RTX Corporation (NYSE:RTX) Q3 2023 Earnings Call October 24, 2023 8:30 AM ET

Company Participants

Gregory J. Hayes - Chairman and Chief Executive Officer
Christopher Calio - President and Chief Operating Officer
Neil G. Mitchill - Chief Financial Officer
Jennifer Reed - Vice President of Investor Relations

Conference Call Participants

Peter Arment - Baird
Noah Poponak - Goldman Sachs
Myles Walton - Wolfe Research
Robert Stallard - Vertical Research
Sheila Kahyaoglu - Jefferies
Ronald Epstein - Bank of America
Seth Seifman - J.P. Morgan
Kristine Liwag - Morgan Stanley
Matt Akers - Wells Fargo
Doug Harned - Bernstein & Company
Ken Herbert - RBC Capital Markets

Operator

Good day, ladies and gentlemen, and welcome to the RTX Third Quarter 2023 Earnings Conference Call. My name is Latif, 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; Chris Calio, President and Chief Operating Officer; Neil Mitchill, Chief Financial Officer and Jennifer Reed, Vice President of Investor Relations.

This call is being webcast live on the internet, and there is a presentation available for download from RTX website at www.rtx.com.

Please note, except where otherwise noted, the company will speak to results from continuing operations excluding acquisition accounting adjustments and net non-recurring 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 other forward-looking statements provided in this call are subject to risks and uncertainties.

RTX 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 opportunity to participate. [Operator Instructions]

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

Gregory J. Hayes

All right. Thank you, and good morning, everyone. Before we start, I want to spend just a minute acknowledging the tragic situation playing out in Israel today. It has been devastating to see what has unfolded there over the last couple of weeks and our thoughts and prayers are with the people impacted including the thousands of RTX employees that call Israel home.

With that said, let me turn to an update on our end markets. On the commercial aero side, air travel demand remains strong. We're seeing solid air traffic growth with global revenue passenger miles essentially back to 2019 levels and domestic air travel well above 2019 levels.

We also expect strong demand for holiday and business travel for the remainder of the year, supporting continued aftermarket strength for both wide-body and narrow-body aircraft. On the defense side, the elevated threat environment is continuing to drive increased defense spending globally. Just one example in the quarter, the United States approved moving forward with the sale of F-35 aircraft to South Korea. That's estimated to be worth about $5 billion and will support further growth with this customer for F-35 content for years to come.

Additionally, the U.S. State Department approved a significant sale to Spain for the Patriot air and missile defense systems earlier this month. And that's expected to include approximately $1 billion of Raytheon content. And as Russia's invasion of Ukraine unfortunately continues, we are seeing significant demand from the U.S. and our allies for advanced air defense systems and munitions.

During this past quarter, this included additional orders for NASAMS, Excalibur, which are precision guided artillery shells, Stinger anti-aircraft munitions, and TOW anti-tank guided missiles.

Domestically, despite what we've seen over the last few weeks in DC, we remain confident that there is bipartisan support for increased defense spending and RTX continues to be well-positioned across all three of our businesses.

Shifting to Pratt & Whitney. Let me give you an update on the powdered metal manufacturing quality matter. Our efforts to-date have been heavily focused on ensuring the safety of our engines. As you saw in the press release this morning, we have finalized the charge recorded here in the quarter, which is in-line with what we had previously disclosed. So, just a few thoughts on the powdered metal issue.

Through the early stages of removals and inspections of the PW1100 engine, which powers the A320 Neo aircraft, our outlook both financially and operationally remains consistent with our expectations. We've also made significant progress on the safety assessments for the other Pratt & Whitney powered fleets. That includes the PW1500, which powers the A220, the PW1900 which powers the Embraer E2, and the V2500, which powers the legacy A320.

With the analyses substantially complete, we do not expect any significant incremental financial impact as a result of those fleet management plans. The focus of both Pratt & Whitney and the entire RTX organization is on maintaining the trust of our customers, and our partners, and we are relentlessly working to improve upon the plans we have in place today.

As I said to many of you over the last few months, we remain confident in the future of RTX because the demand for our products is robust, our end markets remain resilient across both commercial aerospace and defense, and our team is laser focused on driving performance excellence to meet our customer needs. Our backlog is now a record $190 billion with a pipeline of both existing franchises and new technology developments.

As we always have, we continue to actively manage our portfolio. As you saw this morning, we reached an agreement to sell Raytheon's cyber services business and a cash sale for approximately $1.3 billion, which combined with the recently announced sale of Collins actuation business, this will generate approximately $3 billion of gross proceeds in 2024.

So with that, let's turn to slide two. As we also announced this morning, our Board has approved a $10 billion accelerated share repurchase program or ASR, which we will be initiating tomorrow. Simply put, we see a significant discount between the intrinsic value of RTX and our current stock price. The long-term outlook of the GTF remained strong, and Pratt's franchises extend well beyond the GTF. The V2500 has about 6,000 engines still flying and is in the sweet spot of its aftermarket cycle.

Pratt Canada continues to be the world's premier small engine manufacturer with an installed base of more than 60,000 engines. And the military business of Pratt is the sole provider of engines the fifth generation fighters. Collins, has a great portfolio, with

70% of their product line serving is number one or two in their segments, and strong margin expansion opportunities. And lastly, our newly combined Raytheon segment has an incredible number of well-established franchises along with a growing portfolio of next generation technologies. This includes LTAMDS, which is the next generation Patriot Defense System, and the Hypersonic Attack Cruise Missile or HACM.

Given the fundamental strength of the company and growth opportunities ahead, our Board recently approved an $11 billion authority to repurchase RTX shares. This includes $10 billion through an ASR program to help capture some of that value more immediately. The new authorization replaces the company's previous program, which was approved in December of 2022. This ASR of course is on top of the $2.6 billion we've already repurchased year-to-date.

Altogether, this will increase our capital return commitment to share owners to $36 billion to $37 billion through 2025 from the time of the merger. That's up from our previous range of $33 billion to $35 billion. As I said, this ASR program will commence almost immediately and will be funded through a combination of short and long-term debt. And importantly, we'll begin the process of deleveraging in 2024 in parts supported by the proceeds from the recently announced dispositions that I just mentioned. So despite near-term headwinds, the future of RTX remains bright and we remain steadfast in our commitment to deliver long-term shareowner value.

With that, let me hand it over to Chris, to provide additional color on the Pratt matters and to cover the Q3 highlights.

Christopher Calio

Thank you, Greg, and good morning, everyone. I'm on slide three. As Greg said, the powdered metal situation is our top priority. The bottom line is that our outlook for managing both the fleet impact and the financial impact remains intact since our last call, and our team continues to execute on our fleet management and recovery plans. Let me provide a few more details, and I'll start with the GTF.

With respect to the PW1100, there is no change to the plan we outlined in our September call, the fleet management plan and financial estimates remain consistent with what we said six weeks ago, and our focus is on executing all elements of the fleet management plan, in particular, industrial output and material flow, MRO output and customer support. The first launch of the engine removals has occurred, and several of these engines were eligible for project visit work scope, and the turnaround time for these visits averaged roughly 35 days. While project visits will be a smaller portion of the overall shop visits, the turnaround time is encouraging, and our teams are continuing to identify further process improvements.

And from a process perspective, additional bulletins will be released in the next few weeks that outline the life limits and repetitive inspection requirements that we detailed on our prior call. And just by way of background, it is common practice for a fleet management plan to be communicated through multiple service bulletins and airworthiness directives, to address different engine models, compliance times, or components and sections of the engine.

Now let me share some details on our other GTF programs. For the PW1500 and the PW1900, we will institute a fleet management plan that will largely fit inside the shop visit plans that are already in place for these fleets. We believe the financial impact will be significant and has contemplated in our current contract estimates and the financial outlook for Pratt. As part of this plan, we will place a shorter life limit on certain early configuration parts, and an inspection requirement at about 5,000 cycles for current configuration parts.

There will be some incremental AOGs in the first half of 2024, we believe these will be largely mitigated by the end of the year. Regulators and airframers are aligned with this recommendation , we expect the service bulletin implementing these actions will be released beginning in November, followed by airworthiness directives.

Let me now turn to the V2500. And as a reminder, we've had a fleet management and inspection plan in place since 2021. We're going to augment this plan by accelerating certain inspections, but expect this too will have very little impact operationally or financially. It will result in a total of roughly 100 or less incremental removals stretched out over the next four years. The majority of these visits having a project visit work scope.

Again, very manageable given the size of the V2500 fleet, the number of spare engines available, and engines in the market with available Green Time. All of this is contemplated in our current contract estimates and Pratt's financial outlook. This action will be communicated through a service bulletin to be released in the November timeframe.

And lastly, turning to the F135, the joint program office is reviewing our fleet management plan recommendation which we believe will have limited, if any, operational impact on the customer. We continue to evaluate the balance of the Pratt fleet containing powdered metal, and expect any fleet management plan updates, if needed, to have limited impact.

With our fleet management plans largely set, let me turn to the operational initiatives we are focused on to support our customers, increasing capacity and reducing turn times in our MRO shops, and ramping up the production of new full life powdered metal parts.

First, with respect to MRO, we're accelerating previously planned investments in the GTF network to increase capacity and bring more shops online to support our customers. Just last month, Pratt announced they're adding capacity at their Singapore engine center which will be Pratt's third facility expansion this year. And earlier this month, MRO shops operated by China Airlines and Korea Air inducted their first GTF engines. And by the end of the year, Iberia maintenance will also be joining the GTF aftermarket network.

Once complete, this network will have 16 sites globally, having brought online six partner shops this year with plans for an additional three shops to come online by 2025, bringing the total to 19. This will enable the network to be able to conduct more than 2,000 annual shop visits in 2025 to support the global GTF fleet, a roughly fivefold increase from 2019.

We're also leveraging our extensive knowledge and talent across RTX to drive process enhancements to help us improve turn times in our MRO shops compared to our baseline plan. This includes a cross functional team focused on part availability, repair development and industrialization and process improvements on the shop floor.

Second, and as we said in September, our objective is to replace as many HPT and HPC discs as possible with full life discs when engines come in for a shop visit in order to maximize their time on wing when they leave the shop. As we've said before, we previously made the necessary powdered metal production in forging capacity investments and now are increasing our machining and inspection capacity.

Our baseline plan today forecast Q2 2024 to get to run rate capacity for disc production, we are working to accelerate this timeline, which will allow us to replace an even larger portion of the fleet with full life parts.

So to wrap up on powered metal, our fleet management plans on the most impacted fleets are largely complete. The financial impact has been reassessed and remains consistent with what we said our September 11th, call on this subject, and we are fully focused on executing these plans.

I'll shift now to the third quarter highlights, which Neil will provide some additional color on in a few minutes. On an adjusted basis, organic sales grew 12%, our third consecutive quarter of double-digit growth and segment operating profit grew 15%. Adjusted EPS was in-line with our expectations at $1.25, with strong free cash flow of $2.8 billion in the quarter.

Sales growth was again led by the continued commercial air traffic recovery with strong commercial OE growth of 26% and 25% commercial aftermarket growth, while defense sales were up 2% year-over-year. In the quarter, we captured $22 billion in new

bookings and had a book-to-bill of 1.19 across RTX, bringing our backlog to a record $190 billion.

Finally, Q3 was the first quarter we officially began operating in our realigned three business unit structure. We are continuing to develop initiatives to leverage our scale and breadth to better enable customer alignment and best-in-class cost structure. With respect to our 2023 outlook, with one quarter to go, we are raising both our reported and adjusted sales outlook for the year.

On a reported basis, we expect sales to be approximately $68.5 billion, and on an adjusted basis, we expect sales to be approximately $74 billion, up about 10% organically versus the prior year. We're also tightening our EPS range and have incorporated a few cents of tax headwind from some recent IRS guidance around R&D capitalization, which Neil will discuss further. As a result, we now see adjusted EPS between $4.98 and $5.02 for the year.

Additionally, we expect free cash flow for the year to improve by approximately $500 million, driven primarily by the IRS guidance I just mentioned, just favorable from a cash perspective, and we are therefore increasing our free cash flow outlook to approximately $4.8 billion.

So with that, let me turn it over to Neil, to take you through the additional details on the quarter.

Neil G. Mitchill

Thanks, Chris. I'm on slide four. As you saw, we finalized our estimate for the PW1100 powered metal matter here in the third quarter, and have recorded a $5.4 billion sales charge our share of which resulted in a $2.9 billion operating profit impact. This is in-line with what we communicated in September, and resulted in reported sales of $13.5 billion in the third quarter.

As Chris said, we had adjusted sales of $19 billion for the quarter up 12% organically versus the prior year. Growth was primarily driven by strong demand across our commercial OE and aftermarket businesses as OEMs continue to ramp production and airlines supported the busy summer travel season.

We also saw positive growth in defense, as we continue to execute on our growing backlog. On a GAAP basis, earnings per share from continuing operations was a loss of $0.68 and included a $1.53 charge from the Pratt matter, as well as $0.40 from acquisition accounting adjustments, restructuring and other non-recurring and non-operational items. Adjusted earnings per share of $1.25 was up 3% year-over-year with

higher segment operating profit partially offset by lower pension income, a higher effective tax rate and higher interest expense.

As Chris alluded to you, the IRS recently provided guidance on R&D capitalization with respect to customer funded R&D for certain cost plus contracts. This means a portion of our previously capitalized R&D costs for tax purposes will now be currently deductible. While this will result in a slightly higher effective tax rate going forward and will reduce our cash tax payments. In the quarter, this resulted in about a $0.02 headwind to adjusted earnings per share for the full year, we expect this to be about $0.03 of headwind.

Finally, as we had anticipated, we had strong free cash flow generation in the quarter of $2.8 billion which included a benefit of approximately $500 million from the IRS's R&D capitalization guidance, I just discussed.

Now with that, let's turn to slide five, to get into the Q3 segment result. So before I begin, just a reminder, we are now reporting as three business units Collins, Pratt and Raytheon. Starting with Collins, adjusted sales were $6.7 billion in the quarter, up 17% on both an adjusted and organic basis, driven primarily by continued strength in commercial OE and aftermarket growth.

By channel, commercial aftermarket sales were up 30%, driven by a 35% increase in both provisioning, as well as parts and repair, while modifications and upgrades were up 9% in the quarter. Sequentially, commercial aftermarket sales were up 6%. Commercial OE sales were up 27% versus the prior year, driven by growth in both narrow-body and wide-body platforms. And military sales were down 1% primarily due to the timing of deliveries.

Adjusted operating profit of $1.04 billion was up $287 million or 38% in the prior year with drop through on higher commercial aftermarket and OE volume, partially offset by higher production costs, unfavorable military mix, and higher SG&A expenses.

For the full year, given the continued strength in commercial OE and aftermarket, we now expect Collins sales range to be up low to mid-teens an increase from the previous range of up low double digits to low teens.

With respect to operating profit, we are maintaining adjusted operating profit in our prior range of up $825 million to $875 million versus the prior year.

Shifting to Pratt & Whitney on slide six. As it relates to the powder metal matter for the PW1100, in September, we communicated that we expected the gross financial impact to be in the range of $6 billion to $7 billion with an expected Q3 pretax operating profit impact of approximately $3 billion.

As I just mentioned in the third quarter, we recorded a $5.4 billion sales charge resulting in a $2.9 billion pretax operating profit impact, representing our net program share in line with where we expected.

Recall, I mentioned that certain elements of the gross $6 billion to $7 billion cost will be booked upfront and the remainder will be booked over the remaining life of the contract.

So looking at Pratt's quarterly results on an adjusted basis, sales of $6.3 billion were up 18% and 17% on an organic basis with sales growth across all three channels.

Commercial OE sales were up 25% in the quarter, driven by higher engine deliveries and favorable mix in the large commercial engine business.

Commercial aftermarket sales were up 21% in the quarter, driven by both higher volume and content as well as favorable mix in both the large commercial engine and Pratt & Whitney Canada businesses.

And in the military business, sales were up 7% driven by higher F135 development and sustainment volume. Adjusted operating profit of $413 million was up $95 million from the prior year with drop through on higher commercial aftermarket sales partially offset by higher commercial OE volume, higher production costs, unfavorable military mix as well as higher R&D expenses.

Looking ahead, due to higher commercial OE and military volume, we now expect Pratt's adjusted sales to be towards the higher end of our prior range, or up mid-teens versus prior year.

Given the higher military sales, as well as better mix across OE and aftermarket, we're also increasing Pratt's adjusted operating profit from our prior range of up $200 million to $275 million to a new range of up $350 million to $400 million versus the prior year.

Turning now to Raytheon on slide seven. Sales of $6.5 billion in the quarter were up 3% on an adjusted and organic basis, primarily driven by higher volume in Naval Power programs, including AIM9X and Advanced Technology Classified programs.

Adjusted operating profit of $570 million was down $124 million versus the prior year driven primarily by higher volume on lower margin programs and lower net program efficiencies including additional headwind on certain fixed price development programs.

In addition, as expected, there was an unfavorable impact of about $20 million from a significant contract option exercised in the quarter. Raytheon had $7.4 billion of bookings in the quarter, including $1.9 billion in classified awards, a $412 million award

for the next generation short range interceptor program, and a $383 million award for Hawk and Patriot sustainment.

This resulted in a book to bill of 1.16 and backlog of $50 billion. Year-to-date, Raytheon has a book to bill of 1.17. For the full year, we continue to expect sales to be up low to mid-single digits with respect to operating profit while the supply chain continues to improve as evidenced by the increase in material receipts we have seen in the last three quarters, Raytheon continues to have productivity and mix challenges. These stem from a combination of the fixed price development programs we have previously discussed, as well as higher production costs.

As a result, we're reducing Raytheon's adjusted operating profit from the prior range of up $125 million to $175 million to a new range of up $25 million to up $75 million versus the prior year.

Before I hand it back to Greg, just a couple of comments on the environment for 2024. Overall, we anticipate another year of solid growth in organic sales, segment operating profit, margin and free cash flow. However, the level of free cash flow growth will be tempered by the step up in cash impacts associated with the powder metal matter, as well as some headwind from cash taxes related to R&D.

While commercial air travel demand has been incredibly strong from passengers and airlines, we see growth beginning to normalize as we head into 2024, with RPKs back at 2019 levels and the year over year compares becoming more difficult. However, overall, we expect continued growth in OE and aftermarket including the on-going recovery of the wide body.

On the defense side, we continue to expect strong international and domestic demand which is already driven at 2023 year to date book to bill of 1.22 and a record defense backlog that will continue to convert to solid growth over the next several years.

While inflation has begun to moderate, there are still pockets that remain persistently high within our manufacturing base, we expect this to continue into the next year. We'll continue working all the mitigation actions we've had in place the past two years and will implement additional strategic initiatives to offset the pressure we expect to see in 2024.

Finally, as you know, we have seen a lot of volatility in the financial markets and interest rates. We expect this to drive further pension headwind next year that could be about $0.45 on a year over year basis given current market conditions and the actions we are taking to preserve improved funded status of the pension plan. So obviously, a lot of moving pieces here, but we are focused on driving execution an aggressive cost reduction and remain optimistic as we look ahead towards 2024 and 2025.

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

Gregory J. Hayes

Okay. Thanks, Neil. Let's just take a step back if we can for a minute. I know there's a lot of information we've given you today, but really I think there are three key takeaways from our discussion.

First of all, I believe we have our arms around the operational and financial impacts of the powdered metal issue. Our focus at Pratt & Whitney and across RTX is now executing on those plans that Chris laid out.

Secondly, strong demand continues in our end markets. That's evidenced by the 12% organic revenue growth we saw this quarter and the $190 billion backlog we ended the quarter with.

Finally, we see tremendous value in RTX today and we're going to utilize our strong balance sheet to take advantage of this through a $10 billion ASR. With that, let me stop and open it up for questions.

Question-and-Answer Session

Operator

In the interest of time and to allow for broader participation, you are asked to limit yourself to one question. [Operator Instructions] Our first question comes from the line of Peter Arment of Baird.

Peter Arment

Yes. Thanks. Good morning, everyone.

Gregory J. Hayes

Good morning.

Peter Arment

Hey, Greg. The last time you guys, on the update call September, you talked about kind of the headwinds that you would see in Pratt & Whitney margins as you look out kind of to the mid-decade. Has there been any change to that or you can just give us an update on how you think that progresses? Thanks.

Gregory J. Hayes

No, I think -- thanks, Peter. What we laid out, as you recall, back in September, we talked about the fact that some of the costs associated with the inspection interval, will end up in contract accounting at Pratt. And that'll depress margins on the aftermarket by about a point over time. Not significant, but it's all contemplated in the Pratt guidance as we think about 2024, 2025.

Peter Arment

Great. I'll leave it there. Thanks.

Gregory J. Hayes

Thanks Peter.

Operator

Thank you. Our next question comes from the line of Noah Poponak of Goldman Sachs.

Noah Poponak

Hey, good morning, everyone.

Gregory J. Hayes

Good morning, Noah.

Noah Poponak

Can you spend a little more time on defense margins? I mean, I heard the specifics you noted in the quarter, but just you know, continues to move lower. Is there some bigger, broader thing happening at the at the end market level. And Neil, did you ever provide a new consolidated, once you consolidated the two segments, margin target that's in the 25s. And just, you know, as you, as you spoke to 24 earlier in the call, can you just kind of update us on how you're expecting that defense margin to progress into the middle of the decade from here.

Christopher Calio

Hey, Noah, it's Chris. Maybe I'll start and then ask Neil to talk about the consolidated Raytheon. First, in terms of the end markets, demand remains very robust. Here, Neil, talk about the 1.17 book to bill in the quarter, excuse me, year-to-date, the $7.4 billion in bookings in the quarter and the overall backlog of $50 billion. So really strong demand for the products. That said, we have had some headwinds. We've had some inflation hitting some fixed price programs. We've had a handful of challenging fixed price development contracts that have been a bit of a drag.

That said, we have had some productivity gains in certain areas. As you might suspect, those mature higher volume programs, we have had some efficiency gains by leveraging supply chain with larger buys. And as we look forward, the supplier volume is growing. Labor attrition rates are decreasing, and frankly stabilizing. So those are some very positive signs as kind of we look forward in the defense business. And I'll say we just need to get through key milestones on those fixed price development contracts. We've talked about those on several calls now. And we've got some key milestones coming up over the next 12 months or so, that we've got to hit and get these programs through those milestones and then ultimately sold off.

Neil G. Mitchill

Thanks, Chris. Let me just pick up on that where you left off. We definitely did provide a consolidated view, you're looking at margins around the midpoint, a little bit north of 12% when you get into 2025. I think as we look at the backlog, and the mix of what we see the sales shifting to between now and then we talked about, this year being sort of the low point of our mix, more domestically focused that we see that increasing over the next couple of years to be bit heavier on the foreign side, not surprising given the demand signals that we're seeing. So those are going to be the key drivers that get us heading in that direction. What we do know is that we have a really large backlog, $50 billion on the defense side right now and expect that to continue to grow. And we're focused on executing as we transition a number of programs as Chris was alluding to from early production to full rate production and those programs mature.

So we know the formula for driving productivity. We have seen some challenges this year. And I think on the development programs, we'll see that happen over the next 12 months, but that's the story longer term.

Noah Poponak

Is the rate of expansion in 2024 and 2025 similar, Neil, or is it more weighted to 2025?

Neil G. Mitchill

It's going to be more weighted to 2025. We've got, as you know, a growing backlog here, but that will play out in sales probably later next year and accelerating through 2025.

Noah Poponak

Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Myles Walton of Wolfe Research.

Myles Walton

Thanks. Good morning. Hey Neil, maybe on the GTF, I'm looking forward, you're about to endeavor on something that looks pretty challenging in terms of 45% of the GTF powered A320 fleet on the ground. And managing all of the customers and their expectations and then you're on execution.

I'm wondering, could you just lay out sort of the biggest risks in your screen that you're looking at? Is it part availability? Is it discovery of what incremental work might happen when you open up these engines? Is it maybe this MRO network coming online. There's just a lot balancing and maybe just a prioritization of the risk register would be helpful.

Christopher Calio

Myles, this is Chris. Maybe I'll kick it off. The single, I think, biggest lever that we've got here and you kind of alluded to it is MRO output. I mean, obviously, it's a challenging time for the customers. There's going to be a fair amount of the aircraft on the ground. We've got to accelerate MRO output. And the key parts of those are capacity and material flow.

On the capacity side, you heard about the expansions that we're doing both within the Pratt shops and across the network. In terms of material flow, you've heard us talk about this before, our objective is to put in full life HPT and HPC disks at these shop visits. And we've got to go continue to ramp those up.

Again, that ramp up is well underway and progressing in key process steps like the powdered metal production, forging and heat treat. Investments have already been made and that capacity is in place.

And then for more downstream processes like sonic inspection and machining, we're accelerating capacity there to make sure that we can meet this demand. And so some of this performed by Pratt and our partners and some by third parties. But again, very, very focused on the inspection capacity and the machining capacity. But at the end of the day, MRO output is what's going to support our customers and ultimately take down the AOGs and therefore take down the penalties we're going to have to pay to our customers.

Myles Walton

Just a quick follow-up. Is that 19 number in 2025 of MRO shops different than your target earlier this year, I think it's the same. And so maybe just what has changed in terms of MRO network expansion?

Christopher Calio

Yes. Fair enough. It is the same, but we've accelerated as best we can. Some of these investments, I mean, they were in our plan. We've accelerated as much of that spend as we can. And again, it's bringing on the inspection capacity into the MRO shops. That's a key to unlocking, sort of the MRO throughput that I talked about. And then just, beyond that for a second Myles, you heard us talk earlier about the 35 or so day turnaround times on those project visits. And again, we know those aren't preponderance of the visits we're going to get. But there's a lot of learning's that go on and a lot of learning curve that gets tackled when we're doing these things.

So it's how quickly can we tear down? Inspection limits, repairs, test sell time, literally every part through every gate and MRO, taking time out and being more efficient and putting more resources in those areas.

Myles Walton

Thanks, Chris.

Operator

Thank you. Our next question comes from the line of Robert Stallard of Vertical Research.

Robert Stallard

Thanks so much. Good morning.

Gregory J. Hayes

Good morning.

Robert Stallard

This might be a question for Chris. I'm following up on the powdered metal issue. When you spoke about this in September, you seemed pretty convinced that the issue would not be a problem on the A220, the E2 and the V2500, but it does sound like, there is something going on there now, although you said it's not significant. So I was wondering if you could elaborate on how the inspections have progressed on those engines. Thank you.

Christopher Calio

Sure. Yes, thanks for the question. So I think we had telegraphed on the last calls, we're going through our analysis is that those fleets would be far more manageable in terms

of the impact. And while we will have, inspections and life limits on the 1500 in 1900. As we said, they will largely fall within the shop visit forecast we have today. The maintenance intervals on those frankly, are shorter than on the 1100.

And so that's why many of these life limits and inspections fit within those plans. On the V2500, again, we've continued down that, inspection, accelerated inspection path we've had in place for about two years now. We're about halfway through that, through that fleet. And as we continue to do those inspections and learn more and analyze the data from those inspections. We're able to pinpoint, certain engines based on sort of their profile.

Parts they've got in them thrust, you know, other characteristics that we've targeted for accelerated, you know, inspections. But again, think that's very manageable. That's a total of about a 100 or less shop visits stretched out over four years. And again, those are largely going to be project visit work scopes. And we've got a lot of experience on project visit work scope on the V2500.

Those are in a 40 to 45 day turnaround time. We've become very, very proficient at those. So again, that's why we're calling those very manageable and will not have significant financial or operational impact.

Robert Stallard

Thanks, Chris.

Operator

Thank you. Our next question comes from the line of Sheila Kahyaoglu of Jefferies.

Sheila Kahyaoglu

Thanks. Good morning, guys. Maybe if you could just walk us through cash, $1.6 billion generated year-to-date, $4.8 billion for the year. How do you think about the biggest drivers on a segment basis, as you head into the final quarter of 2023. And then just given stepped up GTF payments next year, what are the puts and takes there?

And then if you don't mind, I just have to ask on the $10 billion ASR you know, why announce it now and not, you know, derisk some of the MRO output risk on the GTF?

Christopher Calio

All right. Thanks, Sheila. Let me start with, what we need to do on free cash flow. So we were pleased to see $2.8 billion of free cash flow for the quarter, clearly strong and in line with the trajectory we need to see for the full year. And as you look at the fourth

quarter, there's really two major parts that are going to drive, getting to the $4.8 billion. The first is clearly operating profit and we feel comfortable with that given the ranges we just put out there. And we need to see about $2 billion and a little over $2 billion of working capital improve in the fourth quarter.

And I would break that down into about three buckets, about $500 million of inventory improvement Again, I think given the demand signals we're seeing and the growth we'll see in sales in the fourth quarter, we see that as achievable and manageable. We are expecting some significant advances and achievement of milestones on the defense side. So when you think about net liabilities and advances on contractual, long term contracts, that's about $1.2 billion. So that's a big piece of the fourth quarter. And then the rest really is the timing of disbursements that I would call normal in the course of business here.

So a lot to do but we have good line of sight to those things as we look to the closing out the year. I'm not going to get into specifics about next year or the year after other than to say, we do see free cash flow growth in 2024. And we'll come back in January and provide more of a roadmap as to how you get there. And Greg, do you want to talk about the ASR?

Gregory J. Hayes

Yes, sure. Sheila, the question around the ASR timing, I think it's a relevant question. And I would tell you we had a fulsome discussion with the board, about the timing of the ASR. And what convinced the management team and the board that it was the right time is our confidence in the powdered metal resolution. And having bound the financial impact of that, we saw this as an opportune time to double down on the stock.

And again, if you think about it, we bought $2.6 billion back year to date. This is another $10 billion at what I believe to be a significant discount to intrinsic value. And this is the time to buy. And I think we're doubling down in terms of our confidence, confidence in the future of RTX, but also confidence that we really do have our arms around the powered metal issue.

Sheila Kahyaoglu

Great. Thank you.

Gregory J. Hayes

Thanks, Sheila.

Operator

Thank you. Our next question comes from the line of Ronald Epstein of Bank of America.

Ronald Epstein

Hey, good morning, guys.

Gregory J. Hayes

Good morning, Ron.

Ronald Epstein

When you look back on this situation, right? I mean, my understanding is, it first kind of creeped up, call it, the 2015 timeframe. And here we are today, what are the lessons learned? Like, on a go forward basis, because perhaps a going concern, there'll be new engines in the future. What are the big takeaways to not have this happen again?

Christopher Calio

Hey, Ron, this is Chris. Yes, the incident that led to all of this was in March of 2020. And it wasn't until after we went through sort of a rigorous records review and did all of the investigation and the metallurgical analysis. Did we actually come to realize this was an incredibly rare defect. We hadn't seen it before. And then we were able to go back and trace it to 2015. But again, we didn't we didn't have that, the data in hand to make that determination until again much later into 2020. And if you just sort of step back and say, okay, once you figure that out, what would you guys do about it?

Well, we made a number of systemic changes, you know, a Pratt powder metal processing facility, both manufacturing process changes and inspection techniques, we've gone through a rigorous safety risk assessment. I think you've heard us describe before, which incorporated all of the learnings from all of our inspection data into our models, right across every one of our programs. And you've seen us kind of go through those one by one as we prioritize the most impacted fleets. But again, it gets read across every single engine program that we've got.

And then of course, we've responded by developing comprehensive fleet management plans that have a combination of the enhanced inspections that we've developed and the life limits on the parts. I would say maybe more broadly and unrelated to powdered -- the powdered metal situation. We've continued to leverage outside resources and expertise.

We've got a product safety review committee comprised of outside industry experts and veterans that come in, look at our key engineering processes, do site visits,

interview senior management and then below trying to understand culture and processes and what we can do better and they make recommendations. And we implement those. And that's something we do on a regular basis. Again, unrelated to the powdered metal, but we're not afraid to go leverage outside resources to give us another perspective.

Ronald Epstein

And does that mean kind of going forward in just sort of the nuts and bolts of Pratt? It's just going to require some more investment in, you know, I don't know, infrastructure engineering or whatever to just, you know, kind of make sure everything's where it should be.

Christopher Calio

But we're going to continue to invest, Ron, in automation for sure, both in terms of manufacturing process, and our quality system. I'll tell you, we're also making investments in machine learning so that we can look at all of this, the thousands and thousands of inspection records and data that we've got, you know, in house to help us better identify anomalies get out ahead of issues before they, turn into something, unfortunately, that has an impact on the fleet and on our customers. So we're going to continue to invest in those areas. We've had those investments plans in place. We're going to continue to accelerate those. Again, all part of the modernization of our footprint, and how we do things better, faster, leaner.

Ronald Epstein

Got it. Thank you.

Operator

Thank you. Our next question comes from the line of Seth Seifman of J.P. Morgan.

Seth Seifman

Thanks very much and good morning.

Gregory J. Hayes

Good morning.

Seth Seifman

Maybe a small bundle here of questions about cash. I mean, given what the consensus is next year, $5.2 billion, you're buying back $10 billion stock or you're accelerating

stock repurchase. I mean, is it pretty fair to assume that, you know, streets not going to be disappointed in what you guys have to say in January regarding cash.

And then when we move out to 2025 and we think just about the impact, the change in R&D and the change in the interest expense that you'll have from the share repo. How should we be thinking about the 2025 target versus, what you told us last month.

Neil G. Mitchill

Okay. Set. Thanks for the question. You know, we're not going to get ahead of 2024, but we do see free cash flow stepping up. We are comfortable with our $7.5 billion 2025 free cash flow target that we've talked about. And as you think about what is going to be higher interest and increased benefit from the R&D impact. Those will just about offset in 2025. And so that's why today, I feel comfortable staying with the $7.5 billion target for 2025. Of course, there's a lot of time between now and then, but those are the two moving pieces we see today.

Seth Seifman

Great. Thanks very much.

Gregory J. Hayes

You're welcome.

Operator

Thank you. Our next question comes from the line of Kristine Liwag of Morgan Stanley.

Kristine Liwag

Hey, good morning, guys.

Gregory J. Hayes

Good morning, Kristine.

Kristine Liwag

So maybe moving to a defense question, you know, the White House is requesting $106 billion in supplemental spending for a number of national security priorities, which includes over $50 billion in investment for the U.S. Defense industrial base. Looking at this request, you've got equipment for Ukraine, air and missile defense for Israel, and replenishment of stockpile for both. And this seems to fit quite nicely with the Raytheon Defense portfolio. So how much of this opportunity is addressable to the company and

if the dollars are appropriated, when would be the earliest you could see this convert to revenue?

Gregory J. Hayes

Kristine, let me start on that. So as I think I mentioned earlier in the conversation, we've seen about $3 billion of orders so far related to Ukraine replenishment. And that's really the replenishing U.S. war stocks. We expect another $4 billion of orders in the next two years. And most of that will play out over the next 24 to 36 months in terms of delivery. So you won't see a big revenue pop, even next year from this. As we think about this next tranche, the president's $100 billion plus request, which is more than $40 billion for Ukraine.

What you're going to see is the same things that we have been seeing but in much higher quantities. So obviously, NACAM systems, which is the short range air defense system, and the Amram, munitions that we're using there. We're going to see those orders pick up. We would think significantly. The same is true with the Patriot air defense system. Again, those are GEMT missiles, that we supply for that. Those are in short supply today. So again, a big ramp there. But you'll also going to see other weapons systems come into play, specifically around countering the unmanned air vehicles. And we have systems today like the Coyote, which is very effective in terms of short range, dealing with these unmanned air vehicles.

So again, I think really across the entire Raytheon portfolio, you're going to see a benefit of this restocking. On top of what we think is going to be an increase in DOD top line. Again, as we continue to replenish war stocks and also replenish some of the fleet in Pacific. So that's SM2s, SM3s, and other munitions that are really a huge part of this backlog that we've got today.

Kristine Liwag

Thanks, Greg. And how do we think about the margin profile of these incremental opportunities? Are these new contracts margin accretive?

Gregory J. Hayes

I would no -- actually, I wouldn't say they're margin accretive, nor would I say they're detrimental to margins. These are going out at kind of normal cost type programs, right? So you're talking about margins 10%, 11%, 12%. And again, these are well known in terms of the cost of these systems. We've been producing them for years. So we know what the costs are. And again, I think -- again, it's helpful to overall margins, but it's not hugely accretive. Again, I think Neil 10 to 12 was kind of kind of the sweet spot.

Neil G. Mitchill

I think that's exactly right. These are mature programs that we've got a lot of history on. It's all about getting the supply chain ramped up to deal with the increased production that we expect.

Kristine Liwag

Great. Thank you.

Operator

Thank you. Our next question comes from the line of Matt Akers of Wells Fargo.

Matt Akers

Hey guys, good morning. Thanks for the question. I guess maybe just to clarify, the section 174, the $500 million benefit is part of that recovery from the 2022 payment. And I guess, how should we think about that sort of carrying forward that benefit into 2024?

Christopher Calio

Thanks. That's a good question. Yes, some of that is, in fact, the recovery of the 2022 overpayments, if you will, we were able to file our tax return on a basis that assumed deductibility of these cost plus R&D contracts. What will happen though is it'll be a little bit of a headwind next year because we'll get a little bit more cash back this year in the form of making lower estimated tax payments. And then next year, we'll start to bake that into our next year's estimated tax payments and filing. So that's how that'll play out. If you kind of look at it over a multi-year period of time. It's about 40% of what we previously were deferring and amortizing. So if you kind of stretch that through 2026, that's about $1.7 billion of incremental goodness in free cash flow over that period.

Matt Akers

Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Doug Harned of Bernstein & Company.

Doug Harned

Good morning. Thank you.

Gregory J. Hayes

Good morning.

Doug Harned

Chris, when you talked about the -- on the GTF on the project visits, I mean, 35 days sounds like a very short number. When you look forward, before you would talked about removal to return time of 250 to 300 days, kind of a peak level of AOGs in H1 of 600 to 650. Now that you're looking at this process in more detail. Can you give us a sense of how any of that may have changed? And then also, if you're unable to do the replacements of discs and fibers and so forth, in the short term, presumably, that's an earlier revisit than you would have liked before. How does that affect your customers and the way you're thinking about the economics.

Christopher Calio

Yep. Good questions, Doug. So the reason I mentioned the early, very early sort of handful of project visits and how we've done on turnaround times is honestly just to show, people that we are incredibly focused on taking minutes, hours, days out of this. And that can translate to the larger scope shop visits that we're going to face. And the organization's incredibly focused on literally every gate, within that process, including taking time out of the test cell process. But right now, Doug, those key assumptions that you just laid out the wing to wing 250 to 300, the PKOGs, those are the assumptions, those are what's baked in to the financial impact that we talked about here. And we're doing everything that we can to go, improve upon those. And as I said earlier, MRO output to us is the linchpin on that.

And so I -- that's kind of where the organization's focus is, Doug, and that's where we've got to get better each and every day. To your point about, the new full life discs, yes, our plan today is to put those in, at OE first, in the first quarter of the year and then starting an MRO in the second quarter of the year at each of these shop visits, to the extent that the ramp up and the output isn't where it needs to be on those. We're not going to waste the induction slot. Doug, the engines will come in, they'll get an inspection into your point. They'll have to then come back in at a 2,800 to 3,800 cycle re-inspect, depending on the thrust of the engine, which is why it's so critical for us to continue this, ramp up in powdered metal forgings.

So that when the engines leave the shop for these visits, they have got the longest time on wing, they can have and we don't see these back in our MRO shops during this period just because it'll add just more congestion.

Doug Harned

Then if I may, one of the frustrations that I've heard out there is, you've taken the original tranche, the first tranche off in September, but airlines haven't seemed to be somewhat in the dark on the next set of engines that need to come off-wing and when that impact will, what is taking so long and being able to, help them know exactly what the impact and timing will be.

Christopher Calio

We're actually having those discussions, Doug. I've been part of many of them, again, customer-by-customer looking at their engines by serial number. Again, because you've got to look at the cycle times on those and bounce them off against the fleet management plan. So it is, it's a rigorous thorough process, but we're having those conversations with customers. So they understand their specific impacts.

As we said back, on the September call, the lion's share of these incremental shop visits that we're going to have the 600 to 700 in that ‘23 to ‘26. But two-thirds of those are ‘23 and relatively early in 2024. That's what causes that bow wave, Doug, that peak of 650 AOGs. And I think we talked earlier about when we're going to, provide some of those service bolt-ins and the ADs that are going to follow on. So that -- those communications are happening, you’re going to see that impact early in ‘24.

Doug Harned

Very good. Thank you.

Operator

Thank you. Our next question comes from Ken Herbert of RBC Capital Markets.

Ken Herbert

Yes. Hi, good morning.

Gregory J. Hayes

Morning Ken.

Ken Herbert

Hi, Chris, I wanted to follow-up on that comment regarding your customer conversations. Can you provide any more sort of granularity on where you are in those conversations? And obviously, you've got, it sounds like incremental confidence in the ability to sort of bracket the risk around these, with all the uncertainty still with sort of timing on the shop visits. How are those conversations going and just give us any sort

of metrics around what gives you that incremental confidence, I guess, on the customer side?

Christopher Calio

Sure, Ken. Yes. Thanks for the question. So the focus, as you might imagine, over the last several months is walking our customers through the safety risk analysis, so that they understand that and what we're doing to ensure the continued safe operation of the fleet, then understanding the fleet management plans, cyclic limits, the inspection intervals, and its impact on their specific fleets. We're going to have certain customers, Ken that are going to be more impacted than others, just by virtue of their size, their reliance on the GTF.

Again, it differs by customer. Conversations, as you might imagine, they're difficult. Customers understand what we're doing from a safety risk perspective, and think we're doing the right thing, but they're certainly not happy with the net effect. And they've not been happy with the fleet health even prior to powdered metal and our output on MRO and getting them the spare assets, and the engines in our shops, that the need. And so those are obviously difficult conversations, as you might imagine, Ken, and we're having them with each customer individually as we go through and tailor their support packages.

Again, some are more impacted then others, but those conversations are ongoing, and they will continue into the early part of year once people truly understand a fleet-by-fleet customer-by-customer impact and the changes they're going to have to make for their flights, their network and what not. So those conversation are happening will progress early into next year.

Ken Herbert

Thank you.

Operator

Thank you. That does conclude the Q&A portion of our call. I would now like to turn the call back to, Greg Hayes, for closing remarks.

Gregory J. Hayes

Okay. Thanks Latif, and thanks all for listening in today. As always, Jennifer and the IR team will be around to take your calls, and we look forward to seeing all of you in the coming weeks and months. Take care. Thank you.