Raytheon Technologies Corporation (NYSE:RTX) Q2 2021 Earnings Conference Call July 27, 2021 8:30 AM ET

Company Participants

Greg Hayes - CEO
Neil Mitchill - CFO
Jennifer Reed - VP of IR

Conference Call Participants

Myles Walton - UBS
Ron Epstein - Bank of America Merrill Lynch
Sheila Kahyaoglu - Jefferies
Robert Stallard - Vertical Research
Noah Poponak - Goldman Sachs
Carter Copeland - Melius Research
Doug Harned - Bernstein
Peter Arment - Baird
Kristine Liwag - Morgan Stanley
David Strauss - Barclays
Robert Spingarn - Credit Suisse
Seth Seifman - JPMorgan
Cai Von Rumohr - Cowen
Mike Maugeri - Wolfe Research
Matt Akers - Wells Fargo

Operator

Good day, ladies and gentlemen, and welcome to the Raytheon Technologies Second Quarter 2021 Earnings Conference Call. My name is Tabitha, and I will be your operator for today.

As a reminder, this conference is being recorded for replay purposes. On the call today are Greg Hayes, Chairman and Chief Executive Officer; Neil Mitchill, Chief Financial Officer; and Jennifer Reed, Vice President of Investor Relations. This call is being carried live over the Internet and there is a presentation available for download from Raytheon Technologies' website at www.rtx.com.

Please note, except for otherwise noted, the company will speak to results from continuing operations, excluding net non-recurring and/or significant items and acquisition accounting adjustments, often referred to by management as other significant items. The company also reminds listeners that the earnings and cash flow expectations and any other forward-looking statements provided in this call are subject to risks and uncertainties. RTC's SEC filings, including its Forms 8-K, 10-Q and 10-K, provide details on important factors that could cause actual results to differ materially from anticipated in forward-looking statements.

Once the call opens for questions, we ask that you limit your round to one question per caller to give everyone the opportunity to participate. [Operator Instructions] You may ask further questions by reinserting yourself into queue as time permits.

With that, I will turn the call over to Mr. Hayes.

Greg Hayes

Thank you, Tabitha, and good morning, everyone. I'm on the Slide 2 of the deck for those of you following along. So a couple of months ago, we held our first Investor Day as Raytheon Technologies. And that day, we laid out our 2025 goals to deliver strong top line growth, margin expansion, and at least $10 billion in free cash flow by 2025, all while continuing to invest in our businesses and return significant cash to our shareowners.

We continue to be confident in the future because of our strong franchises, the resilient markets in which we operate, our innovative technologies and our relentless focus on operational excellence and cost reduction, which will drive margin expansion and strong cash flows into the future. And we continue to see encouraging trends across our market.

Our confidence and our ability to achieve these targets remain strong. And as you saw at the end of May, the Department of Defense released the fiscal year 2022 budget request, which was generally in line with our expectations with respect to our portfolio of products and the investments we're making in differentiated technologies, including missile defense, space-to-base systems, next generation propulsion and hypersonics.

Major RTX programs fared well overall as modernization funding remains at near historic highs. Requested funding for these programs is favorable to the overall DoD modernization request, when compared to last year's plan for fiscal year 2022. It's also worth noting that the overall classified funding request, which supports a significant part of our intelligence and space portfolio, was also very well supported.

So, I'd say we're well-positioned with the administration's priorities, driven by our innovative technologies and capabilities to address the evolving threat environment. This is demonstrated of course by the significant awards we received this quarter, which included over a $1 billion in classified bookings at RIS, and two important franchise wins at our missile and defense business, where we are awarded almost $2 billion for the Long-Range Standoff Weapon or LRSO, and $1.3 billion for the next generation interceptor.

I think, also, we should note that the Patriot franchise remains robust, as evidenced by Switzerland becoming the 18th partner nation to select the Patriot Air Defense System. At the same time, commercial air traffic demand continues to gain momentum across many of our domestic markets, as global economies reopen and vaccinations increase.

In the U.S., daily travelers throughout the TSA checkpoints have averaged over $2 million per day in July, and that's more than doubled since January of this year. That said, we are monitoring the COVID variants and the impact and travel and there's still work to do on global vaccinations in our international border reopenings.

With that, let’s turn to Slide 3 and just talk about Q2 for a moment if we can. As you saw from our press release, strong performance during the quarter with sales at the high-end of our expectations and an adjusted EPS and free cash flow exceeding those expectations that we laid out for you last quarter. Strong execution against an increasingly favorable backdrop enabled us to deliver top and bottom line growth of both a year-over-year and a sequential basis.

To give our performance year-to-date and the recent trends across our end markets, we're going to raise the low end of our full year sales outlook by $500 million to a new range of $64.4 billion to $65.4 billion. And we're also going to raise and tighten our adjusted EPS outlook, with a new range of $3.85 to $4 per share. And we're increasing our free cash flow outlook to a range of $4.5 billion to $5 billion for the year.

I'm pleased with the strong orders we saw in the quarter which grew our company backlog to a record $152 billion, that's a 3% increase since the first quarter. Our defense book-to-bill was a strong 1.12, resulting in a defense backlog of over $66 billion and commercial backlog increased by $3.5 billion in the quarter.

On the capital allocation front, we repurchased 632 million shares, bringing us to over a $1 billion in share repurchase year-to-date. And we're on track to meet our commitment of buying back at least $2 billion of shares for the year. We also continue to execute on the merger integration activities. And given our substantial progress in the robust pipeline of opportunities, we're going to raise our gross cost of synergy target by another $200 million to $1.5 billion. And that $1.5 billion will be realized in the first four years following the merger. That's now 50% more than our original synergy commitment, and there's great execution by the team. But I would tell you, we're not done yet. Like everything, there's always more to do.

In addition to making good progress on our synergy targets, we're also making significant progress on our structural cost reduction projects, which you've heard about back in our May meeting. We have a pipeline with hundreds of opportunities, including the previously announced actions that were working across the business.

Let me just give you a couple of examples of what we are doing. And our Collins Aerostructures business has scheduled over 125 lean events this year. And they're focused on specifically reducing the TAT time, labor time for the A320neo nacelle. We've invested in lean events such as these throughout the pandemic, because they've allowed the aerostructures business to reduce nacelle manufacturing time by over 75%. Of course, our normal goal here is about an 87% learning curve. These lean events allow us to exceed that in incredible ways.

At Pratt, we continue to build on the overhaul capability and drive turnaround time across our Geared Turbofan network. The team has made good progress this year, demonstrating a 15% turnaround time, an improvement over the past year. But importantly, they're on track to drive a 30% reduction by the end of this year. These improvements are the direct result of repair infrastructure development and additional productivity improvements across the network, including the application of lean principles in their shop design, as well as automation.

A strong culture of operational excellence is enabled, of course, by the core operating system and significant investments in digital technology and other strategic projects. Altogether, these initiatives will save over $5 billion in costs through 2025. So, you can see the market fundamentals are strong. We're laser-focused on operational excellence, and our key franchises are driving strong financial performance.

So with that, let me turn it over to Neil and Jennifer to take you through Q2 and the next - and the year. Neil?

Neil Mitchill

Thanks, Greg. I'm on Slide 4. As you could expect, I'm pleased with where we landed for the quarter. We exceeded our expectations for both adjusted earnings per share and free cash flow. Sales were $15.9 billion, which was at the high-end of our outlook range, and up 10% organically versus prior year on an adjusted pro forma basis, and up 4% sequentially. Our strong performance was driven by the momentum in commercial aerospace and continued growth in defense.

Adjusted earnings per share of $1.03 was ahead of our expectations, primarily driven by commercial aftermarket and contract-related settlements at Collins, but also better than expected performance at Pratt, RIS and RMD.

On a GAAP basis, earnings per share from continuing operations was $0.69 per share, and included $0.34 of acquisition accounting adjustments and net significant and/or non-recurring items. Free cash flow of $966 million exceeded our expectations, primarily due to the continuation of better than expected collections and lower than expected capital expenditures.

Before I hand it over to Jennifer, let me give you a little color on our synergy progress. We achieved $185 million of incremental gross cost synergies in the quarter, bringing our year-to-date savings to $390 million. And given the pace that we realized these synergies on today, we're increasing our 2021 cost synergy target by $50 million, which brings our new target to the year - for the year to $660 million.

Collins also achieved nearly $50 million of further acquisition synergies in the quarter, bringing total Rockwell Collins acquisition related savings to nearly $560 million since the deal closed in November of 2018. And we now expect Collins to meet their $600 million acquisition synergy target in 2021, a year ahead of schedule. So, great work by the Collins team on that front.

So with that, I'll hand it over to Jennifer to take you through the segment results and I'll come back and talk a bit about the outlook. Jennifer?

Jennifer Reed

Thanks, Neil. Starting with Collins Aerospace on Slide 5, sales were $4.5 billion in the quarter up 6% on an adjusted basis, driven primarily by the recovery of the commercial aerospace industry, and up 11% on an organic basis. By channel, commercial aftermarket sales were up 24% driven by 30% increase in parts and repair, a 16% increase in modifications and upgrades, and a 15% increase in provisioning.

Sequentially, commercial aftermarket sales were up 15% with growth in all three channels. Most notably, provisioning, which grew at 40% and parts and repair which grew 14%. Commercial OE sales were up 8% from the prior year, driven principally by the recovery of the commercial aerospace industry. Growth in narrow-body, regional and business jets was particularly offset by expected declines in wide-body sales. And military sales were down 7% on an adjusted basis to the prior year divestitures, and down 1% organically on a tough compare.

Recall, Collins military sales were up 10% in the same period last year. Adjusted operating profit of $518 million was better than expected and was up $494 million from the prior year, driven primarily by higher commercial aftermarket and OE sales, the benefit of continued cost reduction actions, as well as favorable contract settlements that were worth about $50 million.

Looking ahead, we continue to expect Collins full year sales to be down mid- to down low single digit, with higher expected commercial aftermarket volumes offsetting slightly less than expected OE deliveries. And given the favorable mix in the first-half of the year, the commercial recovery and the benefit of cost containment measures, we are increasing Collins full year operating profit outlook to a new range of up $100 million to $275 million versus prior year.

Shifting to Pratt and Whitney on Slide 6, sales of $4.3 billion were up 19% on an adjusted basis and up 21% on an organic basis, primarily driven by the recovery of the commercial aerospace industry. Commercial aftermarket sales were up 41% in the quarter with legacy large commercial engine shop visits up 56%, and Pratt Canada shop visits up 18%. As expected, we also saw continued ramp in GTF shop visits in the quarter.

Commercial OEM sales were up 30% driven by higher GTF deliveries within Pratt’s large commercial engine business and general aviation platforms at Pratt Canada. Military sales were down 3%, also on a tough compare, given Pratt’s military sales were up 11% in the same period last year. A continued ramp in the F-135 sustainment was more than offset by lower material inputs on production program. Adjusted operating profit of $96 million was slightly better than expected, and was up $247 million from the prior year driven primarily by higher commercial aftermarket sales and favorable shop visits mix.

Looking ahead, we continue to expect Pratt’s full year sales to be up low to mid-single digits. And we are increasing the low-end of Pratt’s full year operating profit outlook by $25 million to a new range of down $50 million to up $25 million versus 2020.

Turning now to Slide 7, RIS sales were $3.8 billion up 12% versus the prior year on an adjusted basis. On an adjusted pro forma basis, including the pre-merger stub period, sales were up 6% driven by strength and Airborne ISR program within sensing and effects, as well as strength in the classified cyber programs within cyber, training and services.

Adjusting operating profit in the quarter of a $415 million was slightly better than expected, and was up $86 million year-over-year on an adjusted pro forma basis, driven primarily by program efficiencies. The quarter also benefited from a gain on a real estate transaction. RIS had $4 billion of bookings in the quarter, resulting in strong book-to-bill of 1.13, and a backlog of $19.4 billion. Significant bookings included approximately $1.1 billion on classified programs, as well as several other notable awards including the STARS follow on award for the FAA to implement a terminal automation system in their airport. And our first production award for the U.S. Navy next generation jammer mid band system that utilizes RTX industry-leading gallium nitride technology. It's worth noting that we continue to expect RIS full year book-to-bill to be about one.

Turning to RIS full year outlook, we continue to expect sales to grow low to mid-single digit, and we're increasing the low-end of RIS's operating profit outlook by $25 million to a new range of up $150 million to $175 million versus adjusted pro forma 2020.

Turning now to Slide 8, RMD sales were up $4 billion up 15% to prior year on an adjusted basis, and adjusted pro forma basis which again includes pre-merger stub period, sales were up 9%, driven primarily by higher volume on the international Patriot program and on Stormbreaker program, both which included liquidation of pre-contract costs. Adjusted operating profit of $532 million was slightly better than expected, and was up $121 million versus prior year on adjusted pro forma basis due to favorable mix and higher program efficiencies.

RMD had $6.1 billion of bookings in the quarter, resulting in an exceptionally strong book-to-bill of 1.55, and a backlog of $29.7 billion. In addition to the franchise awards that Greg discussed. RMD also had a number of other notable awards in the quarter. We also continue to expect RMDs full year book-to-bill to be about one.

Turning to RMD's full year outlook, we continue to expect sales to grow low to mid-single digit, and we're increasing the low-end of RMD's operating profit by $25 million to a new range of up $50 million to $75 million versus 2020 on an adjusted pro forma basis.

I'll turn it back to Neil to provide some color on the rest of the year.

Neil Mitchill

Thanks, Jennifer. I'm on Slide 9, let me update you on how we see the current environment as we look to the second-half of the year. Starting with our commercial end markets, as I've discussed many times before, the shape of the commercial recovery remains critical to our outlook. That said, we are encouraged by the pace of the vaccine distribution, and continued signs of improving air travel demand in many domestic markets. However, we continue to see international air traffic and border reopenings recover slower than we had expected around the world. Keep in mind about 65% of 2019 air travel was international.

While the first-half of the year was a little stronger than expected, and we're seeing signs of strong summer travel, we still need to see the reopening of international borders and the return of long haul routes to drive continued sequential aftermarket growth in the second-half of the year.

Looking longer-term, we continue to expect commercial air traffic to return to 2019 levels by the end of 2023, with domestic and narrow-body fleets recovering before international and wide-body fleets.

Moving to our defense end markets, we were pleased with what we saw in the fiscal year ‘22 defense budget requests. And we remain confident in our ability to grow our defense businesses as we look ahead.

Shifting to operational excellence, as Greg mentioned, we're increasing our gross merger cost synergy target to $1.5 billion. And that's driven by higher savings from the corporate segment consolidations, as well as additional procurement and supply chain savings. At the same time, we're maintaining a focus on implementing our core operating system and driving structural cost reduction across the businesses. And finally, our financial flexibility is underpinned by our strong balance sheet which supports our investments in the business and our capital deployment commitments.

So, let's turn to Slide 10, following our strong first-half, we're confident in our full year outlook. As Greg discussed, we're bringing up the low-end of our sales range by $500 million, and we're raising our adjusted earnings per share range to $3.85 to $4 per share, or up about $0.33 from the midpoint of our prior outlook. About half of the increase comes from the segments, primarily Collins, and the other half is from $0.13 of tax improvement and about $0.03 of lower corporate tax items. The $0.13 tax benefit is driven by the ongoing optimization of the company's legal and financing structure that we expect to realize discreetly in the third quarter.

On the cash side, given the improved earnings outlook, we now expect free cash flow in the range of $4.5 billion to $5 billion for the year. And finally, it's worth mentioning that we've included an updated segment outlook, as well as an updated outlook for some of the below the line items in the webcast dependencies.

With that, I'll hand it back to Greg to wrap things up.

Greg Hayes

Okay. Thanks, Neil. So we're on the final slide here, Slide 11. I just want to reiterate our priorities for 2021, and again, no surprises here. These priorities remain the same that is first and foremost, to continue to support our employees, our customers, and our suppliers and communities during the pandemic, and to keep our employees safe.

Our team is dedicated to solving our customers’ most complex problems by investing in differentiated technologies to capitalize on our strong franchises. At the same time, we're going to continue to execute on the integration and deliver the cost synergies, and we're committed to operational excellence to drive further structural cost reduction across all of our businesses.

And finally, as Neil said, we have a very strong balance sheet, combined with our cash generating capabilities, provides financial flexibility to support investments in our business, and our commitment to returning capital to shareholders, including at least $20 billion to shareowners in the first four years following the merger.

So with that, let me go ahead and open it up for questions. Tabitha?

Question-and-Answer Session

Operator

[Operator Instructions] First question comes from the line of Myles Walton with UBS.

Myles Walton

Hey, good morning. Greg, you mentioned the GTF improvement that you're doing on the cost side, I was just curious could you talk about the losses that you're currently incurring per unit. How much of an improvement the cost reduction efforts are actually translating into unit costs? And then, maybe just as you look at the glide slope of losses on the engine, I think, the prior comments were around peaking in 2025, and maybe size how far off you are from that peak? Thanks.

Neil Mitchill

Sure, Myles. Thanks. I'll take this one. It's Neil. Good morning. First of all, if you think about the second quarter, the Pratt and Whitney large commercial engine business saw a very slight year-over-year decline in the OE operating profits. So we're making really good progress driving costs out of the engine in spite of much lower volumes than we had previously expected. So I feel good about that.

And as you look at the rest of the year, the team continues to drive down the cost curve. And we'll see slight cost improvement year-over-year, and again, in spite of some significant absorption headwind that we're dealing with relative to today's volumes versus what we were expecting pre-pandemic.

Looking a little bit further out, we do continue to see some upward pressure on negative engine margin as the volumes increase. But we do see that as a positive sign, frankly, those are investments we're making in the future aftermarket, not going to get into quantifying that today. But we do see OE volumes going up in the 2025 time period. And the Pratt and Whitney team is aggressively working cost reduction actions to contain that negative engine margin at an appropriate level.

Operator

Okay. Your next question comes from the line of Ron Epstein with Bank of America.

Ron Epstein

Hey, good morning. How are you?

Greg Hayes

Good morning.

Ron Epstein

Can you speak a bit about what you're thinking on mid-term growth on defense for the business? I mean, we saw in the quarter, in particular, in Europe, foreign military sales for the industry did well, you guys did well with the order on the Patriot. But what do you think in mid-term for the defense business growth? So, if we step out a couple of years from now, not just next year, but if we go out maybe three, four years from now.

Greg Hayes

Yes, I think it's pretty much what we had talked about back in May, Ron, which is, we're going to probably see low to mid-single-digit organic growth across all the defense businesses. And, as you know, that's a mix of both U.S. defense spending as well as international. And obviously, on the international side, we've seen a little bit of an impact this year with the pandemic and the havoc that we’ve done on budgets.

But at the same time, I think we continue to see strong backlog there. I mean, interestingly, in Switzerland, both F-35s and the Patriot defense system. So defense business internationally remains good. The backlog, as we said, remain strong over $66 billion at the end of the quarter.

So I think, we easily see that kind of 3% to 5% growth. Of the mid-term, I'll call it out through 2025, because who knows beyond that, but again, it's all about having the right technology for, I would say the next conflict, not the last conflict. And that means having space-based technologies, it means hypersonic weapons, it means cyber weapons. All of those things are going to enable us to help the warfighter in whatever that next conflict might be.

Ron Epstein

Thank you.

Operator

Your next question comes from the line of Sheila Kahyaoglu with Jefferies.

Sheila Kahyaoglu

Good morning, guys. Thank you for the time.

Greg Hayes

Good morning, Sheila.

Neil Mitchill

Good morning, Sheila.

Sheila Kahyaoglu

So the better outlook at Collins $225 million of it of the $275 million seems to be core productivity. How do we think about what drove that, given the top line that really hasn't changed? And just on first-half margins, ex-contract settlements are about 9% and it implies second-half margins are 8%. So, why the contraction in the second-half? And how do we think about the improvement off that base?

Neil Mitchill

Sheila, I'll start. First of all, I think on the Collins side, the way I would think about the second quarter profit was really driven by higher aftermarket drop through in part, I'd say substantially, it was due to that. We also did realize about $35 million of cost reduction, that dropped to the bottom line combined with about the same number from productivity and mix. So those are really the key drivers.

The reason you're not seeing the overall sales go up for RTX is recall, we had a very, very broad range on the sales coming into the year, most of that range was attributed to aftermarket risk. We're halfway through the year now. We're derisking that. We've taken up the bottom and a $1 billion six months into the year. As you think about that $500 million increase, about $200 million of that I would attribute to Collins, a little bit less than that to Pratt and Whitney. And then we also are seeing some improvement on the bottom end, probably $30 million or so at RIS and the rest at RMD.

So, as I look at the rest of the year and you think about the margins, there's a couple things I just want to highlight for you. We had about $0.05 of, I'd call it, one-time items in the second quarter that I don't expect to repeat in the second-half of the year. $0.03 of those were at Collins those contract settlements that we called out. We also had about a $0.01 in RIS related to a land sale, and then another $0.01 within our RMD as well, given some contract - pre-contract liquidations that went through driving about 70 basis points in margin expansion at RMD.

So, as you think about the second-half of the year at Collins, in particular, probably $75 million to $100 million of EMD headwind in the second-half. Remember, we have been cautious in terms of the phasing of our discretionary spending. We'll see that ramp up, now that we're seeing the strength in the aftermarket. And we had furloughs in place for the first-half of the year at Collins. Those are now expired and so they'll have that incremental cost as we head into the second-half of the year.

Sheila Kahyaoglu

Thanks so much.

Neil Mitchill

You're welcome.

Operator

Your next question comes from the line of Robert Stallard with Vertical Research.

Robert Stallard

Thanks so much. Good morning.

Greg Hayes

Good morning, Rob.

Robert Stallard

Good morning. Maybe just a follow-up on Sheila's question. You did see a very big sequential increase in the Collins aftermarket in Q2 compared to Q1. But it seems like you're a little bit cautious about extrapolating that going forward. So maybe, if you go into a little bit more color of what you actually saw in Q2, and why you're perhaps a little bit squishy about this continuing in the second-half?

Greg Hayes

Excuse me, let me start there, Rob. I think, what surprised us in Q2 was how quickly the commercial aftermarket came back, especially in China and in the U.S. And you've heard us talk historically about expecting typically a six-month delay from the time, we start seeing RPMs recover until the time we start seeing the aftermarket recover.

The anomaly this year is the airlines are actually spending money ahead of the recovery in anticipation of a resurgence in demand, which was exactly what they have been seeing. And so the second quarter was much, much better, I think than anybody had expected going into this, especially as we think back to January is really putting the plans together for the year. So as we think about the back-half of the year, a lot of that pent-up demand we think has already been satisfied here in Q2.

But I would also tell you the bigger part on Collins you got to remember is 40% to 45% of their aftermarket is wide-body. And that is the piece that we do not see recovering here in the back-half. Again, you'll see some reopenings, we hope some transatlantic routes reopen here in the third quarter and into the fourth quarter. The transpacific is pretty well still shut down. The inner Asia, long haul routes are pretty well still shut down. And so that's kind of the governor, I would tell you on the back-half at Collins is the long haul wide-body marketplace.

So again, strong domestic demand in the U.S., strong domestic demand in China, starting to see some of that in Europe now. But it's really the wide-body that is, I would say the overall governor on the back-half.

Neil Mitchill

Yeah, and let me just add a couple of other points too. I think one of the things that was very notable in the second quarter was the 40% sequential growth and provisioning. So again, I think that's all the airlines getting ready for the expected increase in demand here in the second-half of the year. So that's a watch item as we kind of think about the back-half.

On the aftermarket side and I'm talking Collins in particular, we had 15% sequential growth, as you pointed out, really strong growth here in the second quarter. As we look at the next two quarters, think more about 5% sequential growth. And again, that's off of a higher base here in the second quarter, I mean still ahead of what we were talking about back in January. So we're seeing that improvement, but that's sort of what we're calibrating in our forecasting as we look at things today.

Robert Stallard

That's very helpful. Thank you.

Operator

Your next question comes from the line of Noah Poponak with Goldman Sachs.

Noah Poponak

Hey, good morning, everybody.

Greg Hayes

Good morning, Noah.

Noah Poponak

Hey, just in the legacy Raytheon defense segment margins, those have improved, notably over the last few quarters. I understand you had the acquisition accounting reset there, we can see that they were higher in the past before that, and we can see what your future targets are. We're just wondering how linear that improvement can continue to be. The guidance implies they stepped down in the back-half versus the second quarter. But given what you're doing on the cost side, and given the steady recovery from the acquisition accounting input, and again, where that long-term target is, it's not clear to me why that would happen.

Neil Mitchill

So Noah, let me try to share a little bit of perspective on that. First, I think as we think about the first-half of the year, the margins, both in RIS and RMD are strong, stronger than we had expected. You'll recall in the first quarter, I commented on a couple of items in RMD, we had the pension tailwind, we also had some international mix. We also here in the second quarter in RMD had some contracts that were awarded that resulted in us liquidating some costs that had accumulated on the balance sheet. Now we can recognize revenue and profit on that. So those couple of things our RMD are providing some uplift in the first-half of the year that we don't expect to repeat in the second-half of the year.

And at RIS, I pointed out that asset sale that we had in the second quarter as well. If you take that out for RIS, you'll see margins in the back-half of the year that are fairly consistent with what we just saw in the second quarter. Now, from a productivity perspective, we are seeing improved productivity, and it's about $50 million each in those two segments. So where that goes, as the year continues, we will see that's a function of hundreds of the EACs being done each quarter, but we are seeing that improvement in the underlying productivity in a net favorable way.

But, keep in mind at RMD, as we've talked about back at our Investor Day, you will see a mix shift in the products and the margins in the second-half of the year, as we get into more DoD FMS sales. So that's sort of the margin story. I mean, feds business, we’re very pleased with where they're heading, and still see longer-term the targets that we set out in May achieving those.

Noah Poponak

Thank you.

Operator

Your next question comes from the line of Carter Copeland with Melius Research.

Carter Copeland

Hey, good morning, gentlemen. Hey, Neil, just so I can make sure we're all speaking the same language here. When you refer to productivity across the two segments the $50 million, are you saying that the gross or excuse me, the net cumulative adjustments to the EACs were $50 million in each of those two segments?

Neil Mitchill

On a year-over-year basis, yes. Net EAC year-over-year, yep.

Carter Copeland

And is the big driver of that you up the synergy target, you realized it's some incremental cost out for all the reasons you stated earlier. And you're just putting that into the EACs and we're just getting that flowing into Q2, because that's when we sort of put in the plan.

Neil Mitchill

Yeah, that's right. And, you're seeing sort of that play through and then the natural evolution of us getting further along the percent complete, since we had to reset that back in April of 2020. But that goodness, neck goodness, is dropping through in the form of EAC favorability. There's a lot of EACs that get done every quarter and so sort of that's the net effect of everything.

But generally speaking, we're seeing good productivity in both RIS and RMDs businesses.

Carter Copeland

Okay, great. Thank you for the clarification. I’ll stick to one.

Operator

Your next question comes from the line of Doug Harned with Bernstein.

Doug Harned

Thank you. Good morning. When you talk about how you're looking at how you're modeling traffic trends, and I think you said, by the end of 2023 for traffic to be back. How do you think about your aftermarket recovery in Pratt and Collins with respect to that trend? In other words, how do you see those lining up on that traffic recovery?

And perhaps in Collins, maybe if you could break it down by what I would say, traditional UTAS Collins avionics and interiors that would be really helpful.

Greg Hayes

Well, I guess if you think about it, Doug, originally -- well, our forecast would say that we don't see a complete return of air traffic to pre-COVID levels until 2024. We had expected pretty much just to see as we have historically, that kind of six months delay from that with aftermarket recovery tracking RPM recovery. That's obviously not the way we've seen it play out this year, again, because people have been come back, there's a lot of pent-up demand. And I expect, we will see the aftermarket pretty much line online with RPM growth here over the next couple of years, as we see that recovery.

Again, I think the various pieces of the business will see I would say a different trajectory. If you think about the interiors business, for instance, while it's still up sequentially, a little bit, that business is still suffering from the dearth of wide-body departures. And so we're not seeing great traction in interiors.

On the avionics front, though, we're seeing kind of a normal as expected recovery. The same with I would say some of the legacy UTAS businesses as you call them, our power and controls business, landing gear, wheels and brakes, all of those things recovering pretty much in line with what we're seeing for traffic.

So again, if I think about the weakest link in the Collins business is probably interiors, but it will come back. We're convinced that we're going to see wide-body traffic recover, it’s just going to take some time. And again, that's a relatively high margin business, it's all customer furnished equipment. So that will play out into the recovery of the margins at Collins as well, probably into that ’23, ‘24 timeframe.

Neil Mitchill

Yeah, let me add a little more color to, Greg, I agree with all that. Maybe making some comments about 2021 year what we see for the rest of the year. And I'll focus on ASMs. I mean, we saw about a 22% increase in ASMs from Q1 to Q2. And as I think about, going from Q2 to Q3, that's probably more in the 30%, 35% range. And that's starting to level out, call it mid-single digit 5% kind of growth from Q3 to Q4.

Getting back to what Greg said, our aftermarket should start to trend with those ASMs, as we look further out through the recovery.

Operator

Your next question will come from the line of Peter Arment with Baird.

Peter Arment

Good morning, everyone. Nice results. Hey, on working capital can you maybe just talk about the progress you're making on the kind of inventory levels at Collins and Pratt? I believe that's kind of the best opportunity for you to show gains going forward? And is there any kind of change here in your thinking on long-term goals, and then maybe just expectations around free cash flow cadence in the second-half? Thanks.

Neil Mitchill

Yeah. Thanks, Peter. So actually, I'm very pleased with what we're doing on inventory in both Pratt and Collins. With the significant increase in sales that we're seeing a known ramp that we're facing, inventory levels have stayed pretty much in line. At the company level, up $50 million higher than we exited the first quarter with. And obviously, some work to do to drive that down in the back-half of the year. As we see the markets strengthen here, we'll be making sure that we have that inventory in place. Could there'll be a little bit of pressure on that? I suppose, but I'm very happy to see that we're still forecasting inventory turn improvements as we exit the year, and good focus on working capital management.

As you think about our $4.5 billion to $5 billion of free cash flow at the midpoint of that range, I'd say that increment comes from the improved profit, if we're able to get to the higher end that will likely be on slightly improved CapEx. And we'll be watching the working capital, but we got the right focus on it. We want to make sure we're ready for the recovery, ready for our customers, but at the same time, not bringing in inventory that we don't need.

In terms of calendarization for the second-half of the year, as I think about the third quarter profile, probably about the same increase in free cash flow that we saw from Q1 to Q2. So again, we're very happy with the collections that we're seeing. And, right now, that's sort of how I see third quarter playing out.

Peter Arment

Appreciate the color. Thanks.

Operator

Your next question comes from the line of Kristine Liwag with Morgan Stanley.

Kristine Liwag

Hi, good morning, guys. Neil, earlier you mentioned the variable $75 million to $100 million EMD in Collins for the back-half of the year. Can you provide more details on what that is? And how much more flexibility you have in deferring to spend?

Neil Mitchill

Sure. That really is across the Collins portfolio. We did a very deep dive last year, as you probably expect on where we were spending our EMD, and especially through the pandemic, we wanted to make sure that we're focused on the next generation technologies where we can insert our upgrades into the existing Collins platforms.

I'd say there's always flexibility around the allocation of those dollars to specific investments, but it's really in our interest to make sure that we spend the money. We want to make sure that we do not starve any of our businesses. I think we're a long ways from doing that. You've heard Steve Tim talk about investing about 6% of sales over the next several years. And I think our spending is about right, we're poised to invest about $6 billion of our own money between capital and EMD over the each of the next four years.

So, there's some flexibility Kristine there, but I do know that we've got a long list of important projects that Collins team is aggressively working.

Kristine Liwag

Thanks, Neil.

Neil Mitchill

You bet.

Operator

Your next question comes from the line of David Strauss with Barclays.

David Strauss

Thanks. Good morning, everyone. Neil, you highlighted the sequential ASK growth that you're expecting in Q3. I guess, in light of that, maybe talk about what you're seeing so far in terms of July on the aftermarket side?

And then Greg, since the Investor Day, Airbus came out with much higher potential narrow-body production rates as we look out ’23, ’24, ’25. I guess, what do you think of those potential rates? And how could that change when you've guided Collins and Pratt to look like out in 2025? Thanks.

Neil Mitchill

Sure, I'll start. Obviously, we haven't even closed the month of July yet, but we do look at that data regularly. We're seeing continued growth, as we head into July consistent with the forecast that we've got baked into our outlook. What I would say, as we think about Pratt, for example, I think a big piece of the second-half is in the shop visits. We were really happy to see 56% year-over-year large legacy shop visits. As I think about Q3, we will be probably north of 30%, 35% and even over 20% growth year-over-year in the fourth quarter.

So some good indicators there, we've got pretty good line of sight, as we look at the back-half of the year, particularly on the Pratt shop visit side.

Greg Hayes

So David, as we think about the narrow-body ramp, if you will, I think you'll see both Boeing and Airbus are starting to ramp up production. We were a little surprised, I would tell you, but we have been talking to Airbus. I know Guillaume and company are laser focused on trying to take some market share and so they're being pretty aggressive by showing that 70 to 75 aircraft a month figure out in 2025.

I would tell you, while we're working with Airbus, that remains a challenge for us to get to those levels. Right now we're capacitized to, I think it was rate 63 was the latest high point. Obviously, we will do whatever we need to, to support our customers.

Now, whether or not that rate actually materializes, I guess will be the question. Obviously, with the XLR coming along as A321 XLR, I think Airbus got a great aircraft. And they want to take advantage of that in the marketplace. But, we'll see.

Again, as I think about this, the air traffic is going to grow 4% or 5% a year. So you're going to continue to see plenty of demand out there for narrow-body. And the question will be, is it A320s? Or, is it 737s? We're positioned on both, obviously a little bit different content on the A320 with the neo engines, but we're keeping an eye on all of this. And I think, we'll work with a supply chain, we'll make sure that we're adequately capacitized to be able to serve our customer there. And we'll see what happens.

But there's plenty of time between now and then to get ready if the ramp actually occurs as quickly as what Airbus hopes.

David Strauss

Thanks very much.

Operator

Your next question comes from the line of Robert Spingarn with Credit Suisse.

Robert Spingarn

Hi, good morning. Greg, you talked about the surprising second quarter narrow-body aftermarket demand. And you also talked about the lagging wide-body recovery. But maybe a year from now or even sooner, if we end up with the vaccines getting traction, and we see more long haul traffic strength, could we have a surge in demand both for maybe wide-body and narrow-body at the same time?

And, given the headcount reductions, do you have the capacity to address it? In other words, could the demand curve turn into a sine wave at some point here?

Greg Hayes

From your lips to God's ears. I think in fact, we are optimistic that we could see a faster recovery, should we get a more robust vaccine rollout. And keep in mind, in the U.S., about half of the population is vaccinated, it's getting to be the same in Europe. China, vaccine is also taking hold. But globally, it's only about 9%. So we've got a long way to go I think. The good news is most of the air traffic, of course, is between China and the U.S. and in Europe. So we could see a quicker recovery.

I would tell you that we are more than adequately capacitized to take advantage of that recovery from an aftermarket perspective. As we took all those cost cuts last year, that kind of $2 billion of cost takeout, what we didn't do was close a lot of factories or eliminate a lot of capacity. As Neil mentioned before, one of the overhangs of course at Pratt from a cost standpoint is you get all this unabsorbed overhead. Well, that's because we still have the facilities. We're still facilitized to do 1,000 Vs if we saw that kind of a ramp.

This year, we'll probably do 550 V's overhauls, but the capacity still exists. It's the same on the GTF. It's really the same across the Collins portfolio. We haven't closed factories and we can bring folks back, we can work extra shifts to pick up on the demand. So I'm not actually worried if we were to see that kind of a recovery. It would be good. Certainly, not what we expect today, but we are ready for it.

Robert Spingarn

Thank you.

Operator

Your next question comes from the line of Seth Seifman with JPMorgan.

Seth Seifman

Hey, thanks very much. And good morning, everyone. Greg, I was wondering if you could maybe put on your business roundtable hat and talk a little bit about where getting into the second-half of the year. And there's still no resolution on the R&D tax issue for next year. And so, I wonder if you could talk about A the prospects for that in the Congress? And B the prospects to get some relief from that outside of Congress, maybe with some kind of IRS interpretation of the law that removes customer funded R&D from the equation?

Greg Hayes

Yeah, that's a great question, Seth. We were very hopeful, I would say three or four months ago, as we were thinking about the infrastructure bill as it was winding its way through Congress. And clearly, we were having discussions on the hill, both the Senate and the House side. People are very sympathetic to the fact that this R&D amortization language that was in the 2017 Jobs Act is not helpful in terms of driving the kind of investments that we want to see in technology. And so we have been pressing folks to include relief on the R&D amortization formula in any infrastructure bill that's out there.

Obviously, there's pressure to take the corporate rate up. We'll see where that goes. But I think we're still hopeful that we will see some type of relief. And maybe it comes in December, as is typical with the tax extenders that we get some relief here. It's just hard to imagine you want to stop folks from investing in R&D, as the academy comes back from the pandemic. So, again, we're still hopeful, folks at business roundtable are doing a good job educating the Congress on this, and we'll see where it goes.

But we're not going to give up hope. I think this is something we just have to get done.

Seth Seifman

Right. And anything outside of Congress?

Greg Hayes

We haven't actually explored a regulatory role. And I haven't seen a pathway for IRS or Treasury to change the statutory language of the 2017 Jobs Act. So right now, I think it's going to require an act of Congress.

Seth Seifman

Thank you very much.

Operator

Your next question comes from the line of Cai Von Rumohr with Cowen.

Cai Von Rumohr

Yes. Thanks so much. So could you comment on bizjet trends at Legacy UTX? And also, you didn't have much of an uptick in commercial OE at Collins. What do you see going forward for the pickup in rates on the MAX and the 787 where Boeing's been having their own problems? Thanks.

Neil Mitchill

Yeah, let me start with some bizjet context. Cai, how you doing today? Obviously, bizjet has rebounded very quickly. And so, whether that's at the affecting the Collins business, or the Pratt Canada business, we're seeing very good performance there, that I'd say combined with general aviation, both are at or near or even slightly above where we were in 2019. So that is a major contributor here to part of the Collins. Q2 performance, we're seeing it within the Pratt aftermarket as well.

As I think about OE, we are certainly seeing that OE growth at both Collins and Pratt. And as I think about the back-half of the year, we will start to see 737 MAX start to be a bigger contributor. We've talked about being aligned with Boeing's production schedule, but having delivered about a third of their requirements for this year already. And so, as we pick up on that second, third, if you will, or two-thirds rather, that'll start to ramp up as we go through the third quarter and more heavily into the fourth quarter. And then, of course, another step as we get into ‘22, which we'll talk more about later in the fall.

Greg Hayes

You obviously picked also Cai, the 787 that's down to I think five a month. In fact, it's because of some of these production delays, we think it might be even a little bit slower than that. So there's some impact there. You recall, revenue on that's about $10 million a ship set for the Collins business. So there is a little bit of a governor, I would say on Collins OE, even here into the third quarter. And we expect again, as Neil said, once 737 production rates pick up here, as well as we get some of these production issues behind this at the Boeing line on 787 that should that should help the towards the end of the year and into next year.

Cai Von Rumohr

Thank you.

Operator

Your next question comes from the line of Mike Maugeri with Wolfe Research.

Mike Maugeri

Hey, good morning, everyone. Thanks for the time. Greg, you mentioned having the right technology for the next conflict. So can you talk about the longer-term sort of supply demand balance in your missile business as the DoD customers priorities shift back towards peer adversaries from asymmetric threats?

Greg Hayes

Yeah, Mike, it's an interesting discussion. If you think about what the -- as we talk about having the right technologies for the next conflict. As we see this right, the next war and I've said this before, it gets fought in cyberspace in outer space initially. You aren't going to see land wars in Asia or tank battles across Europe. What you are going to see is cyber-attacks, you're going to see attacks against strategic assets in space to compromise communications and sensing systems, and being able to defend those assets, being able to project and to replenish those assets is really what we're focused on across the RTX portfolio.

And the other piece of this of course, is how do you have assured communications. And you'll hear a lot about JADC2 this Joint All-Domain Command and Control. Having assured communications, having reliable, replenishable comp systems is also part of this. And again, we played in that really across the business from the sensing systems at our RMD to the processing that we do at RIS to some of the communication systems that come out of Collins. We think we were uniquely positioned there as well.

So look, it's a complex battlefield as we think about it. There's no one single answer. It's not like we're going to replace all of the missiles we have with high powered microwaves or high powered lasers. It's going to be a layered defense, where you're still going to see SM3s and SM6s, and you're still going to need AMRAAM missiles, as well as some things to deal with, I would say the emerging threat of hypersonics, which we think is primarily going to be high powered microwaves. So, a lot to pull apart there, but, I think again, we have technologies in all of those spaces that can differentiate us.

Mike Maugeri

Thank you.

Operator

And our last question will come from the line of Matt Akers with Wells Fargo.

Matt Akers

Thanks. Good morning. Could you just touch on sort of the military engine outlook? And kind of specifically in light of some of the F-35 kind of disruptions we've seen on the aircraft side last year, this year. And Lockheed's comments about maybe a little bit of a slower growth profile here going forward. Just how we should think about that kind of trending going forward?

Neil Mitchill

Yeah, I'll take that. As we look at the rest of the year for Pratt on the military engine business pretty steady. And we're at or near sort of the rate, we need to be on the F-135 engine. And, we're clipping along. We're not quite halfway through our delivery schedule for the year, but we're pretty close to it. So I'd expect the back-half of our year to look pretty similar to what the first-half did, in terms of engine deliveries.

And as we've talked in the past, we pretty much see that kind of rate holding steady for the foreseeable future there.

Greg Hayes

And keep in mind too, Matt it’s not just F-35 right, we're also on the KC-46 the tanker. We're going to be on the next generation B-21 as that goes into flight test, and then into production in the next couple of years. So there's more than just JSF out there. And the F-100 and the S-16 remains opportunities for us to continue to utilize a platform that literally is 40-years old.

So there's more to the military engine business than just JSF. Obviously, it’s the biggest piece, but those other pieces are important as well.

Matt Akers

Got it. Thanks, guys.

Greg Hayes

Thanks, Matt. All right. Well, thank you, everyone, for listening in today. As always, Jennifer and team are prepared and ready to take all of your questions. So, thanks for listening in and we'll see you guys soon. Take care and be well. Bye-bye.