RTX Corporation (NYSE:RTX) Q2 2024 Earnings Conference Call July 25, 2024 8:00 AM ET

Company Participants

Chris Calio - President and CEO
Neil Mitchill - CFO
Nathan Ware - VP of IR

Conference Call Participants

Peter Arment - Baird
Robert Stallard - Vertical Research
Myles Walton - Wolfe Research
Sheila Kahyaoglu - Jefferies
Doug Harned - Bernstein
Samantha Stiroh - Bank of America
Seth Seifman - JPMorgan
Kristine Liwag - Morgan Stanley
Cai von Rumohr - TD Cowen
Jason Gursky - Citi
Matt Akers - Wells Fargo
David Strauss - Barclays
Scott Mikus - Melius Research
Noah Poponak - Goldman Sachs
Scott Deuschle - Deutsche Bank

Operator

Good day and welcome to the RTX Second Quarter 2024 Earnings Conference Call. My name is [Livia], and I'll be your operator for today. As a reminder, this conference is being recorded for replay purposes.

On the call today are Chris Calio, President and Chief Executive Officer; Neil Mitchill, Chief Financial Officer; and Nathan Ware, 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 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 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. [Operator Instructions]

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

Chris Calio

Thank you, and good morning, everyone.

As you saw from our press release this morning, RTX delivered strong operational and financial performance in the second quarter as we continue to execute on our customer commitments and strategic priorities.

Let me start with the highlights on Slide 3. We saw another quarter of excellent top line growth with adjusted sales of $19.8 billion, which were up 10% organically. Adjusted EPS of $1.41 was up 9% year-over-year, driven by profit growth and margin expansion across all three segments, and free cash flow was strong at $2.2 billion.

We also saw continued growth in our backlog, which ended the quarter at $206 billion with a book-to-bill of 1.25. There were also some notable contract wins in the quarter, including a 10-year MRO agreement to support Collins significant content on Air Canada's 787 fleet of up to 70 aircraft, including avionics, air management and electric power systems. Collins also received a multibillion-dollar award for the U.S. Air Force's next-generation survivable airborne operations center, and Raytheon received a $639 million award for SPY6 radar production for the U.S. Navy.

As you saw in early July, Germany placed an additional order for Patriot Systems. This is on top of the $1.2 billion order they placed for multiple systems in the first quarter of the year. We also saw some positive GTF announcements at the Farnborough Airshow earlier this week, with over 700 GTF engines ordered, including options and commitments. These include Cebu Pacific selecting the GTF to power the carriers order for up to 152 additional single-aisle aircraft and Avalon selecting the GTF engine for up to 160 aircraft. So another quarter of robust orders with significant wins already secured early here in Q3 and more expected as the year progresses.

We also continue to make progress on our critical initiatives. Specifically regarding the GTF fleet management plan, we remain on track with our financial and operational outlook consistent with our prior comments. As of the end of Q2, we have inspected over 6,000 powder metal parts that are in the field across all programs and the associated fallout rate remains below the 1% we had assumed and the findings are consistent with the assumptions that underpin our fleet management plan.

At our MRO facilities, throughput of engines continues to improve, and overall capacity is expanding with the recent addition of two new MRO shops into the network. PW1100 MRO output increased 10% versus the first quarter. We expect this ramp to continue in the second half of the year. As it relates to the PW1100 fleet, AOGs have leveled out over the past few months and remain in line with our expectations.

We've also now reached support agreements with 20 of our customers, covering roughly 65% of the impacted fleet and the terms are in line with our assumptions. Beyond our operational performance, let me also comment on the legal and contract charges we outlined in our press release this morning, and then Neil will provide a more detail in a bit.

We're nearing completion of agreements with the Department of Justice, SEC and Department of State to resolve several legal matters. These matters primarily arose out of legacy Raytheon Company and Rockwell Collins prior to the merger and acquisition of these companies. We've already taken robust corrective actions to address the legacy gaps that led to these issues, being implementing enhanced compliance and training measures.

We also took a charge related to the anticipated termination of Raytheon fixed price development contract that was entered into before the merger. As we've been discussing in the last few quarters, we've been battling through some challenges in a handful of fixed price development programs, including this one.

But this specific contract is unique in terms of its scope, deliverables and associated risk profile, which led us to pursue termination. So we're pleased to be putting these matters behind us. And as I highlighted earlier, our operational performance was very strong in the quarter.

Given this performance and the continuing strength of our end markets, we are raising our outlook for adjusted sales and EPS. We've also revised our cash outlook for the year as a result of matters I just discussed. Lastly, as you saw in May, we raised our dividend 7% and remain on track to return $36 billion to $37 billion of capital to share owners from the merger through the end of next year.

Okay, with that, let's move to Slide 4, and I'll spend a few minutes on our strategic priorities that will enable us to drive best-in-class performance across RTX, including meeting customer demand, continued sales growth, margin expansion across our segments and strong cash flow generation.

Given our growing installed base and the unprecedented demand for our products, our first priority is executing on our commitments, powered by our core operating system, our focus is on driving incremental operational improvements to ramp output and deliver on this demand.

Today, we have over 4,000 core projects being worked across the company. For example, at Collins, our avionics business improved first pass yield by 2x in its fire detection product line by reconfiguring the production sell-out, creating digital tools and upgrading equipment. And at Raytheon, the team conducted a core leadership week to identify initiatives to more than double weekly output on a key component of our AIM9X effector. As a result, the team achieved a 90% increase in output in the quarter, is on track to hit their full year target by the end of Q3.

We also continue to add capacity to meet the demands of the industrial ramp-up. During the quarter, we announced a $200 million investment in our carbon break facility in Spokane, Washington.

Once complete, it will add 70,000 square feet of manufacturing footprint to meet rapidly growing demand for our Collins brake solutions. And on the defense side, we're investing in test equipment and tooling to more than double production capacity by year-end in our Coyote program, which is a low-cost kinetic effector for the counter unmanned aircraft systems that directly address today's drone threats.

In addition to creating new capacity, we continue to modernize our existing footprint as part of our Industry 4.0 initiatives. Across RTX, we have now connected 26 factories with our proprietary digital analytics technology, providing us with real-time data to boost equipment efficiency, improve quality and yield higher output. This represents a 30% increase in connected sites since the start of the year, and we remain on track to connect 40 factories by the end of the year. These incremental efficiency, capacity and technology improvements are critical to meeting the needs of our customers as we operate in the strongest demand environment in our history.

Let me move now to our second priority, innovating for future growth. We are executing on our cross-company technology roadmap to develop differentiated solutions in areas such as sustainability, advanced propulsion, next-generation sensing, connected battle space and hypersonics, this year alone, we will spend over $7.5 billion on company and customer-funded research and development to mature and introduce new capabilities to our customers and sell our product pipeline.

For example, we are working on a number of hybrid electric demonstrator programs to deliver advanced propulsion technologies and enable greater fuel efficiency across all future aircraft segments. Recently, our Collins, Pratt and Technology Research Center teams completed a significant milestone in the development of our hybrid electric demonstrator, validating the integrated system functionality of the engine, electric motor, batteries and high-voltage electric power distribution.

And in the quarter, we delivered the first TPY2 radar that incorporates our proprietary gallium nitride technology. This technology is a game changer for our sensing capability, providing expanded surveillance range and supporting additional missions in the space domain and hypersonic defense.

We also continue to invest in our digital transformation and AI. This year, we are adding an additional 30-plus use cases that generate incremental productivity and cost savings across RTX using advances in artificial intelligence and deep learning. In total, we have over 200 AI use cases currently deployed across various internal functions. Our AI investments are also enabling new and improved capabilities in our products such as predicting equipment failures and aiding human operators in executing complex tasks.

These types of investments in innovation will allow us to continue to develop next-gen products and solutions well into the future. Our third priority is to fully leverage our breadth and scale across RTX to drive value for our stakeholders. Specifically, this includes creating a more efficient and competitive cost structure and managing our common supply chain. For example, over 35% of our product procurement spend is with common suppliers that support all three of our businesses. We're using a unified RTX approach to our contracts and sourcing strategy.

It also includes harmonizing our product lifecycle and management processes developing integrated solutions for strategic campaigns and pursuits such as NGAD, FLORA and next-generation commercial platforms. And of course, we'll also continue to review our portfolio and prune where needed as well as target bolt-on M&A to support our RTX technology roadmap and grow our core franchises.

And underlying all three of these priorities is our unwavering commitment to safety, quality and compliance and everything that we do. It's what we and our customers expect and a commitment we will never compromise on. Putting it all together, I'm extremely excited and confident about the future of RTX.

With that, before I turn it over to Neil, I want to acknowledge the leadership update we announced last week. As you saw, Steve Tim has decided to retire after 28 years with the company. Steve was a great partner in teammate, and I want to thank him for his leadership at Collins, and we're very fortunate to have a strong bench and are very excited that Troy Brunk is taking over as the new President of Collins. Troy has served as the President of three of the six Collins business units is uniquely qualified for the role . Okay.

Let me turn it over to Neil to take you through the second quarter results in more detail. Neil?

Neil Mitchill

Thanks, Chris.

I'm on Slide 5. As Chris said, operationally, we had a strong quarter and continue to make progress on key financial metrics across RTX. RTX adjusted sales of $19.8 billion were up 8% and on an organic basis, were up 10%. By channel, commercial OE was up 19% as we continue to support aircraft demand.

Commercial aftermarket was up 14% as domestic, international and long-haul travel continues to grow. And excluding the Raytheon cybersecurity divestiture, defense sales were up 7% as we execute on our backlog. . Segment operating profit of $2.4 billion was up 19% with growth at all three businesses contributing to consolidated segment operating margin expansion of 100 basis points.

Adjusted earnings per share of $1.41 was up 9% from the prior year, driven by segment operating profit growth as well as a lower share count, which was partially offset by expected headwinds from higher interest and tax expense and lower pension income.

On a GAAP basis, EPS from continuing operations was $0.08 and included $0.29 of acquisition accounting adjustments and $0.03 of restructuring and other significant nonrecurring items. In addition, as it relates to the items Chris mentioned, GAAP EPS also includes a $0.68 charge related to the expected resolution of several legacy legal matters and a $0.33 charge related to a fixed price development contract at Raytheon.

With respect to the legal matters, we are working to finalize deferred prosecution agreements and a civil settlement with the DOJ and an administrative order with the SEC. These agreements will cover the previously disclosed investigations of defective pricing claims for certain legacy Raytheon company contracts, which were entered into between 2011 and 2013 and in 2017. They will also cover the previously disclosed investigations of improper payments made by Raytheon Company and its joint venture, Thales-Raytheon Systems in connection with some Middle East contracts dating back to 2012.

As a result, we recorded a pretax charge of $633 million in the quarter, which brings our total reserves associated with these matters to $959 million. In addition, we recorded a pretax charge of $285 million related to voluntarily disclosed export controls compliance matters primarily identified during the integration of Rockwell Collins and Raytheon Company into RTX including matters which are expected to be addressed in a consent agreement with the Department of State.

As part of the resolution of each of these three matters, we will be required to retain independent compliance monitors over the 3-year term of the agreements. In total, we expect to pay about $1 billion related to these matters this year and have incorporated that into our updated free cash flow outlook for the year. I'll take you through the other moving pieces of our outlook on the next slide.

While the financial impact of these items is above what we had previously reserved, we believe the provisions we have taken put these issues behind us financially, and we will continue to cooperate with the government and external monitors as we move forward. As it relates to the fixed price development contract, as you know, we've been discussing the challenges we've been working through on this front for some time. In conjunction with that effort and an anticipated termination on one of our Raytheon programs with a foreign customer, we've recorded a pretax charge of $575 million in the quarter.

Again, we've incorporated the expected cash outflows into our revised free cash flow outlook for this year. For the quarter, cash flow was robust with $2.2 billion of free cash flow that was driven by strong collections across the portfolio and some lower tax payments. We also continued our deleveraging in the second quarter and paid down another $750 million of debt bringing our total debt repayments since the accelerated share repurchase was initiated last October to $2.7 billion, and we returned $867 million of capital to shareowners primarily through dividends during the quarter.

On the portfolio front, we're also pleased that Italy has approved the sale of Collins actuation business, and we continue to actively support the remaining efforts to complete the transaction. And as you may have also seen, we have entered into an agreement to sell Collins hoist and winch business for over $500 million. Another great example of the portfolio pruning we are doing to focus on our core franchises.

Okay. Turning to Page 6. Let me share a few details on our updated outlook for the year. As you've seen, the first half performance across all three of our businesses has been strong, driven by end market demand and continued execution. There are, of course, a few areas we continue to monitor, including pockets of supply chain challenges, inflation and the ongoing OE production rate uncertainty.

But given the results to date, we are increasing our full year adjusted sales outlook to between $78.75 million and $79.5 billion, up from our prior range of $78 million to $79 billion and we now expect 8% to 9% organic sales growth for the year, up from our prior range of 7% to 8%.

We are also increasing our adjusted EPS outlook by $0.10 on the low end and $0.05 on the high end, putting the new range at $5.35 to $5.45, up from $5.25 to $5.40. The improvement is driven primarily by lower interest in corporate expenses, higher pension income and a lower full year effective tax rate. We have included the corresponding updated outlook for these metrics in the appendix of our webcast slides.

On free cash flow, as I mentioned earlier, we've incorporated our expected cash outflows associated with the legal and contract matters into our outlook. Partially offsetting these impacts is some improvement in current year tax payments of roughly $500 million. All in, we have updated our free cash flow outlook to be approximately $4.7 billion compared to our previous expectation of approximately $5.7 billion.

With that, let me turn it over to Nathan to talk you through our segment results and outlooks.

Nathan Ware

Thanks, Neil.

Starting with Collins on Slide 7. Sales were $7 billion in the quarter, up 10% on both an adjusted and organic basis, driven by strength in commercial aftermarket, commercial OE and defense. By channel, commercial aftermarket sales were up 12%, driven by a 16% increase in parts and repair, a 15% increase in provisioning and a 9% decrease in mods and upgrades. With mods and upgrades coming off a difficult prior year compare that benefited from the 5G mandate.

Commercial OE sales for the quarter were up 10% versus the prior year, driven by growth in narrow-body, wide-body and regional platforms, and defense sales were up 7%, primarily due to higher volume. Adjusted operating profit of $1.15 billion was up $230 million or 25% from the prior year driven primarily by drop-through on higher commercial aftermarket volume as well as higher defense and commercial OE volume.

Looking ahead, on a full year basis, we now expect Collins sales to grow high single digits on both an adjusted and organic basis up from the prior range of mid- to high single digits, driven by continued strength in commercial air traffic and defense volume. And we continue to expect operating profit growth between $650 million and $725 million versus 2023.

Shifting to Pratt & Whitney on Slide 8. Sales of $6.8 billion were up 19% on both an adjusted and organic basis with sales growth across all three channels. Commercial lease sales were up 33% in the quarter on higher engine deliveries and favorable mix in the large commercial engine business.

Commercial aftermarket sales were up 15% in the quarter, driven by higher volume and favorable mix in both the large commercial engine and Pratt Canada businesses. And in the military engine business, sales were up 16%, primarily driven by higher sustainment volume across the F-135 and F-117 platforms.

Adjusted operating profit of $537 million was up $101 million versus the prior year. Drop-through on higher commercial aftermarket volume and favorable mix as well as favorable large commercial OE mix was partially offset by headwinds from large commercial OE engine deliveries and the absence of a $60 million favorable prior year contract matter.

Drop-through from higher military volume and favorable mix was more than offset by higher production costs and higher R&D and SG&A expenses. Turning to Pratt's full year outlook. We now expect sales to grow mid-teens on an adjusted organic basis, up from our prior range of low double digits driven by stronger military volume and higher commercial OE, and we continue to see adjusted operating profit growth between $400 million and $475 million versus 2023.

Now turning to Raytheon on Slide 9. Adjusted sales of $6.6 billion in the quarter were down 2% as a result of the cybersecurity divestiture completed in the first quarter. On an organic basis, sales were up 4%, primarily driven by higher volume on land and air defense systems, including Patriot, counter UAS programs and Stinger.

Adjusted operating profit of $709 million was up $47 million versus the prior year, driven primarily by drop-through on higher volume, favorable mix and improved net productivity, partially offset by the impact of the cybersecurity divestiture, and Raytheon had $5 billion of bookings in the quarter, resulting in a backlog of $51 billion. On a rolling 12-month basis, Raytheon's book-to-bill is 1.13.

In addition to the SPY-6 award that Chris mentioned earlier, Raytheon also had $928 million of classified awards and a $393 million award from NASA to design, produce and deliver four units that will provide advanced earth observation. Looking ahead, we now expect Raytheon sales to grow by mid-single digits organically, up from the prior range of low to mid-single digits, driven by improved material flow.

As a result, we now expect Raytheon's operating profit to grow between $125 million and $200 million versus 2023, up from the prior range of between $100 million and $200 million, and this includes the impact from the cybersecurity divestiture.

With that, I'll turn it back over to Chris to wrap things up.

Chris Calio

Okay. Thanks, Nathan.

I'm on Slide 10. As you've heard today, our second quarter operating results were very strong, and we're confident in our updated outlook for the full year. But if you step back and just think of beyond 2024 and look at the long term for RTX, we've got the best position franchise programs with the right content on the right platforms across commercial, aerospace and defense.

Our large and growing installed base will support significant commercial aftermarket growth for decades to come, and our industry-leading defense capabilities address the threats playing out across the global landscape.

All right. With that, let's open the line for questions.

Question-and-Answer Session

Operator

[Operator Instructions] The first question comes from the line of Peter Arment from Baird. Peter Arment, your line is open.

Peter Arment

Hi, thanks. Good morning, Chris, Neil, Nathan.

Chris Calio

Good morning.

Peter Arment

Chris, nice results. Just, I guess, maybe just on the GTF fleet management plan. It sounds like everything is going according to plan and remains on track, but maybe if you just peel back the onion a little bit, I know you talked about some pacing items in the past about getting full life distant to the MRO shops and just kind of material availability. It sounds like the MRO capacity is going as planned, but maybe any kind of metrics or any color, what you're seeing and any opportunities actually where any of these metrics might still be able to come into the left before 2026? Thanks.

Chris Calio

Yes. Okay. Peter, thanks for the question. Let me take you through where things stand. As you noted, our key assumptions around AOGs, lingering turnaround time, shop visit mix between heavy and light and customer compensation all remain consistent. And as I noted up front, our assumptions on the inspection follow-up rates and the findings are all consistent, or even better than we planned.

So good stability around the key assumptions. As you know, MRO output is the key enabler and we're focused on improving the material flow, better processes in the shops and we've added some capacity on this front. And again, we saw some good signs of progress here in the first half of the year. I mean, output was up 10% from Q1 to Q2 and first half output on the 1100 is up over 30% versus the first half in 2023.

So continue to drive some output there, which is helpful. The key enabler of course on the MRO output is material. You had mentioned that, no upfront. We're continuing to see some progress on structural castings. Structural castings are up about 5% sequentially and 14% year-over-year, so good progress there. And then on forging, the powdered metal parts. We continue to drive output there as well.

Isothermal forging were up almost 100% year-over-year. And we continue to add additional capacity for inspection and machining. For example, we've nearly doubled our sonic inspection capacity for the year. So again, driving on all the key enablers, Peter, to try to get this fleet in as healthier shape as we possibly can. I'll also just note, sort of unrelated to the fleet management plans. We continue to drive OE output as well.

OE deliveries were up sequentially, up 30% in the first half on a year-over-year basis, despite sort of grinding through some of the supply chain portabilities. And we're also pleased with the additions to the GTS backlog that were announced at Farnborough recently. So again, focusing on what we can control on the fleet management plan and continuing to drive both supply chain and new orders into the backlog.

Peter Arment

Appreciate all the details. Thanks, Chris.

Operator

Thank you. And our next question coming from Robert Stallard from Vertical Research. Robert Stallard, your line is open.

Rob Stallard

Thanks so much. Good morning.

Chris Calio

Good morning, Rob.

Chris Calio

Hi, Rob.

Rob Stallard

Chris, following on the GTF theme, I was wondering if you could comment on what the situation is with Airbus and their recent forecast cut, because they've clearly not been getting as many new engines as they anticipated. So those engines instead go into the spare engine pool? Thank you.

Chris Calio

Yes. Thanks, Rob. So again, you heard me say just a minute ago to Peter that ROE deliveries are up sequentially and up first half of the year, 30% on a year-over-year basis. We're not necessarily where we need to be with Airbus. But again, we're seeing strong growth sequentially and year-over-year. And our outlook reflects our assessment of kind of where Airbus needs support from us. And we're aligned on what they need.

You alluded to the fact that, we're balancing both OE and spare engine and material. And that's true. And we need to do that for the support of the fleet. But again, I continue to be encouraged by what we continue to drive in terms of production, and getting Airbus what they need. And I think in the back half, we're going to continue to balance the OE spare engine and MRO needs. But I think, we'll be in a position to get Airbus what they need.

Operator

Thank you. And our next question coming from the line of Myles Walton from Wolfe Research. Miles Walton, your line is open.

Myles Walton

Thanks. Good morning.

Chris Calio

Good morning.

Myles Walton

Hi Chris or Neil, I'm not sure, which on the defense side and on Raytheon, could you maybe dig a little bit into, what are the problem programs still remaining? Maybe a percentage of revenue, if that's where you want to handle it, or backlog. And then specifically to this decision to sort of proactively cut losses and terminate the contract, not an easy decision. But are there other contracts where you could extinguish similarly, or would that cause customer distress? And lastly, was there a cash impact? Thanks.

Chris Calio

Yes, thanks, Myles. I'll start and then Neil can certainly chime in. Certainly not an easy decision, but we've been alluding to the fact that we've had a significant classified program out there that was, we would say, not in our wheelhouse. Meaning the work that we had taken on, and this contract was pre-formation of RTX, was not within our core competency.

And we struggled with that, and we struggled to get to the right technical solutions, and ultimately came to a point where, we just didn't think it was productive anymore to continue to go down this path. And ultimately decided it was in the best interest of us, and the customer to just kind of do a reset here, and allow us to go focus our resources on some of the other programs that we've got.

You had mentioned a handful of other, I'll call them classified development, fixed price development programs that we've been talking about. I'll say those are much different in terms of risk profile than the one we took action on here. Those have some important milestones here in '24 and in '25.

But we feel like we've got a much better handle on those than the one we're talking about here. And feel like we understand the risks much better there, and what needs to be done to get them to closure.

Neil Mitchill

And just to add, Myles, in terms of the cash flow impact. So, as I sit here today, there's really just a few changes that we've made to our '24 outlook. The first is about $1 billion related to the legal matters. We sold about a $0.5 billion related to the contract matter that Chris just was talking about. And offsetting that is about a $0.5 billion of improvement that we've seen operationally in our tax payments due to some planning that we've done.

So, net-net, that's $1 billion. And I would expect that that mostly sits in the fourth quarter of this year. It'll depend on when we get the final resolutions with the government agencies, but that's trending towards certainly late September, or early in the fourth quarter.

Myles Walton

Okay. Thanks for the color.

Neil Mitchill

Yes.

Operator

Thank you. And our next question, coming from the line of Sheila Kahyaoglu from Jefferies. Sheila, your line is open.

Sheila Kahyaoglu

Good morning, guys, and thank you.

Chris Calio

Good morning.

Sheila Kahyaoglu

So, right Neil maybe another one for you. Just you're going to do about $7.2 billion of net income this year on an adjusted basis, and generate $4.7 billion of cash. Some of that is one-time items with the DOJ, the powder metal and tax. So, how do we think about that gap closing on net income to cash flow? And then just on the DOJ, can you elaborate a little bit more how we think about that, the outcomes of it and the cash impact outside of '24?

Neil Mitchill

Sure. Let me start with free cash. You just heard me talk about sort of the changes that we rolled into our outlook for the year. As I think about the absolute value of the $4.7 billion, remember, that includes a couple of non-recurring items that are pretty substantial. And if you adjust for those things, you kind of get to a $7 billion, $7.5 billion, maybe even higher level of free cash flow that is operational.

So, I think as we look forward, Sheila, and we get the powder metal payments behind us this year and next year, just a little color, so far we're a little less than $200 million into our $1.3 billion in powder metal outflows this year. We expect that to obviously ramp up. You heard us talk about doubling the number of customers that, we've got agreements with, and about two-thirds of the fleet under agreement.

So, I would expect third and fourth quarter kind of be split pretty evenly, with respect to the rest of the payments this year. But if you look at the underlying operations, you can see that there's real strong organic sustainable cash flow. And I think that's what we'll be looking to see sustain itself over time. Now, in particular, there's some working capital improvement.

I've talked about like $1.1 billion of improvement year-over-year and arriving at our $4.7 billion. Obviously, inventory was a use of cash in the first half. We expect that to turn around in the second half, which is typical for our business. We've got a little bit of headwind from the OE production rates that we've contemplated in that, but we're seeing stronger collections on the customer side.

So, that balances for the rest of this year. So, that's how I would characterize the free cash flow situation today. As it relates to the DOJ and the outcomes, I think we feel very certain about the amount of cash impact that's going to happen this year. As we talked about in our prepared remarks, we've reached agreements in principle. There's some work to do to get that finalized with the various government agencies.

That could take a few months, but when it happens, that will get filed and be available publicly. And then shortly thereafter we'll be required to make the payments associated with that. There's very little that lingers beyond that. I'd say it's in the $50 million a year kind of range following 2024, so it's manageable.

Those costs will include some residual payments on the global trade related consent agreement, as well as some internal costs that we'll obviously invest in to continue to improve our processes, as we support the monitor activities. So, I would leave it at that for now with those items.

Sheila Kahyaoglu

Cool. Thank you.

Neil Mitchill

Yes, thank you.

Operator

Thank you. And our next question, coming from the line of Doug Harned from Bernstein. Doug Harned, your line is open.

Doug Harned

Thank you. Good morning.

Chris Calio

Good morning, Doug.

Doug Harned

What you've talked about and what we've heard as well is that, your shop on the GTF, that a lot of the shops visit times, you've brought that down significantly the time in the shop, which is great. And so, presumably, this is with improved parts availability that's allowed you to do that. And I know in Q1 you did divert resources away from V2500 work in order to better enable you to provide GTF parts. And so, two things on this. I guess first, and where do you stand now on V2500 MRO? Is that kind of back to normal? And then second, even though those shop visit times seem to have come down significantly, everything we've seen is that induction wait times are still quite long. And perhaps, if you could address those two issues, it would be really helpful?

Neil Mitchill

Doug, let me start on the V2500. Then I'll hand it over to Chris to talk a little bit about the GTF induction times and turnaround times. On the V2500 on a first half basis, we're at about 369 inductions to-date. So, we had talked about 800 on a full year basis, and we expect that. We still expect that to continue. And I guess the good news there is that, with that acceleration, not only are we seeing an increase in the number of shop visits in the second half of the year, we're also seeing more work scopes.

So, these are heavier overhauls. And all of that will contribute to the second half growth that we'll expect to see coming from Pratt & Whitney, particularly in the aftermarket. So, the second half story for Pratt's, operating outlook is really focused around what we call the mature commercial engines, the V2500 being the biggest part of that. So, that's where we sit today on that front. Chris, maybe a couple comments on GTF.

Chris Calio

Yes. Before I do that, Doug, I'll just say on the V, I mean, obviously our customers are relying heavily on that, given the other stress in the fleet. So, we're heavily focused on making sure that, V inductions, turnaround times and what not, that the support is there for the customer base. On the GTF MRO, you're right. In the shop, when we've got material flowing, when we've got material in the right positions in gate two and gate three.

We are seeing significant reduction in shop turnaround time, both our shops and our partners, which is really encouraging. The induction times are really a function of what we would call the parking lot. Doug, there are a lot of engines that came off wing, obviously, when the AD hit. People did some of that proactively. So, we are still working through a large parking lot of engines that need to get inducted into the shop.

But again, we're encouraged by what we're seeing when the material is there, which is why we're so heavily focused on making sure the supply chain is healthy. You heard me talk about structural castings, isothermal forgings. These are the things that are going to be the biggest unlock for us as we take the AOG numbers down, and support our customers.

Doug Harned

Very good. Thank you.

Operator

Thank you. Our next question, coming from the line of Ronald Epstein from Bank of America. Ronald, your line is open.

Samantha Stiroh

Hi, good morning. This is Samantha Stiroh on for Ron Epstein. I was wondering if you could talk a little bit about Collins, particularly interiors, kind of what they're doing and what your expectations are there? Thank you.

Chris Calio

Good morning, Samantha. How are you doing? Let me start there. I mean, we're seeing significant improvement in the interiors business. And frankly, the second half story for Collins is going to rely substantially on the aftermarket uptick there, in mods and upgrades. And the one thing I would say about the Collins portfolio of businesses as we've seen really strong performance across all the segments, the - SBU segments there.

And many of them are at or above, frankly above, where we were in 2019. Interiors is the one place where we're still lagging. So we're encouraged by the orders we are seeing there. And we do expect that to translate to substantial growth in the second half of this year that's going to be driving a substantial part of Collins aftermarket year-over-year.

Operator

Thank you. And our next question coming from the line of Seth Seifman from JPMorgan. Seth, your line is open.

Seth Seifman

Hi, thanks very much and good morning.

Chris Calio

Good morning.

Seth Seifman

Chris, Neil, I wonder if you could address the free cash flow target for next year. Kind of talk about whether you feel like that still stands, areas of risk, areas of opportunity and kind of your level of confidence?

Chris Calio

Yes. Thanks for the question. Right now, Seth, we don't see a reason to change the outlook. The fundamental business drivers remain strong on both the commercial and defense side, our end markets have proven pretty resilient and demand remains strong as we set up front. I think with everybody else, there are several items that we're tracking that have 2025 implications.

I think OE rates kind of continue to see the strength in the aftermarket. That's a big part of the cash walk in 2025. And of course, the supply chain I mean you just heard me talk about the sequential improvement and the stability we're seeing, but that's got to continue to ramp. But again, still feel like the 2025 cash goal here is achievable based on everything we see today, both within our four walls and the macro environment.

Seth Seifman

Thank you very much.

Operator

Thank you. Our next question coming from the line of Kristine Liwag from Morgan Stanley. Kristine Liwag, your line is open.

Kristine Liwag

Hi. Good morning Chris, Neil and Nathan.

Chris Calio

Good morning.

Kristine Liwag

Maybe back with Pratt, you guys have highlighted that isothermal forgings are getting better. You're seeing doubled capacity increases in sonic inspections, which are all good, but structural castings continue to be an issue. Can you provide more color on why structural casting continues to linger. And then also, I mean, look, this historically has been one of the bottlenecks for previous aerospace ramp ups. So I guess, how is your approach different this time around to mitigate risk? And any color you could provide on the underlying tightness would be helpful?

Chris Calio

Sure. Thanks, Kristine. And you're right, structural castings has been a habitual sort of constrained value stream even since the beginning of the ramp-up back in the '16, '17 time frame, while we've seen some improvement here, I mentioned up 5% sequentially. It needs to be higher than that, in order to continue to meet the demands of both OE to the airframers, spare engines, and MRO.

So again, while we're seeing sort of positive incremental improvement, it needs to continue to grow. And the reason its constrained is because there are very few people that do this. And a lot of us in the industry rely on the same players. And so, we're all ramping up around the same time. To your point about what we're doing differently. I would say we're really working hard on making sure that our demand signal is crystal clear that people know what we need both from an OE, but also an MRO perspective.

And then getting on LTAs as quickly as we can, so that we can make sure that, again, supply chain knows what we need, when we need it and that they can go make the necessary investments to deliver.

Neil Mitchill

One thing I would add there, too, is that we've forward deployed a lot of our own people to these suppliers to help sort through the assessments that are required around the inspection criteria. As you know, these are parts that are built to extremely tight tolerances. And it's important to have our engineering teams working collaboratively with the supply base.

To make sure that we can clear those items, as they come through the production process. And that's been something that I think we've put a lot of effort into over the last couple of years, frankly, but we've ramped that up recently.

Kristine Liwag

Great. Thank you.

Operator

Thank you. Our next question coming from the line of Cai von Rumohr from TD Cowen. Cai von Rumohr, your line is open.

Cai Von Rumohr

Thanks so much.

Chris Calio

Good morning.

Cai Von Rumohr

So operations look good at Pratt and Collins in the quarter, sales beat, margins beat, and you've increased sales for the year, but you basically didn't touch profit guide, for Pratt or Collins, is that conservative? Or are you assuming, I mean, it looks like in Collins, the margins are the same or basically a little bit lighter in the second half than the second quarter. Give us some color on that, if you could?

Chris Calio

Hi Cai, thanks for the comments. Overall, we're pleased with the first half results as you kind of outlined there, and we've updated our full year guide to reflect that strong top line growth. When we think about the segments and what's going on there, there are some headwinds. We've got some higher product costs, primarily in the defense pieces of Pratt and Collins.

We've got a little bit of under-absorption with some of the lower OE rates. And we've seen some higher E&D. Now we have offset some of those headwinds with some below-the-line items, such as corporate spending reductions and tightening. So there are a few moving pieces here, but we've got good momentum as we enter the second half of the year, and we're confident in the updated outlook.

Neil Mitchill

Thanks, Chris. Yes, let me add a little bit, Cai, in terms of the top line, maybe some perspective on the moving pieces. You saw that we took up our sales 750 at the low end, 500 at the high end. So think about the midpoint, obviously, 625. If you break that down, I would put $500 million of that is in the Pratt & Whitney business. It's really two pieces of that.

About $400 million of that, 80% is in the military business. We saw really strong material inputs, particularly supporting the F135 and F117 aftermarket. We dropped that through. And the rest is slightly higher OE. You saw the numbers we had in the first and second quarter. And so, we're seeing good mix and we're letting that flow through to the full year as well.

As Chris mentioned, the profit side of Pratt, we're seeing higher production costs, again, particularly in the military side of the business as we burn down the F135 contract and a little bit of higher R&D spending supporting the continued certification of the GTF advantage and obviously, the powder metal related things. At Collins, we also took that guide up a little bit, see high single-digit, I think, 7% to 8% higher end of the range that we were at before. That's about $100 million of sales.

And as I think about that, it's a couple of hundred million, maybe a three points lower on the commercial OE side. We've taken our rates down on the Boeing side in particular, but offsetting that or more than offsetting that is the aftermarket and the military side of Collins as well. So about a one point increase on the commercial aftermarket, two points on defense.

Just to kind of round it out, at Raytheon, we now see solid flat, if you will, organically up mid-single digits. It's about $50 million. There's slightly higher eliminations at the corporate level. We're going to kind of hold as a placeholder of what we saw in the second quarter for the rest of the year, a lot more intercompany activity between Collins and Pratt and Collins and Raytheon there.

So again, we're early, we're encouraged by the first half results on the profit side. But certainly, on the top end, we're seeing a trend towards the top end of our prior ranges, taking them up slightly here. And of course, if there's more, you'll see that in the results. I want to kind of see another quarter play out.

Cai Von Rumohr

Terrific, thank you very much.

Neil Mitchill

You're welcome.

Operator

Thank you. Our next question coming from the line of Jason Gursky from Citi. Jason Gursky, your line is open.

Jason Gursky

Great. Thank you, and good morning, everybody. And Nathan, welcome to the call. Hi Chris, I know - I recognize that you're executing on the existing engine platforms. But I'm wondering if you wouldn't spend a few minutes talking about the future. These flow coming out of Farnborough suggests maybe rolls is going to get back into the narrow-body market. GE made some comments this week on its earnings call that customer interest in the rise continues to grow. And then I think somebody at Pratt at Farnborough suggested that your next generation GTF might be 25% more fuel efficient. Not clear to me whether that was relative to the existing GTF, or it was a comment about the overall existing fleet. But I'm wondering if you can just kind of paint a picture for us, on what the next generation of engines is going to look like from your perspective, where the customers are kind of starting to have more conversations with you all about that, and what the potential timing of a new engine on the narrow-body side might be? Thanks.

Chris Calio

Yes. Thank you, Jason. And as you might imagine, having been a Farnborough this week, there was a lot of conversation around the future of narrow-body on sustainability and on when those platforms will be launched and get into service. I will just - I'll kind of maybe break this into sort of near medium and then longer term. Near medium, our focus and you sort of alluded to this, is on the GTF advantage.

Right now, we're about 90-plus percent of the way through that testing. We've got some good results out of our environmental and durability, and so we're continuing down that certification path. As you know, another 1% of fuel burn, 4% thrust, but a more durable and reliable engine. So that's the near term. As we think about sort of the medium, longer term, I will tell you, we're evaluating and investing in a number of key enabling technologies for insertion into future GTF configurations.

Think, composite fan blades, advanced materials like CMCs, planetary gear system. And then you referenced hybrid electric. Some of those numbers that were coming out of Farnborough are, what I would call hybrid electric or electric applications. And you think about that for the narrow-body, I view that as more of an assist, if you will, around sort of corner points of the flight envelope, lower platform, smaller platforms, the hybrid electrical view more work.

And we continue to invest there and have made some really strong strides in some of our demonstrator programs. So again, we've said this before, the GTF architecture continues to have runway. And so, these are all the enabling technologies that we continue to invest in that we think we're going to be able to insert in that for the next-generation single-aisle.

I'll also make the point that many of us in the industry are focused on fuel efficiency, and rightly so. I will tell you that we're also really focused on durability and reliability. As we continue to go push efficiency gains in the engine, there's always going to be trade-offs. We've got to make sure that those trades make sense, which is why we continue to invest in things like advanced coatings, and other advanced manufacturing techniques that can help with the durability of the engines.

If you talk to operators today, the number one thing that they want in addition to sustainability and fuel efficiency is time on win. We've got to make sure that as we're driving efficiency and rightly so, that we're also focused on the durability of the engines in the time on wing. That's frankly how - that's what the customers need and that's what we need for our business model.

Operator

Thank you. And our next question coming from the line of Matt Akers from Wells Fargo. Matt Akers, your line is open.

Matt Akers

Yes. Hi, guys. Good morning. Thanks for the question. I wanted to see if you could touch on divestitures a little bit. You've been pretty active there. Could you talk about just kind of what inning we're in there? What's left to divest? And specifically, are you able to give the revenue and EBIT contribution from the Hoist & Winch deal?

Neil Mitchill

Good morning Matt, this is Neil. We're really happy, obviously, with some of the transactions that we've announced recently in Hoist & Winch in particular. Not going to be able to give you the numbers today, but once that transaction is closed, we'll get that out there in the right form. But we got good value there. We expect to close that in the fourth quarter as it relates to the actuation business at Collins.

We are pleased to see the Italian approval in the last quarter. We're continuing to support Safran and the efforts that are required to close that transaction. Again, nothing that we see we can't get through here, but it's going to take a little bit of time, some regulatory hurdles still remain there. But there's other things we're looking at. We're always looking at the portfolio.

As Chris and I have talked about, we're targeting bolt-on type M&A that fits into our technology road maps where it's appropriate. We want to be opportunistic there, but we also want to be thoughtful and careful. And then we're always looking at the portfolio from a pruning perspective, nothing to announce today.

But I can tell you that we're going through a rigorous process, as we always do every year. And there'll probably be a handful of others that we come up with. We've talked about some of them in the past, but again, nothing to say today.

Chris Calio

Yes. Maybe just to add to that, Matt, we do have a robust and rigorous process, to take a hard look at the portfolio every year. And while there are businesses that might be solid performers, we want to make sure that they fit into the criteria long-term within RTX, namely technology differentiation and strong aftermarket tails, right? So continuing to look at the portfolio through that prism.

I'll also remind you that we've set up an RTX Ventures. We've been making investments in early-stage companies keeping our eye on some of those trends, both commercial and defense. And so those may yield some opportunities as well for bolt-ons that fit into, again, our criteria.

Matt Akers

Great. Thank you.

Operator

Thank you. And our next question coming from the line of David Strauss from Barclays. David Strauss, your line is open.

David Strauss

Thanks. Good morning, everyone.

Chris Calio

Hi David.

David Strauss

Went through Neil, your comments on Collins and the Boeing OE reach, you said took them down. I didn't know if that meant you actually have reduced the rate at which you're building on the MAX and 787, or are you just going up more slowing? Maybe if you could clarify that? And if possible, talk about where you are exactly on the MAX and 787? Thanks.

Neil Mitchill

Sure, David. Listen, I'm not going to get into specific rates per se, but I'll tell you that, obviously, we started the year with a more aggressive outlook in terms of what that rate ramp would look like. What I would tell you is that we're in the low 30s in the first half of the year. And we do expect the rate to ramp up as the year goes on. So it's not a flat rate assumption, but I'd say it's a calculated increase.

And you'll be able to hear from Boeing next week. I think I'm sure they'll have something to say about their rates. I'd say today, we're aligned with the airframers, but we're monitoring it just like everybody else. On the Airbus front, Chris talked about it already same thing. We're aligned there with the Airbus team on output.

There is always a desire to increase those rates, but we're doing the best we can to balance between airline customers and the OEMs here. But I'd say from an outlook perspective, we're reasonably well calibrated, barring some change that we're not aware of right now.

David Strauss

Thanks very much.

Neil Mitchill

You're welcome.

Operator

Thank you. And our next question coming from the line of Robert Spingarn from Melius Research. Robert, your line is open.

Scott Mikus

Thank you. This is Scott Mikus on for Rob Spingarn.

Chris Calio

Good morning.

Scott Mikus

Neil or Chris in the past, you've mentioned that you don't exactly like the business model where the engine OEMs go through a heavy development cycle, lose cash on the OE sales and have to recoup your investment in the aftermarket. So I'm just wondering with the general misalignment of profit drivers between the airframers and the engine OEMs that can create tension when allocating scarce resources. On a future clean sheet aircraft program, is there going to be a broader industry discussion to better align those profit drivers between the airframers and engine OEMs?

Chris Calio

Thanks for the question, Scott, and it's a good question. Yes, the short answer is yes, there's going to need to be a discussion around aligning our business model. And I believe that's not only in the interest of -- I'll speak from the engine side from the Pratt team, but also from the airframer team. When you are - you've got different incentives in terms of how you make your money, it does just drive a tension.

And ultimately, sometimes the customer is the one that's sort of caught in between there. And so again, I think the more that we can align our business models the better will be for the OEMs and for the customer base. And you're right, the opportunity to do that is going to be on the next platform.

We're already obviously entrenched in their current platforms. But I think we're both seeing this at times, misalignment play out. And I think with the new platforms, it gives us a chance with a clean sheet of paper to sketch out how do we get better aligned and better serve our customers.

Scott Mikus

Thanks. I'll stick with one.

Operator

Thank you. And our next question coming from the line of Noah Poponak from Goldman Sachs. Noah, your line is open.

Noah Poponak

Hi, good morning guys.

Chris Calio

Hi Noah.

Neil Mitchill

Hi Noah.

Noah Poponak

With regard to the GTF powdered metal process, is it possible to put numbers around of the number of engines that will need to come off wing, how many - what percentage even if a range have come off wing and of that, how many have actually fully gone through the full fixed process, versus are waiting in line to do so?

Chris Calio

Thanks, Noah. So let me just step back and give you sort of a powder metal sort of ramp-up and insertion background here. So as we've talked about before, since late last year, everything coming off the line going to the OEMs had the full life powder metal parts. Now all spare engines have those as well. MRO was always a, I'll call it, a phased ramp-up.

And so we'll start to see this ramp up here in the second half of the year, and it's going to continue to accelerate into 2025 and into 2026. Again, we've put a lot of emphasis on isothermal forging production. As I said, upfront, we put a lot of demand into the system, as you might imagine, given what's happened with the fleet. And we've seen some solid progress we need to continue to see some more ramp up.

And as we said before, when a shop - excuse me, when an engine comes into the shop for a visit, we do an evaluation based on the work scope it needs, where it operates, when it was naturally going to see another shop visit to determine whether or not insertion of those parts makes sense. Again, we're trying to get the longest time on wing that we can and make sure that we allocate these resources appropriately.

And so that -- those are all the things that go into decision as to which engines get the full life parts in, which we can do an inspection and do all the other things in the engine, because it was already slated to come back in advance of the time limits that, we've established. So there's a lot of moving pieces here. But suffice it to say, it's going to be a continued ramp back half of this year, '25 and '26 on powdered metal production and insertion and MRO.

Noah Poponak

Okay. As you are going through incremental customer negotiations, are you finding yourself able to change assumptions either are better or worse based on what you've experienced thus far? Or is it more kind of the assumptions remain similar, because the output has been in line?

Chris Calio

The assumptions remain similar, Noah. But I'll tell you, each customer negotiation is different based upon where they operate and how they operate. And so the agreements are tailored to those, I would say, airline-specific metrics and criteria. But we're using the same, I'll call it, key assumptions that we outlined upfront across the board.

Noah Poponak

Okay. Thank you.

Operator

Thank you. And final question coming from the line of Scott Deuschle from Deutsche Bank. Scott, your line is open.

Scott Deuschle

Hi, good morning. Thanks for taking my question.

Chris Calio

Hi, Scott.

Scott Deuschle

Hi, Chris, are you seeing progress with the FAA in terms of getting some of these wide-body first-class seats certified? And then I'm sorry if I missed it, but are you seeing momentum on ramping up output on the 787 heat exchanger? Thanks.

Chris Calio

Yes. Thanks, Scott. So yes, we - on the seating question, we continue to work our way through the certification there. These are actually a lot more complex, and I think people understand and the certification requirements are relatively high bar, but we think we have our arms around what we need to do there to get these certified and ultimately into the hands of airframers and the airlines.

On the heat exchanger, I'll just remind everyone that, that was a part that we had to move as a result of the conflict in Russia/Ukraine, out of Russia, and then set up another source here, and set up a separate supply chain, and that has taken some time. But we're starting to ramp up there to the rates that we need to support what we think Boeing's demand is.

Scott Deuschle

Thank you.

Chris Calio

Thank you.

Operator

Thank you. And with that, I will now turn the call back over to the RTX team.

Chris Calio

All right. Thanks, Olivia. That concludes today's call. As always, I and the Investor Relations team will be available for follow-up questions. I really appreciate everyone joining us today, and have a good day.