Raytheon Technologies Corporation (NYSE:RTX) Q3 2021 Earnings Conference Call October 26, 2021 8:30 AM ET

Company Participants

Greg Hayes – CEO
Neil Mitchill – CFO
Jennifer Reed – Vice President

Conference Call Participants

Peter Arment – Analyst
David Strauss – Barclays
Ron Epstein – Bank of America
Sheila Kahyaoglu – Jefferies
Seth Seifman – JPMorgan
Noah Poponak – Goldman Sachs
Robert Stallard – Vertical Research
Doug Harned – Bernstein
Myles Walton – UBS
MIke Maugeri – Wolfe Research
Matt Akers – Wells Fargo
Cai Von Rumohr – Cowen
Kristine Liwag – Morgan Stanley

Operator

Good day, ladies and gentlemen, and welcome to the Raytheon Technologies Third Quarter 2021 earnings conference call. My name is Mistie, and I will be your Operator for today. As a reminder, this conference is being recorded for replay purposes. On the call today are Greg Hayes, Chairman and Chief Executive Officer. Neil Mitchill, Chief Financial Officer, and Jennifer Reed, Vice President of Investor Relations.

This call is being carried live on the Internet. And there is a presentation available for download from Raytheon Technologies website at www.rtx.com Please note except where otherwise noted, the Company will speak to results from continuing operations, excluding acquisition accounting adjustments, and net non-recurring and/or significant items, often referred to by management as other significant items.

The Company also reminds listeners that the earnings and cash flow expectations and any other forward-looking statements provided in this call are subject to risks and uncertainties. Our TCS SEC filings including its Form 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 statement.

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] You may ask further questions by reinserting yourself into the queue as time permits. With that, I will turn the call over to Mr. Hayes.

Greg Hayes

Thank you, Misty, and good morning, everyone. As you saw from our press release this morning, we delivered another solid quarter. A few comments before I turn to the highlights. We continue to feel good about the long-term fundamentals of our business and our ability to drive growth and margin expansion over the next several years. During the quarter, we made great progress on cost reduction, driving operational excellence through our businesses, and achieved some notable milestones which we'll touch on in just a moment. From a market perspective, commercial air traffic continued to recover despite some regional impacts from the COVID variance.

The global ASMs are available, SEC miles estimated to have grown about 30% sequentially in Q3. And here in the U.S. passenger traffic through TSA checkpoints averaged about 1.9 million travelers per day in Q3. That's up from about 1.6 million per day in Q2. International borders, as we know, are starting to reopen and that's another positive. And on the Defense side, Fiscal year '22 budget request was in line with our expectations. And as we've said, defense spending is nonpartisan, and we're encouraged to see Congress supporting plus ups to the president's budget that are also aligned with our -- to our business in our investments in new technologies. Overall, we continue to be cautiously optimistic on both the Commercial and Defense trends that we're seeing.

Okay. Let's move to slide 2, some highlights from the quarter. Adjusted EPS exceeded our expectations, free cash flow was in line with what we expected. And we delivered another quarter of top and bottom line growth on both a year-over-year and a sequential basis. As we had capitalized on the commercial after-market recovery and our defense portfolio continues to grow. Based on our strong performance year-to-date, we are again increasing and tightening our adjusted EPS outlook for the year to $4.10 to $4.20 a share.

That's up from our prior outlook of $3.85 to $4. Neil Mitchill will get you into the details on sales and free cash flow where we were also tightening our outlook in both areas. On the capital allocation front, we repurchased about $1 billion of RTX shares during the quarter, bringing our total for the year to $2 billion, which was our commitment that we talked about back in Q2. Before I turn it over to Neil, couple more details on our results. Let me cover some strategic and operational highlights for the quarter where we continue to execute on our key programs. Starting with strategic highlights, we announce the acquisition of FlightAware, which will become a significant accelerator for Collins connected ecosystem strategy, and enhances our capabilities in growth areas like aviation network services, digital solutions, and aerospace modernization.

And we're organizing our business around optimizing these capabilities within Collins Aerospace. We also announced the acquisition of Seeker engineering, a leading provider of advanced Space Electronics Solutions. Seeker strengthens are offerings to solve our customers most complex problems by expanding our space-based capabilities with the integration of Blue Canyon, this also enhances our IRS competitiveness, and reliability of satellite bus hardware, and customized space electronics.

At the same time, we continue to divest non-core businesses. During the quarter, we announced an agreement to divest of our global training and services business, which is part of RIS. On the operational side, the missiles and defense team and their industry partners successfully completed the first test of a scram jet powered hypersonic air-breathing weapon concept or HAWC DARPA and the U.S. Air Force, The HAWC successfully sustained hypersonic speeds, offering faster time on target and greater maneuverability.

The successful test puts us on track to deliver a prototype system to the U.S. Department of Defense. And lastly at Pratt, the Columbus forge disk business continues to integrate critical operations to drive further quality performance and cost reduction. Utilizing our core operating system tools, the team in Columbus reduced the lead time of forgings by up to 35 days and reduced both cost and inventory. As you can see, driving operational excellence through our organization is a key to our success over the long term. With that, let me turn it over to Neil have you take you through the quarter in detail. Neil.

Neil Mitchill

Thanks, Greg. I'm on Slide 3. I'm pleased with our performance in the quarter where we saw strong year-over-year sales growth, adjusted earnings growth, and free cash flow. Sales of 16.2 billion were up 10% organically versus prior year on an adjusted basis. Our performance was driven by the continued recovery of domestic and short-haul international air travel and continued growth in defense. That was partially offset by some supply chain pressures and lower 787 OE volume. And while we expect these headwinds to continue in the near-term, we only see this as a timing issue.

Nonetheless, we remain focused on our cost actions and program execution to drive continued earnings and cash flow growth. Adjusted earnings per share of $1.26 was ahead of our expectations, primarily driven by Collins, Pratt and some corporate items. On a GAAP basis, EPS from continuing operations was $0.93 per share and included $0.33 of acquisition accounting adjustments, and net significant and/or non-recurring items.

It's worth noting that both GAAP and adjusted earnings per share benefited from about $0.16 of lower tax expense related to previously disclosed actions we took to optimize the Company's legal entity and operating structure in the quarter. As well as pension-related benefit that was worth about $0.05. Free cash flow of $1.5 billion was in line with our expectations, keeping us on track for the full year. Before I hand it over to Jennifer, let me give you a little color on our synergy progress.

During the quarter, we achieved about 165 million of incremental merger gross cost synergies. And given our strong performance, we are again increasing our 2021 target, and now expect to achieve over 700 million cost synergies this year. This will bring us to nearly $1 billion in cumulative gross cost synergies since the merger. And we're well on our way to meeting our $1.5 billion commitment. So with that, let me hand it over to Jennifer to take you through the segment results.

Jennifer Reed

Thanks, Neil. Starting with Collins Aerospace on slide 4. Sales were 4.6 billion in the quarter, up 7% on an adjusted basis, and up 9% on an organic basis, driven primarily by the continued recovery in the commercial aerospace end markets. By channel, commercial aftermarket sales were up 38% driven by a 44% increase in parts and repair, a 43% increase in provisioning, and a 22% increase in modifications and upgrades. Sequentially, commercial aftermarket sales were up 4% roughly in line with our expectations. Commercial OE sales were down 3% with strength in narrow-body more than offset by lower wide body deliveries, primarily 787.

And military sales were down 5% on an adjusted basis and down 1% organically on a tough compare. Recall, Collins military sales were up 8% in the same period last year. Adjusted operating profit of 480 million was up 407 million from the prior year. Higher commercial aftermarket sales, favorable mix, and synergy capture more than offset lower military volume. Looking ahead, due to expected supply chain pressures and 787 OE delivery headwinds, we now expect Collins full-year sales to be down mid-single-digit.

However, given the continued recovery in the commercial aftermarket and the benefit of cost containment measures, we are increasing Collins full-year operating profit outlook to a new range of up 250 to 300 million versus 2020. Shifting to Pratt & Whitney on Slide 5. Sales of 4.7 billion were up 25% on an adjusted basis, and up 35% on organic basis, primarily driven by the continued recovery of the commercial aerospace industry.

Commercial aftermarket sales were up 56% in the quarter with legacy large commercial engine shop visit up 49% and Pratt Canada shop visits up 18%. Sequentially, commercial aftermarket sales were up 17%. Commercial OE sales were up 22% driven by higher GTF deliveries within Pratt, large com -- business. The military business sales were up 2% on another tough compare. Recall, Pratt military sales were up 11% in the same period last year.

Growth in the quarter was driven by a continued ramp in F135 sustainment, which was particularly offset through inputs on production and classified development programs. Adjusted operating profit of a 189 million was better than expected and was up 232 million from the prior year. Drop-through on higher commercial aftermarket sales, more than offsets the impact of higher Commercial OE volume and higher SG&A and E&D.

Looking ahead, due to the continued commercial aerospace recovery, we now expect Pratt's full-year sales to be up mid-single-digit. In addition, we are increasing Pratt's full-year operating profit outlook to a new range of flat to up 50 million versus 2020. Turning now to slide 6, RIS sales of 3.7 billion were in line with prior year results on an adjusted basis and down 1% on an organic basis, driven primarily by the timing of material input from suppliers. Adjusted operating profit in the quarter of 391 million was in line with expectations and was up 41 million year-over-year on an adjusted basis, driven primarily by higher program efficiencies.

RIS had 2.9 billion of bookings in the quarter, resulting in a book-to-build of 0.4 as expected, and a backlog of 18.7 billion. Significant bookings included approximately 1 billion on classified programs. It's worth noting that we expect RIS full year book-to-bill to be greater than 1. Turning to RIS full-year outlook, due to the timing of material inputs from suppliers we now see RIS sales growing low single-digit. However, as a result of improved productivity, we continue to expect RIS 's operational -- operating profit to grow 150 million to 175 million versus adjusted pro forma 2020.

Turning now to slide seven. RMD sales were 3.9 billion up 7% on an adjusted basis, and up 5% on an organic basis, driven by liquidations of pre -contract costs on an Amram award received in the quarter, and the expected ramp in our [Indiscernible] franchise. Adjusted operating profit of 490 million was in line with our expectations and was up 59 million versus the prior year primarily on higher sales volume. RMD's bookings in the quarter were approximately 3.9 billion, resulting in a book-to-bill of 1.02 and a backlog of 29.6 billion.

Significant bookings in the quarter included AMRAAM Lot 35 for 570 million, a Patriot GEM-T order for 432 million, as well as several other notable awards. We also expect RMD's full-year book-to-bill to be greater than 1. We remain confident in our full-year outlook for RMD, with sales growing low to mid-single-digit and operating profit growing 50 to 75 million versus adjusted pro forma 2020. And now, I'll turn it back to Neil to provide some color on the rest of the year.

Neil Mitchill

Thanks, Jennifer. I'm on Slide 8. As we look ahead at the fourth quarter, we continue to be encouraged by the recovery of commercial air travel that has driven sequential aftermarket growth so far this year. However, the recovery of long-haul international traffic continues to lag expectations. And on the OE side, 787 build rates have come down more than we had expected, resulting in a significant impact to our top-line outlook for the year. Additionally, we aren't immune to the global supply chain pressures that are seeing some isolated impacts from the supply chain, primarily at Collins and RIS. However, we are working with our suppliers to mitigate these timing issues.

And finally, while we anticipate the pending vaccine mandate may put further pressure on the supply chain in the near-term, higher vaccination rates will continue to build confidence in the safety of air travel going forward. With that backdrop, we're adjusting our sales outlook and now see full-year sales of about $65 billion slightly higher than the low end of our prior outlook.

However, given the strong performance on cost control, synergy capture, and program execution, we are raising and tightening our adjusted EPS range to $4.10 to $4.20 per share, or up about $0.22 from the midpoint of our prior outlook. About $0.07 of the increase comes from the segments, Collins and Pratt and the remainder comes from improvements in corporate items.

And on the cash side, we are also raising the low-end of our free cash flow outlook and now see free cash flow of approximately $5 billion for the full year. It's worth mentioning that we've included an updated outlook for the segments and some below the line items in the webcast appendix. With that, I'll hand it back to Greg to wrap things up.

Greg Hayes

Okay. Thank you, Neil. We're on slide nine and this is just kind of our view of the operating environment that we're facing going into 2022. We're not going to give specific guidance on 2020 to today, other than to say that the trends that we talked about in our May Investor Conference are proving to be pretty much on track with what we're seeing for next year. On the positive side, obviously, we expect the commercial aerospace recovery to continue and we feel good about our ability to grow our Defense franchises with our robust $65 billion backlog in the bipartisan support for the Fiscal 22 -- Fiscal year 22 budget.

And of course, the international demand for our products and technologies continues to be strong. We're also laser-focused in driving operational excellence to deliver cost reduction and further margin -- This is really a part of our core operating system roll out. Again, it gives us confidence that we can continue to grow the margins along the trajectory that we talked about. On the challenges side, no real surprises here. We anticipate the global supply chain pressure will continue, and that lower 787 build rates will carry into next year.

Again, none of these are, I guess, new to us. We'll manage through them but something I think everybody is going to face in the industry. And of course, we are watching, monitoring if you will, the reopening of international borders. It all looks to be positive so far, but again, the COVID variance can change that in a hurry.

Global tax and inflationary environment are also a concern of -- as we think about next year. And lastly, the impact of the COVID vaccine mandate. As you know, all federal contractors are required by December 8th to have all of our employees vaccinated. We certainly expect that there will be some disruption in both the supply chain and with our customers as a result of this, but we're going to work our way through it. All right. So before we get to the Q&A, let me just close by saying that I'm really pleased with our performance in the quarter. And I'm confident in the strength of our businesses as we look ahead.

I want to reiterate, we remain focused on supporting our employees, customers, suppliers, and our communities, but our most important mission is keeping our employees safe. And finally, the strength of our Balance Sheet along with the cash-generating capabilities of our business will continue to provide us with financial flexibility to support investments in our business while still returning capital to shareowners, including our commitment to return at least $20 billion to shareowners in the first four years following the merger. With that Mistie, let's open it up for questions.

Question-and-Answer Session

Operator

At this time if you would like to ask a question, [Operator Instructions]. Your first question comes from the line of Peter Arment with [Indiscernible].

Peter Arment

Good morning, Greg, Neil, Jennifer. Nice report. Hey, Greg, maybe you could just talk a little bit about the lost sales in Defense. Maybe how you're thinking about how that recovers and do we expect to get all that back in 2022 and maybe just any color about the supply chain challenges that you're seeing in Defense. Thanks.

Greg Hayes

So the lost sales on the Defense side, I would category -- 3 categories of issues there, 1, I think the pullout in Afghanistan, there's about $75 million impact to full-year revenue. Not huge, but meaningful. That will not recover obviously. Those are services that we were providing to the U.S Government or the Afghan Government prior to the pullout so 75 kind of goes away.

You've got another probably 275 million of actual supply chain and people issues. And then by people issues, I mean, our -- the fact is we haven't been able to bring enough people on board to generate the revenue that we were expecting. That's [inaudible 00:20:10] that the other is actual supply chain pressure where we're not getting the material in.

As you know, Peter, when we get the material in on the Defense side, we -- that gets billed right away to the customer and we recognize the revenue. So that piece will come back, the hiring piece will come back, the Afghanistan piece won't come back. So think about that 275 million. I don't expect -- we're not going to see it clearly in the fourth quarter, but we're not going to lose of next year. I can't tell you what quarter it's going to be in, but we'll get that back.

Peter Arment

I appreciate all the color and thanks, Greg.

Operator

The next question is from the line of David Strauss with Barclays.

David Strauss

Thanks. Good morning.

Neil Mitchill

Good morning.

David Strauss

Greg, want to ask you a couple of questions on the error rates. I guess, first of all, on that. This year you talked about 161, are you actually going to hit that? On 77 where are you exactly today? Are you actually producing anything? And on A320, I know Airbus is talking about a big ramp up there, but if you look at their deliveries, it doesn't look like much is actually happening. Can you talk about where you are on A320 rates as well? Thanks.

Greg Hayes

Go. All right, David. Let's just try to unpack that. Let's start with 737. We still believe Boeing is going to deliver those aircraft. Keep in mind for the first half of this year, we were not really delivering material to Boeing because they had it in their inventory. And so, we've just really started to ramp up the OE deliveries out of Collins again and keep in mind that's about $2.5 million roughly the ship set of revenue on 737. So we still fully expect Boeing will be taking production up there, on 737 [inaudible 00:21:55] here as they work through their backlog of undelivered aircraft and they go through the ramp-up process.

As far as 787, that I think, is maybe the big question that we have right now. We are not shipping anything today on 787. We had expected to be delivering about five a month. And keep in mind that's a $10 million revenue per aircraft impact. So you think about the -- part of the problem at Collins in Q4 will be 787 deliveries. Now, again, they'll catch back up, but probably not this year. As it relates to the A-320, again, we -- I think they're probably building at a rate of what? 43 a month going up, we think a little bit next year. And continuing on towards [Indiscernible] goal, I believe of rate 75.

Not clear we're going to get all the way to rate 75, but clearly we see demand strengthening for the A320. It's a great aircraft and it's got great performance characteristics. And keep in mind -- so the GTF -- today we've got just over 900 aircraft delivered. We've flown about 9.5 million hours. We've got a 99.9 dispatch reliability rate. The engine's great and we continue to see opportunities to grow our market position on the A320. But we don't see any shortage of demand in the near-term on the A320.

David Strauss

Thanks very much.

Operator

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

Ron Epstein

Hey, good morning.

Greg Hayes

Hey, Ron.

Neil Mitchill

Good morning, Ron.

Ron Epstein

Can you guys talk a little bit about the F35 re - engining? There has been a lot of, I guess, noise and discussion in the Defense community around the re - engining, the adaptive engine transition program. There has been some talk on it on the hill. Where are you guys on that? And how do you defend yourself against the GE offering?

Greg Hayes

Okay, Ron. So let's go through that. So the adaptive engine GE and Pratt Whitney both have adaptive engines on test. We're going into -- we did ground tests this summer, we'll be doing flight test early next year. There is a thought of re-engineering the A, I'm sorry, the F-35 sometime in the 2027, 2028 time frame, which is extremely aggressive. The issue right now with the adaptive engine is it does not fit on the carrier-based version, the navy version, or the marine corps version, the shortlist [Indiscernible]. The Air Force would have to fund the entire development cost of the new engine.

The other issue we've got with the adaptive venture, this is brand-new technology. Unlike the F135, which has millions of flight hours on it on the core. And you're talking about a single-engine fighter. I think it's going to be a tough part to think about putting a brand-new paper engine on the F-35 in the near-term. We have to talk to the [inaudible 00:25:18] about the enhanced engine offering of the 135, or we can upgrade the current F135 to provide more cooling and more thrust, and at a significantly lower cost than a brand-new centerline engine. So we're going to continue to work with the services on this.

Again, I think it's the thought of a brand-new engine that's going to be a tough putt. It's not to say we're not going to look for ways to improve the current version. I think that's just a question of finding the funding because as the Block-4 gets introduced, we are going to need more cooling, we are going to need more thrust. But we have a plan to address that with the JPO.

Ron Epstein

All right. Great. Thank you.

Operator

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

Sheila Kahyaoglu

Hey. Good morning, guys. Thank you so much for the time, Greg, Neil, and Jennifer. I want to maybe ask about the aftermarket. When we look at the two-year stack basis, Pratt aftermarket seems to be at 76% of 2019 levels. And Collins is that 66%, also at a lower growth rate. Can you talk about what's driving some of that growth differential? Is it just engines versus air-frame and overall program mix?

Neil Mitchill

Sheila, let me start. Good morning. We're very pleased obviously with the aftermarket performance in the quarter. You saw Pratt up 56% year-over-year, 17% sequentially, and Collins at 38% also in line with our expectations sequentially almost 5% -- 4%. The difference, I think, comes down to the product mix of offerings and frankly as we've talked about, Collins has a fair share of wide-body and that hasn't yet recovered. As we all know, we do expect that to be the next growth driver for Collins as we get into next year and the international routes start to reopen.

Neil Mitchill

On the Pratt side, very good shop visit induction. We saw a 49% year-over-year legacy shop visits come in. That's a little higher than the 30%, 35% that we thought we would see. So that upside probably about $75 million of sales is contributing to a full year $100-million increase in the Pratt outlook for the rest of this year. So pleased with the narrow-body recovery. As we look to fourth quarter, we'll continue to see shop visits at Pratt on the legacy side up year-over-year, probably in the neighborhood of 20%. Down a little bit sequentially, because we had some pull ahead into the third quarter, but still very solid there.

We're well-positioned to support those inductions with parts and aftermarket. And then at Collins, same thing, we will continue to see the narrow body perform quite well. As Greg just talked about, 737 MAX stepping up. Probably by the middle of next year, we'll start to align the rates of our deliveries with Boeing's deliveries. and that will come with aftermarket as well, and then we'll see the wide-body.

Sheila Kahyaoglu

Thanks so much for the detail.

Neil Mitchill

You bet.

Operator

The next question is from the line of Seth Seifman with JPMorgan.

Seth Seifman

Hey, thanks very much, and good morning everyone. Maybe I'll continue along the aftermarket line of questioning. The sequential growth at Collins was in line with the outlook, but I think Greg, you've spoken in September and I think, correctly or not, people came away with maybe a little bit more optimism.

And was the pace of growth, did it kind of slow towards the end of the quarter? And then if you could give us at Collins, are you still looking for that mid-single-digit in the fourth quarter? Is there any kind of provisioning ahead of international travel returning in the U.S. that might help the way that domestic did earlier this year or any kind of update on how much the trends in Collins aftermarket improvement are being affected by both demand and supply issues?

Greg Hayes

Yes. Let me -- so as Neil said, I think sequentially, Collins was up about 4%. We were expecting 5%. So it was a little bit slower than what we had expected. And I think I would attribute that mostly to that kind of slowdown in the middle of the summer. That we saw in August and September is the Delta variant of COVID. became more problematic. Again, as we closed out the quarter and as we move into October, we see that kind of low single-digit 4% -- 5% growth again, sequentially, that is in Q4.

I think the real issue at Collins and Neil hit on this is their exposure to wide-body. That's 40% to 45% of their aftermarket. And we were hoping we were going to see a faster reopening of the international markets. They are reopening I would say at a rather tepid pace. And so that's really the governor I would tell you on Collins aftermarket growth. Narrow-body is all good. That's operating -- 320 fleet out there is operated about 80% of pre - COVID similar, it's like 70% on the V2500 fleet. that's all good.

The real issue is wide-body and until we see a pro -- a reopening of the international routes, and right now we're seeing North Atlantic opening up, which is great, but we're still not seeing the Asia routes. And that is the thing that we really don't expect to see until 2023, which means you're not going to get a full recovery until probably the end of 2023 back to '19 levels at Collins.

Seth Seifman

All right. Thanks very much.

Operator

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

Noah Poponak

Good morning, everybody.

Greg Hayes

Morning, Noah.

Neil Mitchill

Hi, Noah.

Noah Poponak

Neil, the updated full-year '21 guidance, I think has the margin -- the segment margin down sequentially in every segment. Just sort of wondering broadly how much of that is conservatism versus specific headwinds. And I guess in Collins in particular, the margin and the EBITDA dollars have to be down a decent amount in 4Q, even with revenues still up. Notwithstanding the headwinds you've cited here. If you could walk us through why that happens.

Neil Mitchill

Sure. Thanks. Not conservatism, I don't believe. I think we've got this reasonably calibrated, but let me take you through each business unit. At Collins, if you are doing the math, which it looks like you've done Noah, you'll see margins in the 9% range in the fourth quarter. There were a couple items in the third quarter that helped Collins to the tune of about $0.02. We had a land sale, we also had a worker's comp adjustment that was favorable.

Those two items, if you adjust form would get Collins' Third Quarter Ross in the neighborhood of 9%. So I think we see flattest margins for Collins between Q3 and Q4. Recall we've been talking about the ramp in R&D and some of the discretionary spend. We saw some of that happen in the third quarter. We'll see more of that in the fourth quarter. So that's the Collins story. At Pratt, it's a different story. The margins are sequentially down.

That's largely on higher A320 neo. In fact, all of our GTF deliveries will be higher in the fourth quarter than the third quarter. So the negative engine margin headwind will persist. And then similarly, we'll see continued E& D and SG&A grow just a little bit. Both those companies, Collins and Pratt have done a really nice job to control the spending, but it was back and loaded as we positioned ourselves to adjust depending on how the year turned out.

For RIS, we'll see margins around 10%. We should see continued productivity there. So no major changes there. And R&D, they will exit the year around 12%, pretty much in line with the third quarter. I'll point out for both RIS and RMD, there are four fewer days in the fourth quarter of this year than there were last year. And so that will give us a little bit of just headwind but of course, that's just timing.

Noah Poponak

Given your comments on wide-body, and then what's happening with the A320, do we need to all be calibrated to -- with respect to the aerospace business margins, do we need to be calibrated to a non-linear path to the 2025 targets, I guess specifically next year, if wide-body is still a bit slow in the A320's ramping in Pratt?

Neil Mitchill

Noah, I think we've been talking about this for almost 2 years now since the pandemic started, that the recovery is going to be, I'll call it lumpy, in fact, and that depends on the routes, the airlines including wide body is going to be a big piece of that. So I do think there will be a little lumpiness to the margin trajectory. Keep in mind that Greg just talked about the 787 that's a huge revenue contributor, not a big margin contributor, until you get into the aftermarket. So I think that's a fair assumption. We'll certainly be back here in January to give a little more color on what '22 looks like for us based on what we see during the fourth quarter.

Noah Poponak

Okay. Thanks so much.

Neil Mitchill

You bet.

Operator

The next question is from the line of Robert Stallard with Vertical Research.

Robert Stallard

Morning.

Greg Hayes

Good morning, Rob.

Neil Mitchill

Good morning.

Robert Stallard

Greg, a couple of months ago, you sounded perhaps a little bit skeptical about Airbus A320 ramp plans, but today you sound a bit happy about it. So I was wondering if you could maybe elaborate on your latest thoughts on this and whether you do feel more comfortable on the A320 now.

Greg Hayes

Rob, I would tell you, I remain somewhat skeptical about rate 75. I think that's just natural. I think you'll hear it from the leasing companies out there that there's probably not demand unless it comes up of Boeing's. And again, as Airbus ramps up production, Boeing will ramp up production, question is, are we really going to see a market that will support? I call it, 50 737s and 75 A320s on a monthly basis or 125 airplanes a month. Again, it's -- it could happen. We'll be ready to support Airbus, our customer, if indeed it does. But I would tell you that our plans -- our 5-year plans do not anticipate getting to that kind of rate and by 2024, 2025. Again, we -- maybe we're being conservative. But again, we will support the customer if the demand is there.

Robert Stallard

That's great. Thank you very much.

Operator

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

Doug Harned

Good morning. Thank you.

Greg Hayes

Hi, Doug.

Doug Harned

I just -- I wanted to follow up on what Rob was talking about there because if you look at the A-320 family, I guess there are two things here. You said -- expressed some skepticism about the planned rate increase. Your CFM counterparts have also done that. Some in the customer community have. Boeing has. Everybody could have different motivations here. But when you go forward, they are -- they have holding fast to this production plan. How does this break? In other words, when do you or your counterparts say, okay, we will facilities for 70-a-month and make that investment. How does this process move forward?

Greg Hayes

So keep in mind though the A320 family, it is a shared platform between CFM and Pratt & Whitney, and so our goal here is to make sure that we have the most profitable piece share of that business. And so again, we will continue to sell the engines where we think we can make the most money. But again, we're not going to chase every last engine campaign just to get to a higher rate. So we want to be disciplined on pricing. And again, if the demand is really there, it's -- we're out talking to customers every single day. If the demand is there, if Gilman Airbus are correct, we will get our fair share. Maybe it won't be 50%, maybe it will be 45%, maybe it will be 40%, but we'll get our fair share of whatever the ultimate demand is.

Doug Harned

And if I can just follow on that because, one other thing that's going on right now is that Airbus deliveries are lagging production today and they probably a 130 plus airplanes parked and majority would be in the A-320 family. How does that affect you if you have this gap in deliveries and production in Airbus in terms of your deliveries of engines to them, and then you're planning for the next few quarters?

Neil Mitchill

We do not foresee a gap in our delivery profile for the Airbus engines. We're continuing to produce, and, in fact, as I just said, in the fourth quarter I expect them to go up sequentially. As you know, Airbus has a huge backlog for the A320 and they are working with their customers as we are to make sure they take delivery. Not going to get into predicting how many they will deliver, but we don't foresee any gaps in our engine delivery profile.

Greg Hayes

If you think about that though, Doug, we've got thousands of 7 or A320s in backlog and the fact that there's a few parked, that's just really the state of the airline industry today that some of the airlines looking for financing. But we don't see any interruption in the production rate. And as Neil said, it'll it will continue to go up both this year and next.

Doug Harned

Okay. Very good. Thank you.

Operator

Our next question is from the line of Myles Walton with UBS.

Myles Walton

Thanks. Good morning. Greg or Neil, I was wondering how are you quantifying the -- sort of risk around the vaccine mandate, booking your operation and in the supply chain. And also, I guess what's the bigger supply chain issue that's hitting you now? Is it people? Is it raw material? Is it the chips? And sort of what's the growing risk and what's the fading risk? Thanks.

Greg Hayes

So Myles, in that $275 million number we throughout before in terms of supply chain impact to the year, the people part of it is about a third. And so that's -- we are expecting some level of disruption, some level of challenge in the supply chain, just because they're -- keep in mind it's not just the prime contractors, but it's also all of our subcontractors that need to follow the mandate as well. So we are expecting some minor level of disruption. Now this is not huge in the grand scheme of $64.5 billion of revenue, but there will be some expected impact.

And as we get closer to the deadline date of December 8th, this could pick up. So we're monitoring it, we're out talking to all of our key suppliers, we're talking to our customers, and we're just trying to stay on top of that. As far as shortages, people are a piece of it. But I would tell you there's -- it's also raw materials and while it we have good coverage under long-term agreements, we've seen lead times double on some of these raw materials. Chips, not a huge issue for us, I think again, we've got adequate supply, but it's always a watch item out there.

The logistics, getting trucks to pick up material, getting material in is also proving to be a challenge. But looking at in the grand scheme of RTX. I just don't think that's -- there's going to be a meaningful or material impact on us for the year. We're managing it pretty well. We've got a robust team in supply chain and operations that are all over this, and we'll just -- we will keep managing through it.

Myles Walton

All right. Thank you.

Operator

The next question comes from the line of MIke Maugeri with Wolfe Research.

MIke Maugeri

Hey, good morning, and thank you for the time. Neil, can you spend a little bit more time on cash flow and working capital through the end of the year. And then how that sets up for your working capital into next year. And then related on the Capex trim this year, is that pushing Capex or is that Capex going away?

Neil Mitchill

Good morning. Thanks for the question. Let me just share a couple of thoughts around the free cash flow. We obviously took the range up the bottom end by $0.5 billion on a couple of things. One, improved profit and two, slightly lower capex as you pointed out. Year-to-date working capital has been an outflow. And that's pretty typical for us. So we're expecting the fourth quarter at least a billion-and-a-half of positive working capital. Again, a lot of that comes from the defense side of the business as we receive receipts from our customers, cash receipts that is. So we feel pretty good that we'll continue to see a net working capital and [inaudible 00:43:27]. It could be a little [inaudible 00:43:29] than the number we talked about at the beginning of year as we make sure we have an appropriate amount of buffer stock in some places for the issues Greg just talked about, but all-in-all really good progress.

Just to give you a couple of thoughts, inventory has been a real bright spot, frankly. Collins, sequentially, their inventory was only up $30 million from Q3 or Q2 to Q3. And Pratt is in fact down nearly $100 million sequentially. So the teams are doing a fantastic job of managing inventory as we recover through this cycle. So I'm very happy with that. In terms of the timing of the Capex. we've got a big ramp in the fourth quarter, which is also typical for us.

I do think that some of the savings we're seeing this year could slip into next year particularly, around our large structural projects. But the good news is we're completing those projects within budget so it's all kind of contained in our cash outlooks. I won't get into where we see free cash flow next year, but I do expect it to grow as we've talked about back at the Investor Day. And we'll be back in January with more details on how that's expected to unfold.

MIke Maugeri

Thank you.

Neil Mitchill

You bet.

Operator

Your next question is from the line of Matt Akers with Wells Fargo.

Matt Akers

Hey. Thanks. Good morning.

Neil Mitchill

Good morning.

Matt Akers

Just to comment a little bit about fuel prices and just put the uptick year-to-date. Is that starting to flow through it all into your customer behavior on a commercial side, either kind of flying some of the older aircrafts differently or maybe potential demand for new aircraft to kind of get the fuel efficiency savings? Is there anything you're seeing from your customers there?

Greg Hayes

Matt, not really any impact except we have seen pricing going up. And I think if you're out buying a ticket today to fly any place, you're going to see the prices have gone up significantly somewhat from what we saw this summer. So while fuel prices are up, oil North of $80 a barrel, We believe that the airlines are being -- are able to pass along those higher fuel costs in the form of higher ticket prices. Obviously, if it's a prolonged increase, it does drive demand for next-generation aircraft. And right now, of course, there's a lot of aircraft out there still sitting on the ground, so I wouldn't expect there would be a near-term impact like that, but clearly, the airlines are raising prices to compensate for the higher fuel costs.

Matt Akers

Got it. Thank you.

Operator

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

Cai Von Rumohr

Yes. Thank you very much. Great results. So the F-35 peak production target, as you know, has been brought down and supply chain has emerged as a bigger issue recently, you mentioned 275. But maybe could you give us color on A, where the supply chain issues are the biggest worry. And secondly, what the F-35 rate impact does to you because clearly it looks like it does quite a bit to the prime.

Greg Hayes

Yes, Cai. So as we think about going down from roughly, what, 16 engines a month down to 13 engines a month, it will have an impact on Pratt. But again, it's a -- so I think about the 135, it's a small piece of our overall defense budget. It's not, when you're talking, let's call it $10 million in engine so you're going to lose 30 million a month. So you may lose 350, $360 million dollars of revenue going forward. Again, on the defense backlog of 65 billion is just not that significant. Obviously, it's a much more important to the prime on that parti -- you see those kinds of

Greg Hayes

reductions. In terms of specifics on supply chain, I don't know that I could point to a single supplier that is -- other than -- again, it's components, it's raw materials. Think about aluminum prices going up, thinking of steel, all of the basic raw materials, lead times pushing out. And it's just harder to get material in the door on time. And we're also seeing, of course, labor shortages in our supply chain, which is also slowing down input. And I think that's going to be a continuing problem into next year. And the vaccine mandate, probably not going to help that. Although a vaccine mandate probably will help us on the commercial aerospace side if everybody gets vaccinated. So we're all for that.

Neil Mitchill

Cai, let me just add one thing on F135 rates. Keep in mind that there's the production engines, but there's also power mods and pieces that Pratt makes, that support the aftermarket. And so you'll get 1, 1.5 equivalent engines per month on top of so production rate. So it'll be a little below the 16 a month and all of that has been calibrated in our long-term outlooks that we talked about earlier this year. So certainly a little bit lower on the production side, but not a full drop. So I just wanted to add that extra point there for you.

Cai Von Rumohr

Terrific. And then on the supply chain, Greg, you mentioned raw materials. To what extent do you have raw material price escalators in your contracts?

Greg Hayes

So typically, as you know, Cai, we've got protection from say, abnormal escalation in our contracts. So there's a dead-band in terms of inflation for most of the contracts. But we also, for most of those raw materials, we also have long-term supply agreements which cover us for the vast majority of the material. So we're not seeing the impact today of all of the, I would say, spot prices for materials that, say, you might otherwise be thinking about. Most of that's coming in under LTA. If these prices persist long term, then we will see So, an impact. And again, we'll extent -- to the extent that that is greater than these dead-bands will be able to pass that on and recover that through our contracts.

Neil Mitchill

Put some numbers on that that, Cai, 90% of Pratt 's products are under LTA, probably 70% at Collins and so on average, we're about 80% protected. So again, as Greg said in the near-term, it's not a major issue for us.

Cai Von Rumohr

Terrific. Thank you very much.

Neil Mitchill

You're welcome.

Operator

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

Kristine Liwag

Hey, good afternoon, guys. Good morning.

Greg Hayes

Good morning.

Kristine Liwag

With Defense stable and Aerospace recovery coming along nicely, can you discuss your capital deployment priorities? And how are you thinking about the portfolio and M&A at this point in time?

Greg Hayes

Sure. I think for us right now, there is no news and there is no change I would say in the focus on -- of the portfolio. We're going to continue to look for investments like Seakr Engineering and like FlightAware that can enhance the offerings that we already have. especially in software and in the space business. At the same time, we're going to continue to look at lower margin, lower growth businesses for divestiture. And nothing to announce today. We'll keep looking at the portfolio as we always do.

As far as capital allocation, I think first and foremost, we're going to invest in E&D and Capex. And you should think about that number this year, it will be about $5 billion. Next year will probably be closer to $6 billion of investments between Capex and E &D. That is the first priority is to invest for the future of the business. At the same time, we'll continue to take up share buyback over the next couple of years. We've got to do another $6 billion of share buyback to hit that $20 billion target that we've got out there. And we fully expect to be able to do that, if not a little bit more.

And then again, we've got a lot of flexibility with the Balance Sheet. We got $7.5 billion of cash to be in there at the end of the third quarter. And we've got plenty of liquidity if we decide we want to make some other investments. But for the time being, we're going to focus on generating cash, investing in E&D, investing in the business, and growing it.

Kristine Liwag

Great. Thanks, Greg.

Greg Hayes

Thank you.

Operator

I will now like to turn the call back over to Mr. Hayes for closing remarks.

Greg Hayes

Okay. Thank you, Mistie and thank you, everyone for listening in. A good quarter, I hope everyone would agree. Neil and Jennifer and the team will be available all day today to take your questions. So thanks very much for listening and take care. Bye.

Neil Mitchill

Bye.

Operator

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

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