

RTX Corp

Fresh start to 2024: Taming the metal powdered beast; Upgrade to Neutral

Rating Change: NEUTRAL | PO: 100.00 USD | Price: 89.49 USD

Faster engine fixes by P&W buoys optimism

We upgrade RTX to Neutral mainly to reflect better than expected execution in servicing contaminated powder-metal discs in Geared Turbo Fan (GTF) aircraft engines. Pratt & Whitney (P&W) is not only delivering new full-life disks ahead of expectations. It is also fixing affected engines faster to prevent a peak of 650 aircraft on the ground (AOG). Additionally, Collins Aerospace continues to benefit from increased aftermarket demand and a recovery in widebody flight volume. While Raytheon defense will likely continue to be pressured, recent restructuring and management changes give us more confidence in a turnaround of that business in 2025. Thus, we raise our PO to \$100 from \$78.

GTF remedy coming earlier as the ramp is well underway

RTX announced all original equipment (OE) GTF engines (including spares) are being delivered with clean full-life discs and will not be impacted by the powder-metal issues. Some maintenance, repair and overhaul (MRO) customers have also started to receive full-life discs earlier than the originally anticipated 2Q24. Other customers have already replaced the disks and/or run checks to extend the life of their engines. RTX now expects AOG to be lower than the 650 peak initially expected. The lower the number, the more options P&W and the airlines have to mitigate the impact (including higher MRO capacity to absorb the required replacements/checks). While several risks remain including further FAA directives and future GTF aftermarket profitability, we are positively surprised by P&W's execution so far.

Raytheon inching toward an inflection point

Raytheon (RTN), the business unit, continues to face margin challenges driven by low productivity, legacy fixed-price development programs, and supply chain constraints. However, we are encouraged by management's turnaround strategy and the recent leadership change. It's notable that 70% of RTN's cost headwinds are due to legacy fixed-priced contracts which will take years to see a meaningful change in mix shift to foreign military sales (FMS) and direct commercial sale (DCS). However, under new Raytheon President Phil Jesper, the unit is implementing stronger supplier inflation protection on contracts going forward, taking a more disciplined approach to contract selection. RTX also expects greater cost absorption from consolidating existing sub-business units.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	4.81	5.04	5.40	6.15	6.70
GAAP EPS	3.53	2.22	4.31	5.11	5.72
EPS Change (YoY)	12.6%	4.8%	7.1%	13.9%	8.9%
Consensus EPS (Bloomberg)			5.29	6.13	6.79
DPS	2.16	2.32	2.48	2.65	2.84
Valuation (Dec)					
P/E	18.6x	17.8x	16.6x	14.6x	13.4x
GAAP P/E	25.4x	40.3x	20.8x	17.5x	15.6x
Dividend Yield	2.4%	2.6%	2.8%	3.0%	3.2%
EV / EBITDA*	18.4x	22.8x	14.6x	13.4x	12.6x
Free Cash Flow Yield*	3.8%	4.2%	4.5%	5.4%	6.5%

* For full definitions of *IQmethod*SM measures, see page 6.

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Timestamp: 25 January 2024 06:00AM EST

25 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Inv. Opinion	B-3-7	B-2-7
Inv. Rating	UNDERPERFORM	NEUTRAL
Price Obj.	78.00	100.00
2024E Rev (m)	75,007.6	78,547.8
2025E Rev (m)	78,254.3	85,036.9
2026E Rev (m)	83,529.5	89,115.8
2024E EPS	5.20	5.40
2025E EPS	5.60	6.15
2026E EPS	5.95	6.70

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Stock Data

Price	89.49 USD
Price Objective	100.00 USD
Date Established	25-Jan-2024
Investment Opinion	B-2-7
52-Week Range	68.56 USD - 104.91 USD
Mrkt Val (mn) / Shares Out (mn)	128,678 USD / 1,437.9
Free Float	99.9%
Average Daily Value (mn)	756.89 USD
BofA Ticker / Exchange	RTX / NYS
Bloomberg / Reuters	RTX US / RTX.N
ROE (2024E)	11.9%
Net Dbt to Eqty (Dec-2023A)	60.6%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to

iQprofileSM RTX Corp

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	3.9%	2.6%	5.4%	6.2%	6.8%
Return on Equity	9.8%	11.0%	11.9%	13.0%	13.5%
Operating Margin	8.2%	5.4%	10.1%	10.7%	11.1%
Free Cash Flow	4,880	5,468	5,744	6,965	8,309

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.0x	1.1x	1.2x	1.2x	1.2x
Asset Replacement Ratio	0.6x	0.6x	0.6x	0.7x	0.7x
Tax Rate	12.1%	11.9%	19.5%	21.0%	21.0%
Net Debt-to-Equity Ratio	34.6%	60.6%	57.3%	50.7%	41.6%
Interest Cover	4.3x	2.4x	3.9x	5.2x	6.6x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	67,074	69,059	78,548	85,037	89,116
% Change	4.2%	3.0%	13.7%	8.3%	4.8%
Gross Profit	13,668	12,228	16,784	18,681	19,666
% Change	9.4%	-10.5%	37.3%	11.3%	5.3%
EBITDA	9,612	7,772	12,113	13,270	14,041
% Change	1.0%	-19.1%	55.9%	9.5%	5.8%
Net Interest & Other Income	613	275	(550)	(255)	5
Net Income (Adjusted)	7,147	7,258	7,184	8,168	8,916
% Change	11.0%	1.6%	-1.0%	13.7%	9.2%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	5,266	3,195	5,734	6,787	7,613
Depreciation & Amortization	4,108	4,211	4,199	4,170	4,148
Change in Working Capital	(1,024)	237	(1,791)	(1,387)	(895)
Deferred Taxation Charge	(1,663)	(402)	0	0	0
Other Adjustments, Net	481	642	194	200	206
Capital Expenditure	(2,288)	(2,415)	(2,592)	(2,806)	(2,763)
Free Cash Flow	4,880	5,468	5,744	6,965	8,309
% Change	-2.6%	12.0%	5.0%	21.3%	19.3%
Share / Issue Repurchase	(2,803)	(12,870)	(1,000)	(500)	0
Cost of Dividends Paid	(3,128)	(3,239)	(3,494)	(3,719)	(3,985)
Change in Debt	484	12,326	0	(5,000)	(5,000)

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	6,220	6,587	7,837	5,582	4,906
Trade Receivables	9,108	10,838	10,760	10,950	11,231
Other Current Assets	27,115	30,992	31,945	34,151	35,195
Property, Plant & Equipment	15,170	15,748	16,076	16,550	16,911
Other Non-Current Assets	101,251	97,704	95,769	93,931	92,185
Total Assets	158,864	161,869	162,387	161,164	160,428
Short-Term Debt	1,220	1,472	1,472	1,472	1,472
Other Current Liabilities	37,894	45,289	44,744	45,953	46,483
Long-Term Debt	30,694	42,355	42,355	37,355	32,355
Other Non-Current Liabilities	14,878	11,343	10,971	10,771	10,671
Total Liabilities	84,686	100,459	99,542	95,552	90,981
Total Equity	74,178	61,410	62,845	65,613	69,446
Total Equity & Liabilities	158,864	161,869	162,387	161,164	160,428

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Aerospace

Company Description

Raytheon Technologies is the combined entity resulting from the merger of equals between Raytheon and United Technologies. RTX is the largest Aerospace & Defense company in the world and has 3 operating units: 1) Pratt & Whitney (military and civil aircraft engines and service operations), 2) Collins Aerospace (interiors, aviation controls, and systems), and 3) Raytheon (previously Raytheon Intelligence & Space and Raytheon Missiles & Defense).

Investment Rationale

We continue to see RTX benefiting from scale, as well as tailwinds in both the Commercial OEM ramp, and stronger Aftermarket demand. We view P&W's execution in remedying the most recent setbacks on the GTF program as a positive, however the full potential impact is not fully known. Additionally, while Raytheon defense is making progress turning around the business, the timing of the turnaround could offset mid-term profitability prospects.

Stock Data

Average Daily Volume 8,457,812

Quarterly Earnings Estimates

	2023	2024
Q1	1.22A	1.30E
Q2	1.29A	1.32E
Q3	1.25A	1.36E
Q4	1.29A	1.43E

Collins in position to outperform

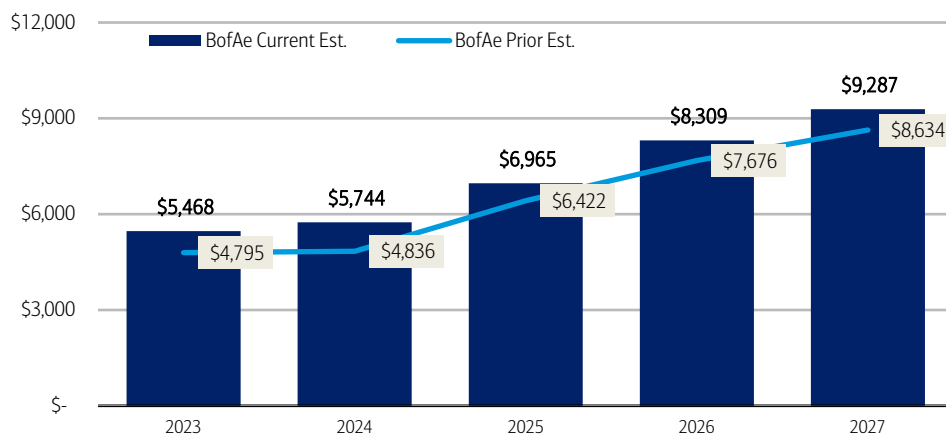
We continue to see Collins Aerospace as the best positioned RTX business unit. Demand remains strong across both commercial OE and aftermarket end markets, translating into higher flight hours supporting aftermarket revenues and higher OE production rates. While RTX expects OEM growth to outpace Aftermarket in 2024, we expect CA's aftermarket to outperform the 10% Y/Y growth outlook set. We view the recent MAX-9 incident, and increased FAA scrutiny on OEM production as another sign the Commercial OEM ramp will take longer than expect, and CA's aftermarket to benefit.

2025 Free cash flow commitment reaffirmed

RTX reaffirmed the \$7.5bn in free cash flow generation in 2025. RTX anticipates driving the majority of cash generation through tighter inventory control (anticipating inventory to remain flat Y/Y), greater segment margin performance (overhead absorption, higher volumes, and productivity gains), and lower CapEx. RTX expects the gains to offset charges related to the GTF contaminated disk charges, tax headwinds, and lower pension income.

Exhibit 1: Current BofA FCF Estimates vs. Prior

For 2024E we now anticipate RTX to generate \$5.7bn in FCF

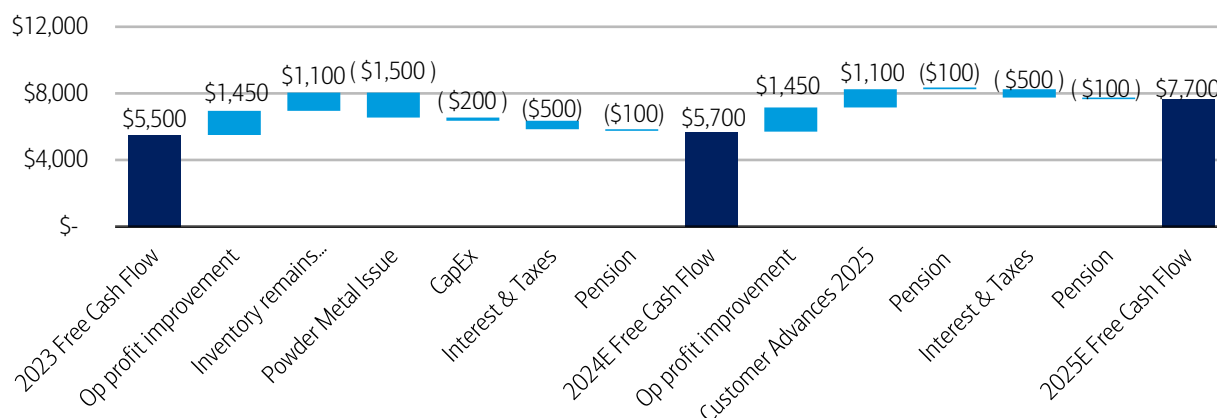


Source: BofA Global Research

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Exhibit 2: RTX 2023 to 2025 Free Cash Flow Outlook Walk

RTX expect \$2.2bn in operation growth to meet 2025E FCF Outlook



Source: Company filings, BofA Global Research

BofA GLOBAL RESEARCH

2024 Outlook across segments

Pratt & Whitney: Management expects the strong demand for A320neos to drive engine deliveries up 20% Y/Y, Commercial OE revenue up 10%-15%, Commercial Aftermarket up 10%, and Military up ~5%.

Collins: Management expects wide-body demand as well as the commercial OEM ramp to drive Commercial OE revenue up mid-to-high single digits, Commercial Aftermarket up >10%.

Raytheon: Excluding revenues from the Cybersecurity business management expects low-to-mid single digit revenue growth, as well as modest margin gains on higher volumes, productivity improvements, offsetting mix headwinds and further supply chain constraints.

Updating estimates – GTF containment & Collins strength

We update our estimates to add back \$1.5bn in sales from the Collins' Flight control business, as well as strong volumes and pricing expectation at Collins. Additionally, updating P&W revenue and margin expectations reflecting favorable maintenance /replacement requirement guidance. Lastly, we continue to expect 2025E FCF below the \$7.5bn outlook management provided (\$6.96bn vs. prior \$6.42bn). The updated expectations results in Pro-forma adj. 2024E EPS: \$5.40 (vs. prior \$5.20), 2025E: \$6.15 (vs. prior \$5.60), 2026E: \$6.70 (vs. prior \$5.95), 2027E: \$7.25 (vs. prior \$6.50). We raise our PO to \$100 from \$78.

Upgrade to Neutral on GTF execution & Collins strength

We upgrade RTX to Neutral from Underperform, mainly to reflect better than expected execution around the GTF powder-metal disks. Pratt & Whitney (P&W) is not only delivering full-life disks ahead of expectations, but has also managed the affected engines to avoid the previously expected 650 peak aircraft on ground (AOG). Additionally, Collins continues to benefit from increased aftermarket demand and widebody recovery. Lastly, while Raytheon defense will likely continue to be pressured, the timeline forward, restructuring, and recent management change gives us more confidence in business' turnaround by 2025. Our price objective of \$100 is based on a discounted cash flow (DCF) analysis that factors in a discount rate of 10.6% vs. prior 11.3% (60bps form macro conditions + 30bps on better beta), a 5% next five-year growth rate, and a terminal growth rate of 4%.

Exhibit 3: BofA RTX DCF Valuation

Our DCF valuation implies a \$100 share price value (10.6% Discount Rate | 5% - 5-year growth | 4% TVGR)

DCF ex pension + NPV

	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	CV
Cash available for shareholders before pension	\$ 5,128	\$ 6,348	\$ 7,867	\$ 9,050	\$ 9,507	\$ 9,935	\$ 10,382	\$ 10,849	\$ 11,337	\$ 11,847	\$180,221
Excluding R&D tax credit impact	6028	6998	8317	9150	9507	9935	10382	10849	11337	11847	\$180,221
DCF based on FCF incl R&D impact	\$5,128	\$6,348	\$7,867	\$9,050	\$9,507	\$9,935	\$10,382	\$10,849	\$11,337	\$11,847	\$180,221
Continuing value multiple	14.7										
Continuing value	\$180,221										
Cost of equity capital	10.6%										
Net present value ex-pension	\$130,582										
NPV Pension	\$2,000										
NPV	\$132,582										
Shares outstanding	1327										
Value per share	\$100										

Source: BofA Global Research

Discount rate	10.6%
Next 5 year growth rate	5%
Implied growth rate	4%
% NPV From CV	61%

Price objective basis & risk

RTX Corp (RTX)

Our price objective (PO) of \$100 is based on a discounted cash flow (DCF) analysis that factors in a discount rate of 10.6%, a 5% next five-year growth rate, and a terminal growth rate of 4%.

Upside risks to our PO are if the GTF issues are fixed faster and smoother than anticipated, if the commercial aero and bizjet recoveries are better than expected, if margins fare better than we are forecasting, if the company executes on existing programs better than expected, or if gains share in the international market or makes a materially accretive acquisition.

Downside risks to our PO are a downturn in commercial aviation due to the natural business cycle or an exogenous event such as a terrorist attack or a pandemic, additional complications related to the GTF powder-metal issue present further risks, a severe global economic slowdown affecting top-line growth as 45% of sales are generated outside the US, execution risk on defense programs or unexpected cancellations to programs, and uncertain timing around orders from international programs.

Analyst Certification

I, Ronald J. Epstein, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AerCap Holdings N.V.	AER	AER US	Ronald J. Epstein
	Air Lease Corporation	AL	AL US	Ronald J. Epstein
	Boeing	BA	BA US	Ronald J. Epstein
	Booz Allen Hamilton	BAH	BAH US	Mariana Perez Mora
	BWX Technologies, Inc.	BWXT	BWXT US	Ronald J. Epstein
	CACI International	CACI	CACI US	Mariana Perez Mora
	Cadre Holdings Inc	CDRE	CDRE US	Ronald J. Epstein
	Crane Co.	CR	CR US	Ronald J. Epstein
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	HEICO Corporation	HEI	HEI US	Ronald J. Epstein
	Howmet Aerospace Inc.	HWM	HWM US	Ronald J. Epstein
	KBR	KBR	KBR US	Mariana Perez Mora
	Leidos Holdings	LDOS	LDOS US	Mariana Perez Mora
	Leonardo DRS, Inc.	DRS	DRS US	Ronald J. Epstein
	Northrop Grumman	NOC	NOC US	Ronald J. Epstein
	Palantir Technologies	PLTR	PLTR US	Mariana Perez Mora
	Parsons Corporation	PSN	PSN US	Mariana Perez Mora
	RBC Bearings Inc	RBC	RBC US	Ronald J. Epstein
	Rocket Lab	RKLB	RKLB US	Ronald J. Epstein
	Teledyne Technologies Inc	TDY	TDY US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
NEUTRAL				
	Albany International	AIN	AIN US	Ronald J. Epstein
	Garmin	GRMN	GRMN US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L3Harris	LHX	LHX US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	RTX Corp	RTX	RTX US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein



US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
UNDERPERFORM	Bombardier	BDRBF	BDRBF US	Ronald J. Epstein
	Bombardier Inc.	YBBD B	BBD/B CN	Ronald J. Epstein
	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein
	CAE Inc.	CAE	CAE US	Ronald J. Epstein
	Huntington Ingalls Industries	HII	HII US	Ronald J. Epstein
	Mercury Systems	MRCY	MRCY US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein
RVW	Triumph Group	TGI	TGI US	Ronald J. Epstein

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

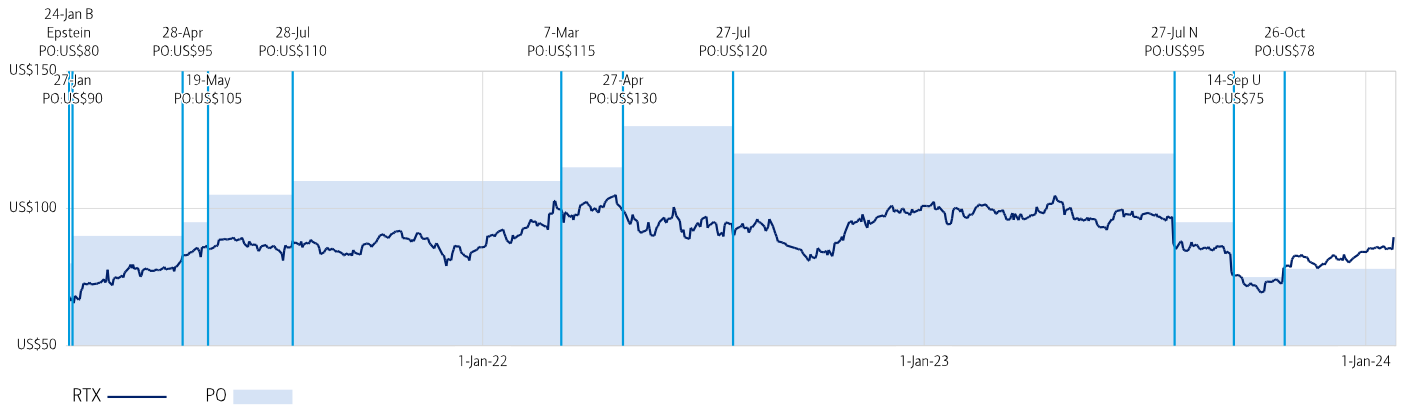
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Disclosures

Important Disclosures

RTX (RTX) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	31	62.00%	Buy	23	74.19%
Hold	11	22.00%	Hold	9	81.82%
Sell	8	16.00%	Sell	6	75.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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