow our market share in the US government and DOD markets, particularly in the classified areas.

In the other 29% of our business, the international and commercial markets, those have been growing, and we expect that they're going to continue to grow in the foreseeable future. On the international, or foreign government, side, there's a very large addressable market for L-3. The last few years, we've been increasing our marketing and selling efforts, our business development efforts, and we've also been introducing more of our products for export, and that has led to good gains in our sales.

And we expect that we can continue to grow our international sales, or the foreign government sales, whether or not there's growth in the underlying foreign military budgets, and that's because of the size of the market that we're going after.

On the commercial part of our business, which was 14% of sales in 2014, we believe we have very good, favorable fundamentals that are largely tied or correlated to global GDP growth, most of it in the aviation and communication markets which we expect to grow in 2015. And the area that is declining is our shipboard, or marine products, and that's a business that we announced that we're going to be divesting sometime in the second quarter of this year.

So, good fundamentals that should endure in the international and commercial markets for L-3.

A few comments in each of our segments. Electronic systems, which is our largest and most profitable segment, sales of about $4.6 billion. It's a very diverse collection of businesses in six sectors, as we have organized the segment. Those products include sensor systems, simulation and training equipment, power and propulsion equipment, aviation products, and a couple of other business areas.

Nearly half the segment is international and commercial, and that's growing.

We've been continuing to expand or gain market share in this segment through our investment in R&D and some niche investments and acquisitions.

I'd just said we're divesting the low-margin marine systems international business, which is going to further increase the margins in the segment.

And we believe that electronic systems will be the key driver of L-3's core margin expansion the next several years.

Aerospace systems is our second-largest segment. This year, it will do about $4.1 billion or $4.2 billion in sales. We're experiencing some headwinds due to the final parts of the Afghanistan drawdown of the US military, which is impacting our small ISR aircraft sales. And the sequestration cuts has caused some budget shortfalls, and that's impacted some of our business in the platform systems area; namely, the Compass Call program and the P-3 work.
That said, the DOD, or Department of Defense, continues to require low-cost, quick-reaction fleet upgrades and modification work, and we're well suited to address those. And about one-half of this segment is ISR systems. We have very solid, strong positions, and that business continues to grow.

So, we're investing in both the tactical and the strategic next-gen ISR systems, also a multi-mission aircraft, as well as continuing to do work to provide service life extension programs on international C-130 and P-3 aircraft.

Our margins are expanding this year, because we had some issues last year with some problems that caused an internal review. So, we have an easy comparison, and we expect that we'll be able to modestly expand these margins in this segment the next few years, as well.

Communication systems. About $2 billion in sales. We have very solid, long-term and, in many cases, sole-source positions in this segment.

This year, the sales are flattening, after having declined significantly in the last couple of years due to the Army and tactical ISR budget reductions in the US, or DOD, market. But those pressures are abating, and we expect to return to growth here next year.

We continue to invest in advanced communication systems, namely the A2/AD type of communications.

Our core margins are expanding here, improving. That's coming from greater manufacturing productivity improvements, as well as consolidation synergies. About a year ago, we combined our legacy microwave and communication systems groups to create the communication systems segment. So, we expect to enjoy some synergies out of that combination.

And then, lastly, national security solutions, or NSS, which is our smallest segment, about $1.2 billion in sales. It's definitely experienced the greatest amount of market pressures in this DOD downturn, whether it be the efficiency initiatives or the better buying power; declining IT budgets in, really, all or most US government markets; and also a movement to set aside more business for small business, and those are called small business set-asides.

That said, the segment has been doing really well competitively the last couple of years. We're gaining market share, and last year we had some very key wins with intelligence community customers.

We're also building our cybersecurity business here through targeted contract pursuits.

And we expect that our margins are likely going to continue to be under pressure and stay somewhere between the 6% and 7% range, unless we start generating some meaningful growth in our top line in NSS.

So, that's the segments. Here's our consolidated financial guidance that we provided at the end of January when we reported our fourth quarter 2014 earnings. So, sales are only going to decline about 2%. That's an improvement compared to the last couple of years.

We expect to increase our operating margin by about 40 basis points, and that's even after a pension expense headwind which is reducing margins by about 50 basis points and EPS by about $0.45 in 2015 versus last year. And that's largely due to the decline in interest rates that occurred in 2014.

That said, we expect that over the next few years pension expense is going to be a source of earnings growth, because we expect that it's going to continue to modestly decline the next few years -- really, indefinitely -- because we froze our pension plans in 2007. So, that's going to be a source of margin improvement, earnings growth, as well as cash flow improvement, because we'll be making smaller contributions into the pension trust in the future.

We're not anticipating a federal R&E tax credit for 2015, because it was only enacted for one year last December by Congress. But if Congress does reenact it, that's also going to improve our EPS by a considerable amount. We estimate that it's worth about $0.24 of EPS in 2015 if it is reenacted. And ultimately, we think we're going to have R&E credits. It really depends on when Congress enacts it in the current year or in the future.

Here's a look at what we've been doing with our cash flow the last three years. And as you can see, we've been returning essentially all of our free cash flow to our shareholders, mostly in the form of share repurchases, coupled with a modestly increasing dividend each year. And we just raised our dividend, about a month ago, another nickel per quarter, or $0.20 per year. And I expect that we'll stay on that trajectory for the foreseeable future.

And here's a look at our cash sources and uses: the actuals for 2014 and what our guidance for 2015 contemplates. So, the key thing here is that after we pay our dividend in 2015 and we make our planned share repurchases, which are starting at $0.5 billion, for 2015, we expect that we'll end this year with about $700 million of cash on the balance sheet. That's not counting the $300 million, or so, that we expect to receive from divesting the MSI business.
So, we're going to have ample resources to make acquisitions if we can find any good ones to make, buy back more of our stock, and if we need to, even to repay some of our debt.

Which brings me to my summary of the Company. L-3 continues to have affordable solutions and technologies that are well aligned with the customer priorities, whether they be military or commercial customers. The DOD budget is set to inflect upward in FY16. The only question is at what rate it grows in the future, but we're going to be returning to growth in short order in the US defense budget, and that's a very positive indicator for the Company.

We continue to win our contract recompetitions, as well as win new business. And the Company really has no major recompetitions, in terms of singularly large contracts the next two or three years. So, no major recompetition risks at L-3.

We continue to grow our international and commercial business and generate a robust cash flow.

So, that concludes my comments. Thank you. And I guess we'll start the Q&A now.

Seth Seifman - J.P. Morgan - Analyst

Great. Thanks very much, Ralph.

QUESTION AND ANSWER

Seth Seifman - J.P. Morgan - Analyst

In one of your later slides, you talked about cash deployment. And so, maybe that provides an entree to start off by talking a little bit about M&A. You do have some cash potentially to deploy there this year. Can you talk a little bit about the landscape, just in terms of what's out there, what valuation is like? There have been some decent-sized deals recently, including one announced just yesterday. Do you have an appetite for a larger deal? Maybe talk about M&A a little bit?

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

Sure. So, we talked about this topic at the end of January when we reported our fourth quarter results. And what we said was M&A continues to be a key part of our business and growth strategy. While we've done very modest M&A the last three or four years -- mostly small, niche, bolt-on type acquisitions -- we certainly would like to do more M&A.

And the improvement in the DOD budget is going to make us more inclined to invest in business acquisitions. I think we'll get some more clarity about where any additional sequestration constraints will be sometime this year. So, that's also going to provide more stability to the outlook, which enables us to take bigger risks in M&A.

And M&A will continue to be opportunistic for L-3, in that the targets have to be available. We don't like to force transactions, if you want to say it that way, because it tends to lead to overpaying. And we'll continue to look for businesses that fit well with L-3 and that provide attractive economic returns.

So, I expect that you're going to see an increase in the pace of M&A at L-3 in short order.

Seth Seifman - J.P. Morgan - Analyst

Great. Thanks. What about --? You've been very successful in recent years on the commercial side. Do you ever think about making a major acquisition on the commercial side? Is there a cap on that percentage of sales that you'd like to see the commercial businesses represent?

Ralph D'Ambrosio - L-3 Communications Holdings, Inc. - SVP & CFO
No, there isn't. Our primary objective is to grow the Company. And depending on what the environment is, on what the market conditions are, we'll try to grow the fastest in the end markets that have the best growth opportunities.

So, it's not surprising that with the downturn in the defense spending the last four or five years, there's been better growth opportunities in the commercial and international, or foreign government, markets. So, we're not managing the Company to achieve any type of end customer mix; we're managing the Company to optimize our growth.

And that said, I said earlier that we expect the international and commercial markets to continue to grow. So, we expect that over time, after you adjust for the divestiture of MSI, which is about 4% of sales, that we'll continue to have incrementally more growth, albeit modest growth, in the international and commercial markets relative to the DOD or military markets, unless there's a big uptick in defense spending and that's not presently contemplated.

Okay. And then, maybe flipping it around to the other side and thinking about divestitures, I think the NSS segment is maybe something that stands out here a little bit, and it's something that you and Mike have talked about a little before. I know you've gotten the question. The margins aren't quite to a level that you'd like. What's your timeline for when this business has to be at a place that you'd like to see it, before you would consider selling it?

Well, we commented on that also at the end of January, and what Mike Strianese said, our Chairman and CEO, was that we'll see how things unfold the next year, or so.

The business, NSS, while it's been under a lot of pressure, it does give us most of our exposure in the cybersecurity market, and that's going to be a market that we expect that will continue to grow. So, we think it's important to have exposure through NSS in that area.

And like all the other larger defense companies, we think it's important to have a service business, a service solution business, like NSS, like everyone else has.

So, that said, we'll see how things unfold.

I'm sure you have a plan to improve the profitability there. Are there any big awards that stand out that might change the landscape or go a little bit of a way toward changing the profitability in that business? Or, is it going to be just grinding it out gradually?

Well, we are pursuing some significant new business opportunities. We tend to have the most large new business opportunities in that segment, and that's because a lot of that business turns over rapidly.

So, we expect that we're going to -- the margins are going to stay kind of where they are, which I explained, unless we have a meaningful increase in sales. So, that's something we're certainly trying to achieve, but I don't want to commit to it just yet. I'd like to see us win some more new competitions.

Sure. Sure. In terms of other potential changes in the portfolio, there's the logistics solutions business in aerospace, which is fairly sizable, and I know the margins have taken a hit. Is that something you think of as something that may not be part of the Company for the long term, or maybe part of it?
Well, I don't want to get into any of those specifics, but what I will say, when it comes to portfolio shaping, especially in the area of divestitures as opposed to acquisitions, we want to be smart and intelligent about what we're doing. So, if we take any portfolio actions, we want them to be value-creating for our shareholders.

And therefore, there are a lot of considerations that go into potential divestitures, including valuation, tax basis, and after-tax proceeds, which is really what matters. And then, where we believe the business is. You mentioned logistics solutions, and we think that, clearly, had a very difficult year in 2014. That's where the genesis of our problems were. But we think that business in terms of margins is at the bottom and likely has some improvement prospectively.

So, even if we were to sell the business, the last thing we want to do is sell a business at the bottom and leave economics on the table. That would not serve our shareholders well.

So, it's not a very simple equation, if you will. There's a lot of considerations, but the key thing is that we're trying to grow our earnings and our cash flow, as well as the stability in those earnings and cash flow.

**Seth Seifman - J.P. Morgan - Analyst**

Understood. [Maybe] talking a little bit about margins, which seems to be a high priority. You talked about electronic systems and that being a margin driver for the Company. When you think about the relative importance of what's going to change there and bring that margin up to the 13%, 14% range, there's mix, operating leverage or productivity, and cost take-out. What are the key components? How would you rank them?

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

Clearly, we're going to have -- we think our sales are going to start growing there soon. So, were going to have some operating leverage.

We continue to take cost out of the business, or the segment, that is, by consolidating business units or administrative and support functions. And we still have more opportunity in that regard, particularly within the six sectors that will remain after we divest MSI.

And the business which is nearly one-half commercial and international, we tend to have higher margins in that business. And also, on the US government, or DOD, side, which is the other half of the business, a lot of what we do is fixed priced in nature, supplier-oriented. And therefore, to the extent that we can generate cost savings and not trade them away in competitions, they fall to the bottom line. So, that gives us a good source of margin expansion opportunity.

And lastly, in electronic systems and as is the case everywhere else in the Company, we're focused on improving our contract performance. And what I mean by that is our financial contract performance, in that L-3 has always had a very strong track record of delivering very good value to our customers in terms of being on time and on budget with affordable solutions. I'm talking about increasing the financial returns and the ROS in our contract performance. And that's something that we're focusing on everywhere at L-3.

**Seth Seifman - J.P. Morgan - Analyst**

And the potential that you mention for streamlining and cost take-out, is that something that exists principally in electronic systems? Or, are there material opportunities there across the business?

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

It's mostly in electronic systems and communication systems. Most of the consolidation activity is largely completed in the other two segments.

**Seth Seifman - J.P. Morgan - Analyst**

Maybe we'll see if there are any questions from the audience. I see we have one in the front row, here. So, we'll start off over there.

**Unidentified Audience Member**
Ralph, can you just comment on the Moody's note that came out that put the Company on negative watch? And it sounds like just from reading the note that the onus is a little bit on the Company at current trajectory levels. They seem like they might be likely to downgrade you to high-yield. So, I just want to get a reaction whether or not that's important to you?

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

Well, at the beginning of my commentary, I said that the investment-grade ratings are important to L-3 and that we intend to preserve them. So, among the rating agencies, Moody's I think clearly has the most onerous calculations. And what's impacted our leverage metrics there recently is we had a large increase in our pension obligation, the unfunded obligation, last year, of about $600 million, or so, driven by the decline in interest rates.

But as I said earlier, the pension expense along with the obligations is something that's going to systematically decline at L-3 into the future. So, that will be a natural source of deleveraging.

I also said that we expect to return to growth soon. So, we'll be in a mode where we're growing our operating income and our EBITDA, which is going to improve the leverage metrics. To the extent that we make any acquisitions, that will also help. And as I said earlier, if we need to, we could also afford to make some modest debt repayments without disrupting the cash returns that we've been providing to our shareholders the last several years, and I explained that in one of my last charts.

So, that's what we think about Moody's.

Seth Seifman  - J.P. Morgan  - Analyst

And maybe we'll take one over here.

Unidentified Audience Member

Ralph, can you just remind us just embedded in your 2015 guidance, in your 60% of the business, roughly, that's DOD, what revenue headwinds are embedded in your 2015 guide, with and without the OCO pressures maybe? That's the first.

And then, maybe the second, even under an embedded sequestration assumption, in your comments you mentioned that the DOD [base-on] revenue, or budget, will still grow. How long from when the budget may positively inflect in 2016 until you can see an impact in your business on the DOD side?

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

We think it's going to be quickly. Certainly, within a year or a year and a half in terms of what happens in the budget. And that's because a lot of our sales are funded [at O&M]. We tend to be in the shorter cycle parts of the DOD budget.

So, when the budgets start growing, we should start growing our defense sales shortly thereafter.

With respect to our sales for 2015, which is a 2%-type decline in consolidated sales, that contemplates about a 5% reduction in our DOD business, for which about one-half of it is coming from the drawdown from Afghanistan, which I talked about that as being a headwind of about $250 million in 2015.

The rest of it, really, is some of those legacy DOD programs that I talked about in platform systems that will continue to decline in 2015, programs like Compass Call; the P-3 work that we do, as that aircraft transitions to the P-8 over the next several years; as well as we also have small quantities this year in some of the cabin assembly work that we do on the CH-47 and the UH-1Y.

So, those are the main drivers in our DOD business.

Seth Seifman  - J.P. Morgan  - Analyst
That kind of segues into the next question that I had, which is, as we move into the second half of the decade, with the budget growing again, should we think about a generic growth rate for your business being kind of the rate at which the budget is growing, with a little bit of a plus-up for the commercial and international activity? And that's sort of a generic growth rate for the next few years?

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

I'd like to suggest that that should be a starting point, because we want to try to outperform the DOD budget. So, I think that's a good starting point.

Seth Seifman  - J.P. Morgan - Analyst

Okay. Excellent. And then, digging in a little more on the commercial side, you highlighted some areas that are growing and where you've had some success: aviation products, security and detection. It's very nice growth that you're forecasting on the commercial side this year. Where specifically are the real opportunities? What's growing there? And then, are there any investment requirements on the commercial side, in terms of additional R&D or any other investments that you might need to make?

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

Well, we continue to invest a lot in R&D each year in the commercial side. So, that's not changing.

We are increasing our R&D investment this year, and some of it is in the aviation product side, and we talked about it -- not here today, but earlier. We're also investing more in the US government classified markets, where we see very good growth opportunities the next several years.

But one of the newer growth areas for us in the commercial side has been simulation and training relating to civil aviation. We acquired a business a little more than two years ago that does simulation devices and training work for commercial aircraft, which complemented our fast-jet military business nicely. It's called Link, and that business we named Link UK, the commercial side. And that's an area where we continue to see not only growth in the end market, but meaningful opportunities for us to increase our market share, as well.

Seth Seifman  - J.P. Morgan - Analyst

Okay. And then, the incremental R&D that you've outlined in the defense side and for classified, is that the beginning of a longer-term investment period? Or, is that something that's more focused on 2015?

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

No, I would say the next few years. That is, we have a very broad portfolio of technologies, with really some excellent opportunities to bring those technologies to bear, to address several meaningful classified market opportunities, and that's something we're focused on. So, we think that's going to be a good source of growth for us, not in the short term but definitely in the medium and long term, because it's going to take some time to seed those investments. But we think we'll have good returns on that higher R&D investment there.

Seth Seifman  - J.P. Morgan - Analyst

Great. Maybe go out again to see if there are any questions from the audience?

Here's one right over here.

Unidentified Audience Member
Ralph, you had mentioned that M&A could be accelerating. I was hoping you could elaborate on that a bit and, in particular, talk about the competitive environment for M&A. Are you facing a lot more parties as you look at deals? Describe how that's shaping up, please?

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

Well, in terms of the competitive M&A environment, I don't believe it's really changed meaningfully for us the last few years. I don't see it changing meaningfully now. So, it's really more a function of what we want to do, I would suggest.

As I said earlier, what we're trying to do is to grow our earnings and our cash flow, and our capital allocation, or deployment, is a big part of that. So, to the extent that we can find good M&A opportunities with economic return characteristics similar to that of L-3, you'll see us make more acquisitions. And we do have some opportunities where we can probably also generate some nice synergies.

So, I'm not sure if I'm answering your question, but I don't want to be predictive about M&A transactions. We like to -- as I said, it's opportunistic for us. And to the extent that we can find and capitalize those opportunities, you're going to hear more about M&A from L-3.

So, I think that's the correct way to calibrate that discussion.

**Seth Seifman - J.P. Morgan - Analyst**

Okay. Great. I think we're down under a minute here. So, if there are no more questions from the audience, maybe we'll wrap up.

Ralph, thanks very much for joining us.

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

You're welcome. Thanks for having me.