Q3 2021 Earnings Call

Company Participants

- Darius Adamczyk, Chairman and Chief Executive Officer
- Greg Lewis, Senior Vice President and Chief Financial Officer
- Reena Vaidya, Director of Investor Relations
- Torsen Pilz, Senior Vice President and Chief Supply Chain Officer

Other Participants

- Andrew Obin, Analyst
- Andy Kaplowitz, Analyst
- Deane Dray, Analyst
- Jeff Sprague, Analyst
- Joe Ritchie, Analyst
- Josh Pokrzywinski, Analyst
- Julian Mitchell, Analyst
- Nicole DeBlase, Analyst
- Peter Arment, Analyst
- Scott Davis, Analyst
- Sheila Kahyaoglu, Analyst
- Steve Tusa, Analyst

Presentation

Operator

Good day ladies and gentlemen and welcome to Honeywell's Third Quarter Earnings Release.

At this time, all participants are in a listen-only mode and the floor will be open for your questions following the presentation. If you would like to ask a question at that time, please click on the race-in icon at the bottom of your zoom screen. As a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Reena Vaidya, Director of Investor Relations. Reena, please go ahead.

Reena Vaidya

Thank you (inaudible). Good morning and welcome to Honeywell's Third Quarter 2021 Earnings Conference Call. On the call with me today are Chairman and CEO, Darius Adamczyk and Senior Vice President and Chief Financial Officer, Greg Lewis. Also joining us are Senior Vice President and General Counsel, Anne Madden and Senior Vice President and Chief Supply Chain Officer Torsen Pilz.

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Note that elements of this presentation contain forward-looking statements that are based on our best view of the world and of our businesses as we see them today. Those elements can change based on many factors including changing economic and business conditions and we ask that you interpret them in that way. We identify the principal risks and uncertainties that may affect our performance in our annual report on Form 10-Q and other SEC filings.

This morning, we'll review our financial results for the third quarter of 2021 share our guidance for the fourth quarter and full-year 2021 and share some preliminary thoughts on 2022 plan. As always, we'll leave time for your questions at the end.

With that, I'll turn the call over to Chairman and CEO, Darius Adamczyk.

Darius Adamczyk {BIO 18702500 <GO>}

Thank you Reena and good morning everyone.

Let's begin on Slide 2. Our outstanding discipline and execution enabled us to deliver third-quarter results that met or exceeded our financial guidance in an increasingly challenging environment. We achieved a high-end of our third quarter adjusted earnings per share guidance range and exceeded the high end of our segment margin guidance by 60 basis points. Despite significant headwinds from inflation and supply chain constraints which hampered down our topline growth eventually. Despite that, organic sales were up 8% year-over-year driven by double-digit organic growth in Safety and Productivity Solutions, the commercial aerospace aftermarket from Advanced Materials and UOP.

Segment margin expanded 130 basis point to 21.2% driven by strong actions that we took across the portfolio to address the headwinds we faced from inflationary pressures and supply chain disruptions. Specifically, with continued to operate our strong productivity playbook, we took swift pricing action that allowed us to stay ahead of the inflation curve. We drove a 4% increase year-over-year on the topline and yielded approximately 40 basis points of margin expansion, net of inflation. Adjusted earnings per share was $2.03, up 29% year-over-year achieving the high end of our guidance range.

We delivered a strong third quarter despite a volatile backdrop that included a hurricane, our PMT factory corridor, power blackouts in China and the persistent and ongoing impacts of the supply chain more broad [ph].

I am pleased by our disciplined execution, which enabled us to navigate the challenges in the macroeconomic environment and capitalize on the ongoing recovery in our end markets. I continue to be encouraged by the strength we are seeing in many areas of our portfolio. Orders across Honeywell are up high single digits, year-over-year organic, excluding the impact of COVID-related mask business which has seen significant demand decline since the pandemic that has been subsiding. Orders across Honeywell were up double digits year-over-year. Backlog was up 7% to $27.5 billion and up 9% excluding the impact of COVID-mask orders driven by strength in many of our segments in positioning us to deliver next phase of the recovery, as we head into 2022. As always, we continue to execute on a rigorous and proven value creation framework that drives outstanding shareholder value.

Now, let's turn to Slide 3 to discuss some of our exciting recent announcements. Last month United Airlines and Honeywell announced the joint multimillion dollar investment in Alder Fuels powering the biggest sustainable fuel agreement in aviation history. Alder Fuels is a clean tech company that is pioneering first of its kind technologies for producing sustainable aviation fuel or SAF at scale. When used together across the fuel lifecycle, the Alder technologies coupled with Honeywell's Ecofining process have the ability to produce a carbon-negative alternative to today's jet fuels.

As part of the agreement, United is committing to purchase $1.5 billion gallons of SAF when produced at United's requirement, which is 1.5 times the size of the known purchase commitments of all global airlines combined, making this easily the largest publicly announced SAF agreement in aviation history and demonstrating the power of Honeywell technologies continue to bring to the oncoming global energy transition.

We also recently announced the acquisition of Performix, a provider of manufacturing execution system or MES software for the pharmaceutical manufacturing and biotech industries. This acquisition builds on our strategy to create the world's leading integrated software platform for customers within the life-sciences industry who are striving to achieve faster compliance, improved reliability and better production throughput at the highest levels of quality. The Performix MES software joins Honeywell's large and growing portfolio of automation solutions for the life-sciences industry including Sparta Systems' quality management software and Honeywell's experienced process knowledge system. A combined offerings will address life-sciences customer needs across the product lifecycles from automation project execution to optimal production to sustainable quality.

Lastly, we unveiled an all new aircraft cockpit system earlier this month, called Honeywell Anthem, the first in the industry build with an always-on cloud-connected experience that improves flight efficiency, operations, safety and comfort. Honeywell Anthem offers unprecedent levels of connectivity and exciting and intuitive interface model after everyday smart devices in a highly scalable and customizable design. This next generation flight deck is powered by our flexible software platform that can be customized for virtually every type of aircraft and flying vehicle, including large passenger and cargo planes, business jets, helicopters general aviation aircraft and the rapidly emerging class of advanced air-mobility vehicles.

In fact, Honeywell Anthem has already been selected by Vertical Aerospace and Lilium with their vertical takeoff and landing all electric aircraft. As these announcements highlight, we're continuously innovating and enhancing our portfolio exciting new technologies aligned to our long-term strategic objectives.

Now, let me turn it over to Greg and Slide 4 to discuss our third quarter results in more detail.

Greg Lewis {BIO 20594853 <GO>}

Thank you and good morning everyone. As Darius highlighted, we executed with the typical level of rigor that you have come to expect from Honeywell and delivered on our commitments despite a challenging backdrop. Our third quarter was strong with sales up 8% organically to $8.5 billion, segment margins expanding 130 basis points to 21.2% resulting in 36% incremental margins and free cash flow of more than $900 million, up 20% year-on-year. Our third quarter performance demonstrates our ability to deliver for our shareholders in all environments.

Now, let's take a minute to discuss how each of the segments contributed to that. Starting with Aerospace, third quarter sales were up 2% organically as the ongoing recovery in flight hours drove another quarter of strong double digit commercial aerospace aftermarket growth. As expected, air transport aftermarket sales continue to gain momentum growing more than 10% sequentially from the second quarter and growing 40% year-over-year.

Commercial original equipment returned to growth in the quarter driven by strong demand for business jets. The growth in commercial aerospace was partially offset by defense and space, which was down 17% in the quarter primarily due to supply chain constraints which limited our deliveries. Excluding those impacts, defense and space would have been down mid-single digits in the quarter, an improvement versus the first-half run rate.

Aerospace segment margins expanded 390 basis points to 27.1% driven by growth in our high-margin aftermarket business, strong productivity from our lower cost base and pricing. Building technologies sales were up 3% organically driven by broad-based demand across the building products portfolio as well as continued growth in building solution services. Orders were up double digits year-over-year for the fourth straight quarter driven by demand for fire products, building management systems and projects.

Backlog for building solution services was up over 35% year-over-year, positioning the business for growth into 2022. In addition, our healthy buildings portfolio maintained strong customer momentum with approximately $100 million of orders in the quarter, bringing year-to-date orders to $250 million. HBT segment margins expanded a 190 basis points to 23.5% driven by pricing and productivity, partially offset by inflation.

In PMT, sales were up 9% organically led by 29% growth in UOP and 14% growth in advanced materials. UOP sales growth was driven by higher petrochemical catalyst shipments and their backlog grew double digits year-over-year, which should drive growth well into 2022. Process Solutions sales were down 2% organically as the recovery in projects is lag, partially offset by high single-digit growth in thermal solutions and lifecycle solutions and services. HPS orders were up 20% year-over-year driven by broad-based demand across the portfolio providing confidence in the longer-term outlook of the business.

PMT segment margins expanded 260 basis points to 22.2% in the quarter driven by pricing, strong operating leverage and a healthy mix of UOP. In Safety and Productivity Solutions, despite battling supply chain and inflation challenges, sales were up 21% organically driven by another quarter of double-digit warehouse and workflow solutions growth, productivity solutions and services growth and gas analysis growth. Orders in these three businesses were also at double digits year-over-year resulting in a robust SPS backlog of more than $4 billion.

Personal protective equipment sales declined year-over-year as mass demand declined meaningfully. This was partially offset by growth in the hearing, gloves, and fall protection categories. SPS segment margins contracted 70 basis points to 13.2% driven by unfavorable business mix, which combined with targeted investments and supply chain challenges in Intelligrated drove inefficiencies in manufacturing installation as the business has been scaling to outsized growth which was 60% organically this quarter.

Finally growth across our portfolio was underpinned by continued progress in Honeywell connected enterprise. Our connected buildings and cyber solutions delivered another quarter of double-digit organic growth and third quarter recurring revenue growth was once again up double digits year-over-year.

So, overall, we delivered strong organic sales growth, drove a 130 basis points of improvement in segment margins 60 basis points above the high end of our guidance despite the challenging environment. For the quarter, we delivered GAAP earnings per share of $1.80 and adjusted earnings per share of $2.02, up 29% year-over-year achieving the high end of our guidance. A bridge from 3Q '20 adjusted EPS to 3Q '21 adjusted EPS can be found in the appendix of this presentation, which includes reference to a $160 million non-cash charge related to ongoing UOP matters that are described in our Form 10-Q.

The majority of our year-over-year adjusted earnings growth of $0.26 was driven by our strong segment profit improvement. Below the line items were a $0.13 tailwind driven by lower repositioning and higher pension income. A lower effective tax rate of 22.9% and lower weighted average share count of $699 million shares drove a $0.04 and $0.03 benefit respectively.

We generated $900 million of free cash flow in the quarter as increased earnings -- increase in working capital due to growth of the business and related supply chain challenges are tamped [ph] that down a bit. Finally, we strategically deployed $1.5 million primarily to share repurchases, dividends and CapEx in the third quarter, which significantly exceeded operating cash flow. We paid $646 million in dividends, deployed $208 million of capital expenditures, and reduce $650 million of Honeywell shares reducing our weighted average share count to $699 million.

Total capital deployment was up 44% year-over-year. In all, this was another strong quarter under difficult circumstances. We continue to manage through the multi-speed recovery across our portfolio making disciplined investments for the future and meeting or exceeding our commitments, while proactively addressing macroeconomic challenges.

With that, let's turn to Slide 5 to discuss the impact of the supply chain constraints we're facing and how Honeywell is adapting to address those channels. As we saw last quarter, the world continues to face persistent supply chain challenges as the sourcing environment for direct materials and electrical components continues to be tight. Logistics capacity remained strained and labor availability becomes more challenging, all driving constraints in operating and inflationary pressures on our cost base.

Semiconductors remain an acute problem due to a structural disconnect between supply and demand driven by can't -- canceled industrial and automated -- automotive orders during COVID-19 as well as unplanned growth of 5G, personal computing and consumer electronics. We also started feeling pressure in aerospace as the supply chain broadly ramps up more slowly than needed leading to parts challenges due to deteriorating supplier delivery.

While we have been mitigating the overall risk by proactively partnering with distributors and alternative suppliers, the challenge has accelerated in the last quarter constraining growth in some of our businesses. The most affected businesses in our portfolio are SPS, aerospace and HBT. We provide guidance ranges for our quarterly and annual outlook in order to incorporate an adequate level of risk for things just such as this, as we see these dynamics in the last few quarters.

We are managing this situation aggressively on a daily basis and have deployed the full strength of our re-engineering efforts to qualify alternative parts which has mitigated some risk in our productivity solutions and services, advanced sensing and fire businesses. We created tiger teams using advanced digital tools to track shortages and deploy a number of actions to liberate supply in the market.

We also continue to mitigate inflation of materials, freight and labor in our operations through targeted regular pricing actions. For the longer term, we're developing dual-source platforming strategies and executing long-term supply agreements with some of our key suppliers. This coupled with strengthening direct engagement with the semiconductor OEMs and foundries we'll improve our ability to secure increased volumes in the future. We do expect this environment to persist into the fourth quarter and the first half of 2022. We continue to adapt as we manage through this period.

With that, let's turn to Slide 6 to talk about our expectations for the fourth quarter. As we enter the fourth quarter and given the ongoing challenges I mentioned, we expect sales to be in the range of $8.5 billion and $8.9 billion, down 4% to flat on an organic basis, which includes the impact of the COVID-19 driven mass sales decline. Excluding this impact, organic sales would be down-to to up-to organically.

We would also normally see a seasonal step-up from the third to the fourth quarter, which this year will be somewhat dampened by the unique calendar impact of having more days in the third quarter than we do in 4Q. In aerospace, we expect our commercial businesses to continue to improve as business aviation and air transport flight hours continue to accelerate driving continued sequential and year-over-year growth in the commercial aftermarket sales.

The pace of the air transport acceleration will continue to vary regionally with domestic travel recovering faster than international. Commercial original equipment build rates will also continue to progress gradually. Defense and space sales will be down due to lower demand from U.S. DOD programs driven by moderating U.S. defense spend and soft international defense volumes.

We will continue to manage through the constraints as the aerospace supply base ramps up, but we are expecting to miss out on potentially hundreds of millions of dollars worth of shipments due to these continued challenges in Q4. We now expect organic sales growth to be down mid-single digits for the year in aerospace. In Building technologies, we expect continued strong demand across the portfolio as the world continues to reopen and sustainability solutions take hold, driving sales and orders growth in the fourth quarter.

We will face ongoing pressures from the supply chain constraints, but continue to work our mitigation actions as we anticipate mid-single digit sales growth for the year. In PMT, we see continued strength in the short-cycle HPS businesses though this will be tampered by the slower recovery in projects. Our strong orders growth in the third quarter will support our growth acceleration into '22. For UOP, we're pleased with our robust 3Q performance and expect continued growth into the fourth quarter and into '22 supported by the strong backlog, which is up double digits year-over-year.

Last, we expect continued healthy demand for products across the advanced materials portfolio. We expect PMT organic sales to be up low-single digits for the year. In safety and productivity solutions, we expect another quarter of robust growth in our warehouse and workflow solutions and productivity solutions and services businesses. In our productivity solutions and services business, we just had an outstanding year. Backlog remains up triple digits year-over-year, which combined with our Intelligrated backlog that is over $2.4 billion gives us confidence in these businesses for the remainder of '21 and into '22. Mass demand has accelerated as expected as the world recovers from the pandemic though we will partially offset this softness with strengths in other areas of the PPE portfolio.

Finally, we expect to see strength in our short-cycle gas analysis and advanced sensing businesses driven by double-digit orders growth in the third quarter. We continue to manage through this challenging supply environment, which will impact our growth potential but will record strong double-digit growth for the year.

Now, let me turn to our expectation for our other core guided metrics. For the fourth quarter segment margins, we expect to be in the range of 21.2% to 21.7%, up 10 to 60 basis points year-over-year. We expect margins to continue to benefit from pricing actions ahead of inflation, volume leverage and ongoing productivity from our streamlined cost base despite the headwinds from unfavorable business mix in Intelligrated and efficiency challenges due to the supply chain environment.

Fourth quarter net below the line impact, which is the difference between segment profit and income tax and income before tax is expected to be in the range of negative $10 million to negative $95 million with a range of repositioning between approximately $140 million and $250 million as we continue to fund ongoing restructuring markets.

We expect the effective tax rate to be approximately 20% and average share count to be approximately $698 million shares. As a result, we expect fourth quarter adjusted earnings per share between $2.03 and $2.13, down 2% to up 3% year-over-year. Given these fourth quarter expectations, full-year organic sales growth will be in the range of 4% to 5%, narrowing the range we provided last quarter of $34.2 billion to $34.6 billion.

We are once again raising the low end of our segment margin guidance by 10 basis points for the year to a new range of 20.9% to 21.1%, representing an expansion of 50 to 70 basis points for the year. We expect margin expansion in Aero, HBT and PMT as we carefully invest back into the business while managing the multi-speed recovery across the portfolio.

Our fixed cost management remains a focus and we are tracking favorably to the permanent reduction of $1 billion of fixed costs from our 2020 cost actions. We expect our net below-the-line impact to be in the range of $40 million to $125 million including capacity for $400 million to $475 million of reposition.

Our full-year effective tax rate will be approximately 22% and weighted average share count will be approximately $701 million for the year over delivering on our minimum 1% reduction in shares. This will take adjusted earnings per share to a range of $8 to $8.10, up 13% to 14% year-over-year. This maintains the high end of our previous guidance and raises the low end by $0.05. Despite these challenges, we are maintaining the same cash flow outlook for the year in the range of $5.3 billion to $5.6 billion.

Now, let's turn to Page 7 and review our guidance progression throughout the year. Since we provided our initial 2021 guidance in January, we have navigated through several uncertainties, the ongoing global pandemic, supply chain challenges, unprecedented raw material inflation and labor market challenges, and at each turn our rigorous operating principles have enabled us to continue to demonstrate our resilience.

At our latest update, we have adjusted our sales outlook purely due to the constraints we are battling in supply chain which dampened [ph] 3Q and our fourth quarter sales potential. We continue to have a robust backlog of demand. Despite these changes to top-line expectations, we have not only maintained the high end of our segment margin and adjusted EPS guidance, but we have further increased the low end of both ranges and maintained our previous free cash-flow guidance. These are excellent proof points of our ability to execute in all economic cycles. In total, I'm encouraged by the strength we are seeing in key areas of the portfolio as we head into '22 particularly driven by strong orders growth and backlog position as well as aggressive supply chain packets [ph] that are mitigating risks, enabling us to deliver on our long-term commitments.

Now, let's move to Slide 8, where we can talk about some of the preliminary thoughts we have in 2022. With the commercial aerospace recovery in view, upcoming capital reinvestment in the energy sector, non-residential construction spending returning to 2019 levels and the exponential growth, we continue to see in e-commerce, we have a strong setup for 2022. We expect organic growth in all four segments driven by strong portfolio-wide demand in backlog underpinned by year-to-date orders growth of 17% in HPT, 14% in Aero, 10% in PMT and 6% in SPS or 8% in SPS if we exclude the COVID-mask business.

This coupled with the strategies we have in place that are focused on driving uniquely innovative and differentiated technologies to address the world's increasing demand for digital transformation, process technology and sustainable solutions gives me confidence in our future. However, we do expect growth in the first half of '22 to be constrained due to continued challenges from labor force uncertainty, supply availability and logistics challenges. Inflation will continue to be a factor under these circumstances though our pricing rigor as reflected in our margin rates will help us.

We do expect changes to corporate tax legislation though the exact impact of that is as of yet unknown. With these dynamics in mind, let's look at our key markets. In Aerospace, we expect strong growth in our commercial aerospace business. Ongoing improvement in global flight hours will drive growth in our commercial aerospace aftermarket. We also expect original equipment build rates which have lagged the flight hour recovery to ramp up in '22. In defense and space, we expect flat-to-low single-digit growth year-over-year as U.S. and international defense budget spending stabilizes and our supply challenges abate.

In HBT, we expect non-residential construction growth and an ongoing return to public spaces to drive demand for building products, services and projects. We also expect continued demand for our portfolio of healthy building solutions as well as tailwinds from U.S. infrastructure plans. We expect a large backlog to draw from its well at the end of 2021. In PMT, we're assuming improved macroeconomic conditions and higher stable oil prices will improve growth in UOP and also help recover automation projects in HPS.

We expect continued strength in advanced materials driven by demand in the auto, construction and healthcare sectors. For safety and productivity solutions, we expect strong demand in our productivity solutions and services, gas analysis and advanced sensing businesses. We also execute on our robust backlog of major projects in our warehouse and workflow solutions businesses. However, we will face constraints to growth as supply chain challenges continue in the first half of '22. Mass demand will remain at our lower second half exit rates as the world recovers from the pandemic.

For overall Honeywell, we expect margin expansion to be driven by aftermarket recovery in aerospace, accelerating catalyst shipments in UOP and improving mix in SPS. Our strong productivity and pricing actions, which should carry through to next year and provide potential upside will enable key investments to support medium term topline growth, including a step up in R&D and our digital initiatives.

We look forward to completing the combination of Honeywell quantum solutions with Cambridge Quantum Computing, which is a very big strategic step forward for us, but will be a minor drag on our margins. We have significant balance sheet capacity for M&A and share repurchases and we expect to reduce our share count by a minimum of 1% again in 2022.

So overall, we have some insight into our end markets and a lot of confidence in our continued operational execution, which will give us the ability to deliver another strong financial performance and continue to execute our strategy to be the premier software industrial. We'll provide more specific inputs once we close out the year. So with that, I'd like to turn the call back over to Darius.

Darius Adamczyk {BIO 18702500 <GO>}

Thank you Greg. Before we wrap up, I'd like to take a minute on Slide 9 to discuss an important topic, Honeywell's culture of inclusion and diversity. Our commitment to inclusion and diversity enables us to better decision making, helps build competitive advantages and further long-term success. Inclusion and diversity is one of our foundational principles and Honeywell expects all employees to exemplify these principles.

We continue to build out our initiatives to promote racial equality and inclusion in diversity including employing mandatory unconscious bias training to our global workforce establishing our global I&D steering committee co-sponsored by me in fortifying Honeywell's I&D governance structure by embedding I&D councils into each business group.

We also established 2021 goals for each of my direct reports that include an annual objective for driving diversity with his or her organization. These initiatives have yielded results, women and people of color represent a higher percentage of the workforce at Honeywell compared to our peers. In addition, representation of women and people of color in Honeywell is increased each year since 2018, which is a testament to our ongoing commitment to hiring, developing and retaining diverse talent.

Now, let's wrap up on Slide 10. We delivered on our third quarter commitments despite a challenging backdrop. As always, we remain laser focused on executing our strategic objectives and investing in growth opportunities that position our business well for the next phase of recovery. Were executing on our proven value creation framework with the rigor you can expect from Honeywell which will continue to consistently drive shareholder value.

With that, Reena let's move to Q&A.

Reena Vaidya

Thank you Darius. Darius, Greg and Torsen are now available to answer your questions. We ask that you please be mindful of others in the queue by only asking one question. (inaudible), please open the lines for Q&A.

Questions And Answers

Operator

Thank you Reena. The floor is now open for questions. (Operator Instructions) We will now take our first question from Steve Tusa from J.P. Morgan. Steve, over to you.

Q - Steve Tusa {BIO 4278663 <GO>}

Hey, good morning. Can you hear me, okay?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yes.

Q - Steve Tusa {BIO 4278663 <GO>}

Great. Just on the organic growth guidance for next year. Would you expect first half to be -- to actually grow or are you looking at it being kind of more like the fourth quarter? And then, I mean you talked about all four segments growing I guess, does that mean like will you decelerate from this year because of the first half? Like, maybe just give us some -- a bit of guide post on kind of what the messaging is on first half versus all of next year on this front?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah. So, the short answer to your question, Steve is that yeah we do expect the first half to grow. I think how much is, could be a little bit dependent upon some of the supply chain challenges that we've pointed out that we're seeing in Q4. Frankly, we see it this way, which is; on semiconductors we actually see some positive tailwinds as we head into the first half next year, so that's good. I don't think that is going to be completely alleviated but it's going to get that. When it comes to some of the other components, particularly for Aerospace in some of the Tier 2, Tier-3 suppliers particularly castings, forgings, things of that nature we are not sure we are in that improvement cycle because it really just kind of popped up in Q3 and a (inaudible) phase so we're a little more cautious there.

But, the short answer is, we do expect growth in the first half of 2022. What I will say is that we have --we'll have some headwinds in SPS due to what I call COVID-related masks, but I think those are going to be particularly acute in Q1 of next year, that are evident here in Q4 of '21 and to a lesser extent Q2 of 2022 and then you know it's kind of going to get back to the normal run rate. So, we -- as you can see it's -- the year to '22 is setting up terrific, we're up double-digit orders growth in each of our SBGs one exception SPS is sort of call it mid single digits, but if you exclude the impact of the COVID masks, we would be up double-digit as well.

So, the only constraint that we see to some extent is supply chain. And, at least in semiconductors, we think that Q4 is the peak of those challenges, that's the way we see it today. Now, I will say this lastly, which is, it's a dynamic environment, there were some puts and takes here in Q3 that were probably more takes then positives, so we're going to monitor this closely as Q4 ends.

A - Greg Lewis {BIO 20594853 <GO>}

And, that's why, we have such a wide guidance range for the fourth quarter, $400 million of revenue range is wider than we're typically doing and it's exactly to those businesses.

Q - Steve Tusa {BIO 4278663 <GO>}

Or, does terrific mean, reacceleration from '21? That's my -- just my follow up. Thanks.

A - Darius Adamczyk {BIO 18702500 <GO>}

Well, I think it's -- I -- all I can say is we expect growth in the first half and when we get together with you in January or February to give you our outlook we'll have a better view. But, we certainly expect growth the backlog supports that -- and our story hasn't changed from really the end of Q2 earnings report. I think the setup for Honeywell for '22, '23 is terrific. There is nothing here that makes me want to change my mind.

Yes, we're going to have to deal with some supply chain challenges that are here, the real, they're probably understated in the market. I think that frankly it's only recently that it's been realized how severe they are, but we've been co-operate that in our guide for Q4 and and I think we're working diligently to try to resolve it. We've been at this for 12 weeks now and it's not just one way, it's not just pushing suppliers harder, it's also doing redesign alternative products, different ways to generate revenue. So, I think we got a pretty good playbook, but I won't understate this, the challenges are real and fairly substantial.

Operator

Our next question comes from Julian Mitchell from Barclays. Julian, over to you.

Q - Julian Mitchell {BIO 21229700 <GO>}

Thanks very much. Yes, good morning. So, maybe my question with focus on the revenue outlook in Aerospace, certainly the guidance for this year has come down three quarters in a row now in that division. So, just wanted to try and understand your level of confidence in when the defense and space piece will return to growth again? Is it sort of early next year or towards the end of the year? And also, any updated thoughts on commercial Aero aftermarket and how you think your own revenues will lag or move in line with the recovery in traffic because of spare parts and so forth?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, okay. Yeah, so Julian, couple of points. In defense and space, as you saw, we kind of had a -- frankly a bit of a disappointing double digit negative for Q3, but remember that had we not had some of these supply chain challenges, which really became very evident in Q3 because think about these as Q3, Q4 suppliers, which are smaller, which reduced capacity during the pandemic and now we're getting a lot of demand, not just from us but probably some of the other aerospace players. It's going to take some time to work through that, but we would have been down mid-single digits in Q3 had that not happened.

We have unfortunately more (Inaudible) due than we want defense and space that's went up substantially in Q3 and we've got to work our way through that. What I will tell you about defense and space is, if you look at our bookings or where we are at this cycle early Q4 versus where we were at the same period of last year that gives us some, well quite a bit of confidence than we're looking at flat to low-single digits.

Now, that could get even better, I don't know that if it's going to get a lot worse. What we're seeing here is, if you recall, if you go back to 2020, we had very strong orders and revenue in 2020 in defense and space, then you see the effect of some level of usage and destocking by some of those defense and space customers and distributors. So, we're optimistic about normalization in that in '22 and based on what we see today and this is important to say today and that could change, we see flattish to low single-digit growth.

And let's, now switch gears and talk about commercial aftermarkets. We see that continue to improve it. You saw that strong growth in Q3. We think it's going to continue to get better. We're still nowhere near the 2019 levels, but it continues to get better, as you know November 8 we're going to open up the borders and more international traffic is going to step up. So, as more international comes back as COVID abates which we think is going to happen here in Q4 and Q1 next year, we see continued growth in our aftermarket coupled with stronger growth in both in air transport as well as BGA. So, the setup for Aerospace, I think for '22 is quite good. Greg, I don't know if you would like to add?

A - Greg Lewis {BIO 20594853 <GO>}

No, I think you got it.

Q - Julian Mitchell {BIO 21229700 <GO>}

Great, thank you.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you.

Operator

Our next question comes from Scott Davis from Melius Research. Scott, over to you.

Q - Scott Davis {BIO 2393277 <GO>}

Hey, good morning guys and I hope you can hear me okay, but Darius could you -- can you quantify what you think supply chain cost you in revenues in the quarter? You have a sense of that, (Multiple Speakers) and if you have a sense of that Darius, do you have a sense of can you delineate between like a lost sale and a delayed sale? How much of that has gone forever versus just pushed into (Multiple Speakers) quarter, whatever?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, no, that's I can. So, think about the impact in Q3, about $300 million plus or minus and think about what's embedded in our Q4 outlook of an impact of $300 million to $500 million. Now, in terms of loss forever versus push, it's not lost forever. As I talked about some of unfortunately some of our pass-through is going up and that we're not $200 million to $300 million just in Q3, so it's not lost. We've got to be able to get our supply chain to function more effectively and efficiently and that's exactly what Torsen and his team are working on, and -- but it's we don't envision that as lost. The customers still need those products and frankly I think when this earning cycle ends I don't think we're going to be that unique in terms of some of the bottlenecks that we're seeing.

Q - Scott Davis {BIO 2393277 <GO>}

Okay, thank you. Good luck guys.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you.

Operator

Our next question comes from Nicole DeBlase from Deutsche Bank. Nicole, over to you.

Q - Nicole DeBlase {BIO 16935492 <GO>}

Guys, good morning.

A - Darius Adamczyk {BIO 18702500 <GO>}

Good morning.

A - Greg Lewis {BIO 20594853 <GO>}

Good morning.

Q - Nicole DeBlase {BIO 16935492 <GO>}

Maybe, you could talk a little bit about how you're thinking about driving 4Q margin expansion despite at the midpoint of revenue decline? And, the reason I ask is just how are you driving cost cutting in an environment where I know things are tough, but you're also up against a very strong backlog with the potential for growth to really bounce back in 2022? So, how do you balance that against cutting costs for the short-term issues that you're facing?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, well, yeah, I -- first of all Nicole, I don't -- cost cutting is not what we're doing, we're actually investing this year particularly in business is like Intelligrated which are growing in clips that probably no other business has seen before. But, the biggest lever here and I think one of the best operational stories for Honeywell that you see here in Q3 is our pricing discipline, we think we gained in terms of our price cost 40 to 50 basis points of margin expansion and that's what you're seeing come through in our margins. I think that was a terrific commercial execution by the team and they did a great job. So, this is not so much a function of sort of cost cutting, this is more of a function of commercial execution. Greg?

A - Greg Lewis {BIO 20594853 <GO>}

Yeah, I would agree. If you think about it Nicole, last year, obviously we were in a substantial cost-cutting mode and our repositioning pipeline and the projects around that reflected it. This year, we always say that we continue the productivity playbook fixed cost, power one create operating leverage by growing sales and holdings, fixed cost flat is just a (inaudible) of the way we work and so to Darius's point we're not doing massive cost cutting. We are being smart about where we're putting it back though and we are using the things that we spoke about last year in terms of automation in our digital capabilities to help us deliver.

I'll be honest this -- the supply chain work that we're doing, that Torsen and the team are doing are very much enabled by our Honeywell digital tools and capabilities and some of the visibility of that he's put into his own capabilities in supply chain to manage. So, this isn't about cutting costs, it's about managing them properly and we are investing back in the business as Darius mentioned, but we're going to be doing it diligently.

So, I feel pretty good about the margin rate expansion. You would see the implied margin rate expansion is a little bit lower than what our guide was previously simply because the sales numbers are down, so we have a little bit less operating leverage from an opportunity standpoint, but still very healthy margin expansion in Q4.

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, and just to add to that, and Greg this is an important point. Honeywell digital has two elements. Number one is, it helps us to operate the business better and Torsen and his team have done a great job instrumenting exactly how do we uncork some of these bottlenecks that we're seeing, you know it's not perfection, it's not that we're going to completely avoid, but I think we're doing a nice job.

And, second of all, which is continue to drive productivity as Greg pointed out through automation. Automation is a big lever for us and one that frankly we're using aggressively both in sort of our manufacturing facilities, but also in the opposite part and it's been enabling us to drive productivity.

Q - Nicole DeBlase {BIO 16935492 <GO>}

Thanks for the clarification guys, super helpful.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you.

Operator

Our next question comes from Jeff Sprague from Vertical Research. Jeff, over to you.

Q - Jeff Sprague {BIO 1494958 <GO>}

Thank you. Good morning everyone.

A - Greg Lewis {BIO 20594853 <GO>}

Hey, Jeff morning.

Q - Jeff Sprague {BIO 1494958 <GO>}

Hey, good morning. Sort of a related question Darius and Greg one of the other themes out of earning season so far is the double-edge sword element of backlog, in other words things not priced in the backlog for the current inflationary market. Given that you run with relatively large backlog, so just wonder if you could address the profitability in your backlog? Do you have inflation protection and any particular headwinds we should think about as that backlog converts?

A - Darius Adamczyk {BIO 18702500 <GO>}

It's a very good question, Jeff and we've thought about that one. And, you're right we're aged backlog, you got to be very very careful because if you don't go back and revisit your backlog and reprice it then you're going to have a problem and I can tell you that's a very active exercise we're doing because as you can imagine -- whether you are going to -- just to quote some figures, steel is up 198% year-over-year, nickel 25%, copper 46%, aluminum 66%. These fairly substantial increases. So, what we've been doing in more or less all of our businesses and particularly long cycle ones is trying to go back and reprice some of our backlog. You, almost have to do that because -- and not to even mention labor inflation which we're also seeing. So, it's part of our playbook, part of our exercise and exactly what we've been trying to do.

Operator

Okay. Thank you very much. Our next question comes from Josh Pokrzywinski from Morgan Stanley. Josh, good morning and over to you.

Q - Josh Pokrzywinski {BIO 16605674 <GO>}

Hey, good morning everybody. So, I guess one question for Darius and Torsen since he's on the line as well. How is that $500 million of supply chain that you guys talked about the 2019 Analyst Day looking? You're probably looking at the composition of that a little differently today just given how much has changed? And then, just a smaller follow-up. How do we think about the cadence of UOP catalyst shipments from here, those were pretty solid in the quarter?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, let me start with the UOP question, I'll turn it over to Torsen for the other. UOPs bookings remain very very strong, you saw that both in revenue and booking rates here in Q3, so we're optimistic. And, keep in mind, which really gets us excited also and I've talked about this before, HPS follows UOP by a 12 to 18-month cycle, so UOP leads HPS follows. And, so that gives you another good indicator that we should see a nice impact on in HPS 12 to 18 months from now. We've done this analysis before and that's the typical lead lag cycle.

So, not only is this good news and let's face it, we all read the same articles; the world needs more energy. Some of it is going to come from renewables, but frankly some of it is going to have to come from hydrocarbons as well. So, we think that that's -- overall the world right now is energy short and there's going to be reinvestment cycles both in renewables to some extent hydrocarbons. I'll turn it over Torsen.

A - Torsen Pilz

Yeah. The $500 million split primarily between our short-cycle business especially in SPS and HBT and the long-cycle business in Aerospace, so that's what we are seeing. We first saw dramatic impact on the short-cycle business but now in Q3 we really saw that supply shortages are kicking in also in the long-cycle in the Aerospace business. But, the majority sits primarily in the semiconductor-related short-cycle business.

Q - Josh Pokrzywinski {BIO 16605674 <GO>}

Okay, thanks a lot guys.

A - Torsen Pilz

Yeah, thank you.

Operator

Thank you very much. Our next question comes from Deane Dray from RBC Capital Markets. Dean, Good morning. We'll come back to Dean. Our next question comes from Andrew Obin from Bank of America. Andrew?

Q - Andrew Obin {BIO 6337802 <GO>}

Yes. Can you hear me?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yes, Good morning.

A - Greg Lewis {BIO 20594853 <GO>}

Yes, Good morning.

A - Torsen Pilz

Yes. Good morning.

Q - Andrew Obin {BIO 6337802 <GO>}

Good morning. Just a question, a follow-up question. A, on China when do you guys see China accelerating? And, another question is, if I look at HPS and UOP, China has been a huge market, huge source of growth and what we've been reading is because of these energy constraints in China, China is reassessing some sort of more commoditized energy in terms of industries like textiles but more importantly chemicals, we've read about some chemical -- large chemical projects being canceled. What does it mean for HPS and UOP in China going forward? Thank you.

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah. First of all, we actually just to give a data point from Q3, our growth in China continues to be robust. We were up high single digits in Q3 and we actually don't see that abating. So, our position in China continues to be very good. Our orders rate continuing to be -- as you know, there is probably a focus in China right now to actually generate more energy particularly to support the industry right now, that's happening in Q4. So, we actually think that's going to create a very favorable investment environment and business opportunity for us.

And, the other business opportunity for us which we're very excited about is our focused in China on sustainability and when we think about some of the UOP, HPS solutions and our sustainability technology solutions business that's going to create a giant opportunity for us in China and frankly one we're very excited about. So, we think that there's going to be kind of a twofold opportunity here. I think there's going to be a reinvestment cycle what I call, a little bit more of the traditional energy, but really an accelerated and more pronounced investment cycle in renewables. And, as you know, we have a very strong position in China and we think we could be a major player in that sustainability.

Operator

Our next question comes from Andy Kaplowitz from Citigroup. Andy?

Q - Andy Kaplowitz {BIO 15179203 <GO>}

Good morning, guys.

A - Darius Adamczyk {BIO 18702500 <GO>}

Good morning.

A - Greg Lewis {BIO 20594853 <GO>}

Good morning.

Q - Andy Kaplowitz {BIO 15179203 <GO>}

Guys many of the multi-industry peers that you have been relatively acquisitive over the last six months, we know Honeywell's been active also but level of activity has been maybe a little lower and given the size of your company, so is this just a function still of valuation being pretty high and I know Darius you spoke about this before, you've spoken last quarter I think just about being more aggressive with the balance sheet. So, what does that mean, do you see a step-up for Honeywell in M&A related that should be over the next year?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, I think M&A is -- still the desired way to deploy capital, we have done Sparta this year although it didn't require cash we think the CQC Honeywell Quantum Solutions is a very important and meaningful transaction. Yes, it's a merger not a deployment of capital (inaudible) it is a transaction that's good for us. We just did perform (inaudible), it's a smaller acquisition but it's a critically important one and you see a little bit of a pattern, right; Sparta, life sciences, Performix life sciences like that segment and we're going to continue to -- look -- yeah with this level of -- with this kind of interest rate environment that we have today, the M&A market is overheated, it is what it is. But, I've said so we're not going to stay on the sidelines forever. yes versus any historical metric the multiples are high.

And, I don't love it, but the market is what the market is, it doesn't mean we're going to stay on the sidelines forever and wait for the turn, it's been this way. If interest rates go up, I do think, it will probably cool off a little bit so which may allow us to be even more active. But, we are active, we are looking at numerous deals and nothing is 100% the role of M&As, but we're hopeful that able to get something done, and certainly want to deploy our capital in that way. But, it has to be the right business, it has to fit our technology orientation, it has to be at the right value for us, although nothing is cheap these days.

And, we're thrilled with what we're doing in with Sparta, I think that's been looking back at this it's been about six months plus since we've acquired that company, it's going to be a winner. I'm very confident of that.

Q - Andy Kaplowitz {BIO 15179203 <GO>}

Appreciate it guys.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you.

Operator

Our next question comes from Peter Arment from Baird. Peter?

Q - Peter Arment {BIO 1553462 <GO>}

Yes. Can you hear me?

Operator

Yes.

A - Greg Lewis {BIO 20594853 <GO>}

Good morning Peter.

Q - Peter Arment {BIO 1553462 <GO>}

Hey, good morning guys, so great. Darius, maybe you could just talk a little bit about how you're viewing SPS margins the outlook going there? You talk a little bit about kind of improved mix and execution, but obviously you're up against some headwinds there in that business, you talk a little bit about supply chain and also just the PP&E business declining. How should we think about just kind of the outlook improving margins in SPS?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, well, as you know the fastest growing business and SPS is Intelligrated, t is margin dilutive, we've been talking about that. And, look that business grew 60% this quarter, any business growing at that kind of pace is going to have some challenges, but you coupled that kind of level of growth which holds some things like electronics, steel, metal with the supply chain challenges we have, it's going to have some efficiency challenges, particularly since it's -- there is a strong correlation between third-party by our own manufacturing and installation and when those things don't work together well, there is some challenges. I can tell you we're investing heavily in that business to really prepare it to be a $4 billion, $5 billion, $6 billion business, which is the path that it's on. There is an investment play, there is efficiency play and son. Having said that, a lot of our other businesses such as AST such as PSS had an absolutely terrific quarter.

PSS has been a great success story for us. It's winning in the marketplace, so we think that this margin challenge is going to abate over time, particularly as we made some of the process improvements and investments in Intelligrated.

A - Greg Lewis {BIO 20594853 <GO>}

Yeah, I would just echo that, we always talked about this as creating end market for ourselves for it to follow later with service and software that's still our expectation, but as

Darius mentioned when material availability doesn't match up with the installation, labor it becomes challenging and that's really what we're facing right now. We'll get through it, but it's this availability of material throughout the supply chain creates some big challenges when you're seeing this type of growth.

Q - Peter Arment {BIO 1553462 <GO>}

Appreciate the color. Thanks.

Operator

Alright. Our next question comes from Deane Dray from RBC Capital Markets. Dean, are you there?

Q - Deane Dray {BIO 1722688 <GO>}

Yes, thank you. Good morning everyone.

A - Greg Lewis {BIO 20594853 <GO>}

Hey Dean.

A - Darius Adamczyk {BIO 18702500 <GO>}

Great.

A - Torsen Pilz

Hey Dean.

Q - Deane Dray {BIO 1722688 <GO>}

Hey, sorry I was juggling multiple calls this morning, so thanks for letting me get back in. I want to circle back on a topic that Josh raised and just the idea of UOP leading HPS and it just begs the question about the oil and gas industry CapEx cycle. It's really been slow to recover here but now with that spike in oil prices what's your expectation on release of new projects, even as simple as MRO has still been lagging as well but what's your outlook there please?

A - Darius Adamczyk {BIO 18702500 <GO>}

Yeah, I think this is becoming clearly obvious and we all read the same articles and see what's going on, which is -- there is going to have to be a reinvestment cycle. As much as we all want sustainable and renewable technologies to takeover sort of energy needs tomorrow, it's probably going to be a little bit of a longer term and it's very clear to me that there is going to be reinvestment cycle. We're seeing a good reinvestment cycle, when I call some of the shorter projects, refurbishment, focus 50 installed base, but we're strong believers there is going to be a fairly strong reinvestment cycle in '22 and '23 here, I think that's necessary.

So, we're bullish on that segment and certainly the price of oil, price of gas support that kind of investment. If you look at gas and oil, there are at very very attractive levels, what we need now is some level of stability, so that's good. But, let me give you a couple of other specific data points. Our renewable fuel orders this past quarter were up 86%, I think we forget sometimes that we just characterize UOP as oil and gas, it is not just oil and gas. It has an incredibly strong green fuels portfolio which is winning in the marketplace, in fact it has seen 86% growth. Also, some our energy storage controls orders were up 64% this past quarter in our HPS. So, those are just a couple of data points for you that we are very excited about the energy future.

We have a portfolio that's going to play in it. Having said that, there is going to have to be a reinvestment cycle in sort of what I call the all energy infrastructure.

Q - Deane Dray {BIO 1722688 <GO>}

That's really helpful. Thank you.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you.

Operator

Alright. Our next question comes from Joe Ritchie from Goldman Sachs. Joe?

Q - Joe Ritchie {BIO 16351356 <GO>}

Thanks, good morning everyone.

A - Greg Lewis {BIO 20594853 <GO>}

Morning Joe.

Q - Joe Ritchie {BIO 16351356 <GO>}

Guys, when I take a look at your performance just from a growth standpoint and what we're seeing from a backlog orders perspective, HBT is probably the one where we are seeing the biggest disconnect. And, so I'm curious if you could maybe just provide a little bit more color on whether it's specific components, labor, what specific regions you're really seeing some of the supply issues, supply constraint issues, and when we would expect some of that to alleviate for the growth to really pick up?

A - Greg Lewis {BIO 20594853 <GO>}

Yeah, this is one of the places where the electronics shortages are very acute and so just the fire business in particular uses some very specific semiconductors, which have been extremely short, I think Doug Wright and supply chain team have done a very good job of trying to free up capacity from other distribution points.

They've also been doing, we talked a little bit about the reengineering work, they've done a lot of reengineering to try to include different chipsets into some of their platforms. So, this one is really pretty acutely tied to the whole capacity expansion that's going on in the fab industry. So, I think we're going to feel this. We talked about the fourth quarter and into the first half of the year, and this is one of the businesses, I think we are going to feel that probably more than others, but it will come to an end. That, I think it's a very -- it's not a thousand parts, it's measured in like tens of parts here.

Q - Joe Ritchie {BIO 16351356 <GO>}

Okay, thank you.

Operator

Our last question comes from Sheila Kahyaoglu from Jefferies. Sheila, over to you.

Q - Sheila Kahyaoglu {BIO 17240338 <GO>}

Good morning Darius and Greg, and thanks for fitting me in.

A - Darius Adamczyk {BIO 18702500 <GO>}

Morning Sheila.

Q - Sheila Kahyaoglu {BIO 17240338 <GO>}

Greg -- good morning guys. You guys noted to an earlier question to defense was down mid-single digits, ex the supply chain issues; maybe could you parse a little bit about how much of that mid single-digit decline came from U.S. DoD O&M budgets declining versus international programs and somewhat related to that margins are still growing pretty nicely despite the supply chain issues and the OE growth in the quarter in a row, so is defense materially lower or was there better price in the segment?

A - Greg Lewis {BIO 20594853 <GO>}

Yeah, maybe I'll take the last one first. Think about the operating leverage that we're getting across the portfolio, pretty heavy in aerospace in particular, that was the -- we talked about our cost reduction programs last year and Aero was at the top of that list, PMT second in terms of the level of fixed cost take out.

So, part of what you're seeing from Aerospace in terms of the almost 400 basis point improvement is a big operating leverage that they're getting even though it's only 2% revenue growth. In terms of the split between U.S. DoD and international, I think what we seeing is similar to what we spoke about before, the U.S. DoD and International are both down from a demand perspective, as we're going through that re-calibration, if you will on some of the pre-buying that had been done last year. And, we do see the the supply chain issues that we're having are really in a lot of the mechanical spaces.

So, I expect that we'll start seeing that improve as the supply chain in the aerospace supply chain complex ramps up into the fourth quarter into the early part of next year. I don't know Torsen if you want to make a few comments on that.

A - Torsen Pilz

Yeah, I mean this is -- we seen this in '18, '19 and we were eventually able to grow this by 18%, 19% 20% year-over-year in this particular the next couple of quarters.

Q - Sheila Kahyaoglu {BIO 17240338 <GO>}

Great, thanks so much.

A - Darius Adamczyk {BIO 18702500 <GO>}

Thank you.

Operator

That concludes today's question-and-answer session. At this time, I would like to turn the conference back to Darius Adamczyk for any additional proceeds. Darius over to you.

A - Darius Adamczyk {BIO 18702500 <GO>}

I want to thank our shareholders for your ongoing support. We delivered strong third quarter results and continue to navigate effectively to uncertainties while gaining traction in key strategic growth factors and positioning ourselves to capitalize on improving key end markets. Thank you all for listening and please stay safe and healthy. Thank you.

Operator

Thank you. This does conclude today's conference call. You may disconnect at this time. Have a wonderful day.
