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.

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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.

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.

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Sales Growth (3 yr.)</th>
<th>Gross Margin (NTM)</th>
<th>EBIT Margin (NTM)</th>
<th>Return on Invested Capital (ROIC)</th>
<th>Return on Equity (ROE)</th>
<th>Adjusted EBITDA</th>
<th>Total Debt</th>
<th>Sales Growth</th>
<th>Gross Margin</th>
<th>EBIT Margin</th>
<th>ROIC</th>
<th>ROE</th>
<th>Avg. Rank</th>
<th>Evaluation</th>
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<td>L3Harris</td>
<td>9.60</td>
<td>27.86</td>
<td>16.34</td>
<td>4.31</td>
<td>12.59</td>
<td>$17,814</td>
<td>$3,194</td>
<td>$7,938</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>4</td>
<td>3.3</td>
<td>Less Profitable</td>
</tr>
<tr>
<td>Lockheed Martin</td>
<td>10.93</td>
<td>13.05</td>
<td>12.83</td>
<td>26.23</td>
<td>70.92</td>
<td>$67,044</td>
<td>$10,461</td>
<td>$16,646</td>
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<td>1.3</td>
<td>More Profitable</td>
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<tr>
<td>Keysight Tech</td>
<td>25.60</td>
<td>30.05</td>
<td>29.92</td>
<td>19.89</td>
<td>48.06</td>
<td>$5,420</td>
<td>$1,556</td>
<td>$2,018</td>
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<td>33.00</td>
<td>31.64</td>
<td>20.51</td>
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<td>Profitable</td>
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</table>

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

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<td>2.30x</td>
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<td>6.04</td>
<td>1.35</td>
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<td>15.00x</td>
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<td>35.99</td>
<td>6.60</td>
<td>1.61</td>
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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

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Cusip</th>
<th>Coupon</th>
<th>Maturity</th>
<th>Credit Rating (Moody’s/S&amp;P)</th>
<th>YTW</th>
<th>OAS (Trsy)</th>
<th>Altman Z-score (Bloomberg)</th>
<th>Outstndng Issuance</th>
<th>Duration</th>
<th>2.0 Yield Spread Rank</th>
<th>1.0 Default Risk Rank</th>
<th>1.0 Int. Rate Risk Rank</th>
<th>1.0 Financial Risk Score</th>
<th>Weighted Rank</th>
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<tbody>
<tr>
<td>L3Harris</td>
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<td>4.400%</td>
<td>3/2028</td>
<td>Baa2/BBB/BAAA</td>
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<td>4.13</td>
<td>5907,994,000</td>
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<td>12/2029</td>
<td>A3/A-/A-</td>
<td>130.7</td>
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<td>Baa2/BBB/BBB</td>
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</table>

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.
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.

REFERENCES

L3Harris confirms deal to acquire Aerojet Rocketdyne for $4.7B

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Secular Trends to Balance Weaker Macro for US Industrials

Buy Raytheon, sell L3Harris going into 2023, Goldman says of defense stocks
Federal funding for defense

Telecommunication Networking Equipment Manufacturing in the US

Non-NATO defense spending

Defenses Carved Into the Earth

What Putin’s War in Ukraine Reveals About Russia—and the Likely Path Ahead

Ukraine Can Win the War. But the Cost May Be Too High for the West.

As Ukraine Retakes Kherson, U.S. Looks to Diplomacy Before Winter Slows Momentum

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