RTX Corporation (NYSE:RTX) Q3 2024 Earnings Conference Call October 22, 2024 8:30 AM ET

Company Participants

Christopher Calio - President & CEO
Neil Mitchill - CFO
Nathan Ware – VP, IR

Conference Call Participants

Robert Stallard - Vertical Research
Myles Walton - Wolfe Research
Jason Gursky - Citi
Sheila Kahyaoglu - Jefferies
Peter Arment - Baird
Ronald Epstein - Bank of America
Gautam Khanna - TD Cowen
Seth Seifman - JPMorgan
Noah Poponak - Goldman Sachs
David Strauss - Barclays
Douglas Harned - Bernstein
Gavin Parsons - UBS
Scott Deuschle - Deutsche Bank

Operator

Good day, ladies and gentlemen, and welcome to the RTX Third Quarter 2024 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 Chris Calio, President and Chief Executive Officer; Neil Mitchell, 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 non-recurring and/or significant items often referred to by management as other significant items. The company also reminds (ph) listeners that the earnings and cash flow expectations [Technical Difficulty] 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 the opportunity to participate. [Operator Instructions]

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

Christopher Calio

Thank you, and good morning, everyone. As you saw from our press release this morning, RTX delivered another strong quarter of performance, building on our momentum from the first half of the year. Demand across the business, including double-digit growth in commercial aftermarket and defense remains robust and drove 8% organic sales growth.

Our focus on execution drove 100 basis points of segment margin expansion in the quarter and free cash flow was strong at $2 billion. Based on these results and our expectations for the remainder of the year, we are again raising our full year outlook for adjusted sales and EPS, and Neil will take you through the details here in a few minutes.
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Also, of note in the quarter, we completed the accelerated share repurchase program we initiated last October, returning $10.3 billion of capital to shareholders. We've now returned over $32 billion of capital to shareowners since the merger, putting us well on track to deliver on our commitment of $36 billion to $37 billion by the end of next year.

Looking ahead, we continue to experience robust demand for our products and services. We saw incredible growth in our backlog, which ended the quarter at a record $221 billion with a book-to-bill of 1.8, and included $25 billion of defense, and $11 billion of commercial orders. Clearly demonstrating the differentiated performance that our products and services provide to our customers and supporting our confidence in the long-term growth of RTX.

There were several notable highlights. At Raytheon, we booked a record $16.6 billion of awards in the quarter, driven by the continued global demand for integrated air and missile defense capabilities, with 45% of these bookings for international customers. Key awards included $3 billion associated with our Patriot and GEM-T products, $1.3 billion for SM-3 and $1.2 billion for AMRAAM.

Importantly, we booked $1.9 billion for LTAMDs, the first domestic and international production order for our next-generation 360 degree air and missile defense system. At Pratt, we were awarded a $1.3 billion contract for the continued development of the

F135 engine core upgrade program, which will deliver enhanced engine range and performance for all variants of the F-35 well into the future.

And at Collins, the FAA awarded our connected aviation team a $470 million sustainment contract for the continued technical refresh and enhancement of our air traffic control automation system, which was deployed at over 500 air traffic control towers across the U.S. The system provides a real-time view of the airspace and tools to assist with air traffic management and airspace safety.

Okay. Let's move to Slide 4, and I'll provide an update on how we are progressing on our strategic priorities, all of which are enablers to drive best-in-class performance across RTX, including continued top line growth, margin expansion and strong cash flow generation.

I'll start with executing on our commitments. And first and foremost is our GTF fleet management plan. We remain on track, and our financial and operational outlook remains consistent with our prior comments. At the end of Q3, our inspections of powdered metal parts continue to progress according to plan. The associated fallout rate remains below the 1% expectation and the findings are consistent with the underlying assumptions of our fleet management plan.

At our MRO facilities, throughput of engines is improving. PW1100 output increased 10% sequentially and 27% on a year-over-year basis. The team is utilizing core practices to optimize the inspection sequence and implement concurrent assembly operations in our MRO facilities. We've now reached support agreements with 28 of our customers, covering roughly 75% of the impacted PW1100 fleet. The terms continue to remain in line with our assumptions.

We're also leveraging our core operating system and Industry 4.0 initiatives across the company to drive continuous performance improvements while expanding capacity. For example, at our Raytheon facility in McKinney, Texas, our focus on core implementation, along with investments in capacity and automation has significantly increased production of our 360 degree sensor suite for the F-35, known as EODAS, which stands for electro-optical distributed aperture system.

Specifically, the team drove yield improvement and streamlined test and inspection operations and move from an assembly line production process to a single piece build flow, which has resulted in a 5x increase in production capacity for EODAS over the past 12 months.

And at Collins, our avionics business is already benefiting from our connected equipment by deploying an automated smart torque system resulting in zero torque related defects and saving over 20,000 labor hours so far this year. Across RTX, we've now connected 34 factories with our proprietary digital analytics technology, and we are on track to connect 40 factories by the end of the year.

On the capacity front, we continue to invest in increasing output on our key franchise programs to deliver on strong customer demand. This month, Pratt opened a new 845,000 square foot facility in Oklahoma City that will support global sustainment efforts for military engines, including the F135, F117 and F100. This state-of-the-art facility also features automation and advanced manufacturing technologies that will streamline processes, resulting in improved productivity and throughput.

Shifting to innovating for future growth. We continue to execute on 14 cross technology road maps across RTX to develop next-generation technologies in domains that support our customers' long-term needs. An example is our hybrid electric propulsion technology to improve fuel efficiency. In the quarter, Airbus Helicopters selected Collins and Pratt Canada support the development of a hybrid electric propulsion system for its PioneerLab technology demonstrator, which is targeting a 30% improvement in fuel efficiency on a twin engine helicopter.

Pratt Canada will provide a derivative of its PW210 engine, combined with two electric motors from Collins. And as part of our Advanced Materials roadmap, Collins and Raytheon are working together to adapt commercial break carbon-carbon composite technology to hypersonic missile applications. Thermal management is a critical requirement given the high level speed, and high temperature environments at play.

In the quarter, the team achieved Technology Readiness Level 6, demonstrating the ability of the parts to survive and perform in extreme environmental conditions. These initiatives highlight our commitment to developing critical next-gen products and solutions for our customers.

Finally, we're focused on leveraging the breadth and scale of RTX. This includes driving simplification within our digital footprint and harmonizing common processes to take cost and complexity out of the business, will ultimately help drive productivity. So far this year, we've eliminated over 265 systems to streamline our engineering, supply chain and manufacturing processes. For example, Collins is on track to reduce their engineering systems by 20% this year. This will help optimize the end-to-end process flow through standard work.

We're also leveraging our scale within our supply chain to drive increased efficiencies, speed and savings. Through a coordinated RTX approach, we've identified more than 100 million pounds of common metals across 60 unique alloys that are procured by our suppliers. We have negotiated long-term agreements with these alloys that our suppliers can leverage to reduce lead times and cost, and currently have 45 suppliers utilizing these agreements to plan to add 15 more by year-end.

We expect to realize a 10% to 15% cost savings on these alloys utilizing this approach. Okay. So overall, I'm pleased with the progress we've made in our strategic priorities and the momentum we've created across our businesses.

With that, I'll turn it over to Neil to take you through the third quarter results in more detail. Neil?

Neil Mitchill

Thanks, Chris. I'm on Slide 5. As Chris said, we delivered another strong quarter of organic sales growth, segment margin expansion, and free cash flow. RTX’s adjusted sales of $20.1 billion were up 6% and up 8% organically. By sales channel, growth was led by commercial aftermarket, which was up 11%, and that's on top of 25% growth last year as global air travel continues to grow.

Defense sales were up 10% organically as we continue to execute on our backlog and commercial OE was flat as favorable mix at Pratt was offset by lower narrow-body volume at Collins. Segment operating profit of $2.4 billion was up 16% with segment operating margin expansion of 100 basis points versus the prior year.

Adjusted earnings per share of $1.45 was also up 16% from the prior year, driven by segment operating profit growth, a lower share count and a lower effective tax rate which were partially offset by expected headwinds from higher interest expense and lower pension income. The tax rate in the quarter benefited by about $0.07 per share from tax impacts principally related to a legal entity reorganization.

On a GAAP basis, earnings per share from continuing operations was $1.09 and included $0.31 of acquisition accounting adjustments and $0.05 of restructuring and other significant non-recurring charges. And free cash flow was again strong at $2 billion as continued strength in collections helped offset some higher inventory.

In the quarter, we returned $1.1 billion of capital to share owners, including dividends and $294 million, principally related to the closeout of the accelerated share repurchase program initiated last year. On the portfolio front, we expect the sale of the Collins hoist and winch business to close here in the fourth quarter and the actuation business mid-next year.

Okay. Turning to Slide 6. Let me share a few details on our updated outlook for the year. As you've seen through the third quarter, the performance across all three of our businesses has been strong, and our end markets remain robust. As a result, we have updated our full year outlook to incorporate this performance, along with our expectations for the rest of the year.

Specific to commercial OE production, based on our latest assessment of production rates, we now expect OE sales at the RTX level to grow roughly 10% versus prior year towards the low end of our prior expectation. And at Collins specifically, commercial OE is now expected to be flat for the year, and that's down from our prior expectation of mid-single digit growth. This outlook assumes that we're able to restart some level of shipments to Boeing in the fourth quarter, and we see no change to the long-term structural demand for our OE products.

With that said, strength across our other sales channels, including commercial aftermarket, Pratt original equipment and defense is expected to more than offset these impacts. All-in, we're increasing our full year adjusted sales outlook to between $79.25 billion and $79.75 billion, up from our prior range of $78.75 billion to $79.5 billion, and we continue to expect approximately 8% to 9% organic sales growth for the full year.

We are also increasing our adjusted EPS outlook by $0.15 on the low end and $0.13 on the high end, putting the new range at $5.50 to $5.58, up from $5.35 to $5.45. Improved segment profit outlook that Pratt and Raytheon more than offset a change at Collins, and we have also flowed through improvements in our tax rate and some below the line items. Nathan will take you through the segment outlook updates in more detail, we've included the corresponding updated outlook for other items in the appendix of our webcast deck.

On free cash flow, we remain on track to achieve our outlook of approximately $4.7 billion. In the fourth quarter, we expect powder metal related disbursements to increase as well as payments associated with the legal and contract matters that we discussed and recorded in the second quarter. For the year, we now expect powder metal outflows to be about $1 billion down $250 million from our prior expectation. This, combined with slightly lower CapEx is expected to offset the working capital impacts associated with the lower commercial OE volume at Collins.

Before I hand it over to Nathan for the segment details, just a few comments on how we're thinking about next year. Right now, we are working through our annual planning process across the company. And overall, with our current backlog and the expectation of continued global demand across our end markets, we expect another year of solid organic sales growth and segment margin expansion, as well as significant free cash flow generation.

We continue to analyze scenarios around aircraft production rates, the profile of commercial aftermarket growth and the likelihood of an extended continuing resolution for U.S. defense spending. We also continue to actively work through supply chain and inflation challenges with our mitigation strategies, including forward deploying our people to suppliers, second sourcing arrangements, increasing our long-term supplier agreement coverage and customer pricing initiatives.

With that said, we feel good about the strength of our businesses and our underlying fundamentals, and as we always do, we will be back in January on our fourth quarter earnings call with a complete outlook for the next year, incorporating our latest assessment of these items.

Okay. Let me turn it over to Nathan.

Nathan Ware

Thanks, Neil. Starting with Collins on Slide 7. Sales were $7.1 billion in the quarter, up 6% on both an adjusted and organic basis, driven by strength in commercial aftermarket and defense, partially offset by lower commercial OE volume. By channel, commercial aftermarket sales were up 9%, driven by an 11% increase in parts and repair, a 16% increase in provisioning and a 6% decrease in mods and upgrades.

With mods and upgrades continuing to be against a difficult prior year compare that benefited from the 5G mandate. Defense sales were up 14%, primarily due to higher volume across multiple programs and platforms, and commercial OE sales for the quarter were down 8% versus the prior year, driven by lower narrow body volume, including the impact of the Boeing work stoppage.

Adjusted operating profit of $1.1 billion was up $53 million versus the prior year. Drop through on higher commercial aftermarket and defense volume was partially offset by lower commercial OE volume unfavorable commercial OE mix and higher R&D expense. Looking ahead, on a full year basis, we continue to expect Collins sales to grow high-single digits on both an adjusted and organic basis, though likely at the low end of this range.

We expect a lower commercial OE volume that Neil mentioned earlier to be partially offset by higher defense volume. And we are updating the outlook for operating profit to grow between $575 million and $650 million versus 2023 compared to our prior range of between $650 million and $725 million, as we incorporate the impact of the lower OE volume and associated absorption and disruption impacts.

Shifting to Pratt & Whitney on Slide 8. Sales of $7.2 billion were up 14% on both an adjusted and organic basis with sales growth across all three channels. Commercial OE sales were up 9% in the quarter, primarily driven by favorable mix in large commercial engines. Commercial aftermarket sales were up 13% in the quarter, driven by higher volume in both large commercial engines and Pratt Canada.

In the military engines, sales were up 20%, driven by higher sustainment volume across the F135 and F117 platforms, as well as higher development volume driven by the F135 engine core upgrade program. Adjusted operating profit of $597 million was up $184 million versus the prior year, driven by drop through on higher commercial aftermarket and military volume.

Favorable mix and lower OE delivery volume in large commercial engines were offset by higher production costs. In the quarter, Pratt booked over $11 billion of awards. In addition to the Engine core upgrade award that Chris mentioned earlier, Pratt also booked $2.3 billion of F117 sustainment and $6.6 billion of commercial awards.

Turning to Pratt's full year outlook. We continue to expect sales to grow mid-teens on an adjusted and organic basis, most likely towards the higher end of this range, driven by stronger military volume and the favorable mix in large commercial engines that we've seen so far this year. And we are updating the outlook for adjusted operating profit to grow between $475 million and $525 million versus 2023, up from our prior range of between $400 million and $475 million.

Now turning to Raytheon on Slide 9. Sales of $6.4 billion in the quarter were down 1% on an adjusted basis as a result of the cybersecurity divestiture in the first quarter. On an organic basis, sales were up 5%, driven by higher volume on land and air defense systems, including Patriot, NASAMS and counter-UAS programs, as well as higher volume on advanced technology programs. This was partially offset by lower volume on air and space defense systems.

Adjusted operating profit of $661 million was up $91 million versus the prior year, driven primarily by favorable mix improved net productivity and drop through on higher volume, partially offset by the impact of the cybersecurity divestiture. In the quarter, net productivity improved $33 million year-over-year and included an unfavorable impact of $53 million related to a classified program. Of note, Raytheon has now seen four consecutive quarters of year-over-year margin expansion.

And as Chris highlighted, bookings in the quarter were $16.6 billion, resulting in a backlog of $60 billion and a book-to-bill of 2.6. On a rolling 12 month basis, Raytheon's book-to-bill is 1.48. In addition to the awards mentioned earlier, Raytheon also booked $1.2 billion of classified awards, $737 million for AIM9X and $538 million for Javelin. In total, Raytheon's backlog is now 44% international, up over 10 points from last year.

Looking ahead, we continue to expect Raytheon sales to grow mid-single digits organically for the year and due to the volume drop through and favorable mix you've seen so far this year, we now expect Raytheon's operating profit to grow between $200 million and $250 million versus 2023, up from our prior range of between $125 million and $200 million and this includes the impact of the cybersecurity divestiture.

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

Christopher Calio

Okay. Thanks, Nathan. I'm on Slide 10. As you heard today, RTX is extremely well positioned for growth. We've got an installed base in commercial aerospace that has a long aftermarket tail and leading defense franchises that are seeing record global demand. Our team remains focused on supporting our customers and executing on our commitments, which led to our strong third quarter performance and an improved outlook for the full year. And as we continue to drive our strategic priorities, we're confident in our ability to deliver sustained growth in organic sales, earnings, and cash flow over the long term. .

Okay. With that, let's open it up for questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of Rob Stallard of Vertical Research. Please go ahead, Rob.

Robert Stallard

Thanks so much. Good morning.

Christopher Calio

Good morning.

Neil Mitchill

Good morning, Rob.

Robert Stallard

Chris, a question for you on the GTF. I was wondering, how you manage the competing demands of the spares pool versus the Airbus line in the third quarter, and how confident you are in hitting the delivery targets for the fourth quarter? Thank you.

Christopher Calio

Yeah. Thanks, Rob. Obviously, a critical initiative for us. So look, we've continued to ramp deliveries this year of both OE and spares. So, if you think about year-to-date, in aggregate deliveries of about 16% and also about 7% up sequentially, that's the composite. But I'll also tell you that both OE and spares are up individually as part of those composite numbers.

I'll also note that we're well above our 2019 volume. So again, continuing to ramp and balancing all the needs. And that balance is going to continue as we're going to allocate amongst OE, spares and MRO to support the fleet. Our situation with the fleet and with powdered metal, we've got to continue to make those trades in order to support our customers.

And a big part of that balance and supporting that balance is that we've got to continue to drive production of key part families. So think isothermal forgings, they continue to ramp up 38% year-over-year. And then the other piece I would say is structural castings. We've got to continue to improve in that area. There are some part numbers that have recovered the plan, some that are going to take a little bit longer to recover.

But I would say, all-in-all, Rob, we're aligned with Airbus and what they need here in the fourth quarter and laser-focused on helping them make their deliveries at the end of the year.

Robert Stallard

Thanks, Chris.

Operator

Thank you. And our next question comes from the line of Myles Walton of Wolf Research. Your question, please, Myles.

Myles Walton

Thanks. Good morning.

Christopher Calio

Good morning.

Myles Walton

I was hoping you could touch on Raytheon. Obviously, really good bookings and -- but the organic growth has been sitting around 5% for a couple of years. What's the type of acceleration we should all think about into '25 and beyond. And also from a mix perspective, that 10 points higher mix in the backlog, how quickly does that impart into a significant mix shift in the sales in '25 and '26? Thanks.

Christopher Calio

Hey, Miles. So look, the story at Raytheon right now is the demand is incredibly strong, right? I mean, if you think about the $16.6 billion of bookings this quarter, it's fantastic. The rolling 12 month book-to-bill is almost 1.5 and they've got a $60 billion backlog today. And as you noted, the international piece of this is up over 10 points, about 44% of the total backlog. Now that's going to take some time to work through, that's not going to be something that's going to materialize in large measure in 2025.

We've got to continue to work through the backlog that we have and that's going to take some time. We are heartened by the fact that the supply chain and material flow continues to be healthy. We've seen six straight quarters of growth and that's going to need to continue. We've also continued to build out capacity. We've talked before about expansion efforts in Texas and Arkansas, at Redstone as well, and in Tucson.

So supply chain is getting healthier, capacity is being put into place. Demand is there. We just got to continue to work through this backlog. But again, I think that mix shift that we've talked about will materialize and be tailwind to growth at Raytheon in the coming years.

Neil Mitchill

And Myles, good morning. It's Neil. I would just add that we're definitely seeing the benefit of the mix already show up. And as you think about the margin improvement in the quarter, I would attribute over 100 basis points of that to the mix alone. And the good news there as well as we're seeing year-over-year improvement in productivity that Nathan highlighted, and that's in spite of some headwinds that we dealt with in the quarter, frankly.

So still feel good about this year. As Chris has talked about at length, we've got some supply chain challenges that we've been dealing with. And as those continue to free up, then, we'll see the top line grow commensurately with that. Clearly, a strong backlog going forward, though.

Myles Walton

Thank you.

Operator

Thank you. Our next question comes from the line of Jason Gursky of Citigroup. Your question, please, Jason.

Jason Gursky

Yeah. Great. Good morning, everybody.

Christopher Calio

Hey, Jason.

Jason Gursky

Hey, Chris. You mentioned -- you made some comments I should say, about productivity in your prepared remarks. I know, Nathan talked a bit about it in his as well. Why don’t we just could add some context to your views on productivity. Kind of, where we are today, maybe relative to where we were pre-pandemic across your businesses and where do you think this can all go over time, kind of, your expectations about productivity growth in the quarters and maybe multiple years ahead and kind of the expectations that you're kind of building into your plan?

Christopher Calio

Yeah. Thanks, Jason. So look, a couple of thoughts here. I would say, at Raytheon, we've talked about productivity for a while now and the lack of productivity that we've had. And we're starting to see some green shoots there. You just heard Neil talk about that. I think that's going to be a function of, again, the quality and improvements that we're making, core driving improvements and shortening that period of performance all the fundamentals that come with that business as we get into what I would consider to be some of the core of our business there.

The things we know how to do really well, those legacy programs that make up a big part of that backlog. I think we continue to see productivity there, and I already mentioned before, the continuing health of the supply chain being a critical factor there. I think we've got the labor in place. But again, it's the supply chain we need to continue to get healthier. I'll say, across other parts of the business, we're driving productivity in many respects through automation in our factory 4.0.

If you go into our factories today, we're continuing to drive connected factories, making sure that we've got the automation in place to take the labor hours out where it makes sense, again, to continue to drive the kind of productivity we need to see across the business. The backlog is there. It's exceptionally strong, both defense and commercial. And as we continue to see the supply chain get healthy as we continue to drive automation in our connected factories, the productivity, I think, will come in this business across all three segments and frankly, be tailwind to the margin expansion we expect across all three businesses.

Neil Mitchill

And maybe to add with respect to Raytheon, we've already seen about $110 million of productivity benefit year-over-year. So I think really good traction. We had talked about -- seeing about 200 on a full year basis. And I think, we're largely on track to do that. The backlog programs that have been causing consternation in the supply chain aberrations are diminishing now, and we're replenishing that backlog with new bookings that are priced at current prices with the current lead times kind of embedded in them.

So encouraging to see the progress so far, and I think we'll continue to expect that to continue at Raytheon in particular. But as Chris said, across the portfolio in all of our areas where we're doing long-term contract accounting.

Jason Gursky

Great. Thanks.

Operator

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

Sheila Kahyaoglu

Good morning, Chris, Neil, Nathan.

Christopher Calio

Good morning.

Sheila Kahyaoglu

So maybe if we could talk about Collins, please, both on the OE side and the aftermarket. Collins aftermarket was up 9%. OE was down 8%. First on the OE, it implies Q4 down 15%, just given the flat guidance now. So what are you expecting there just around the shipset volumes, if you could give any color? And then secondly, maybe if you could talk about the aftermarket up 9%. I know tough comps in some of the businesses there, but how do you think about the correlation between OE down and aftermarket? Are you seeing any aftermarket benefit from the delayed deliveries?

Neil Mitchill

Thanks, Sheila. Good morning. Let me start on the OE side. As you heard us talk about, we did recalibrate the Collins outlook for the rest of the year, taking into account. The fact that our OE was down in the quarter, and that was really driven by a few things. I would say narrow-body volumes were down. We saw a little bit both on the A320 side as well as the 737 side. We obviously had a little bit of impact from start of the strike as well.

And what we've done is, we've calibrated a level of impact here in the rest of the year going forward. We think we got that reasonably calibrated. We do expect to resume some shipments later in the quarter. And like everybody, we're looking forward to tomorrow and the situation at Boeing getting resolved. So I think we got that calibrated, that's really what's driving the majority of that.

There's also a little bit of mix headwind going on within the wide-body. Wide-body in the quarter was up about 1% on the sales line. But what we saw is a little bit higher weighting towards 787 and lower A350. And as you all know, the 787 is not a profitable line for us on the OE side, that's been exacerbated by the movement of heat exchangers from Russia into the United States and the U.K. So a couple of things that we're dealing with there. But I think as we look at the rest of the year, we've got that reasonably calibrated on the OE side, and that's what causes us to take down the number.

Now on the aftermarket side, we're continuing to see good provisioning, good repair work going through at Collins. And so, I still feel good about that. I think it remains to be seen about longer term how this plays out, but clearly, the older platforms are continuing to fly. We've seen very low levels of retirements and that supports continued aftermarket strength that we're seeing at Collins, and I expect that to continue into next year as well. So those are a few comments there on those two items.

Sheila Kahyaoglu

Thank you.

Operator

Thank you. Our next question comes from the line of Peter Arment of Baird. Your question, please, Peter.

Peter Arment

Yeah. Thanks. Good morning, Chris, Neil, Nathan.

Christopher Calio

Hey, Peter.

Peter Arment

Hey. Maybe, Neil, just to level set us on maybe free cash flow kind of the cadence when you think about it going forward. You've talked about, obviously, this year, if we back out the payments and everything, you guys are probably over 80% kind of conversion. Just thinking at a high level, when you think about '25, how you're thinking in terms of any moving parts or pluses or minuses we should be thinking or does conversion improve with all of kind of the initiatives that Chris has established on productivity and whatnot? How do we think about that? Thanks.

Neil Mitchill

Yeah. Thanks, Peter. First of all, in '24, we remain very confident in the $4.7 billion. As I laid out in my prepared remarks, we've got a couple of moving pieces, but I think we'll be able to manage the inventory going forward to deal with the headwind that we're seeing this year. We're still counting on some significant working capital benefit this year, about $700 million year-over-year. And I think that's a big opportunity for RTX. As we look at our balance sheet, we've been doing the right things to protect the supply chain. We've got significant sales ahead of us. So we want to be ready to deliver on that. But that's an opportunity for us to continue to convert the working capital turns, drive those up higher and deliver some more free cash flow.

I think big picture, we see a lot of organic strength in the free cash flow. I think that's evidenced by the $4 billion of free cash flow we've seen year-to-date. We're expecting another strong operational fourth quarter. We've got some payments that we're going to deal with that are consistent with what we talked about last quarter. But as we look longer term, I see no reason why the business here won't generate 90% to 100% free cash flow conversion against adjusted net income. So all the right pieces in place, the underlying demand is there. We need to kind of calibrate around OE deliveries longer term, and everybody's got an eye on the broader economy and inflation. But right now, I think the underlying drivers of the business remain strong.

Christopher Calio

Yeah. And just to add on to that, Peter, as we've talked about, I think, pretty consistently, a big piece of that cash flow growth is the profit growth in the aftermarket and up 23% last year. Year-to-date growth this year, 12%, so still robust, continue to see strong RPK growth. Collins has that installed base that's out of warranty, that's about $1 billion. V2500 continues to be strong. We've seen low retirements there. So the fundamentals, as Neil pointed out, in the aftermarket continue to be really strong, big piece of that cash story.

Peter Arment

Appreciate the details. Thanks, Chris and Neil.

Operator

Thank you. Next question is from the line of [Technical Difficulty]. Your question, please, Ron.

Ronald Epstein

Yeah. Hey. Good morning, guys. Thanks. Hopefully, you can hear?

Christopher Calio

Hey, Ron. We can. We got you.

Ronald Epstein

So what are the takeaways? It seemed like after spending a couple of days at AUSA this year that this next generation of company seems to be getting a little bit of traction, right? So who I'm talking about, the Palantir's and roles (ph) of the world. How are you thinking about them? Are they a competitive threat? Are they potential partners? How are you thinking about defense tech? I know you've got your RTX Ventures division, but broadly, how are you thinking about that? And is it an opportunity or a threat?

Christopher Calio

Yeah. Thanks, Ron. I think it's both. I think there are areas where I think we're competing in the marketplace. And I think we remain always paranoid about competition across the landscape, established players and some of these new players. We continue to invest heavily in R&D and in our innovation roadmaps and story.

And I think one of the advantages that we've got is our ability to scale and scale production, a very sophisticated production system and be able to scale. Now there are things that we also learn from our competitors about agility, about low cost, about getting things out to market faster. Again, all parts of the things, when we look at the competitive landscape, we're looking at and bringing in-house, seeing how we can adapt.

But at the end of the day, I think we've got a fantastic product portfolio that's going to be critical to the U.S. and our allies for decades to come. But I also, as I said upfront, view it as potential partnership opportunities. There are things that they do very well, perhaps on the software side that could be of use to our [indiscernible] products, given our hardware expertise. So again, we're looking at it both ways.

And as you noted in your question, we continue to invest in early-stage companies through RTX Ventures. And I'll tell you just reviewed this with our board. There's a few promising investments that we've made that we think will give us access to technologies that we can integrate into our established product portfolio to add capabilities and performance.

Ronald Epstein

All right. Thank you.

Operator

Thank you. Our next question comes from the line of Gautam Khanna of TD Cowen. Please go ahead, Gautam.

Gautam Khanna

Hey, thanks. Good morning.

Christopher Calio

Good morning.

Gautam Khanna

I was wondering if you could frame up for us when do you think at Raytheon defense productivity takes a more significant turn. I mean, obviously, this year, it's a big change year-over-year. You do have some challenged programs that at some point, I imagine are also kind of a negative to that ledger. When do those kind of roll off? And do we ever get back to the kind of pre-pandemic $200 million plus of favorable, and if so, when is that realistic? Thanks.

Neil Mitchill

|Thanks. Thanks for the question, and welcome to the call. I want to thank Cai for over 50 years of following our company. So welcome to following us, it will be good to work with you. Just a comment on the -- not the Patriot, on the productivity here. We've seen $110 million year-over-year improvement, like I said, expect that to be close to $200 million. So I think we're certainly turning the corner there. And as you pointed out, there are still some headwinds in there. And I think there always will be.

Programs will go well and some will have some challenges. We do difficult stuff. I won't get into specifics for next year, but we expect that to continue to improve as we go forward. Whether we get back to the same levels of the kind of productivity, I think, depends entirely on the mix and the environment that we're operating in. Now we clearly have a lot of backlog, which allows us to buy material at large volumes. And that's where we tend to drive the majority of our productivity.

What we really need to do to see greater levels of productivity relative to the bidding margins here is to have productivity in our factories as well on the assembly side. And that will come with improvement in the supply chain, and we already talked about the importance of rocket motors to that value stream. So those are the kinds of things we're watching, but I would say that there is a lot of good positive productivity embedded in the business. We're working through the backlog where the pricing was not aligned with the cost inflation that we've experienced over the last few years and we're seeing the international mix improve.

I think longer term, we'll start to see LTAMDS and other large franchises come into play as well, and those will give us more opportunities for productivity. So bottom line, hard to put a number on it, but we're going to see that margin improvement. We're seeing it this year. We expect to see more of that next year. And I think this business has turned the corner in terms of the productivity steps forward that we're all hoping for.

Operator

Thank you. Our next question comes from the line of Seth Seifman of JPMorgan. Please go ahead., Seth.

Seth Seifman

Hey. Thanks very much. Good morning. I wanted to follow up on Collins. There was a shortfall in the quarter, the guide is down, I think, about $75 million, which is around what you guys missed my estimate in this quarter. And you talked about the guide down relating to absorption of the Boeing strike and all that, which seems like it should be ahead of us. But it would seem that the you kind of need kind of a pickup in the margin at Collins in the fourth quarter. And I wonder, if you could talk about what's driving that and how much kind of that absorption really impacted Q3 versus other stuff?

Neil Mitchill

Sure, Seth. Let me take that one. Let me talk about a few of the moving pieces on the ROS for the quarter. First of all, we did see positive lift of about 300 basis points from higher volume in Collins commercial aftermarket defense channels. So that was good to see, and that dropped through. Offsetting that, we saw about 200 basis points of headwind from the lower commercial OE volume and the associated absorption and disruption impact and unfavorable mix in the quarter. So we did experience some unfavorable mix and drop-through on that. The volumes are down sequentially and year-over-year on the OE side. So I already talked about some of the moving pieces there. Talked about 787 volume being a little bit higher inside of the wide-body, and so that creates headwind as well.

And third, we saw about 100 basis points of headwind from a combination of a few things. We had higher R&D, about $40 million. I attribute that to mostly timing within the year that was within our Avionics business as we continue to invest in upgrades to those platforms, slightly higher SG&A, and we saw a little bit of headwind in our interiors business. We've talked in the past about some of the first-class and business class seating, certification challenges that the business is seeing, you've heard about that with us and more broadly across the industry. So we did have about $35 million of contract headwind in the quarter. Again, I don't expect that to repeat.

So as we look from Q3 to Q4, we see about 130 basis points at the midpoint of our outlook margin uptick. And I think that's going to largely come from the mitigation actions that we're undertaking to address the temporary reduction in the OE deliveries at Collins, in particular and of course, the absence of the EAC headwind on the interiors business that we saw here in the third quarter. So I kind of characterize these items as short term in nature, one-time. There's good strong underlying strength in the business. The aftermarket is really strong. We're getting good drop-through there. Defense has been very, very strong. And Collins has taken good proactive measures here to make sure we balance, keeping our supply chain warm and our factories moving so that we're prepared to restart deliveries as soon as Boeing gets the work stoppage behind them.

Seth Seifman

Great. Thanks very much.

Neil Mitchill

You’re welcome.

Operator

Thank you. Our next question comes from the line of Noah Poponak of Goldman Sachs. Please go ahead, Noah.

Noah Poponak

Hey. Good morning, everybody.

Christopher Calio

Good morning, Noah.

Neil Mitchill

Hey, Noah.

Noah Poponak

Hey, Neil. Just following up there on the Collins margin. You had the '25 framework implied that segment margin just below 20% and had the incremental stepping up a lot next year. Is that still the directional framework or have just a lot of things moved around? And then, on the GTF powdered metal, any numbers you can put around how many engines have actually gone through the process and are back in service. And then of the engines we can see are off wing, how many of them are in a shop versus in line to get in a shop?

Christopher Calio

Yeah. No, I'll start with the powdered metal and then Neil can chime in on the Collins margin question. So again, just to reiterate, been pretty consistent on this, everything coming off the line today, going to the airframers as the full life powder metal parts. MRO, again, it's a balance of the material and of that allocation and it's going to be a ramp, again, as I said, throughout the year. I would say, you're going to really start to turn the corner on the insertion of powdered metal parts as we head into 2025.

As we continue to ramp up the isothermal forging, as I said, 38% up year-over-year, and we're putting in place continued capacity in all pieces of that value stream to continue to ramp in 2025. So we have to do less balancing of that material in 2025. So that's the story on powdered metal. In terms of what's being inducted and what's in the parking lot, yeah, there still remain a significant number of engines that are awaiting induction.

Again, that's a big part of what it's going to take us to power through this particular situation over a multiyear period. I would say, the turnaround times, however, are still in line with what we've talked about previously, the shop visit mix still consistent between heavy and light. And as I've said before, when we get our gate two, which is our material accumulation into a healthy spot. We've had pockets of this throughout our MRO shops.

Our turnaround times, in particular on heavy work scopes has been exceptional. So again, we've got to continue to get the material flow going again, try to get to a point in 2025 where that balance has to become less pronounced. And once we do, we'll start to see that flow through our engines and get inductions and WIP in a better spot.

Neil Mitchill

Thanks, Chris. On the margins, no, let me just talk a little bit about, I'm not going to get ahead of ourselves on '25 and provide specific guidance today. We'll be back in January to do that. But as I think about the Collins business, there are a few things we're watching. Notably, the OE levels, I think that's an important ingredient. And as we get through the fourth quarter here, we'll have a lot more clarity on what that's going to look like.

As we've talked about for a long time now, the Collins business is capacitized to deliver at volumes that are much higher than where we are today. And frankly, in some cases, much higher than where we were in 2020 and certainly in 2019. So absorption is a really important part of the Collins OE story, and we need to see the volumes increase to get better unit cost on the deliveries, that's a watch item for us.

Like everybody, we're continuing to update, renew our long-term agreements and with that comes some pressure on the cumulative effect of inflation over the years. So something that we also want to make sure we get calibrated into our outlooks for next year. But underlying all this is really, really strong Collins demand. They're on the right platforms, the provisioning has been strong, repairs are strong. We see the demand for the OE side continuing both Airbus, Boeing and Embraer.

So it really is strong fundamentals, but a few watch items that we need to kind of calibrate into the margin story. That said, I expect the margins to grow at Collins. We expect good operating profit growth next year, and we expect that to convert to free cash flow growth as well. So the fundamentals of the business are there and remains strong for both next year and years to follow.

Christopher Calio

And maybe just to add, Noah, I think Neil laid it out well, obviously, the installed base, the $100 billion of out-of-warranty equipment. It's going to continue to drive aftermarket and profitability and margin expansion at Collins. But the part that I'll accentuate here is, the cost reduction actions that are a key part of this. Just the tactical, you heard Neil talk about some of those cost curtailment actions that Troy and the team have put in place as a result of the work stoppage and the lower OE volumes, so we've been pretty aggressive there.

But also talk about the more structural cost reduction that's happening there. The movement of 2.7 million hours to low cost areas, the formation of centers of excellence like electronics to get economies of scale in important parts of the value stream. So that's the other piece of the Collins story that the team is focused on. As Neil said, on the right platforms, that's going to continue to provide tailwinds. The focus on cost is going to be really important as well.

Noah Poponak

I really appreciate all that. Neil, did you quantify the EAC in Collins in the quarter?

Neil Mitchill

Yeah. It's about $35 million on the interior side.

Noah Poponak

Okay. Thanks so much.

Neil Mitchill

Yeah.

Operator

Thank you. Our next question comes on the line of David Strauss of Barclays. Your question, please, David.

David Strauss

Thanks. Good morning.

Christopher Calio

Good morning.

Neil Mitchill

Hey, David.

David Strauss

So I wanted to follow up on GTF and the spend there. I think, Neil, you had talked about it ramping up in Q3. It doesn't look like it did. It sounds like you plan on spending less this year, maybe if you can help us what the path looks like from here as it relates to '25 and '26. But I guess just high level, if you're reaching compensation agreements with your customers, your customers have a lot of aircraft on the ground out of service. I guess, why aren't you paying more or are you swapping maybe cash payments for something else in the future? Thanks.

Neil Mitchill

Sure, David. Happy to provide a little more color there. First of all, just so everyone's grounded, we do expect to make about $1 billion worth of payments this year. We've made a little over $300 million year-to-date. We've talked about the number of customer agreements that we have in place. It's 28 now, covers about 75% of the AOGs. And so what we do as a matter of our practice years, we're crediting the customers as the AOGs occur. We consider that a cash payment when that credit is applied to a customer account or we make a cash payment. So that's how we're quantifying it. It's a cash equivalent, if you will, impact to us during the year.

It's coming down a little bit because it's taken some time to get these agreements in place. And once we have agreements, then we're following the terms of those agreements and issuing those credits or making those payments. We do expect that to ramp up now in the fourth quarter. What I can say is, overall, all of the underlying financial assumptions that gave rise to the charge we took and the reserve we put up remain consistent and the agreements that we've executed also remain consistent with those underlying assumptions.

So I won't get into specifics around when we expect the ultimate payments to make place, but we'll continue to provide the same level of transparency about what we're spending and how much we're spending, so that we all and you all have a good look at the underlying organic performance of the business. So that's where I would say, we are today. We'll certainly see the fallout of these payments take place over the next couple of years as those AOGs continue to exist and then come down as planned as we move through next year and into '26.

David Strauss

So thanks for that. I think you had said $1.5 million next year and then $200 million tail in '26. Does that doesn't hold anymore, it's more likely to kind of shift out to the right?

Neil Mitchill

Well, I would just say that sometime over the next two years, we're going to make the full amount that we've accrued for at this time. The assumptions remain the same. We'll provide an update on that in January as well. Again, giving everybody the visibility and transparency to exactly what we're assuming. If it's different, we'll update our outlook accordingly.

David Strauss

All right. Thank you.

Neil Mitchill

You’re welcome.

Operator

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

Douglas Harned

Good morning and thank you.

Neil Mitchill

Hey, Doug.

Douglas Harned

On Raytheon, you've got great orders here, strong international focused very much on missiles and missile defense. So that's very good, as I see it for margin expansion going ahead. But can you talk a little bit about the other side of the business, the airborne and space systems, which have been more difficult for you for growth. What's going on there in terms of strategy and how you see that part playing out?

Christopher Calio

Yeah. Thanks, Doug. I think you're right. It has been a more challenged story for us. As you pointed out, when you look at the demand in the backlog today, significant strength in that integrated air and missile defense. And that's going to be a driver of Raytheon in '25 and beyond, frankly, when you look at the size of this backlog. There are other pieces of the business that we're evaluating, Doug. I think we've got, for instance, some real strength in our space business.

Now, is it where we've historically been strong and will that continue into the future, that's what we're evaluating. There are certain parts of that space domain today that have been really, really difficult for anybody to make into a sort of profitable business right now. We don't want to go chase business and buy business at really, really difficult margins on, fixed-price development programs, that's not who we want to be in that space.

We've got to play to our strengths, things like space protection, ISR, C2. So those are the areas that we're continuing to look at and say, how do we strengthen the foundation and other pieces of this business that we either need to invest further in or decide that's not where we see the growth in that portfolio coming.

Douglas Harned

Is there a time frame that you can see where you'll pretty much have a new strategy in place and positioned for growth?

Christopher Calio

Well, first of all, I think Raytheon is exceptionally well positioned for growth. I would say, it large, Doug, as you kind of in your question. In these particular areas, yeah, we're undergoing a portfolio evaluation across the board, as we always do, to determine what parts of the business while might be strong historically. Aren't necessarily going to be a part of the business going forward, that's ongoing. We do that every year around this time of year and we'll make some of those decisions as we head into 2025. Now again, these are long-cycle businesses, as you know, Doug. So pivoting a strategy in some of these areas will take some time, and we're going to be thoughtful about it.

Douglas Harned

That’s very good. Thank you.

Operator

Thank you. Our next question comes from the line of Gavin Parsons of UBS. Your question, please, Gavin.

Gavin Parsons

Thanks. Good morning.

Christopher Calio

Hey, Gavin.

Gavin Parsons

I know we'll learn tomorrow on the Boeing front, but I just wanted to learn more tomorrow anyway. But I wanted to clarify that you said you're full stopped. And if your expectation is that you would resume when Boeing resumes or if you think there's some possibility for destocking there?

Christopher Calio

Yeah. Hey, Gavin. So yeah, like you, we'll be watching closely tomorrow. Pleased about the news regarding a potential resolution would be good news, not just for Boeing for us but for the industry. I think everyone is certainly rooting for that. We've actually and Neil referenced this in the prior answer, we've continued to try to keep our value streams healthy, our supply base and our factories, that means, we've continued to take in material on certain higher volume programs and continue to build product. And once this work stoppage is over, then whatever has to happen logistically for Boeing to start receiving material, we want to be prepared to be able to do that. I mean, obviously, Boeing is going to want to ramp in '25 and beyond.

We want to make sure that all facets of the value stream are healthy enough to do that. So we haven't just stopped cold turkey that just wouldn't be healthy for the supply chain, wouldn't be healthy for our factories. So we've continued to do that. There are other parts of the Boeing product portfolio that we have that have stopped that we've taken certain cost curtailment measures. But by and large, we've continued to, again, take in material and build product because we want to be ready when the re-ramp arrives.

Gavin Parsons

Appreciate the detail.

Operator

Thank you. Our final question comes from the line of Scott Deuschle of Deutsche Bank. Your question, please, Scott.

Scott Deuschle

Hey, good morning. Chris, it seems like there's a lot of 787s already built sitting in Charleston, I think, waiting for seats, I think mostly for Lufthansa and American. Is Collins the seating supplier for either of those airlines? And then, do you have any sense for where you're at on the FAA review there for those customers, assuming Collins actually is seating supplier for either of those?

Christopher Calio

Yeah. It is Scott. It is a seating supplier on certain of those, not all of them, but certain of them. And yes, you're absolutely right, we are working through the certification with both Boeing and the FAA, so that is ongoing. While that's ongoing, we're continuing to drive the supply chain to make sure that we've got the material we need, so that when that gets behind us, we can go make deliveries and then they can continue their flow and get it out to the customers who are obviously looking for the lift.

And again, I said this before, as the strike has happened, 787 tier point is not a part of that. And so we've just been full steam ahead on making sure that as Boeing decides it wants to take rate up that we're there and ready to do it. Neil referenced heat exchangers and what we need to do there in terms of the environmental control system. There are other parts of the 787 content that we've got to continue to ramp to support Boeing. We know that's going to be a crucial part of their recovery, and we want to make sure we're poised to help them there.

Scott Deuschle

Thank you. And Neil, sorry if I missed this, but is there any directional framework you can share on how to think about military aftermarket growth at Pratt next year? Just given the installed base that we think would be growing a lot now that delivery hold has been lifted, and I assume flight activity starts to ramp up? Thanks.

Neil Mitchill

No problem. Thanks, Scott. Yeah. I don't want to get too far ahead of us, but I mean we saw a really strong 20% military growth at Pratt in the quarter. I would say, the aftermarket was right in line with that. So as the installed base, as you pointed out, continues to grow, I do expect Pratt to continue to see the benefits of the top line growth there. I won't put a number around it today, but it's going to be -- continued strong growth on the military business of Pratt, that's a great business there. And we're seeing the margins grow as well as the mix shift goes from sort of a baseline of OE levels of production that then grows on the top line on the sustainment side. And it's not just F135, it's F117 as well as we pointed out in our prepared remarks. So see continued growth there. The orders in the quarter at Pratt were 2x what they were a year ago and even more so at Raytheon. So again, the backlog remains really, really strong in all of our defense businesses as we look ahead.

Scott Deuschle

Thank you.

Operator

Thank you. With that, I would now like to turn the conference back to Nathan Ware.

Nathan Ware

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