Raytheon Technologies Corporation (NYSE:RTX) Q1 2022 Earnings Conference Call
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Company Participants

Gregory Hayes - Chairman & Chief Executive Officer
Neil Mitchill - Executive Vice President, Chief Financial Officer
Jennifer Reed - Vice President of Investor Relations

Conference Call Participants

Myles Walton - UBS
Robert Spingarn - Melius Research
Peter Arment - Baird
Robert Stallard - Vertical Research
Ron Epstein - Bank of America
Sheila Kahyaoglu - Jefferies
David Strauss - Barclays
Kristine Liwag - Morgan Stanley
Douglas Harned - Bernstein
Noah Poponak - Goldman Sachs
Michael Maugeri - Wolfe Research
Kenneth Herbert - RBC Capital Markets
Seth Seifman - JPMorgan
Cai von Rumohr - Cowen

Operator

Good day, ladies and gentlemen. Welcome to the Raytheon Technologies First Quarter 2022 Earnings Conference Call. My name is Ludie [ph], 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 on the internet, and there is a presentation available for download from the Raytheon Technologies website at www.rtx.com.

Please note, except where otherwise noted, the company will speak the results from continuing operations, excluding acquisition, accounting, adjustments and net nonrecurring and/or significant items often referred to by management as other significant items. The company also reminds listeners that the earnings and cash flow expectations and any 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 those anticipated in the forward-looking statements.

Once the call becomes open for questions, we ask that you limit your first round to one question per caller to give everyone the opportunity to participate. [Operator Instructions].

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

Gregory Hayes

Thank you, Ludie, and good morning, everybody. Before I get into the results, I just want to spend a minute to address the Russian invasion of Ukraine. I know it's first in center on everybody's mind. It's obviously been devastating to see these tragic events unfold and our thoughts and prayers are with the Ukrainian people. We, of course, have ceased all of our business activities with Russia in line with global sanctions, and we remain committed to supporting our allies and ensuring the safety of our people around the world. This event, more than any other, demonstrates our unique responsibility as a global company and trusted with supporting our customers as they navigate a difficult and complex geopolitical landscape, and we remain focused on honoring that mission.

All right. Let me turn to the first quarter. As you saw from the press release, we're off to a good start for the year. On the commercial aerospace side, we remain optimistic on the market recovery, despite a slower than expected start to the year due to the impact of Omicron and increased geopolitical tensions.

That said, air traffic is rebounding again in many markets around the world. In the U.S., passenger traffic through TSA checkpoints remained steady versus Q4 at about 1.8 million passengers per day in the quarter. But importantly, it averaged over 2 million passengers per day in March, a significant increase last year and a nearly -- that's nearly 90% of what we saw in 2019. So recovery is in sight.

On the defense side, we're very pleased with the enacted '22 DoD budget, and we're encouraged by the President's most recent fiscal '23 budget request of $773 billion. The proposed budget includes broad-based support across our key programs and technology investments in cyber, space, missiles, missile defense systems and others, and we expect the enacted budget could be even higher to account for inflation and the many unfunded priorities identified by the services.

Looking internationally, our allies are also increasingly prioritizing defense spending with a focus on defensive systems, which we are uniquely positioned to support. Resilient commercial air traffic, coupled with growing global defense budgets and our strong backlog continue to support our long-term outlook for our businesses and gives us confidence in our ability to drive top-line growth and margin expansion over the next several years.

All right. Turning to Slide 2, this has some highlights for the quarter. As I said, it was a good start to the year, despite the impact of Omicron and continued supply chain constraints. Commercial aftermarket remained strong in the quarter, growing 38% from Q1 of last year. We delivered solid financial performance in the quarter where we exceeded our expectations on both adjusted EPS and free cash flow.

That said, as a result of ceasing business activities in Russia, we are going to reduce our full-year sales outlook by $750 million to a new range of $67.75 billion to $68.75 billion. However, we are going to hold our adjusted EPS range of $4.60 to $4.80, and we continue to expect free cash flow of about $6 billion for the year. Neil will give you a little more color on this in just a minute.

Our defense backlog remained very strong at $62 billion exiting the quarter and total company backlog was $154 billion. Notable defense awards in the quarter included about $1.2 billion of classified bookings at RMD, including a significant competitive award as well as $650 million for the SPY-6 full rate production contract and RIS booked about $1.1 billion of classified awards.

On the capital allocation front, we repurchased $743 million of RTX shares during the quarter, and we remain on track to repurchase at least $2.5 billion of share for the year. Yesterday, of course, you saw we increased our quarterly dividend by nearly 8% from $0.51 per share to $0.55, continuing our long history of growing and paying a dividend.

Since completing the merger, we have returned nearly $9 billion to RTX shareowners, and by the end of this year, by the end of '22, that will be in excess of $13 billion. And of course, we remain committed to returning at least $20 billion to shareowners in the first four years following the merger. That shouldn't be an issue at all.

On the program execution front, we recently delivered the first LTAMS unit into the U.S. Army test program. It's an important milestone for what will be a franchise program for RMD. And finally, we launched RTX Ventures to accelerate our pipeline of innovative technologies to grow -- to drive future growth and see an ecosystem of groundbreaking technology companies.

With that, let me turn it over to Neil, and I'll will be back for the wrap-up and Q&A. Neil?

Neil Mitchill

Well, thanks, Greg. I'm on Slide 3. As Greg noted, we delivered adjusted earnings per share and free cash flow that exceeded our expectations for the quarter. Sales of $15.7

billion were in line with our expectations and up 4% organically versus the prior year. Our performance in the quarter was primarily driven by the continued recovery of domestic and short-haul international air travel that was partially offset by continued supply chain constraints across our businesses.

Adjusted earnings per share of $1.15 was up 28% year-over-year and ahead of our expectations, primarily driven by commercial aftermarket at Collins, $0.04 of commercial OE timing at Pratt and other corporate items, including lower tax expense, which more than offset the supply chain constraints.

On a GAAP basis, EPS from continuing operations was $0.74 per share and included $0.41 of acquisition accounting adjustments and net significant and/or nonrecurring items, which included $0.14 of charges associated with the impact of global sanctions on Russia. And free cash flow of $37 million was better than our expectations of an outflow of $500 million, driven primarily by working capital, most notably the timing of collections during the quarter.

And finally, let me give you an update on our synergy progress. During the quarter, we achieved incremental gross cost synergies of about $90 million, putting us on track to achieve $335 million of incremental cost synergies for the full-year.

With that, let me hand it over to Jennifer to take you through the segment results, and I'll come back and share our thoughts on the rest of 2022. Jennifer?

Jennifer Reed

Thanks, Neil. Starting with Collins Aerospace on Slide 4. Sales were $4.8 billion in the quarter, up 10% on an adjusted basis and up 11% on an organic basis, driven primarily by the continued recovery in the commercial aerospace end markets.

By channel, commercial aftermarket sales were up 39%, driven by a 73% increase in provisioning, a 43% increase in parts and repair and 11% increase in modification and upgrades. Sequentially, commercial aftermarket sales were up 5%. Commercial OE sales were up 12% with strength in narrow-body, offsetting expected headwinds from lower 787 deliveries. And military sales were down 12%, driven primarily by supply chain constraints and expected declines in F-35 volume.

Adjusted operating profit of $584 million was up $252 million from the prior year, drop-through on higher commercial aftermarket and OE volume more than offset lower military sales volume and higher SG&A expense.

Looking ahead, as a result of ceasing activities with Russia, we now expect Collins full-year sales to be about $375 million lower than our prior expectations, but still expect their sales to grow low double-digits. However, as a result of better mix and spending containment, we are maintaining Collins full-year operating profit range of up $650 million to $800 million versus 2021.

Shifting to Pratt & Whitney on Slide 5. Sales of $4.5 billion were up 12% on an adjusted basis and up 13% on an organic basis, driven primarily by the continued recovery of the commercial aerospace industry. Commercial aftermarket sales were up 37% in the quarter with legacy large commercial engine shop visit inductions up 9% and Pratt Canada shop visits up 22%.

Commercial OE sales were up 12%, driven by favorable mix within Pratt's large commercial engine business as well as higher general aviation platforms at Pratt Canada. In the Military business, sales were down 11%, driven by F-135 production contract award timing and lower expected production volume that were partially offset by higher F-135 aftermarket volume.

Adjusted operating profit of $308 million was up $268 million from the prior-year. Drop-through on higher commercial aftermarket sales volume, favorable large commercial OE mix and higher Pratt Canada OE volume were partially offset by higher SG&A and E&D as well as lower military sales volume.

Looking ahead, as a result of ceasing activities with Russia, we also now expect Pratt's full-year sales to be about $375 million lower than our prior expectations and now expect their sales to grow high single to low double-digits. However, as a result of better mix and spending containment, we are maintaining Pratt's full-year operating profit range of up $500 million to $600 million versus 2021.

Turning now to Slide 6. RIS sales of $3.6 billion were down 5% versus prior-year on an adjusted basis, primarily driven by the divestiture of the global training and service business. Sales were in line with prior-year on an organic basis. Adjusted operating profit in the quarter of $378 million was down $10 million versus prior-year, primarily driven by the impact of the divestiture that was partially offset by net productivity across various programs.

RIS had $2.6 billion of bookings in the quarter, resulting in a book-to-bill of 0.8 in a backlog of $17 billion. In addition to significant bookings that Greg mentioned, RIS also booked $311 million for the next-generation OPIR Geo. It's worth noting that we continue to expect RIS full-year book-to-bill to be greater than 1.

Turning to RIS full-year outlook. We continue to expect RIS sales to be down slightly on a reported basis and to grow low single-digit on an organic basis. We also continue to expect RIS operating profit to be flat to up $50 million versus 2021.

Turning now to Slide 7. RMD sales was $3.5 billion, down 7% on both an adjusted and organic basis, primarily driven by the continuing supply chain constraints and decline in certain land, warfare and air defense programs. Adjusted operating profit of $387 million was $109 million lower than prior-year, driven primarily by lower net program efficiencies and unfavorable program mix.

RMD's bookings in the quarter were approximately $4.1 billion, resulting in a book-to-bill of 1.18 and a backlog of $29 billion. In addition to the awards that Greg discussed, RMD also booked about $385 million for ex-caliber rapid demo for the U.S. Army, about $220 million for AIM-9X Sidewinder for the U.S. Navy, U.S. Air Force and international customers and about $220 million for Patriot engineering support services for the U.S. Army and international customers.

It's worth noting that we now expect RMD's full-year book-to-bill to be at least 1.1. Looking ahead, we continue to expect RMD sales to grow low to mid-single digit and operating profit growth of $150 million to $200 million versus 2021.

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

Neil Mitchill

Thank you, Jennifer. I'm on Slide 8. Let me give you some perspective on how we're thinking about the environment as we look ahead. I'll start with some of the positives. Despite the impact of COVID variants early in the year, we continue to expect that the commercial aerospace recovery will remain resilient and will drive growth in commercial aftermarket and narrow-body OE deliveries this year. Notwithstanding the fact that global RPMs grew roughly four points less than we expected in the first quarter, Commercial aftermarket grew in line with our expectations as operators began preparing their fleets for the summer travel season.

At the same time, we're closely monitoring China domestic and international traffic. And as I've said before, our outlook assumes a significant improvement in wide-body traffic during the balance of the year. That said, we continue to expect commercial traffic to return to 2019 levels by the end of next year.

On the defense side, as Greg mentioned, we are optimistic about the President's fiscal '23 budget request, which included a 5% base budget increase in the modernization accounts where our investments in technology and innovation are well aligned to the administration's priorities and our major programs are well supported. And while it's too early to quantify today, all of our businesses are positioned to support the expected growth in U.S. and international defense spending.

On the cost reduction front, we remain laser-focused on driving operational excellence to deliver further margin expansion, including $1.5 billion of total gross cost synergies. On the challenges side, we continue to see global supply chain, inflation and labor availability pressures across our businesses. And while we saw increasing risk in these areas during the first quarter, we remain focused on mitigating actions and expect supply chain constraints will ease later in the year. And finally, we continue to monitor the broader geopolitical environment, including the impact of global sanctions as well as the U.S. and global tax environment.

Turning now to our outlook on Slide 9. As Greg discussed, due to ceasing business activities with Russia, we are reducing our full-year sales outlook by $750 million, which, as we said, is split evenly between Collins and Pratt. We now see full-year sales between $67.75 billion and $68.75 billion for the full-year. However, from an earnings perspective, we continue to expect adjusted earnings per share to be between $4.60 and $4.80 due to improving sales mix and spending containment at both Collins and Pratt.

And on the cash front, we continue to expect free cash flow of about $6 billion. It's important to remind everyone that our cash flow outlook continues to assume that the legislation requiring R&D capitalization for tax purposes is deferred beyond 2022, which, as I've said before, the free cash flow impact of this legislation is approximately $2 billion for the year.

So with that, let me hand it back to Greg to wrap things up.

Gregory Hayes

Okay. Thanks, Neil. Just a couple of thoughts here on our '22 priorities, which remain essentially unchanged. Obviously, we remain focused on supporting our customers, our employees, suppliers and communities so that we can actually execute on our mission of defending democracy and connecting the world, and today's environment reinforces the need for us to invest in innovative technologies to remain competitive, to drive industry leadership and to deliver the right solutions for our customers.

We'll do this while driving operational excellence and remaining disciplined with our capital, including meeting our capital return commitments. And of course, we're committed to doing all of this responsibly as evidenced by the publication of our first RTX ESG report yesterday, which builds upon our long history of best practices in this area.

And finally, earlier this month, we celebrated the two-year anniversary of our merger. I'm very proud of what we've accomplished together so far, and I want to thank all of our employees for all of their efforts during this very difficult and challenging period. I'm confident in the investment thesis we laid out at the investor conference last May. Our franchises are strong. We operate in resilient markets, and we have great technology. And importantly, we have experienced leadership that is focused on operational excellence and delivering on our long-term commitments.

With that, let me open up the call for questions. Ludie?

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] The first question will come from the line of Myles Walton from UBS. Your line is open.

Myles Walton

Thanks. Good morning. Greg or Neil, could you comment on the gradients of the supply chain constraints you saw in the first quarter as you look to the second quarter? In particular, the two items of Pratt commercial engines and rocket motors. I know you've talked about recovery by year-end, but have you passed the point of low and you're seeing improvement sequentially?

Gregory Hayes

Yes, Myles, thanks for the question. So I think we laid this out last month -- I guess a month and a half ago when we were speaking at the Barclays Investor Conference. But the fact is, we had problem with our structural casting supplier where we were not able to get castings into our MRP schedule. That resulted in about 70 engines moving out of the first quarter. That problem is not behind us, but we are working with that supplier to recover that, and we'll get most of the way there by the end of the year, but it is not without its challenges. Like everybody else, our suppliers are seeing a shortage of labor as well as inflation in their own businesses. So that's the first piece. I think, again, we understand the issue, and we have a plan to recover it.

On the rocket motor side, this impacts most of the RMD businesses and that remains problematic. We have a recovery plan that we work with them on every day. We have a number of our folks that are at their facilities every single day working through this, making sure we're being prioritized, but the recovery is not going to happen this year. I think we are so far behind on rocket motors, it will -- it could well stretch into the 2023 timeframe.

So again, not a new issue, but one that we have not been able to solve yet. And we're off working with other suppliers to try and requalify other rocket motors, but it is a long process to do that. So we're going to be hand to mouth on rocket motors for a period of time yet.

Myles Walton

Okay. Okay. And just a clarification. Did that drive the EAC in the quarter in RMD? Is that the reason to lighter margins?

Neil Mitchill

Myles, it's Neil. Good morning. Let me comment a little bit on the margins. There's a couple of things driving the margins year-over-year. I would characterize it in a couple of different buckets. The first one is about 110 basis points I would attribute to lower EACs in the quarter versus a year ago. And I would say that some of that was, in fact, driven by the fact that because of the supply chain delays that we encountered in the first quarter, they pushed key milestones out to the right that we're looking to that would be the indicators of when we could realize productivity.

So we expect productivity to return to the RMD business in the second quarter and beyond, and certainly, the first quarter, I think, marks a low point of the year for RMD and the margin, but that was the principal contributor. The second piece, just to kind of finish the thought the other 100 basis points I would attribute to the contract mix. And we've been talking about this for quite some time now about the mix to -- from lower international Patriot and NASAMS production volume and some lower-margin development contracts that are in process right now.

So overall, with RMD sales down 7% in the quarter, about half of that was expected and the other half was, I'd say, driven by the supply chain. We also did have one fewer workday in the quarter. That's probably about $50 million for the quarter. But we do expect that to recover as the year goes on. RMD is still expected to be up about 3% year-over-year on a sales basis.

Myles Walton

All right. Thanks for the color.

Operator

Your next question comes from the line of Robert Spingarn from Melius Research. Your line is open.

Robert Spingarn

Well, hi. Good morning.

Gregory Hayes

Good morning, Rob.

Neil Mitchill

Good morning, Rob.

Robert Spingarn

A couple of things on defense. Jennifer talked about, I think it was low to mid single-digit sales growth profile at RMD going forward. Does this embed incremental demand that you talked about expected out of Europe? More specifically, the army -- will the army replace the current 1,400 stingers that were sent to Ukraine? And would that be through a sole source contract or perhaps, a competitive follow-on contract?

Gregory Hayes

Yes. Let me start with that. As far as looking at the sales forecast for RMD, that does actually not contemplate any upside that we see from replenishment of stocks. And again, we're working through all that, trying to understand the timing. Clearly, we won't see any of that benefit this year, but as we think about the next couple of years, as we see the budgets continue to increase and we see the replenishment orders come in, we would expect we will see a benefit to the RMD top-line, which will take that that number up somewhat. So again, we're not quite ready to give you a new number, but I would just tell you, it's going to be higher than what we've got there.

As far as the stingers, we should keep in mind, we have -- we are currently producing stingers for an international customer, but we have a very limited stock of material for stinger production. We've been working with the DoD for the last couple of weeks. We're actively trying to resource some of the material. But unfortunately, DoD hasn't bought a stinger in about 18 years. And some of the components are no longer commercially available, and so we're going to have to go out and redesign some of the electronics in the missile of the seeker head. That's going to take us a little bit of time.

So again, we'll ramp up production what we can this year, but I would expect, again, this is going to be a '23, '24 where we actually see orders come in for the larger replenishments, both on Stinger as well as on Javelin, which has also been very successful in theater.

Robert Spingarn

Thanks, Greg.

Operator

Your next question comes from the line of Peter Arment from Baird. Your line is open.

Peter Arment

Good morning Greg, Neil, Jennifer.

Neil Mitchill

Good morning, Peter.

Peter Arment

Hey Greg, can you give us maybe some color on just where you are on the narrow-body build rate side? I mean it seems like that's a big part of the positives for this year? And just are you seeing running into any supply chain issues on that front? Thanks.

Gregory Hayes

Yes, Peter, I think the biggest supply chain challenge that we're seeing as it relates to the narrow body recovery would go to Pratt & Whitney, obviously, as we think about GTF production. And that's the structural castings issue that we talked about that caused first quarter rates to be lower than what we had expected. So that will get better as we go throughout the year. We actually see supply chain constraints across the commercial portfolio, though.

I mean we see it in electronics just like everybody else. We see it in aluminum. We see it in titanium. I think the one of the challenges as we think about Russia, for instance, that was a large source of some of our titanium supplies. And because of the sanctions, we are looking to resource a lot of material, probably not going to impact narrow-body production delivery rates this year, but certainly could going into next year.

I would tell you that we're in lockstep with both Airbus and Boeing on their production rates. Obviously, if you talk to the folks at Airbus, they'd like to see a rate of 70 or 75 by 2025. We'll see if we can get there, but we're certainly doing everything we can to support our customers there. But supply chain continues to be an issue, I would say, across the business, especially on the electronics side where we've seen lead times go from three months out to 12 months plus, and we are on allocation for many of those components. So again, nothing dramatic that's going to change our forecast or change our ability. It's just a watch item that we're actively working.

Neil Mitchill

Peter, maybe I could add a couple of points here, too. Just from a financial perspective, as you think about the sales impact of the Russia on the narrow-body in particular. At Collins, we expect the commercial OE now to be up mid to high teens year-over-year, still very strong growth. And similarly at Pratt, we now expect commercial OE to be up low teens. I had talked about -- Greg and I talked about OE shipments being up about 200. Think about that now is about up 180 at the Pratt business year-over-year. So just a couple of extra data points for you.

Peter Arment

Thanks, Neil.

Operator

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

Robert Stallard

Thanks so much. Good morning.

Gregory Hayes

Good morning, Rob.

Neil Mitchill

Good morning.

Robert Stallard

Neil, maybe just a follow-up on your Russia comment there. I was wondering if you could give us a bit more detail on this hit to revenues that you're anticipating in 2022, because I wouldn't expect Airbus and Boeing to not remarket planes, for example. Is this all coming on the aftermarket and on BizJet?

Gregory Hayes

Yes, Rob, I think if you think about that -- so Russia accounts for about 4% of global RPMs, right? So it's not a huge number, but it accounts for about 1.5% of our total sales. So call that $900 million a year. We're going to be able to mitigate some of that through higher sales elsewhere, but you really do lose some sales associated with aftermarket activity into Russia.

Also importantly, at Pratt, we're not shipping engines to [indiscernible]. We're not shipping engines to Airbus that would otherwise go into Russia. Now Airbus, of course, will remarket some of those so we won't lose those completely, but we will lose the spare sales associated with those engines going into Russia.

So again, we've taken a pretty detailed look at this in terms of the sales impact, and what Neil said, importantly, I think, though, there still is a relatively significant hit in terms of earnings around $200 million. Fortunately, we're going to be able to offset that through cost reduction and just cost containment, but it is not a small number for us as we think about the guidance for the year.

Neil Mitchill

And Rob, I would also tell you that just to kind of think about the profile of that, think about $225 million a quarter in each of the next three quarters. We actually had about $80 million of sales that did not materialize in the first quarter, because of this impact. And as you think about one other thing to add is, Pratt Canada also was selling engines to -- helicopter engines into Russia. So that will impact the OE.

So from a split perspective, Collins about 60% aftermarket, 40% OE. And then at Pratt, about 10% aftermarket, but really heavy on the OE side, 90%.

Robert Stallard

That's great. Very helpful. Thank you.

Operator

Your next question comes from the line of Ron Epstein from Bank of America. Your line is open.

Ronald Epstein

Yes. Good morning Greg.

Gregory Hayes

Good morning, Ron.

Ronald Epstein

Maybe just following on that supply chain team. How are you guys handling the titanium situation, right? I mean Russia was a somewhat important supplier for you guys. I mean are you just looking to move that all domestic? And how are you thinking about it?

Gregory Hayes

Ron, that is a great question. And I think the biggest challenge that we have as we think about these global sanctions on Russia, we did have a relatively significant portion of titanium forgings and castings coming from Russia and many of those are now on the sanctions list. The good news is, as we started looking across the business, and we actually -- we started advanced purchasing back in the fourth quarter when we were able to get ahead of some of the sanctions.

So we have inventory for a big chunk of that throughout through the end of this year. I will tell you though that there are some components, especially at Pratt Canada, where it's going to take us some time to resource some of the castings and that's going to impact some of our customer deliveries this year, full stop.

And as we think about the sales guidance that Neil was just talking about, obviously, the Pratt Canada piece is directly impacting that in terms of not being able to deliver all the engines that we had hoped to. We'll recover those next year, and we're working on the sourcing. I would tell you, trying to find titanium sourcing today is very difficult. Russia accounted for about 15% of global sponge production. So that's really been taken out of the market. But it's not just the sponge production, it's also the casting and forging facilities that are in Russia that are no longer available to us.

So we're working through all of that. I think we've done a pretty good job of identifying what those challenges are and finding second sources. But it's is going to cause us to be late on some deliveries, especially out of Pratt Canada this year, and it's going to take us some time to recover.

Ronald Epstein

Got it. And if I may as a follow-on. Are you thinking about just permanently moving it out of Russia?

Gregory Hayes

We're done in Russia, full stop. We actually -- we had a joint venture there where we built commercial heat exchangers for Boeing and Embraer. We closed that facility. We sold our share. We aren't going back. I think this is, as they say, crossing the Rubicon here as far as we're concerned for Russia. We're not going to support the airlines. We're not going to support the development programs. We're not going to support any Russian customers going forward, while this is going on.

Ronald Epstein

Got it. All right. Thanks, Greg.

Operator

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

Sheila Kahyaoglu

Good morning guys. Thank you for the time.

Gregory Hayes

Good morning.

Sheila Kahyaoglu

Maybe on a more upbeat note, can we talk about profitability? It was pretty good, 50% incrementals in the quarter and guidance sort of implies is flattish for the rest of the year. What's sort of going on there? Are you just mitigating for risk with supply chain? And then now that the two year log has expired with the merger, how are you thinking about the portfolio overall?

Neil Mitchill

Okay. Let me start with the financial piece, and I'll let Greg talk about our portfolio thinking. Good morning, Sheila. So yes, very strong margins for Collins in the quarter, getting a little bit of feedback there. So good margins. The aftermarket, in particular, at Collins, performed quite well with provisioning up 73% year-over-year, and that was really what drove the favorability in the first quarter for us.

So I think we don't expect that to sustain itself at quite that level as the year progresses. And also similar to last year, Sheila, you remember that we had phased our expenditures, our E&D, our SG&A. We had furloughs that were still in effect in the first quarter of last year. So those types of items become a headwind as you get a little further into the year.

So very strong incrementals in the first quarter. We still expect mid-30s for the next several quarters. For Collins as you see E&D ramp up a little bit. You see the effect of our merit increases take hold on April 1 across the company. But if the aftermarket is stronger, you will surely see that in the margins as well. We're very pleased to see double-digit margins again at Collins. Greg, I'll turn it over to you.

Gregory Hayes

Yes, Sheila, just a comment on portfolio rationalization. We obviously haven't been sitting still for the last two years. We've been looking at across the portfolio. But to your point, we were really kind of hamstrung because of the spin transactions and the merger to not really do anything significant with any of our portfolio during that two year period.

So we are actively looking across the portfolio today for both acquisitions as well as divestitures. I would tell you, the acquisitions will probably be technology-related and smaller dollar similar to what we did last year with Seeker Engineering or Blue Canyon in the space side. And then we are going to look at the Collins portfolio for potential divestitures. There are certain businesses that do not have the growth profile, the margin profile or the technical footprint that we're looking for in some of these product lines.

So I would expect over the next six to nine months, we'll complete those analysis. Obviously, you don't want to be selling any of these businesses in a down aero market, but with the recovery that we're expecting this year and next, I would think we will probably be doing something later this year or early next year.

Sheila Kahyaoglu

Thank you.

Gregory Hayes

Thanks, Sheila.

Operator

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

David Strauss

Thanks. Good morning.

Neil Mitchill

Good morning.

Gregory Hayes

Good morning, David.

David Strauss

Greg, on the Collins side, any visibility out of Boeing to go above 31 a month on MAX? And where are you today on 87 and the outlook for production to start moving back up again there?

Gregory Hayes

That's a great question for the Boeing company tomorrow when they release earnings. I would tell you, we're in lockstep with Boeing in terms of the production schedule on MAX for this year. I know they have talked about 31 a month, and we're clearly able to support that level and even higher as we go into next year, 787 production, I think again, it's -- we have been working with Boeing as they're working through their own issues relative to FAA certification to get the aircraft delivered.

Obviously, there's -- we haven't been shipping a lot down to Charleston on the 787 over the last quarter because of some of those issues. But we would expect as the year progresses, we'll start to see that pick up. And I would tell you that Boeing has been very transparent with us in terms of sharing what their delivery and the production forecasts are, and it's all reflected in the guidance that we've given for Collins. So no change to any of that today.

David Strauss

All right. Great. Thanks.

Operator

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

Kristine Liwag

Hey, good morning guys.

Gregory Hayes

Good morning.

Kristine Liwag

On the large commercial engine castings issue at Pratt, is this related to aluminum casting or titanium casting? And also with the raw material and labor inflation, are there threshold limits on how much you're able to pass through to your customers?

Gregory Hayes

So those are primarily titanium castings from a -- from our supplier that's impacting it. These are structural castings, which means you can't really build -- start building most of the engine until you get the castings in and that's what's the holdup is there. I'm sorry, was there another part to that question, Kristine?

Kristine Liwag

Yes. Greg, on raw material and labor inflation, are there threshold limits on how much you're able to pass through to customers?

Gregory Hayes

There are, I think the good news is, as you think about inflation in the supply chain is about 80% of the -- our commercial aerospace supply is on long-term agreements. Obviously, there's -- some of that comes up for renegotiation every year, and we're seeing some cost pressure. Typically, every year, we see maybe $150 million or so of inflation. I would tell you, there's probably an extra $200 million this year of inflation that we're going to have to offset through cost reduction or negotiations with some of the supply chain.

In terms of passing it on to the customers, typically, we have dead band pricing within the contracts, which require us to absorb the first tranche of inflation, and beyond that, we can pass on a portion of it. Unfortunately, we're not going to be able to do that this year. That will be a benefit next year as we can increase pricing. We did, of course, increase pricing on the aftermarket through our catalog that was issued, I think, last October. That was roughly a 6% increase year-over-year. So we're able to offset a chunk of the -- of that inflation through pricing, and the rest is going to have to be offset through either cost reduction, redesign or renegotiation.

Neil Mitchill

And while we're on the topic of supply chain and the castings, that $0.04 benefit that we realized in the first quarter is likely going to end up being a $0.04 headwind as we go through the second quarter and we get the production back on track.

Kristine Liwag

Great, thank you guys. Very helpful.

Operator

And your next question comes from the line of Doug Harned from Bernstein. Your line is open.

Douglas Harned

Good morning, thanks.

Neil Mitchill

Good morning, Doug.

Douglas Harned

If we go back to last summer, you all talked about a five-year CAGR for defense in the sort of 3% to 5% range top line. And now we've seen now that we're seeing the issues with the Russian Invasion, we're looking at stronger defense budgets. You talked about this a little bit earlier. How do you see that trajectory now? Is there upside from there? We haven't seen a backlog increase yet, but does this change the way you look at that five-year outlook?

Gregory Hayes

Yes, Doug as we think about this, given the President's budget request for '23 of $773 billion did not anticipate the Russian invasion of Ukraine. So we were seeing an increase in defense spending before any of this nonsense in Ukraine with the Russians. So I think, again, the trajectory is better than what we had expected. I mean I will go back two years when the merger first occurred, we thought defense spending was going to be flat to up slightly. And I think everybody recognizes the need for modernization and the need to prepare for -- to deter these folks in a more robust fashion.

So clearly, there's going to be upward pressure on sales guidance, but again, you probably won't see any of that until '23 or '24. But as we understand what the implications are of the new defense budget, what we see in terms of the plus-ups as they go through the process on the '23 NDAA, I think, again, we'll have an opportunity to update everybody later this year on our thinking around kind of that three to five year outlook for defense.

Douglas Harned

But your sense is that there could potentially be some upside there as we look in the outer years?

Gregory Hayes

Yes, absolutely. If you look at just the research and development in the budget, that's up 11% versus what was in the '22 budget. So clearly, there is going to be more spending than what we had anticipated, and importantly, it's in those programs like space and some of the other advanced missions that we have an outsized share of.

Douglas Harned

Great, thank you.

Operator

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

Noah Poponak

Hi, good morning everyone.

Gregory Hayes

Good morning, Noah.

Noah Poponak

Neil, could you spend a minute on the progression of the margin through the year at the other segments, the way you did at Collins? Because it looks like RIS is fairly steady through the year, but then RMD mathematically needs a pretty big step up to get into the 150 to 200. It looks like a lot sequentially. So I'm assuming that's back-end loaded, but the more back-end loaded, the higher it has to be. And then at Pratt, I assume or clearly, you'll have different mix OE versus aftermarket as you move through the year, but the guidance implies that margin steps down, and I assume that mix change is also back-end loaded. So just be helpful to hear from you on how we should expect those to change as you move through the year?

Neil Mitchill

Thanks, Noah. Let me start with RMD. As I said earlier, the 11% in the first quarter we see as the low point of the year. And in order to get to our full-year guide, you're right, we have to be in the 13% to 14% margin range, and that business has been there before. That will come on the back of improved mix. It will also come with productivity realization as we get later in the year and these milestones get realized. So I would expect to see sequential increases in the margin at RMD as we go throughout the year, with Q1 being the low point.

I talked about Collins, but just to reiterate, Q1 benefited from the provisioning. I do expect SG&A in E&D to kick in a little bit higher plus we have substantial military growth that's profiled in the latter part of the year, and so that obviously comes with slightly lower margins. And you'll see that kind of come across throughout the quarters as we go ahead.

At Pratt, the story really is about the mix of OE versus aftermarket. And as the OE volume continues to grow, particularly in the large commercial engine business, you should see a 250 basis point or so degradation in the margins as that negative engine margin picks up in the next two quarters, in particular. Typically, we see a larger aftermarket mix in the fourth quarter. And then lastly, I expect to see 20, 30 basis point incremental margin improvements in RIS as we go through the year, again, on better volume, better mix, productivity. We saw good productivity in the first quarter there, and I expect that to continue through the rest of the year.

Noah Poponak

Very helpful, thank you.

Operator

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

Michael Maugeri

Hey, thank you. Good morning everyone.

Gregory Hayes

Good morning.

Michael Maugeri

Neil, following on a couple of the prior questions on the slower GTF deliveries at Pratt. With the supply chain issues, is it just Pratt or I think Greg might have mentioned something broader, is it affecting all of A320? And does that change your thinking at all on peak negative engine margin and separately breakeven cash flow on GTF?

Neil Mitchill

Good morning, Mike. No, I don't see any change to our thinking around peak negative engine margin or our breakeven on the GTF. I would say that the supply chain issues that we've been talking about and we're seeing aside from the casting issue are more acute in the defense side of our businesses at this time. In particular, January and February of this quarter, this past quarter were particularly light. I think that was driven by our suppliers having a lot of absenteeism and an inability to put the overtime to recover, but we have seen that start to slowly recover in March and again in April.

That has really affected Collins as well as RIS and RMD. We've seen that across the board there. At Pratt & Whitney, in the first quarter, in addition to the casting issue on the military side, we did see a delay in getting under contract for the next lots of F-135 engines. We do have a handshake and expect that to be done in the second quarter. So just timing within the year.

Operator

Thank you. And your next question comes from the line of Ken Herbert from RBC. Your line is open.

Kenneth Herbert

Hi, good morning. Thank you.

Gregory Hayes

Thank you, Ken.

Kenneth Herbert

Hey, Greg and Neil, I wanted to ask about China. The traffic data and events in China so far in April have not been encouraging. Has -- can you help us think about the full-year assumptions for international travel and sort of what we've seen in China so far this year? Has that changed the outlook specifically on the full-year for the aftermarket? Or how would you talk about the recovery in international travel and the risk in the back half of the year relative to what we were seeing so far in China in particular?

Gregory Hayes

Yes. Ken, that's kind of an understatement about China. Obviously, I think China accounts for about 16% of global RPMs. A big chunk of that is their domestic market, which is down more than 80% because of the lockdowns that we've seen because of COVID. Obviously, there is an impact to the aftermarket, but we do expect that, that will recover.

And we have seen that several times in the past where the Chinese lockdown their cities. They get passed away within 30 or 60 days and the traffic comes right back. So we don't expect any long-term impacts from this. I would tell you, the aftermarket recovery for wide-body international travels, we're still expecting that to recover to roughly 75% of pre-pandemic levels by the end of this year. China accounts for a piece of that, but a relatively small piece of the international long haul, really what you're going to need to see is traffic picking up to Japan and Australia and Transatlantic throughout the course of the year, which we fully expect. I mean the bookings look very, very solid, and I think while it looks aggressive in terms of that kind of 75% kind of recovery, all indications are that that's exactly what's going to happen.

Neil Mitchill

One thing we also will see as we go into the second quarter kind of to that point is, we have an engine center in Shanghai. And so at Pratt, in particular, you'll see relatively flat sequential aftermarket as that shop is currently shut down, but we expect to recover that this year. On the Collins side, sequentially, I think low single-digit type sequential growth. So still growth in aftermarket, but clearly the China market is a watch item. It's an important one for our narrow-body customers in particular.

Kenneth Herbert

Great, thank you.

Neil Mitchill

You're welcome.

Operator

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

Seth Seifman

Okay, thanks very much and good morning. Greg, you've mentioned in the past that -- expressed some skepticism about Airbus going up to 70 or 75 and indicating that you didn't think that Boeing would really allow them to get to that market share level. When you spoke a little bit earlier today, it sounded like you saw it as more of a supply constraint issue in terms of Airbus getting up to that 70 to 75 per month level. Has your thinking on that topic and on what the market share split could be, has that thinking changed recently?

Gregory Hayes

Seth, I would tell you, it is evolving. As we look at the backlog that Airbus has, if you want a slot to take an A320 delivery, you're talking about 2028 at current production rates. So there is pressure to move up to that 70 to 75. We're currently facilitized for rate 63, which is something we had agreed to with Airbus well before the pandemic.

So I think again, there is pressure to take the rate up to 70 or 75, and I think Boeing will see its share, will continue to also increase production on the 737, but there is robust demand out there for narrow-body aircraft. And I think again the constraint will be supply chain at the end of the day can not just Pratt and Collins, but the entire supply chain support a rate of 75 a month in Talos and Hamburg, and then 40 or 50 a month for narrow-body at Boeing, the 737.

So we'll see. All I would tell you is, we remain in lockstep in terms of what's going on over the next 18 to 24 months with both Boeing and Airbus on the narrow-body, and we're certainly able to meet those demands today, and we'll work with them. If the demand is there, we will find a way to meet it.

Seth Seifman

Great, thanks very much.

Operator

And your next question comes from the line of Cai von Rumohr from Cowen. Your line is open.

Cai Von Rumohr

Yes, thanks so much for taking the call. So Greg, you mentioned 6% aftermarket price hike. You normally do that in October for January, so it hits all at once. But back in October, inflation wasn't quite the threat that it was now. Are you seeing -- were you seeing pushback on that price hike? And secondly, was that across the board or which areas were maybe a little higher than others? Thanks.

Gregory Hayes

Yes, Cai, thanks for the question. So obviously, we saw inflation building and that price increase was a little bit stronger than what we would typically push for the catalog. I thought usually 4.5% or 5%. So we took the opportunity to raise prices. We do it obviously with keeping in mind in terms of where the demand signals are coming from the customer.

And a big chunk of the aftermarket at both Pratt and Collins is on long-term agreements where you don't see that type of 6% increase. But on the time and material, overhaul and repair work that we do, that we will see the benefit. Obviously, inflation is much worse than what we expected it to be for the year. We were thinking 3% to 4%, not 8.5% like we saw last month, but our hope here is that inflation will moderate as we get to the end of the year. And come October, we'll take another look at the catalog, and if inflation is still there, we will have to address it through the catalog again.

Cai Von Rumohr

Thank you.

Gregory Hayes

Thanks, Cai. All right. I think -- go ahead, Ludie.

Operator

Yes, thank you. And we have reached the end of our Q&A session. I would like to hand the call back to Mr. Greg Hayes for the closing remarks. Thank you.

Gregory Hayes

All right. Thanks, Ludie. Thanks all for listening today. As always, Jennifer and the IR team are available all day, answer any and all questions you might have. Thank you. Stay healthy, and we'll see you all soon. Take care. Bye.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.