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PRESENTATION

Seth Seifman - *JPMorgan - Analyst*

Good morning. Welcome to the second day of the JPMorgan Aviation, Transportation and Industrials Conference. We're very happy to start off this morning with L-3 Communications, and the CFO, Ralph D'Ambrosio. Ralph's going to speak for a little while, show us some slides, and then we're going to open it up to questions. So, Ralph, why don't you take it away?

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

Thanks, Seth. Good morning, and good morning to everyone, a well. Pleased to be here today.

So, I have about a dozen or so slides to quickly take you through L-3, and then I'll answer your questions, and I know Seth has a long list of questions. So, L-3 as you know, is an Aerospace and Defense company. This year, we're expecting to do a little more than \$10 billion in net sales. We're both a prime contractor and a supplier, with several areas in each. The first chart lists several of them.

On the prime contractor side, we do a lot of work with respect to ISR systems, and missionizing aircraft for those systems. We also do a significant amount of work in terms of maintaining and sustaining aircraft, and that's military aircraft. We also do simulation and training devices and related services, both for military and on the civil or commercial side. And then of course we're a leader in night vision and image intensification equipment, and also a leading prime contractor for security, detection and screening systems.

And then, on the supplier side, we provide a wide variety of electronic and communication systems that are used on numerous platforms, both on the military side and in the commercial markets.

Some of L-3's other key attributes conclude the fact that the Company's -- while it's 70% US government and DoD, and that's mostly the Department of Defense or DoD, the business base is broad and diversified in terms of our contracts and our technologies. And to give you a couple statistics on the revenue diversity, our top ten contracts comprise about 20% of our sales in 2016, and our top 30 contracts just about 30%, and thereafter the percentages drop off dramatically. So, we're not dependent on any single or handful of large contracts for our revenues.

We believe that we employ a very efficient capital structure, which means we use a lot of debt. We're an investment-grade credit at the lowest tier, which is BAA3 and BBB minus. There's been some discussion about the ratings lately, and we made it very clear that we intend to maintain our investment-grade credit ratings, not to improve them but clearly to maintain them indefinitely. It's not a temporary objective for L-3.

And then also, historically and presently, we've always generated a significant amount of cash flow as compared to our net income or earnings, and that's something that's happening again or will happen again in 2016, and we expect the conversion to be north of 100% for the foreseeable future.

In terms of our strategic objectives, they're all what I would call plain vanilla and straight forward. It starts with satisfying our customers and providing them what they need, fulfilling their demands, etc. We've had a lot of focus recently and will continue to have it on improving and expanding our margins across the business, and it's all about growing operating income, earnings per share and cash flow.



I have a few comments on the US government markets and the international commercial markets. To begin with, in the US government market, which for us is predominantly the Department of Defense, you can see it represents about 68% of our sales for 2016, and the first point is, that the geopolitical situation and conditions continue to be complex, increasing in nature, and clearly we believe they support strong, continued military spending, not only here in the US, but all over the world.

The defense budget for FY 2016, which began last October 1, is growing, which is terrific news after having declined for five years, and the total budget is growing about 4% for FY 2016 versus FY 2015. Congress has reduced the cuts that will be made under the BCA Sequestration Legislation for the first five years, that's FY 2013 through FY 2017, given the recent bipartisan budget agreement that deals with FY 2016 and 2017. So, that's good news, and we expect that there'll be similar relief afterward that will be addressed by the next administration and the next congress.

The drawdowns are ending in 2016, and better buying power or the DoD efficiency initiatives, continue. But, that's a world that we are accustomed to managing in. It's nothing new there, and I expect that we'll continue to effectively manage those initiatives.

There are still constraints within the DoD budget, and you see that in the FY 2017 request which, per the BBA, is about \$17 billion less than what the administration had requested about a year ago, or projected for FY 2017. And most recently, there's been news coming out about the unfunded list, which is about \$20 billion, for 2017. So, we expect that we're entering an upcycle where we'll see low-single-digit growth in the defense budgets on an average basis for the next several years. Could be better than that, depends on what happens with the next administration and future geopolitical events. We also expect that there'll be some more OCO relief for the base budget, just like there is for FY 2016 and 2017.

Some of the key capabilities that L-3 has, which address the US military market, are listed at the bottom of the chart. They include protected communications, those are secure, anti-jam, anti-intercept communications which are needed to operate in an A2/AD environment. We do a lot of work on the ISR side both in terms of missionizing aircraft and supplying enabling equipment that are needed to perform ISR missions, for example the EOIR sensors that collect data. We also do a lot of power systems for the US Navy, both on surface vessels and submarines. We also provide a significant amount of readiness support. This is in the aerospace systems segment in the logistics and the aircraft systems area, and readiness is an area that seems to have been neglected in the downturn. And it's becoming a focus area for the US DoD, and we expect that it should receive stronger funding going forward.

And then of course, we do a lot of work to support the special operation forces, the communication systems and then our Warrior systems business areas, and those are just the few of the key capabilities that L-3 has.

Moving on to the international and the commercial markets, they each comprise about 15% of our sales for 2016, and by international we mean foreign military and foreign government sales. That's a large addressable market for L-3. It's one that we've been growing the last several years, although it's going to take a pause in terms of growth in 2016, and that's largely due to procurement cycles for ISR aircraft with several of our large foreign government customers. But, we expect that the foreign government military market will be a long-term growth market for the Company. We also sell our simulators, the screening devices in the foreign government market, as well as communication systems, night vision, and sensor equipment.

On the commercial side, we believe there are favorable long-term fundamentals. The next chart that I have gives you some more detail on what we do on the -- in our commercial end markets, we'll want to turn to the next page. So, here's a closer look at our estimated commercial sales by business area, if you will, for 2016. It's approximately \$1.4 billion, and on the chart I've identified four areas that comprise about \$1 billion of that \$1.4 billion, and I'll talk you through each of them quickly right now.

So, avionics or aviation products comprises about 23% of our sales for 2016, a little more than \$300 million, and our business mix there by segment or niche in the market is 30% large transport, about 20% for regional and business jets, 10% in the general aviation market, and then the remaining 40% is in the aftermarket, which spreads across those three other main areas on a comparable basis, the mix that I outlined.

We also do about \$300 million a year in RF microwave and power components and devices, which are largely used in one way or another in a communication system. So, a lot of what we do here supports satellite systems as well as wireless communication systems, and it's a broad array of components.



The next two areas also pertain to the aerospace aviation market, we do almost \$250 million in sales in civil training and simulation, which includes supplying the simulation devices for the aircraft as well as providing pilot and air crew training services. Then, we also do about \$150 million a year in the commercial space that deals with airport security screening and checked baggage, checkpoint systems. Outside the US, most of the airports are owned by private entities, and that's why we classify them as commercial sales.

So, that's what we have in our commercial end market, and as you can see, it's well-diversified and we think positioned for good, long-term growth for the Company.

I have a few comments on each of our three segments. I'll start with electronic systems, which is our largest segment in terms of sales, operating income and operating margin. It's very diversified. One of the pies in the chart explains the mix across the six, not five, sectors in electronic systems. We've done a lot of work the last several years to strengthen each of our market positions, essentially building them out through a combination of R&D, acquisitions, and divestitures. As I said, we have the highest segment margins in the segment, and they're continuing to improve. This segment is also, also has our largest international commercial or non-US government sales mix, which is about a little more than 40% in the international and commercial markets, for 2016.

Moving on to aerospace systems, this is our second-largest segment in terms of sales. We've been wrestling with several headwinds on the top line the last couple of years, and they're continuing into 2016, and they concern the US military drawdown from Afghanistan which I commented earlier is ending in 2016 which is good news. We've had some legacy mature DoD programs that are ending like the P3 and the C27J. Then, I earlier alluded to the procurement cycles for international ISR systems and aircraft, and that's impacting our international sales the most in 2016, not only in the segment, but also on a consolidated basis. We continue to invest in missionizing aircraft or ISR, and maritime patrol, as well as other missions, and we're also investing in aircraft sustainment. Recently, we won some work doing some depot maintenance and sustainment work for the US Navy F-18s, which is new business for us. And, if we do well, it should be a growth driver for the aircraft systems sector in this aerospace systems segment.

We have a lot of work to do here, with respect to our operating margins. They've been impacted by volume, mix, some lost contracts that we had last year that are accruing no profit in 2016, as well as the better buying power impacts. I would say when you look at the three sectors, ISR systems which is a little more than half the segment in terms of sales, has strong, healthy margins that are just above 10%. And whether they go higher depends on the international foreign mix. And then, in the other two sectors, logistic solutions and aircraft systems, we believe that the profits there are presently abnormally low and we're going to fix and improve, increase those margins. And they're going to be a source of growth in our operating income and EPS for the entire company. But, we have some work to do there and we're firmly committed to doing that the next couple years.

Last but certainly not least is communication systems segment. We have, I would say, most of our longer-term program positions in this segment. We have more exposure to procurement and RDT&E accounts in the communication systems segment, and we continue to invest in advanced secure communication systems within the protected A2/AD-type systems that I talked about earlier. Our DoD business here is finally stabilizing, it's flat in 2016, and possibly can show some growth depending on if we can capitalize with some upsides we have, here. And on the international and commercial side, we have two items impacting sales that we talked about previously. On the international side, we have a fairly large contract for Australia, supplying VSAT communication terminals, where we did about \$70 million in sales in 2015. This year the sales on those terminals are close to zero, but we expect to book the next follow-on orders later this year, and that should generate sales certainly in 2017 on those terminals and possibly as soon as fourth quarter of 2016. And on the commercial side, I talked about the power devices that we supply, which are traveling wave tubes. We sell a lot of those into the commercial satellite market, and there's been a slowdown in OEM orders the last year or so, and that's lowering sales in this segment by about \$60 million in 2016 versus last year.

With respect to the operating margins, we're also making nice improvement here. It's mostly coming from manufacturing, labor productivity, improvements in the broadband comms area which is the largest sector in this segment, about half of the sales, and then also from consolidation synergies with a couple of small acquisitions in the RF microwave area.

The next chart has our guidance for the full year on a consolidated basis that we provided the end of January. It hasn't changed. We're calling for and expecting growth in operating income, margins, and EPS. So, we're definitely on the right track for 2016.



The next chart shows you our cash sources and uses that we anticipate for current year. The cash deployment is well-balanced, we believe, with the combination of cash dividends that we recently raised earlier, or early last month. We expect to buy back a significant amount of our common stock again, and we're also making about \$300 million of debt repayments to shore up our leverage metrics so that we preserve and maintain our investment-grade credit ratings.

And my last chart here just shows a quick summary of our capitalization and leverage, and as you can see, we do deploy a significant amount of debt in the capital structure. We don't carry significant cash balances, and I would say that our financial policy has been aggressive in terms of enhancing returns for our shareholders. And that's something we expect that we'll continue to utilize into the future.

So, to summarize, the DoD budget is beginning what we believe to be an up cycle. The Company has a diverse base of products and solutions that align well with our customer requirements and priorities, whether it be in the US military, foreign militaries, or in the commercial niches that we're in. We're focused on expanding margin, growing EPS and cash flow, and continuing to utilize a disciplined cash deployment or capital allocation strategy.

So, that concludes my comments, and I'll be happy to answer any questions that any of you may have. Thanks.

QUESTIONS AND ANSWERS

Seth Seifman - JPMorgan - Analyst

Great, thanks very much, Ralph. Maybe I'll kick it off with a few questions, and then we'll open it up to the room. I guess to start off, maybe, can you talk a little bit about the path to return to growth? You know, there's pretty solid growth in the Fiscal 2016 budget, and that's probably going to drive US DoD spending in 2017 and 2018. So, where are you best positioned for that increase in spending that's coming, and where's the overall path back to growth for the Company?

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

Sure, so I'd like to just flip back to one of my earlier charts, which I have on the screen right now. So, we expect that our sales for 2016 are going to decline about 2.5% organically, and across the three major end markets you can see that the DoD business is down about 2%, international minus 14%, and commercial growing 8%. So, with respect to our growth path prospectively, first and foremost, we believe that once we get to next year our US Government DoD business is no longer going to decline. It's going to start to grow at a low rate.

So, the 2% decline that we have or that we expect for 2016 is due to the final run-off of the Afghanistan support sales, which is about \$135 million. Ex that decline, our US military business would be flat in 2016. And so first and foremost again, we expect that we start to grow our US military business beginning next year.

And then secondly, we don't expect that our international or foreign government sales are going to decline 14% in 2017. I'm not ready to commit to the fact that we're going to grow yet, but we're going to be close to growing those sales in 2017. So, that will also help the consolidated growth rate for next year and beyond. And then, we expect that our commercial businesses will continue to show modest growth next year and beyond that. That, of course, is expecting any major global economic disruption like a recession, which I don't think anybody's anticipating right now, but there's certainly some concerns about it. So, that's how we believe we return to a growth path at L-3.

Seth Seifman - JPMorgan - Analyst

And then areas in maybe the 2016 budget and the 2017, perhaps that you felt like were relatively strong for L-3?



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

So, I already talked about one of those, and that is the readiness support activity which is -- certainly received a lot more attention in the FY 2017 budget request, so we think that's going to see more funding, and that concerns resetting and maintaining equipment, training activity, and we do a lot on that side both in terms of maintaining training aircraft as well as supplying training simulation devices. And then of course, we do a lot of sustainment work, maintenance work, on various military platforms.

Additionally, in the FY 2017 request, the DoD talked about seven or eight key capability areas in terms of technologies, and I touched upon some of these at the beginning of my comments. I think L-3 is well-positioned in several of those. Even though we don't supply platforms, we do supply a significant amount of important capabilities and payloads that are used on different platforms. So, in the A2/AD area, we have significant offerings in the communications side, and with respect to sensors whether it be space-based or airborne, or naval, we're also doing more work in terms -- in the space area, itself, in terms of working on resilient systems or protecting our space assets. And, ISR continues to be the key focus area for the DoD and we do a lot there and we're well-positioned, particularly with the Air Force. And then also, supporting special operations forces. So, I think L-3 is well-positioned to address those priority areas, and that's going to drive our growth respectively in the US military market.

Seth Seifman - *JPMorgan - Analyst*

Maybe can you talk a little bit more about the types of investments that you might have to make to accelerate growth in the coming years, and where they are? R&D's been about 2% of sales, which is about where it's been running for you guys for a little while, and for a number of the other defense primes. Does that need to tick up at some point to accelerate your growth? And, just to tack on to that at the end, you talked a little bit about making investments in international growth. What's sort of the scale that you need?

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

Sure. So, we are expecting that we're going to increase our R&D expenditures this year, probably by about \$30 million or \$40 million. That should take the R&D spend as a percent of sales to a little more than 2.5%. And most of it is in our electronics systems and communications systems segment. That's where our more intensive R&D efforts are, and will continue to be, and we're investing in a lot of those -- a lot of the key areas that I just talked about that are technology-focused areas for the US military.

In terms of the international markets, we're doing some investments to adapt or modify some of our US military technologies for export and sale abroad, but we're really not doing anything that I would characterize as different than what we do in the US military side. So, it's just taking what we do well for the US DoD and selling it overseas.

Seth Seifman - *JPMorgan - Analyst*

One of the things you talk about in your filing as a way to grow a little bit more, is through partnering. Talk about maybe what -- who your -- maybe not specifically, but the types of companies partnering with defense primes, and what types of opportunities you're talking about there?

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

Sure. So, we do see a very significant trend emerging, which represents an opportunity for L-3 in the ISR system aircraft recap space or recapitalization space, where we expect that a lot of the newer recap platforms will migrate to business jet platforms. So, we're looking at working on partnering with some of the biz jet OEMs to missionize those aircraft for ISR missions and requirements.

Seth Seifman - *JPMorgan - Analyst*

And is that something that will happen sort of over time, is there a particular recap effort that's coming up that (inaudible - multiple speakers) that?

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

Those recap efforts are in the early stages right now, whether it be stateside or abroad, and we see that activity accelerating toward the latter end of this decade. So, but we need to make our investments now to be ready for that, and we're doing that. That's also one of the R&D focus areas for L-3. So we think that'll be a growth driver a few years out for the company, particularly in the ISR systems sector within the aerospace systems segment.

Seth Seifman - *JPMorgan - Analyst*

And then maybe if you could update us on portfolio shaping? You guys have made some divestitures in the last -- over the last year or so that have improved the quality of the portfolio. If you could talk about what's next on the agenda?

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

Sure. So, we got -- certainly undertook several meaningful portfolio reshaping actions last year, including divestitures and acquisitions, underscored with the sale of NSS that we just completed the beginning of this February. The last time we talked about this topic, when we reported earnings for the fourth quarter on January 28, we suggested that we don't expect any significant additional reshaping activity, at least for the near term. With respect to some of the areas in aerospace systems I talked about what needs to be done there, in terms of increasing the operating margins which we believe are abnormally low at the present time.

And since we believe that we can improve those businesses, the last thing you ever want to do is sell a business that has what you believe to be abnormally low profit margins that you think you can fix, because you get no value, or very little value, for it. And that is not something that benefits the shareholders or the Company, for that matter. So, we think the best thing to do with those businesses is to fix them and make them contributors to L-3's operating income and EPS growth. So, we'll probably have some more small, very small transactions, which I would characterize as some pruning as opposed to removing any major limbs.

Seth Seifman - *JPMorgan - Analyst*

Got you, got you. Okay. And then within those businesses where you have some opportunity on margins, thinking about logistics as one of those, is the work that you do at Fort Rucker, is that in logistics?

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

Correct.

Seth Seifman - *JPMorgan - Analyst*

And that's the biggest contract at L-3, right?

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

That is the biggest, it's our biggest contract in terms of sales.



Seth Seifman - JPMorgan - Analyst

And so there's a re-compete, I think, coming up next year?

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

Well, our contract --

Seth Seifman - JPMorgan - Analyst

Or is (inaudible - multiple speakers), right --?

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

- is scheduled to end September 30th of 2017. We expect that there's a good possibility we could have an extension on that contract for a year or so, in any event, we'll be re-competing over the next couple of years. And, that's an important contract for L-3. It has -- it plays significantly in the readiness support activity that I was talking about earlier. That's a cost-reimbursable type contract, and we think the margins for that type of business are good on their program. So, that's a program that we're performing very well on, in terms of our customer evaluation and performance ratings, and that's a contract that we're focused on retaining.

Seth Seifman - JPMorgan - Analyst

Right, and so that's a contract within the logistics area?

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

Yes.

Seth Seifman - JPMorgan - Analyst

That's where it needs to be in terms of margin already?

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

Yes. Yes.

Seth Seifman - JPMorgan - Analyst

Very good. I like the slide that you had breaking down the commercial activities, and the avionics, I thought it was interesting. How would you describe what you do there, relative to like, are you competing with Rockwell Collins, and Thales, and Honeywell? And if so, are your margins here above the electronics segment?

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

So, what we supply in terms of avionics is a combination of boxes or LRUs, to include ground proximity warning systems, airborne collision warning systems, data and cockpit voice recorders, as well as a variety of transponders and standby indicators. So, the companies that you mentioned,

they're higher up the value chain in terms of supplying or bundling different elements into systems. We don't compete directly with them in terms of offering bundled systems, but we do compete frequently against each of them and in some cases we supply them product when it comes to the different areas that I talked about. And our margins in this area are above the average in electronics systems, and I would say commensurate with the industry averages that you talked about.

Seth Seifman - JPMorgan - Analyst

Yes. And I mean, just looking at these areas, the four areas that you have here, look pretty interesting. I see in two places where you're doing well. Do any of them seem to be places where either it would make sense to have a lot more scale, or where it would make sense to maybe get the value that you have in the businesses, which is significant?

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

Sure. First of all I'd like to make clear that when you look at each of our commercial end market areas, none of our businesses are solely devoted to supplying commercial equipment. We have numerous businesses that supply their products both into the military markets and the commercial markets that we identified on that chart. So, we already have more scale than what you see on that chart, by the dual purpose, dual nature, of those businesses. That said, we are interested in growing those areas, both organically as well as in terms of acquisitions, and in two of the areas, RF microwave and power -- last year and early this year, we acquired two small component companies that we're consolidating with our Narda-MITEQ, as it's called, business today.

And then on the civil aviation and training side, last May, we acquired CTC Aviation Group. So, where we can find good acquisition opportunities that bolt on and enhance those business areas, we'll make those, but in order for the acquisition to qualify as good, first and foremost it has to be a good fit with our businesses, where we think we can realize meaningful synergies both on the cost and the revenue side. Also the M&A investment has to make sense in terms of the return on investment. We're not interested in paying very high prices for good companies that don't become good investments.

We've always been very selective on the M&A side and will continue to be in that regard.

Seth Seifman - JPMorgan - Analyst

Okay. We are inside of a minute, so maybe I'll throw it open, if we have a last question from the audience? We'd take it now? If not, maybe I'll ask a last one, here. I guess I think probably one of the things you're looking at now is probably trimming down the cost days, and if you talk about the areas where you're looking at that, whether it's head count or supply base, or some kind of gradual shift in contract mix over time, like there's a role that (inaudible)?

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

Sure. So, what I'll say, the first point I'll make, is that we at L-3 believe that we've always managed a tight operation with respect to cost control. Some of the recent problems that we've had on the operational side, that adversely impacted the margins, weren't cost equations. They were performance, poor performance in certain areas. It wasn't because our overhead costs were too high, or other labor or material costs were too high.

Therefore, what we're focused on first and foremost is improving our performance, our operational performance, on our programs which for the most part has been very good across the company. And that really is what we believe to be the main driver of our margin expansion, coupled with an improving top line. We believe our overhead is already very lean, and we're at the point where we probably can't take a lot of further cost out from overhead without cutting into the muscle, if you will.

That said, we do see some opportunities on the supply chain. Supply chain comprises about 40% of our cost base, so there's definitely some additional incremental opportunities there, but the supply chain is generally speaking, very diversified. We don't have any significant concentrations, or any one or two or small handful of vendors. So, it's a lot of blocking and tackling across a lot of different areas. That's kind of where we see our improvement coming from.

Seth Seifman - JPMorgan - Analyst

Excellent. Okay, and with that, we're out of time, so Ralph, thanks so much for being here. We really appreciate it.

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

Thank you. Have a nice day.

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