

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

LLL - Q3 2015 L-3 Communications Holdings Inc Earnings Call

EVENT DATE/TIME: OCTOBER 29, 2015 / 3:00PM GMT

## OVERVIEW:

LLL reported 3Q15 consolidated sales of \$2.817b and adjusted diluted EPS of \$2.09. Co. provided 2015 consolidated sales guidance of \$11.45b at midpoint and adjusted EPS guidance of \$6.85 at midpoint.



## CORPORATE PARTICIPANTS

**Mahmoud Siddig** *L-3 Communications Holdings, Inc. - IR*

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

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

## CONFERENCE CALL PARTICIPANTS

**Robert Spingarn** *Credit Suisse - Analyst*

**Cai von Rumohr** *Cowen and Company - Analyst*

**Howard Rubel** *Jefferies LLC - Analyst*

**Myles Walton** *Deutsche Bank - Analyst*

**Seth Seifman** *JP Morgan - Analyst*

**Robert Stallard** *RBC Capital Markets - Analyst*

**Carter Copeland** *Barclays Capital - Analyst*

**Richard Safran** *Buckingham Research - Analyst*

**George Shapiro** *Shapiro Research - Analyst*

## PRESENTATION

### Operator

Good day and welcome to the L-3 Communications third-quarter 2015 conference call.

(Operator Instructions)

Please note this event is being recorded. I would now like to turn the conference over to Mr. Mahmoud Siddig. Please go ahead, sir.

---

### Mahmoud Siddig - *L-3 Communications Holdings, Inc. - IR*

Thanks, Allison. Good morning and thanks for joining us for L-3's third-quarter earnings conference call. With me are Michael Strianese, Chairman and Chief Executive Officer, and Ralph D'Ambrosio, Senior Vice President and Chief Financial Officer. After their formal remarks, Management will be available to take your questions.

Please note that during this call, Management will reiterate forward-looking statements that were made in the press release issued this morning. Please refer to this press release, as well as the Company's SEC filings, for a more detailed description of the factors that may cause actual results to differ materially from those anticipated. Please also note that this call is being simultaneously broadcast over the internet. I would now like to turn the call over to Mike Strianese. Mike, please go ahead.

---

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

Good morning, everyone. Thank you. And thanks for joining us for our third-quarter conference call. Overall, we had solid operating results with higher operating margins in our electronic systems, aerospace systems and communication system segments. We also continue to make good progress on the divestiture of our national security solutions business and expect to make an announcement by year end. This quarter we recognized a non-cash goodwill impairment charge related to MSS. Ralph will provide more details on that charge in his remarks.



Yesterday, as I'm sure you've seen, we announced that Chris Kubasik has joined L-3 as President and COO. Chris has over 30 years of operational experience in the aerospace and defense industry, and is a terrific addition to our already strong leadership team. And we're all very pleased to have him at L-3. These actions reflect our commitment to positioning our portfolio to sharpen our focus on our higher returning electronics communications and ISR businesses where we have market-leading positions. These are areas that are critical to the security of our nation.

Further, we continue to evaluate our portfolio for additional opportunities to improve our strategic position and create value for our shareholders. As we have stated, we're looking to focus on businesses with stronger margin profiles and higher returns in markets where we have leading positions and the strongest potential for growth. We expect to redeploy capital generated by these and future strategic initiatives into our existing portfolio, as well as to fund acquisitions that drive stronger returns. While we continue to face certain macro challenges, we are laser-focused on execution and investing in areas that will improve the overall performance of our portfolio. In many areas of our business, our efforts are yielding positive results, as reflected in some important contract wins in the quarter and we have successfully expanded our customer base.

Turning our third-quarter results, we had net sales of \$2.8 billion, a decrease of 4% compared with the 2014 third quarter. We delivered strong bottom-line performance, thanks to our continued focus on pursuing higher margin business and disciplined cost management. Our consolidated segment operating positions are improving and are better than expected at 10.2% for the quarter, and we're pleased about that. Funded orders for the quarter were \$2.4 billion, which was a slight decrease year over year. We ended the quarter with about \$9.4 billion of funded backlog with a book-to-bill ratio for the quarter of about 0.86 and 0.98 year to date. During the quarter we generated cash from net operating activities of \$317 million, most of which we returned to shareholders. We repurchased \$259 million of our stock in the quarter and paid \$52 million in dividends. Year to date, we've returned nearly \$800 million in cash to shareholders.

Before I go through our wins for the quarter, I'd like to give an update on other key business items across the Company. Our progress on the Head of State programs continues to meet our estimates and schedules, as discussed on our second-quarter call. Earlier this week, we successfully completed a key customer checkout flight. Our progress has been very encouraging. The new management team we put in place has been very focused on the program, and we're seeing the results of their efforts every day.

Operationally, we're also taking steps to improve program performance and to create value for customers through continued investments in R&D and new technology development. As an example of our R&D efforts, our focus on innovation helped us secure a broadband communications system contract for the Apache helicopter. This was a case where we devised a technology enhancement on behalf of our customer and delivered an unprecedented command and control capability. This is an area where I would call it thought leadership for our team where we identified a potential solution for our customer, and developed it on our own, that really enables an unprecedented manned-to-unmanned teaming capacity that up until now has not been available. So we're very proud of that accomplishment, and the customer is very happy with the solution.

In terms of M&A, our goal is to complement L-3's existing business with new acquisitions that expand our market share, broaden our offerings and bring us new customers. Our recent acquisition of ForceX is a great example of that. We've worked with this company for seven years, and it adds new capabilities and customers, which allows us to compete in broader markets. ForceX specializes in the processing, exploitation and dissemination of information.

This technology enables a rapid decision making ability from the data collected by our sensor. This complements our wide area imagery and sensor expertise. Now we will be able to integrate ForceX software into our existing EO/IR sensors, turrets and sub systems. In short, we've transformed L-3 from a sensor supplier to an information supplier in a very strategic ISR market area. Plus, this also creates software upgrade opportunities with our installed base of thousands of L-3 sensor products.

In addition, our acquisition of CTC earlier this year has continued to prove a strong fit. As we discussed last quarter, the commercial aviation training market is enjoying record demand for professionally trained pilots and forecasts show that over 550,000 pilots will be required in the next 20 years. The combined CTC Aviation and Link UK businesses are performing well, and the synergies between these two companies are benefiting customers around the world.

We've had unanimously positive responses from our customers and industry on this new capability. As a result, we've expanded pilot training in our center in Thailand and are developing our business in the UK. We're now providing training on our A320 and 737 simulators at the recently

launched Crawley training facility outside of the Gatwick airport in London with plans to expand our position in this market. This is a great example of our M&A strategy, and we are actively looking at acquiring businesses that will meet our criteria for both margin expansion and top-line growth and enhance our existing portfolio of market-leading technologies.

Finally, I'm very pleased to report that we've been recognized once again with Cogswell Awards for outstanding industrial security practices at three L-3 facilities. We insist of the highest standards in all aspects of our operations and we're honored to receive these awards. Our approach in this area has been to make our industrial security program a business discriminator as it continues to become more important in our current environment.

Now I'd like to discuss some of the wins we've had across our defense, commercial aviation and international businesses. So on the defense side, we were focused on DoD priority areas, including ISR communications, sensors and the classified space. With regard to the defense budget, while we continue to believe that we are nearing the end of an extended period of uncertainty, we are experiencing a delay in the anticipated DoD budget uptick. However, the bipartisan budget agreement provides two years of funding with an increase of \$38 billion in FY16 from the 2015 DoD budget. This was a good fit for L-3 as it enables our long-term planning ability and advances the contract award process. We also have quick reaction capabilities that are sought after, as well as ISR and upgrade maintenance and weapons systems sustainment expertise. The agreement will facilitate this work and is expected to translate into increased activity from programs that we already support.

In the third quarter we received some strategic awards that will further grow our business. As I mentioned earlier, we've been selected to provide our broadband com system for the US Army's Apache helicopter. This was a major win for us where we designed and spiral developed a new solution based on an earlier combat-proven design. This is what I just described, where it's a manned-unmanned teaming expertise. It's known as MUMT-X and under that program we will provide the Apache with its first-ever video and broadband data transmission with multiple universal unmanned platforms.

We were also awarded a contract to missionize 2 C130 aircraft for the US Coast Guard with options to missionize 10 additional C130 aircraft and provide ground flight test support for them. This is a great program win for our team at Waco. We were selected to supply our key management infrastructure for the intelligence community as part of the last mile portable key loader program. This is a 10-year program that extends our leadership position in information assurance. This quarter we earned a spot on two ID/IQ contracts, the US Air Force's TSA 3 and AGILE acquisition programs. Finally, in our military simulation business, we received a contract extension for our C17 simulation program.

For commercial aviation, we're at the beginning of a growth cycle, driven primarily by expansions in developing regions and low cost carriers, with Asia dominating. It's predicted that the worldwide fleet size will more than double in the next 20 years. As the air transport OEMs continue to forecast increased rates, directives such as the 2020 80SB out-mandate continue to drive growth in the US and in Europe. We have a strong commercial aviation business, and we have increased our efforts to capitalize on opportunities in this market.

In our training business, Boeing ordered its first 787 reality 7 full flight simulator. We also received notification that we have been selected by two airlines and an OEM for new simulators. These sales will represent a major step in expanding our base in strategically important regions.

In aviation security, we're concentrating on upgrading our technology and recently received funding from the TSA for software development and algorithms for our examiner systems, as well as an order from France for our check baggage systems. The use of our ProVision system continues to expand globally. We are participating in key product demonstrations in several airports in Japan aimed at the adoption of systems there.

In addition, our new ClearScan system for carry-on baggage will soon be deployed at major -- at a major international airport. Now, this is another example of our folks identifying a solution that they believed would be widely accepted. Everybody knows how troubling it is to have liquids taken out of your carry-on bags or having to take out computers and turn them on. What we've been able to do, utilizing computer tomography, or CT, and advanced algorithm, detection algorithms, we've been able to allow travelers to leave liquids and electronics in their bags as they make their way through security checkpoints, and the system will detect whether there's a banned substance or energetic material that doesn't belong there. As we all know, using the machine to do the detection is a heck of a lot more efficient and should keep lines moving better and provide much better detection capability.



In the international space, part of our strategy is growing our international sales, which we know can be a lumpy business, but it still remains a focus area for us. I'd like to highlight a few of the wins we had during the quarter. Our integrated platform management system was selected by the Royal Canadian Navy as part of a major vessel conversion project. We achieved the first international sale of our CATAPAN global encryption product. This marks an important win for our encryption business as we continue to support the secure communication requirements for a variety of international government customers. We also received continued funding of legacy programs, including Argentina's C130 and the UK Airseeker Program.

Now, let's turn to the outlook for the remainder of 2015. We have positive momentum as we move into the fourth quarter and are capitalizing on this with solid execution and program performance. We continue to explore possible additions to the L-3 portfolio that we believe are a good fit and that further strengthen our core business, improve margin and sales profiles and generate strong cash flow for the Company. Our goal is to expand our market share, extend our product offerings and capabilities, attract new customers, and, of course, grow shareholder value.

We also remain committed to investing in R&D and are encouraged that our investments are paying dividends. We target key areas to keep our technology portfolio fresh and relevant and will continue to invest in this critical area going forward. That said, L-3 is well positioned in several DoD priority areas, including persistent ISR and protective communications, unmanned systems, space, and the classified arena. We're confident that our growth strategies, together with our strong balance sheet and disciplined capital allocation strategy, position us well to drive value for shareholders.

We'll end this year on a strong note, well prepared and energized to drive margin improvement and continue to reposition the portfolio into 2016. We provided our initial outlook in the release this morning. We'll release our guidance and provide further perspective for 2016 at an upcoming Investor Day, which we will be hosting in New York City on Tuesday, December 8. I'm going to turn it over to Ralph now for some more details on the financials, and then we'll be back and take your questions. So with that, Ralph?

---

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

Thank you, Mike. I'll discuss some details about the third-quarter results and then review our 2015 guidance update and the preliminary outlook for 2016.

We had a strong operational performance for the third quarter, with adjusted diluted EPS of \$2.09, which was better than what our outlook was for the third quarter. It was driven primarily by higher operating margin, as well as lower taxes, which more than offset softer-than-expected sales. Free cash flow was \$263 million for the quarter, and also very solid. Adjusted diluted EPS excludes gains and losses on business divestitures and the non-cash NSS goodwill impairment charge.

Third quarter's consolidated sales were \$2.817 billion and declined 1% organically. Sales were about \$130 million less than our third quarter guidance, and that was due to delays and reductions in international and commercial business.

NSS had another disappointing quarter. It missed the plan again, primarily due to continued delays in converting higher margin, international and commercial business, which had similarly impacted NSS's first-half results. A smaller negative impact for NSS has been tasking delays on various DoD ID/IQ contract vehicles. As a result, we reassessed and reduced NSS's future outlook for sales and operating margins, and this triggered the NSS goodwill impairment charge.

Third-quarter operating margins were better than we anticipated in every other segment, with margins for electronics systems and communication systems moving higher and exhibiting the improvement trends which we've been articulating.

Aerospace systems margin rebounded sharply from the second quarter, and it benefited from some items that we do not expect to recur in the fourth quarter or next year. In the ISR systems sector, we had sales volume and better contract performance on three large international contracts that are nearing completion. And those raised margin over 200 basis points for the segment. In the logistics solution sector, we received an \$8 million request for equitable adjustment to recover a portion of the prior-year cost overruns on the previous Army C12 contract, which raised margin another 80 basis points for the segment. Excluding these items, aerospace systems third-quarter margin would have been less than 7%.

With respect to our 2015 guidance update, we tightened our adjusted EPS range and maintained the midpoint at \$6.85. The lower operating income expectation for NSS is being offset by a combination of higher margin in the other segments and a lower tax rate. We also reduced our consolidated sales at the midpoint by \$100 million to \$11.450 billion, and that's due to the international commercial sales trend that I talked about a few minutes ago, which mostly impacts electronic systems and NSS. And we also reduced consolidated operating margin by a modest 10 basis points to 8.3%.

We maintained our free cash flow estimate of \$850 million for the year, and with respect to our capital allocation, we are assuming \$740 million of share repurchases for 2015 after shifting \$60 million to pay for the ForceX acquisition earlier this month. We still plan to repay \$300 million of debt in the fourth quarter.

And for the last point on the 2015 guidance, we now expect the book-to-bill ratio for the year to be approximately 0.97, and that, again, is due to the lower expected international and commercial orders that I talked about which will impact 2016 sales.

So scrolling forward to our preliminary outlook for 2016, we expect consolidated sales to decline about 3% to \$11.1 billion, and this estimate assumes an organic sales decline of about 1.5%. The major change since we last discussed the 2016 sales trends, again, is that now we expect international sales to decline about 15% in 2016 versus 2015. We still expect our US Government sales, including the DoD, to be flat organically versus 2015 and commercial sales are expected to grow about 7%. With respect to the international sales, I'd like to add that we continue to expect foreign military business to be a long-term growth driver for L-3. However, as you know, the international business is inherently lumpy and less predictable than the US DoD business. International has grown at a very nice pace over the last several years. It's going to take a pause in 2016 before we start to grow it again after next year.

At the segment level, we expect organic sales growth to be 1% to 2% for electronic systems, and that will be offset by declines of about 4% for each of aerospace systems and communication systems. For operating margin, we expect consolidated margin to increase 80 basis points to about 9.1% next year, with margins increasing in all four segments. The margin progressions are on target for electronic systems to the mid 12% range and for communication systems to the low 10% range. However, margins are below our objectives for aerospace systems and NSS.

With respect to aerospace systems, the margin for next year is expected to be in the low 6% range, and it's a very different story when you look at the three sectors in aerospace systems. So ISR system sector will have margins for 2016 that will continue to be very solid at about 10%, but they will decline versus 2015 due to those lower international sales and those contracts ending that I talked about earlier, as well as the final runoff in the Afghanistan draw-down sales. Aircraft systems sector margins will swing to profitability in 2016 following the Head of State aircraft losses that we incurred in the first half of 2015, but those margins are only going to improve to about 3%. And lastly, logistic solutions margin will remain about 2% as it continues to wrestle with pricing pressures, LPTA and reduced flight hours.

The tax rate for next year is expected to be 31%, and that assumes no federal or any tax credit. And you can be sure that we're tasking our tax advisers to drive that rate down again like we did in 2016 -- 2015. With respect to free cash flow, we expect it to be \$850 million for 2016, the same as it is expected to be for 2015. What's happening there is that higher operating income is being offset by larger income tax payments due to the tax rate going up. Our planned share repurchases for 2016 start at \$500 million. All of these items that I just discussed for next year in terms of the outlook calculate to EPS of about \$7.25 for 2016.

So to conclude with my financial review, L-3 is in the process of positive transition. We're focused on program performance and margin expansion and making good progress, especially in electronic systems and communication systems. We are also transforming our portfolio of businesses to strengthen the Company and enhance our financial performance. We continue to generate solid free cash flow and are allocating it to increase shareholder value. We acknowledge we have work to do. We can do better, and we will.

And finally, I'd also like to say that I look forward to working with Chris. I'm pleased that he joined L-3. With that, thank you and we'll go to the Q&A.

## QUESTIONS AND ANSWERS

### Operator

Thank you. We will now begin the question-and-answer session.

(Operator Instructions)

And our first question comes from Robert Spingarn from Credit Suisse. Please go ahead.

---

### Robert Spingarn - Credit Suisse - Analyst

Good morning, Mike and Ralph.

---

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

Hello, Rob.

---

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

Hi.

---

### Robert Spingarn - Credit Suisse - Analyst

Well, congrats to Chris for joining the team. We'll all look forward to working with him again. Mike, I wanted to go back to something that you focused on your monologue with regard to the hardware, the electronics businesses and your focuses on the business that really are your core strength. Could you talk about the distinction between expanding share there and revenues and then also what you can do with the margins?

---

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

Yes, sure, Rob. Well, a good example of expanding -- the two acquisitions we did this year, the CTC one, which took the existing simulator hardware business and now built that out to not only include the sale of the device or the simulator to potential customers but the potential to sell training by the hour, which we are hearing customers ask for more and more every day. And it's a very compelling business model when you look at it in terms of the margins it delivers and our capacity to be able to deliver that globally.

You couple that with the demand for pilots over the next 10 to 20 years, and it looks like a very good story for us being able to not only deliver state of the art devices but wrapping the service element around that. The trainers have made it a very strong business for us. We look forward to that growing over the future.

On top of that, the ForceX is a good example, again, of taking an existing leading product, our EO/IR chart, which is on virtually every manned and unmanned platform that has an EO/IR chart and baking into that the software capability to do more analytical work on the data that the sensor gathers. So not just providing raw imagery, if you will, but it's actually providing actionable information and putting the processing capacity on the platform and getting it off the ground, if you will, so getting quicker information into the hands of the war fighter. That also will expand the market by taking an existing product and expanding its capability. We also have an installed base of those products which gives us a ready market to go out and provide upgrades to.

On the margin side, you ask how can we expand margins? One, by targeting businesses in our acquisition program that earn better margins or that have potential, but also working through our portfolio of businesses with an eye towards either consolidation or other forms of cost take out,



whether it's in the facility area, better supply chain management, overall better program execution is an obvious one there. Generally, the entire course model is being challenged at virtually every business unit. We've been very clear with our leadership teams at all of our groups and divisions that margin expansion is going to be a criteria that they're going to be measured on. And we've been very happy with the response that we've been getting from them. They understand it and are being very responsive to us.

---

**Robert Spingarn** - *Credit Suisse - Analyst*

Okay. Thank you for that. Just one more quick one for Ralph. You talked about the international declining next year but then inverting back up in 2017, it sounds like. Could you talk a little bit more about how you have that kind of visibility? What's going on and what specifically gives you the confidence that we'll see the recovery in 2017 and what that looks like?

---

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

Well, we have several large pursuits that we're going after over the next year and we have to book those to be sure in order to return the international to business to sales growth in 2017. A lot of those are in the aerospace systems, ISR sector, as well as in electronic systems with some opportunities in comm systems for additional satcom terminals. So we have work to do, but we're focused on it and we expect to return the international business to growth again after next year.

---

**Robert Spingarn** - *Credit Suisse - Analyst*

All right. Thank you both.

---

**Operator**

Our next question comes from Cai von Rumohr from Cowen and Company. Please go ahead.

---

**Cai von Rumohr** - *Cowen and Company - Analyst*

Yes. Thanks so much. Could you give a little more color on communications next year? Is that -- and I didn't catch it, if whether that is down 4% or that's going to be flattish.

---

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

Sure.

---

**Cai von Rumohr** - *Cowen and Company - Analyst*

And what's driving it.

---

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

Sure. How are you doing, Cai?

**Cai von Rumohr** - *Cowen and Company - Analyst*

Yes, well, thanks.

---

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

I said we expect sales to decline about 4% in comm systems next year. There are really two items driving that. We booked a large sat com terminal order earlier this year for Australia, which was about \$80 million, and we're going to -- we expect to ship all of that order this year. And while we do see follow-ons there, we won't get the next order until late in 2016 or early in 2017, so that's going to cause an \$80 million drop in international sales in the communication systems segment. That's one of the items affecting the international profile I just talked about with respect to the previous question from Rob.

And then secondly, within communication systems, we do about \$300 million a year or so on power devices, or TWTs, that are used in a variety of platforms, including in satellites. There's been a slowdown in new commercial satellite orders this year, where I think there's only about 7 or so that have been ordered year to date which compare to a normal year of about 20 or so sats. For that reason, we expect to have about a \$60 million to \$70 million sales decline next year in that business, in the TWT, business which is in communication systems. That's also affecting the sales next year.

What that is offsetting is growth in the DoD business, especially in broadband comms, or Comms System West, and that business has been recovering very nicely the last year and a half or so. We overcame the ERP implementation issues that we had there the last couple of years and it looks like it's going to be on a nice growth path going forward the next several years. So that's what's happening in comm systems, Cai.

---

**Cai von Rumohr** - *Cowen and Company - Analyst*

Thank you very much. One last one. Mike, you talked about other strategic actions. Can you give us any sense in terms of the magnitude or the time frame by which you hope to have made those decisions? Thanks so much.

---

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

Sure, Cai. We've been through, as we've been saying, a top to bottom review of the entire portfolio with our Board this fall. Again, with the objectives we've been talking about, businesses where we have significant competitive discriminators, which are typically, for us, in the electronic space and then had good profiles for future growth and margin expansion. Businesses that didn't fit that profile are being looked at more carefully with an eye towards potentially divesting. So in terms of timing, I would say we're looking at over the next year or so. This is a process that we look at regularly. It will necessarily change as things change around us. We'll adopt or adapt to those changes and adopt whatever strategies we think are necessary at the time to ensure our continued margin expansion and growth.

In terms of size, I really can't give you a number off the top of my head in terms of sales volume. But to tell you that everything that you would think of that is performing below our composite in margins is being looked at carefully. It's not just paint by numbers, if you will. I mean, there's a little more that goes into the analysis. It's the future growth rate, what the customers are going to require in the future, what the requirements are going to be for technology, et cetera, et cetera. But we think that this process will continue, and there will be further adjustments as we go forward.

---

**Cai von Rumohr** - *Cowen and Company - Analyst*

Thank you very much.

---



**Operator**

Our next question comes from Howard Rubel from Jefferies. Please go ahead.

---

**Howard Rubel** - *Jefferies LLC - Analyst*

Thank you very much. I just have a couple. Nice addition by hiring Chris. That's impressive. First, Mike, you sound like you're close with NSS with this write off as well. Is there any way you can bracket what we have -- what you're going to be able to receive in proceeds?

---

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

Howard, we said we expect to announce something before the end of the year, so we would like to discuss it when we have that announcement.

---

**Howard Rubel** - *Jefferies LLC - Analyst*

I think that's fair. I just -- Ralph, could we also assume there's still a reasonable tax basis in the business?

---

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

Yes, there's a very high tax basis and I can tell you that we expect no tax leakage.

---

**Howard Rubel** - *Jefferies LLC - Analyst*

Thank you. And then just two more small items. Because you have a loss in the quarter, the diluted shares don't -- there aren't any diluted shares. But if we were to look on normalized basis going forward, where is the share count at the end of the period?

---

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

Well, we expect diluted shares in the P&L to be about 80 -- just under 82 million shares. We include that in the guidance, Howard. The share count, in terms of actual shares outstanding, will be below, well below 80 million shares at the end of the year.

---

**Howard Rubel** - *Jefferies LLC - Analyst*

That's where I was driving towards. And then last, with the initiatives, what you've seen so far with the budget, and I realize there's still a lot that needs to be allocated, Mike. How do you see your conversations with your customers going so that you can get a sense of some stability in your outlook on some of the major programs you have.

---

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

Well --

---

**Howard Rubel** - *Jefferies LLC - Analyst*

Specifically, just for example, Compass Call, for example, the language in the -- I think it was in the aprops bill, actually favored more money as opposed to the declines that have occurred. So maybe there's a couple of differences that you could elaborate on. Thank you.

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

Well, yes, that's one of the brighter lights, Howard. But this -- it's been moving around for a while. I can tell you from a macro perspective, whether it's ISR, protected communications, the classified -- the areas we've been focusing on are areas where we're encouraged by what we're seeing in the budget in terms of more clarity and what the future funding is going to be. I'm not really going to take it down to a program level at this point, because it's just too many moving parts right now. As you also probably noticed, a good piece of the increase in the budget is really going towards some of the newer platforms and while we do enjoy content on many of those platforms, they're just not drivers for our entire business. We're more driven by, again, persistent ISR, protected comms, night vision, so com requirements, et cetera. Those are areas where we've been very encouraged by everything we've seen so far.

---

**Howard Rubel** - *Jefferies LLC - Analyst*

Thank you very much.

---

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

Great.

---

**Operator**

Our next question comes from Myles Walton from Deutsche Bank. Please go ahead.

---

**Myles Walton** - *Deutsche Bank - Analyst*

Thanks. Good morning. Hey, I was wondering if maybe take the question on NSS in a simpler way, Ralph, where you said today with the proceeds into next year, are you able to offset whatever earnings contribution NSS has in the pro forma guidance so that it's at least at neutral?

---

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

Well, we -- I expect that we'll be able to offset most of any EPS dilution there, but we could have some modest EPS dilution that comes from the transaction. And that's because we're intending on using a portion of the proceeds for debt repayment as well. So we'll see what happens.

---

**Myles Walton** - *Deutsche Bank - Analyst*

Okay. That makes sense. Mike, what kind of roll role can you talk about that Chris is going to have within the C suite? What is he going to be tasked with initially? Should we read any succession planning on your part into the decision to bring him in as President?

---

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

Myles, our Board takes succession planning seriously and regularly reviews the matter. I'm very excited about the opportunities ahead for L-3. As you know, we've -- a lot we've been talking a lot in terms of the portfolio, shaping it, adding capacity and capabilities to the Company and I'm delighted to have a partner like Chris on board to help Ralph and I execute on our strategic vision. I think given his 30-year experience in this industry and his proven track record, it will really translate into a very, very strong capability at L-3 and will help us move out on our plan on an accelerated basis.

---



So we're very pleased with how it looks going forward for us. It would be the typical functions one would expect from a Chief Operating Officer. So group presidents, supply chain management, bids and proposals, et cetera. It would be the traditional areas one would think about for a Chief Operating Officer.

---

**Myles Walton** - *Deutsche Bank - Analyst*

Okay. And then the last one for me on the deal flows. You've closed on a couple of deals and, Ralph, the cash flow to be used for repurchase came down a bit because you did the last ForceX deal. I'm curious in the \$500 million as a place holder for next year, usually you hold some back for -- you hold some back for M&A. I'm just curious what the place holder is.

---

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

The place holder is about -- is a couple hundred million dollars or so.

---

**Myles Walton** - *Deutsche Bank - Analyst*

Okay. All right. Thanks, guys.

---

**Operator**

Our next question comes from Seth Seifman from JPMorgan. Please go ahead.

---

**Seth Seifman** - *JP Morgan - Analyst*

Thanks very much and good morning. Just to follow up on the last question, maybe you could talk a little bit about how the evolution of the idea of hiring a President and Chief Operating Officer came about.

---

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

Sure. As you know, we have been very focused on positioning our business portfolio going forward to its higher-margin electronics communication and ISR businesses where we have those discriminators in our market-leading positions. But we do recognize we have a lot of work to do going forward and determined that it was the right time to add an executive with Chris's skills and experience to our team.

So I requested that the Board authorize the position and helped oversee the search process for a COO. There were a number of highly qualified candidates that I spoke to, but clearly Chris is, in my view, the best person for this job. I'm glad that he's on board and has decided to continue his career here at L-3. I think he's a great fit, culturally. He knows our business, as one would expect. It's a set of very capable hands to add to Ralph and myself that is on the same page in terms of the things we need to get accomplished here and move the Company forward.

---

**Seth Seifman** - *JP Morgan - Analyst*

Great. Thanks very much.

---

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

You're welcome.

**Operator**

Our next question comes from Robert Stallard from Royal Bank of Canada. Please go ahead.

---

**Robert Stallard** - *RBC Capital Markets - Analyst*

Thanks very much. Good morning. Ralph, I have a question for you. Myles started talking about the debt side of things, so I'd rather finish that off. Where do you think the leverage will end up by the end of 2016 and does it have any implications for where you think the credit rating to be?

---

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

I expect it to end comfortably where we maintain all of our existing investment grade credit ratings. Each of the rating agencies calculate leverage ratios slightly differently because of the way they attribute certain items to debt and leverage. But I expect that we're going to be down -- we'll be at around three times leverage.

---

**Robert Stallard** - *RBC Capital Markets - Analyst*

Okay. And then --

---

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

On the way the --

---

**Robert Stallard** - *RBC Capital Markets - Analyst*

Sorry. Mike, one for you as well. On the NSS sale, you said it's been progressing quite well. How has the offers you got or the multiples that are in discussion matched up relative to what you thought when you started this process?

---

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

Well, there's certainly no surprises there in the range, which was, I would say, representative range based on multiples and transactions we've seen before. I don't want to go beyond that and get ahead of ourselves here because we are at that stage in the process where we're getting down to the end and I think less is better in terms of what we say in terms of pricing right now. We're at a very sensitive point in the process.

---

**Robert Stallard** - *RBC Capital Markets - Analyst*

Right.

---

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

In fact, with more confidence than I expect it to be concluded by the end of the year.

---

**Robert Stallard** - *RBC Capital Markets - Analyst*

That's great. Thanks.

---

**Operator**

Our next question comes from Carter Copeland from Barclays. Please go ahead.

---

**Carter Copeland** - *Barclays Capital - Analyst*

Good morning, Mike and Ralph.

---

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

Good morning.

---

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

Good morning.

---

**Carter Copeland** - *Barclays Capital - Analyst*

Just a couple of sort of structural, big picture kind of questions here. With the emphasis on margin and return in that respect, have you changed any of the incentives (inaudible) structures to level down, or do you envision being any overall change from the more sort of EPS, TSR leaning structure that's there? And then with respect to Chris and the difference between kind of L-3's more decentralized structure and what we see in the other big primes, do you -- is there a signal here of a change in the way we structurally think about how L-3 is run to attack that cost? Thank you.

---

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

Yes. Well, first of all, in terms of the incentives, yes, since we are trying to encourage that behavior of margin expansion and cost control, we are baking that into some of the measures that we have going forward. Even though you might say that, well, their EPS or TSR centric, they'll still include those elements. But if you look at the -- what the plan will be that is going through the basis for an incentive agreement, built into that plan will be a reasonable level of margin expansion.

So in that sense, yes, it's in there. And it's always been in there, by the way, to some degree. Each successive plan has had some level of margin expansion. It's just it's becoming more of a focal point going forward.

And then in terms of L-3 structurally, I've been very mindful and careful not to take some of the very things that have made the Company successful in the past and throw that away. The decentralized structure in many regards works well. We do think that a little bit more control in a centralized sense could make -- could be appropriate at this point in the life of the Company. That we do want to make sure we have the strongest oversight in place that we can have over our business units and that's done in conjunction with our group presidents.

But the answer is, no, we still intend to have a significant level of autonomy at our business unit level. We believe that, that decision making is made best when it's done closest to the customer. But as long as it's done within the parameters that we lay out for our people. And with that in mind, I think adding Chris and his experience to the team will kind of enhance that whole process.

---

**Carter Copeland** - *Barclays Capital - Analyst*

So kind of to the extent you talk about integration, it's more about controls, reporting lines, planning processes and the like, not cost centric?

---

---

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

No. The cost is an element of it, meaning consolidations, if that's what you're getting at. That will be part of it is looking at our cost structure and seeing where there are opportunities to take cost out that we take advantage of that.

---

**Carter Copeland** - *Barclays Capital - Analyst*

Great. Thanks, Mike.

---

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

You're welcome.

---

**Operator**

Our next question comes from Richard Safran from Buckingham Research. Please go ahead.

---

**Richard Safran** - *Buckingham Research - Analyst*

Hi. Good morning. How are you?

---

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

Hi, Rich. How are you doing.

---

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

Hi.

---

**Richard Safran** - *Buckingham Research - Analyst*

First off, I wanted to ask you something. Recently you were among the 12 contractors down selected for that large Air Force training program TSA 3. I haven't seen a lot on this task order program. The numbers look like \$21 billion over 10 years. I want to know if you could discuss this a bit. Is this a program where multiple winners are going to be selected out of the 12, or just down to a very few? I'm just trying to find out if this is a needle mover for you and when do you think it could be awarded?

---

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

I would -- it's very new, Rich. I expect that the task orders, you'll start to see them next year. It would move the needle if we won several of them at the same time for sure, but there are multiple winners here and I think when you get to this place, it becomes a cost shootout, as they say, because you have a bunch of capable winners on the program. So, I mean, we can give updates as we get into next year on it, but it's certainly not going to move the needle this year at all no matter what they do from a -- from a project basis, if you will, or a task order basis. Even if there are task orders awarded this year, there's not enough runway left to really make much of a difference. It will have to be things we see awarded early next year.

**Richard Safran** - *Buckingham Research - Analyst*

Okay. And then just quickly here, at logistic solutions, I was interested in your comments about competitive pressure. Looking ahead, do you expect pricing pressure to continue? Is this a situation where you have cost to take out here that you can maintain margin or is this going to be a source of margin pressure for you going forward?

---

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

Well, I mean, by virtue of their lower margins, they're already pressuring the whole -- the overall margin profile. But we don't expect margins to go any lower from that 2% that I talked about. In fact, we do expect that we'll be able to modestly improve them through cost takeout activities, et cetera, but it's doubtful that can ever get to where we want to move the entire Company margin-wise.

With respect to the LPTA, there's certainly a lot of talk about the pendulum swinging away from it, but all we're seeing is talk right now. In the actual RFPs and the award selection criteria, LPTA is still the main criteria on a lot of these competitions. I think it's a function of the fact that even though the budgets for the US Defense Department are going to turn upward now, we're still in a constrained situation. So there's definitely room for more budget and we hear a lot of our elected leaders talking about that. Hopefully they can bring that to fruition the next couple of years.

---

**Richard Safran** - *Buckingham Research - Analyst*

Okay. Thanks very much.

---

**Operator**

Our next question comes from George Shapiro from Shapiro Research. Please go ahead.

---

**George Shapiro** - *Shapiro Research - Analyst*

Good morning. Congratulations, Mike. I have very high regard for Chris.

---

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

Great. George, I hope you'll join us at the Investor Day. Chris will be joining us as well. You can certainly rekindle that relationship and sit down and have a cup of coffee or something. That's great.

---

**George Shapiro** - *Shapiro Research - Analyst*

My question is, Ralph, can you roughly size the sales in aircraft systems at this point as well as logistics?

---

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

Sure. I can do more than roughly size it. I can give you some more precision there, Howard.

---

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

George.

---

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

I mean George.

---

**George Shapiro** - *Shapiro Research - Analyst*

We've been confused for years, Howard and I, so don't worry about it.

---

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

Well, you're both very good looking. I'm say that. (Laughter) So next year, I say that we expect aerospace system segment sales to decline about 4%. That would put the segment sales in the \$3.9 billion to \$4 billion range and the way that spreads across three sectors is almost \$2.1 billion in ISR systems, aircraft systems would be just under \$700 million and logistic solutions just under \$1.2 billion. Is that rough enough, George?

---

**George Shapiro** - *Shapiro Research - Analyst*

That's pretty -- yes, that's pretty good. And then in aerospace, you commented that logistics, you'd be hard pressed to get the margins. But do we have up side in the aerospace margin after we get rid of the Head of State program, which I think you said the last delivery is 2017?

---

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

The answer is it depends, George. It depends on our ability to win new business, particularly in the Platform Integration division at Waco to replace those Head of State sales and also to replace the P3 sales that have been declining for a while. Someone earlier talked about -- or asked about Compass Call, and that's also a Waco program where we're doing about \$80 million a year now, and that's down from about \$140 million a year -- a few years ago and that's because of what's been happening with respect to reducing the fleet size there. To the extent that we can bring new business in and we'll definitely be able to improve those margins. That's something that we're focused on as well in terms of new business development. That's the threshold question there.

---

**George Shapiro** - *Shapiro Research - Analyst*

For you, Mike, are these two sectors then, sub sectors, the area that you're primarily looking at to divest some of the lower-margin businesses. Because I assume there's a big range of margin with the programs in these sectors.

---

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

That's right, George. There is a big range. It's not just going to be the margins, it's going to be the outlook for the business going forward. Without giving the wrong direction, if you think logistics, which keeps coming up, yes, the margins have been lower. It's been hurt by competitive issues as well as the overall downward pressure on margins.

However, if you look at where the US service people are operating, it's all over the world and logistics happens to be a discriminator that makes that possible. It's a key enabler for our military is having a very robust logistics environment around them. So it's something that I think may get renewed focus by the DoD. But, again, we here are focused on doing whatever it is we need to do to drive value. It's the whole package, whether it's margin, top-line growth, a combination of the two. It's all on the table.



**George Shapiro** - *Shapiro Research - Analyst*

Okay.

---

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

We will take those actions, George. Thank you.

---

**George Shapiro** - *Shapiro Research - Analyst*

Okay. Thanks very much.

---

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

Okay. Just in concluding, moving forward, we plan -- we believe the actions that we've taken and the plans we put in place reflect our customers' priorities and give us a clear path to significantly improve our revenue and earnings performance over time. At its core, our strategy for this win growth is simple and straightforward. We're repositioning our portfolio and investing in our businesses, our people and our technologies, as well as leveraging our cash flow generation to maintain market leadership in our core businesses and return cash to our shareholders.

We're focused on higher-return businesses and markets where we maintain leading positions. We're excited about L-3's progress and prospects for enhancing and expanding our defense electronics, ISR and communications businesses, areas where we have market-leading positions and that represent the core of L-3. We're committed to long-term strategic growth and performance and we'll continue to deliver value for all shareholders.

As I've mentioned a couple of times now, we plan on hosting an Investor Day in New York on December 8th. We will provide additional color and detail on our strategy, our ongoing business transformation and our key initiatives for 2016 and I look forward to seeing you all there and continuing this dialogue. Our Board will be there. Many of the members of the Board will be present as well.

So thanks again for joining us this morning and on the call. We look forward to speaking to you in a couple of weeks. Thank you.

---

**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

---

**DISCLAIMER**

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2015, Thomson Reuters. All Rights Reserved.