

# L-3 Communications – QuickView

6 November 2012

## Investment summary: Poised to strike

L-3's Q3 results signalled that despite all the headwinds and uncertainty, performance has been solid, with sales effectively flat at \$3.3bn in Q3. Diluted EPS was down just 2% at \$1.98/share, demonstrating the agility and adaptability of the group, allowing it to meet or exceed expectations. This was achieved despite lower operating margins, supported by the reduced share count as part of a \$875m share repurchase programme. While the current environment is challenging, it is also seen as manageable through a solid financial performance driven by market share gains, balanced capital allocation and intelligent portfolio reshaping. As budget cuts become clearer, L-3 is poised to take advantage of increased M&A activity.

### Q3 results – solid delivery, efficiency and market share gains

L-3 reported Q3 sales of \$3.3bn, diluted EPS of \$1.98 and order intake of \$3.2bn. Importantly, funded backlog was \$11bn, up 11% from the beginning of the year. The group used a portion of the \$395m cash distribution from the Engility spin-off for debt reduction (\$250m) and will use the remainder for ongoing share buyback activity. Growth increased across three of the divisions, offset by a substantial 16% decline in NSS. Guidance for FY12 was tightened and L-3 provided preliminary guidance for FY13 for a sales decline of 3% due to Afghanistan drawdown, margins maintained at 10% and EPS up 2-4%, with ongoing healthy FCF at >\$1bn.

### Agility and evolution key to future alignment

L-3's strategy is to provide an agile business through balanced cash deployment and a clear focus on M&A, particularly during defence downturns. L-3's acquisition of Thales' civil simulation business is a clear example of this approach, providing both new exposure in civil simulation as well as a full flight simulator capability. As defence cuts become clearer, management anticipates more M&A opportunities and has the firepower to remain agile to respond and gain market share.

### Valuation: What's in the rating

L-3's rating has been hit by the uncertainty regarding sequestration, sitting at 9.1x CY13 EPS. L-3 does operate with an agile approach and is ready to accelerate its proven M&A activity as soon as budget clarity arrives, providing upside potential.

## Consensus estimates

Year End	Revenue (\$m)	PBT (\$m)	EPS (\$)	DPS (\$)	P/E (x)	Yield (%)
12/10	15,680	1,484	8.25	1.60	9.0	2.2
12/11	15,169	1,385	8.77	1.80	8.4	2.4
12/12e	13,043	1,169	7.82	1.99	9.5	2.7
12/13e	12,750	1,145	8.13	2.16	9.1	2.9

**Price** US\$73.94  
**Market cap** US\$7.1bn

#### Share price graph



#### Share details

**Code** LLL  
**Listing** NYSE  
**Sector** Aerospace & defence  
**Shares in issue** 96.55m

#### Business

L-3 Communications is a prime contractor, designer and manufacturer of electronic systems used in military and commercial platforms. The group is split in four divisions: C3ISR (27% 2012 sales guidance); AM&M (19%); NSS (10%); and Electronic Systems (44%).

#### Bull

- Positioned in long-term demand areas.
- Firepower to deliver targeted M&A.
- International growth opportunities.

#### Bear

- Short-term uncertainty surrounding sequestration in US.
- Reductions from Afghanistan drawdown.
- Questions regarding balance of dividend versus share buybacks.

#### Analyst

Roger Johnston +44 (0)20 3077 5722  
[industrials@edisoninvestmentresearch.co.uk](mailto:industrials@edisoninvestmentresearch.co.uk)

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**London** +44 (0)20 3077 5700  
Lincoln House, 296-302 High Holborn  
London, WC1V 7JH, UK

**New York** +1 646 653 7026  
245 Park Avenue, 24<sup>th</sup> floor  
NY 10167, New York, US

**Sydney** +61 (0)2 9258 1162  
Level 33, Australia Square, 264 George St,  
Sydney, NSW 2000, Australia