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Date: January 27, 2023

COMPANY/TICKER: **L3 HARRIS, INC. 4.400% 06/15/2028**

Bond

SELL

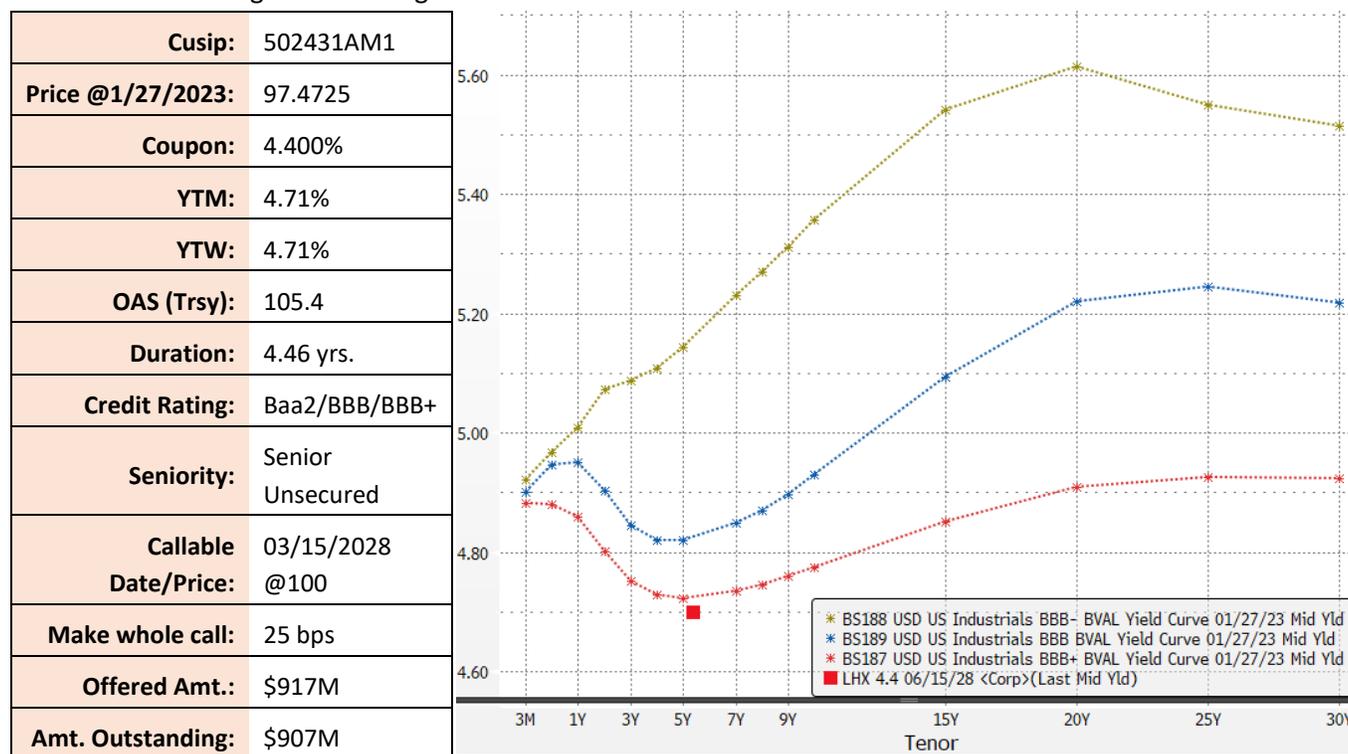
EXECUTIVE SUMMARY

The TCM Bond team recommends a sell of L3 Harris (LHX) 4.400% 2028 bond [502431AM1] (3.3% of the TCM Bond portfolio). Due to the outlook of declining corporate profits, the TCM Bond team’s goal is to reduce our over-allocation in our corporate bonds, such as our BBBs. This bond is split-rated Baa2/BBB/BBB+ with a potential risk of being downgraded if its acquisition of Aerojet Rocketdyne (AJRD) is executed. The Ukraine War has additionally created a higher premium in the aerospace and defense sector, which makes now an adequate time to sell. This war will not last forever and may end sooner than anticipated given the potential for negotiations between Russia and Ukraine, making L3 Harris's premium unsustainable.

To summarize, primary drivers of this recommendation include:

- 1) LHX’s inferior financial position compared to peers, exacerbated by future increases in leverage given their potential acquisition of AJRD.
- 2) With LHX’s OAS declining in the last four months, this security has been significantly overvalued compared to the BBB OAS market from 2022 to early 2023.¹
- 3) In our profitability analysis, LHX ranks the lowest due to its below average performance in all metrics.

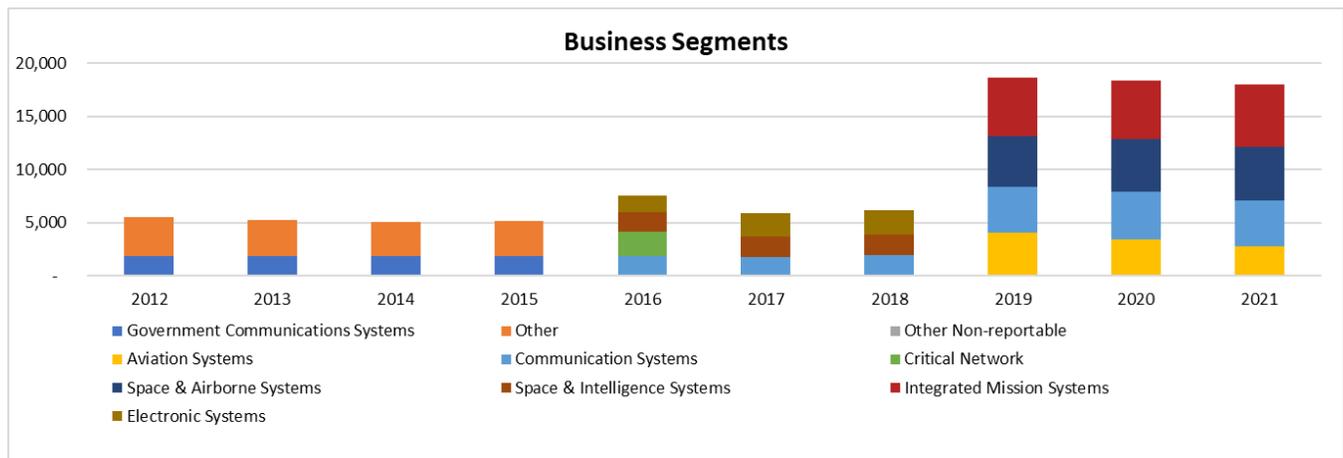
Key uncertainties include if the acquisition of Aerojet Rocketdyne is not executed and the potential for an elongated Ukraine conflict supporting aerospace and defense demand. An increase in U.S. defense spending to stimulate economic growth if rising interests rates cause a recession.



¹ See appendix for OAS charts.

COMPANY OVERVIEW

L3Harris Technologies, Inc. (LHX) is an American technology company that produces communication, electronic, surveillance, and reconnaissance systems for aerospace and defense applications. It serves customers in the aerospace, defense, and commercial markets, including the U.S. Department of Defense, other government agencies, and commercial customers. Some of the company's key products and services include satellite communication systems, aircraft systems, radar systems, and cyber security solutions. The company was formed in 2019 through the merger of L3 Technologies and Harris Corporation. It is headquartered in Melbourne, Florida, and operates in over 100 countries.



*Business Segment Data based on FactSet

Rel Type	Rel Rank	Company	Ctry	Industry	Relationship Value (\$)	Mkt Cap (\$)	Disclosures/Source	3M Price Correlation	Key Risks	Key Events
■	3	Lockheed Martin	USA	Defense Manufacturing	-	117,889	Direct	-0.08	-	-
■	4	United States	USA	Sovereign	13,361	-	Direct	-	-	-
■	20	State of Florida	USA	Province/State	-	-	Direct	-	-	-
■	27	ViaSat	USA	United States Satellite Services	-	2,766	Reverse	0.58	-	-
■	32	Richardson Electronics	USA	Other IT Distributors	-	313	Reverse	0.28	-	-
■	33	Spire Global A	USA	Aerospace Equipment	-	192	Reverse	0.61	-	-
■	35	TESSCO Technologies	USA	Other IT Distributors	-	47	Reverse	-0.55	-	-
■	51	Raytheon Company	USA	Diversified Aerospace and Defense ...	-	-	Reverse	-	-	-
■	52	Austal	AUS	Commercial Transportation Equipm...	-	512	Reverse	0.78	-	-
■	56	Deutsche Lufthansa	DEU	Air Passenger Transportation	-	11,341	Direct	-0.86	-	-

In December 2022, LHX announced its plan to acquire Aerojet Rocketdyne (AJRD) for \$4.7 million, following the Federal Trade Commission's block on Lockheed Martin's (LMT) attempt to purchase the company. LHX will need to take on additional debt to finance the acquisition, as it only has \$530 million in cash. LHX's pro forma net debt is expected to increase to \$11.2 billion, while it already has \$7.8 billion in debt. With an increase in debt, this may lead lenders to charge a higher interest rate on loans.

L3 Harris's financials show a significant effect from when L3 Technologies and Harris Corporation merged to become L3Harris in 2019. Since the merger, we have seen steady financials; however, L3Harris plans to acquire Aerojet Rocketdyne. If this acquisition is successful, pro forma net debt is expected to increase to \$11.2 billion.

Condensed Financial Data								Capital Structure		
	DEC '21	DEC '20	DEC '19	JUN '18	JUN '17	JUN '16	5-yr. Avg.	L3Harris Technologies Inc (LHX)		
Revenue	\$16,771	\$16,121	\$15,843	\$9,766	\$9,080	\$9,170	\$12,792	Industrials <=Industry		
Growth	4.03%	1.76%	62.23%	7.55%	-0.98%		14.92%	Aerospace & Defense <=Sub-Sector		
Operating Margin	12.48%	11.93%	12.20%	18.96%	19.17%	20.51%	15.88%	Fully Diluted Market Cap.	40,999	85.7%
Growth	4.63%	-2.19%	-35.65%	-1.10%	-6.54%		-8.17%	+ Long-term Debt	5,806	12.1%
EBIT / Int. Expense	8.39x	8.04x	8.37x	6.89x	6.58x	6.72x	7.50x	+ Short-term Debt	1,065	2.2%
Growth	4.37%	-3.94%	21.41%	4.84%	-2.09%		4.92%	- In-the-Money Convertible De	-	
Total Debt / EBITDA	2.21x	2.15x	2.20x	2.65x	2.87x	2.98x	2.51x	- Cash & Equivalents	-529	-1.1%
Growth	2.83%	-2.50%	-16.69%	-7.79%	-3.54%		-5.54%	+ Preferred Stock	-	
LT Debt / Total Capital	28.79%	26.82%	24.55%	47.92%	48.81%	54.40%	38.55%	- In-the-Money Convertible Pfr	-	
Growth	7.33%	9.26%	-48.77%	-1.82%	-10.29%		-8.86%	- Investments in Unconsol. Sub	0	0.0%
								+ Non-Controlling Interest	102	0.2%
								+ Pension Liabilities	403	0.8%
								Enterprise Value	\$47,846	100%

FINANCIAL COMPARISON

PROFITABILITY

2. PROFITABILITY Factors (1 - best, 6 - worst: high is better except Total Debt)

Company Name	Sales Growth (3 yr.)	Gross Margin (NTM)	EBIT Margin (NTM)	ROIC (NTM)	ROE (NTM)	Adjusted Total Debt			RANK					Avg. Rank	Evaluation
						Sales	EBITDA	Debt	Sales Growth	Gross Margin	EBIT Margin	ROIC	ROE		
L3Harris	9.60	27.86	16.34	4.31	12.59	\$17,814	\$3,194	\$7,938	4	3	2	4	4	3.3	Less Profitable
Lockheed Martin	10.93	13.05	12.83	26.23	70.92	\$67,044	\$10,461	\$16,646	3	4	4	1	1	3.0	Less Profitable
Keysight Tech	\$26	\$65	\$29	\$19	\$28	\$5,420	\$1,556	\$2,018	1	1	1	2	2	1.3	More Profitable
Timken	\$18	\$30	\$16	\$10	\$17	\$4,133	\$690	\$1,569	2	2	3	3	3	2.5	Profitable
Average	16.24	34.05	18.42	14.89	32.19	\$23,603	\$3,975	\$7,043							

- L3 Harris ranks the lowest in our profitability analysis with its below average profitability across all metrics
- L3Harris holds the lowest ranking for **3-year Sales Growth, Return on Invested Capital (ROIC), and Return on Equity (ROE)**.
- L3Harris has the second least appealing **Gross Margin** within the peer group and is below the peer average.

LEVERAGE

3. LIQUIDITY, LEVERAGE, YIELD (1 - best, 6 - worst: high is better for current ratio, EBITDA/Int. Exp, and yield; low is better for debt ratios and beta)

Company Name	Curr Ratio	EBITDA / Int. Exp	Net Debt / EBITDA	LT Debt / Ttl Capital	FCF Yield	Dividend Yield	Beta	Diluted Shares	RANK							
									Curr Ratio	EBITDA / Int. Exp	Net Debt / EBITDA	LT Debt / Capital	Dividend Yield	FCF Yield	Debt Rank	Yield Rank
L3Harris	1.10	11.61x	2.30x	25.70	6.04	1.75	0.91	191.3	4	4	4	1	2	2	3.3	2.0
Lockheed Martin	1.28	17.17x	0.93x	48.96	5.35	2.98	0.81	265.1	3	2	2	4	1	3	2.8	2.0
Keysight Tech	3.01	19.82x	-0.02x	32.03	4.22	0.00	0.81	180.0	1	1	1	2	4	4	1.3	4.0
Timken	2.03	11.75x	2.00x	37.28	10.80	1.72	1.24	73.9	2	3	3	3	3	1	2.8	2.0
Average	1.85	15.09x	1.30x	35.99	6.60	1.61	0.94									

- L3Harris has the lowest **Current Ratio** within the peer group and below the peer average.
- L3Harris holds the least appealing **EBITDA/Interest Expense** which is ~30% below the peer group average. It's **Net Debt/EBITDA** is additionally almost double that of the peer group average. If LHX's acquires AJRD, LHX's financial position would only continue to deteriorate and lag its peers.

VALUATION ANALYSIS

PEER COMPARISON

5. BOND COMPARISON

Adjust weight if desired by changing these figures=>										2.0	1.0	1.0	1.0	
Company Name	Cusip	Coupon	Maturity	Credit Rating (Moody's/S&P)	YTW	OAS (Trsy)	Altman Z-score (Bloomberg)	Outstanding Issuance	Duration	Yield Spread Rank	Default Risk Rank	Int. Rate Risk Rank	Financial Risk Score	Weighted Rank
L3Harris	502431AM1	4.400%	3/2028	Baa2/BBB/BBB+	4.71%	105.4	4.13	\$907,994,000	4.46 yrs.	4	3	1	3.25	3.1
<i>max 2 bonds per company</i>														
Lockheed Martin	539830AK5	8.500%	12/2029	A3/A-/A-	4.93%	130.7	4.90	\$183,000,000	5.29 yrs.	2	2	3	2.75	2.4
Keysight Tech	49338LAF0	3.000%	10/2029	Baa2/BBB/BBB	4.90%	128.0	7.84	\$500,000,000	5.84 yrs.	3	1	4	1.25	2.5
Timken	887389AK0	4.500%	12/2028	Baa2/BBB-	5.00%	135.5	3.64	\$400,000,000	5.06 yrs.	1	4	2	2.75	2.2
Average OAS and Z-score: 124.9 5.13														

Overall Ranking: 4th

Our bond comparison shows that L3Harris's 4.400% 06/15/2028 bond is the worst among its peers, making it an ideal position to sell due to its low yield spread, default risk, and financial risk. LHX's spread is xx bps less than the BBB investment grade OAS market, indicating that it is overvalued. The TCM Bond team aims to decrease our allocation in lower-credit corporate securities as 2023 is expected to continue experiencing economic uncertainty. Additionally, the current market conditions, including the Ukraine war and inflation, make it a good time to sell the bond while it is at a high price.

Option-Adjusted Spread (OAS): 4th

LHX has the lowest OAS in its peer group. Its premium in the BBB market has been driving the price of this bond, indicating an opportune time to sell.

Modified Duration: 2nd

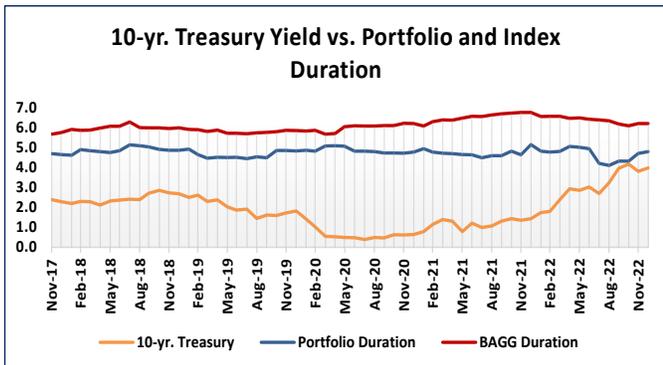
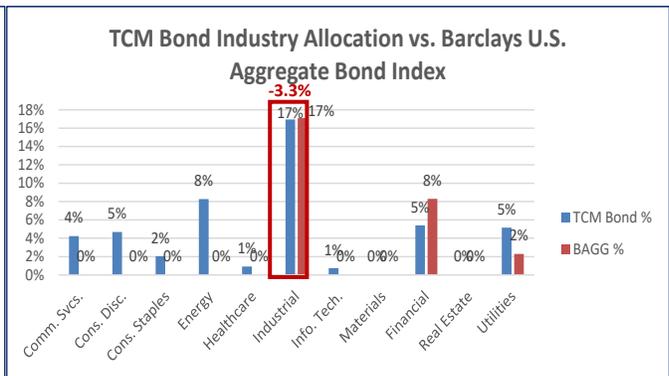
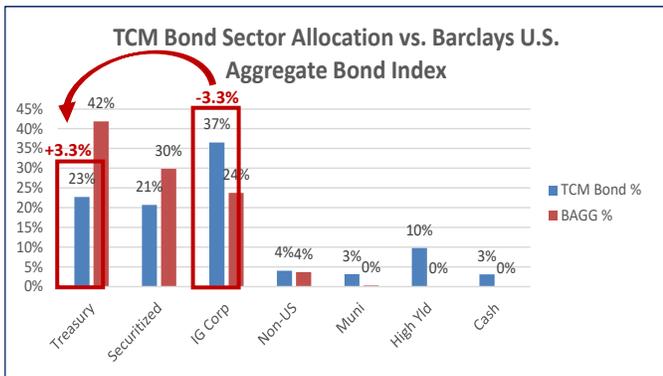
LHX has the most appealing ranking for duration at 4.50 years. Other securities from LHX's peers didn't provide similar maturity dates, which made this ranking the most comparable. Yet, with our portfolio's low duration, we plan to replace this with a higher duration bond that can help move our portfolio's duration closer to the benchmark.

Financial Risk: 4th

LHX's financial risk is the least attractive out of its peers. LHX has the worst **Current Ratio**, **Net Debt/EBITDA**, and **EBITDA/Interest Expense**. Additionally, LHX is planning to acquire AJRD, which is forecasted to increase its net debt, interest expense, and leverage ratio even further.

PORTFOLIO IMPACT AND SUMMARY

The TCM Bond team recommends selling our L3Harris bond maturing in 2028 to increase our portfolio’s overall credit rating and position our portfolio’s duration closer to the benchmark. If L3Harris’s acquisition with Rocketdyne Aerojet is successful, this would increase their debt and pose a considerable risk to their financials. L3Harris's bond is overvalued as investors price in a sharp premium for the increased defense spending from the Ukraine War, even though this increased spending is not sustainable throughout our time horizon. The TCM bond team prefers to sell this security and allocate the proceeds towards treasuries. We look to increase our credit quality and duration based on our outlook of continued economic uncertainty in 2023.



Weighted Average Statistics as of December 31, 2022	Duration	Credit Quality
TCM Bond Portfolio	4.81	A+
BAGG Index	6.22	AA
<i>Difference:</i>	<i>-1.41</i>	

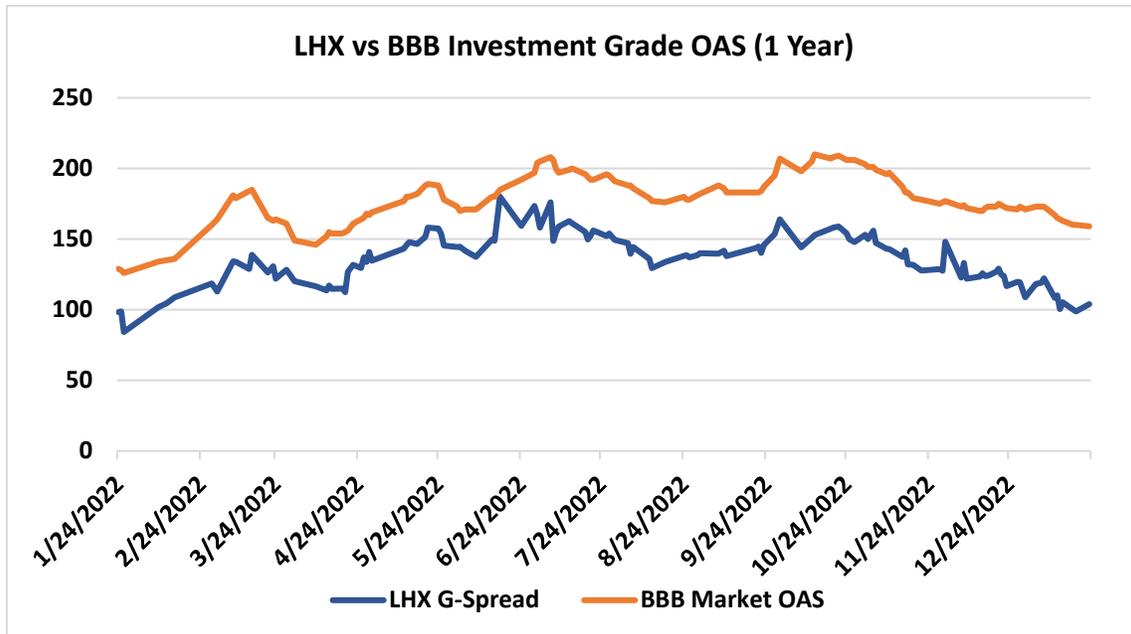
APPENDIX

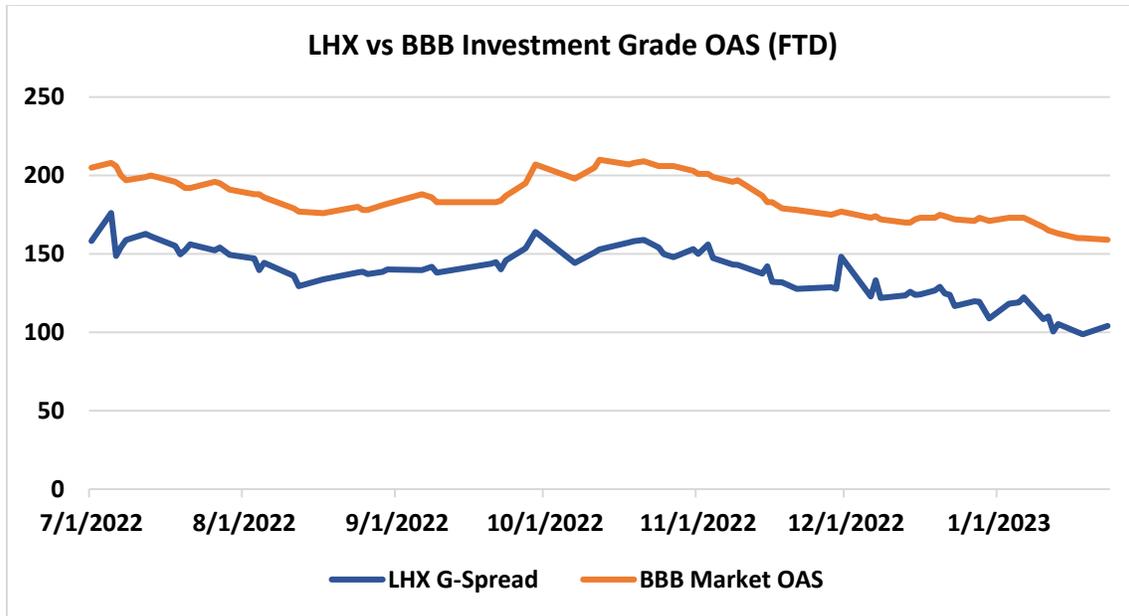
LHX G-SPREAD GRAPH



- The G-Spread graph indicates that the option-adjusted spread for LHX has decreased over the last four months.

LHX OAS VS. BBB INVESTMENT GRADE OAS MARKET





- In the last year and FTD periods, LHX has been significantly overvalued.
- The average difference in OAS between LHX and the BBB corporate market is -42.5 basis points.
- At the end of 2022, the OAS difference between LHX and the BBB corporate market concluded at -62 bps.

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