RTX Corporation (NYSE:RTX) Q4 2023 Earnings Conference Call January 23, 2024 8:30 AM ET

Company Participants

Greg Hayes - Chairman and Chief Executive Officer
Chris Calio - President and Chief Operating Officer
Neil Mitchill - Chief Financial Officer
Jennifer Reed - Vice President of Investor Relations

Conference Call Participants

Robert Stallard - Vertical Research
Cai Von Rumohr - Cowen
Sheila Kahyaoglu - Jefferies
Myles Walton - Wolfe Research
Peter Arment - Baird
Noah Poponak - Goldman Sachs
Doug Harned - Bernstein & Company
David Strauss - Barclays
Ronald Epstein - Bank of America
Seth Seifman - JP Morgan

Operator

Good day, ladies and gentlemen, and welcome to the RTX Fourth Quarter 2023 Earnings Conference Call. My name is Latif, and I will be your operator for today. As a reminder, this conference is being recorded for replay purposes.

On the call today are Greg Hayes, Chairman and Chief Executive Officer; Chris Calio, President and Chief Operating Officer; Neil Mitchill, Chief Financial Officer and Jennifer Reed, Vice President of Investor Relations.

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

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

RTX SEC filings, including its forms 8-K, 10-Q and 10-K, provide details on important factors that could cause actual results to differ materially from those anticipated in the forward-looking statements. Once the call becomes open for questions, we ask that you limit your first round to one question per caller to give everyone opportunity to participate. [Operator Instructions]

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

Greg Hayes

All right, thank you, and good morning, everyone. We've got a lot to cover today, but let me start with the news we shared last month, which I'm sure you all saw. Effective on May 2, the date of our annual share owners meeting, Chris Calio will become the new CEO of RTX. Chris's appointment is the result of a very deliberate and thoughtful succession planning process conducted by our Board of Directors over the past three years. While I'm going to remain in my role as Executive Chairman, Chris will be taking the reins of the company.

As you all know, I've worked with Chris for many years and I can't think of a better person to take on this role. Chris has a deep understanding of our industry our customers' needs, and our operation. And most importantly, he's an outstanding leader. Here I'd like to say that I'm honored to have led this organization for almost the last 10-years. But most importantly, I'd like to thank each and every employee, who has supported our mission over the last decade. We would not have been able to accomplish all we did if not for you.

Going forward, I have the utmost confidence in Chris's ability to lead this great company and continue to drive performance and value creation for all of our stakeholders for years to come.

With that, let me turn it over to Chris to take you through an update on our end markets and the year. Chris?

Chris Calio

Well, good morning, everyone, and thank you, Greg. I'd like to start by thanking all RTX employees for their contributions last year. And I want to share how humbled I am that our board has given me the opportunity to lead this world-class team. As we move forward, our focus will continue to be on delivering our record backlog, accelerating innovation, and driving operational performance across the portfolio to meet our customer and shareholder expectations.

I'd also like to acknowledge a couple of other leadership changes we've recently announced. First I'd like to thank Wes Kremer for his significant contributions to the company as he transitions into retirement. Over the course of his 20-year career here, Wes has led the development of some of Raytheon’s most successful programs, including LTAMs, Standard Missile 3, and a range of strategic missile defense systems that defend the homeland and our allies. Wes has also played a critical role in restructuring the Raytheon business unit to better align with the needs of our customers.

With Wes's retirement, Phil Jasper has been appointed as President of the Raytheon business. Phil brings with him over 30-years of experience in aerospace and defense, and most recently led the Collins Mission Systems business, where he played a critical role in integrating RTX's connected battle solutions this past year. Phil's deep knowledge of our military customers and their priorities, and his experience leading many business transformation initiatives throughout his career, positions him well to lead Raytheon.

Now, before I cover the highlights of the year, let me get into an update on our end markets. First and foremost, demand for our products and services in both commercial aerospace and defense has never been stronger. Air travel has returned to, and in some cases surpassed, pre-pandemic levels, and the global threat environment is driving unprecedented demand, especially in air defense systems.

Starting with commercial aero, we saw solid air traffic growth this past year with global revenue passenger miles back to 2019 levels and domestic air travel now 5% above 2019 levels as we exited the year. The strong recovery has helped drive significant aftermarket demand for both wide-body and narrow-body aircraft, with growth expected to continue into 2024. On the defense side, increases in global spending have led to a defense backlog which is now at $78 billion, up $9 billion from a year ago.

Just this past quarter, we received a GEMT order with $2.8 billion from NATO, which is the largest GEMT contract recorded in Raytheon history. Domestically, we are pleased that a bipartisan funding agreement has been reached supporting increased defense spending and expect Congress will complete their work on the full-year ‘24 appropriations bill in the next several weeks.

With that, let me turn to slide two, provide an update on 2023, and I'll start with some of the highlights. We delivered $74.3 billion in adjusted sales for the full-year, up 11% organically and adjusted EPS of $5.06 was up 6% year-over-year, both of which were ahead of our outlook. And more importantly, we ended the year with $5.5 billion in free cash flow, which also exceeded our commitment.

On a full-year basis, commercial aftermarket was up 23%, commercial OE was up 20%, and defense was up 4%. On the capital allocation front, we returned over $16 billion of capital to share owners for the year, including $12.9 billion of share repurchases supported by our $10 billion ASR and $3.2 billion in dividends. We're beginning the process of deleveraging this year to ensure we maintain a strong balance sheet, which will be in part supported by the closure of our previously announced divestitures. At the same time, we remain focused on ensuring that business continues to be positioned to achieve sustained growth.

In 2023, we spent almost $10 billion in CapEx in company and customer funded R&D, while capturing $95 billion in new bookings, resulting in company-wide backlog growth of 12% in a book-to-bill of 1.28, ending the year with a record RTX backlog of $196 billion. So while there's a lot of positive momentum in our markets and across the business, we have two matters we've been heavily focused on, Pratt's powdered metal situation and Raytheon's margins.

So let me hit these two head on and I'll start with powdered metal. Our top priority continues to be executing on our fleet management plans, and both the financial and operational outlook remain consistent with our call last October. While we are still in the early stages, I'm going to provide a few more details on the progress we've made to-date. As you saw, Pratt has issued the necessary service bulletins and service instructions to operators, which are entirely consistent with our underlying financial and operational assumptions that we previously communicated. The FAA is in the process of drafting the corresponding airworthiness directives, which we expect to be issued within the next month or so.

And just as a reminder, it is common practice for a fleet management plan to be communicated through multiple service bulletins and airworthiness directives to address different engine models, compliance times, or components and sections of the engine. Continue to conduct ultrasonic angle scan inspections and powder metal parts, and our findings remain consistent with our prior analysis and assumptions.

Let me now turn to our industrial plans. You'll recall our focus is on ramping production of HPT and HPC disks to support both OE and MRO deliveries. We've made solid progress here as well. Continue to secure the necessary machining and inspection capacity for increased disk production. Today, all OE GTF engines being delivered to our customers final assembly lines contain disks produced from powdered metal manufactured after Q3 2021 and have full certified lives.

On the GTF MRO front, we have begun installing full life disks during certain shop visits. And the number of engines receiving full life disks in MRO will increase throughout the year as we continue to ramp up production of these parts. Our estimated wing-to-wing turnaround time remains consistent with our prior guidance. Pratt grew GTF MRO output by almost 30% year-over-year in 2023, while also making investments in additional shops, test cell capacity, and repair capability to support even more growth in 2024.

With respect to the number of AOGs, we continue to expect the roughly 350 on average that we previously guided. However, we will likely see a lower peak level than previously anticipated due to the timing of the AD issuance and proactive fleet management by our customers. Additionally, our conversations with customers continue to progress. To-date, we have finalized several customer support agreements, and these have been in line with the assumptions we outlined last year. And lastly, just a comment on the remaining Pratt & Whitney fleets. Both the financial and operational outlook remain consistent with what we discussed on our prior call. We continue to execute on those plans.

I'll now shift to Raytheon's performance. We continue to experience profitability challenges driven by productivity headwinds within the business, primarily attributable to legacy fixed price development programs that we have previously discussed, as well as continued supply chain and operational headwinds.

Let me start by providing some color around our productivity issues. And it’s important to note that we are in fact achieving productivity in several parts of Raytheon's business, in particular on certain legacy product families where we've received successive awards that are creating scale in our factories and in our supply chain. For example, we increased GEMT output by 50% year-over-year by using our core system to refine work instructions, increase test equipment uptime, and reduce product cycle time, all without additional capital or manpower.

We also recognize productivity gains when we successfully retire technical and schedule risks on our contracts, which is more frequent in our programs in the production phase. However, those gains have been overcome by unfavorable productivity in other areas. In 2023, about 70% of this headwind came from challenges on fixed price development programs, and the remaining 30% was driven by unfavorable material costs, as well as supplier delinquencies, which have had the effect of extending the period of performance in several cases.

So what are we doing about it? Our plan to stabilize the current performance and deliver profitable growth consists of a few elements. One, we expect improvement in our fixed price development programs as we satisfy certain technical and programmatic milestones. We will also be more selective and disciplined about the work we pursue moving forward.

Two, we are making modifications in our approach to winning new work. We continue to ensure that our new contracts and additional contractual lots have better protection from supplier inflation. This will take some time to play through, but we expect this will help us improve our margin profile.

Three, we continue to drive improved supply chain performance and material flow. Overall, our material receipts were up 8% in 2023. And we need to continue on that trajectory here in 2024.

Four, we continue to take indirect cost actions that will help us avoid some of the headwinds we experienced in 2022 and ‘23. For instance, we optimized Raytheon's realigned business structure by further consolidating and streamlining several of our sub business units earlier this month. This will reduce indirect costs and overhead and better position the business for profitable growth.

And lastly, there will be some tailwind that comes from a mixed shift in our business as development programs and technical refreshes move into production, and the mix of our sales shifts more towards FMS and DCS. So there's obviously a lot of work to do, but this business has a strong foundation and it starts with its product portfolio. As I said earlier, the demand for Raytheon's products is incredibly strong, and I'm confident that Phil and the team are focused on addressing these challenges and delivering this record backlog at the margins that we need.

With that, let me turn it over to Neil to take you through our fourth quarter results.

Neil Mitchill

Thanks Chris. Turning to slide three, we finished the year strong and ahead of our expectations with solid growth in organic sales across all three segments, even as the year-over-year comparisons became more difficult. And overall segment operating profit for the year was up 18% versus 2022. We also ended the year with strong free cash flow as you heard from Chris.

For the fourth quarter, we had adjusted sales of $19.8 billion, up 10% organically versus the prior year. This was primarily driven by growth in commercial aerospace, as well as growth across defense in all three segments.

Adjusted earnings per share of $1.29 was a bit better than our expectations and up 2% as profit from higher commercial aftermarket at Pratt and Collins and drop through on higher defense volume was partially offset by the expected headwinds from higher interest taxes and lower pension income.

Keep in mind we dealt with about $2.3 billion of inflationary headwinds in 2023 of which about a quarter of that was in the fourth quarter, which we largely overcame through pricing and cost reduction actions. On a GAAP basis, earnings per share from continuing operations was $1.05 per share and included $0.29 of acquisition accounting adjustments, a $0.06 benefit related to a customer settlement, and $0.01 net charges associated with restructuring and other non-recurring items.

And finally, we delivered free cash flow with $3.9 billion in the quarter, bringing our total free cash flow for the year to $5.5 billion, which is about $700 million ahead of our prior outlook, as powder metal related impacts have shifted and year-end collections were stronger than expected.

With that, let me hand it over to Jennifer to take you through the segment results and I'll come back and share our thoughts on 2024 and 2025.

Jennifer Reed

Thanks, Neil. Starting with Collins on slide four. Sales were $7 billion in the quarter, up 12% on both an adjusted and organic basis driven primarily by continued strengths in commercial OE and aftermarket growth. By channel commercial aftermarket sales were up 23%, driven by a 27% increase in provisioning, a 26% increase in parts and repair, and an increase of 7% in mods and upgrades in the quarter.

Commercial OE sales for the quarter were up 17% versus the prior year, driven by continued growth in both narrow body and wide body platforms. And military sales were up 1% primarily due to higher deliveries. Adjusted operating profit of $104 billion was up $190 million or 22% from the prior year with drop through on higher commercial aftermarket volume and favorable mix partially offset by lower commercial OE as drop through on OE volume was more than offset by higher production costs. In addition, higher R&D expenses offset by lower SG&A.

Shifting to Pratt & Whitney on slide five, sales of $6.4 billion were up 14% both on an adjusted and organic basis with sales growth across all three channels. Commercial OE sales were up 20% in the quarter, driven by higher engine deliveries and favorable mix in large commercial engine and Pratt Canada businesses. Commercial aftermarket sales were up 18% in the quarter, driven by higher volume in both large commercial engine and Pratt Canada businesses. And in the military business, sales were up 4%, primarily driven by higher sustainment volume, which was partially offset by lower material inputs on production programs.

Adjusted operating profit of $405 million was up $84 million from the prior year, primarily driven by drop through and higher commercial aftermarket volume and favorable commercial OE mix. This was partially offset by higher commercial OE volume, higher production costs and unfavorable military contract adjustment in the absence of a benefit from a prior year customer contract adjustment. And finally, higher R&D expense was offset by lower SG&A.

Now turning to Raytheon on slide six. Sales of $6.9 billion in the quarter were up 3% on an adjusted basis and 4% organically, primarily driven by higher volume on advanced technology and air power programs. Adjusted operating profit for the quarter of $618 million was up $48 million versus the prior year, driven primarily by higher volume and lower operating expenses partially offset by unfavorable net program efficiencies.

Bookings and backlog continue to be very strong as we finish the year. In the fourth quarter, $9.1 billion of booking resulted in a book to bill of 1.33 and an end of the year backlog of $52 billion. And for the full-year, Raytheon's book to bill was 1.22.

With that, I'll turn it back to Neil to provide some color on 2024.

Neil Mitchill

Thank you, Jennifer. Let's turn to slide seven. Before I get into the specifics on our ‘24 financial outlook just a couple of comments on the environment as we look ahead. So let me start with the positives. As Chris said global RPMs are back to 2019 levels. However, they have not fully recovered with respect to long-haul international travel, particularly widebody, but that is expected to continue to be a tailwind for us going forward. On the narrowbody side, demand for new aircraft remains strong, which continues to support both OE and aftermarket growth.

Specific to the commercial OE side, with increasing commercial production rates, we expect commercial OE revenue will be up between about 10% and 15% in 2024. Now, with respect to commercial aftermarket, we currently expect sales to be up over 10% in ‘24, and that's on top of the 23% growth we saw in ‘23.

Turning to defense, global defense spending remains elevated, which will continue to support our backlog ahead as our key programs remain well funded. Across RTX, we remain laser focused on driving operational excellence to deliver cost reduction and further margin expansion. In 2023, we achieved $295 million of incremental RTX merger cost synergies, keeping us on track to achieve our $2 billion in gross cost synergy goal by the end of 2025.

On the challenges side, there are certain pockets where inflation remains elevated, we will see the lingering effect of the past couple of years inflation as we deliver on our backlog. In ‘24, we expect to see about $1.7 billion of material and labor inflation, which we expect to be more than offset by higher pricing and the benefits from our digital transformation projects and other aggressive cost reduction initiatives across the company.

And as Chris said before, we continue to focus on executing on our GTF fleet management plans and are working relentlessly to mitigate further disruption to our customers. And of course, we're continuing to support the health of the supply chain. While we are seeing continued improvements, there are areas that remain challenged where we are dedicating resources, including suppliers, who provide structural castings and rocket motors. Two critical areas that continue to pace our recovery.

And as I mentioned back in October, we continue to see headwinds due to the actions we have taken to preserve the improved funded status of our pension plans, as well as the recognition of historical asset experience. And finally, we're keeping an eye on the U.S. and global tax environment, congressional action on the fiscal year ‘24 budget, and of course the broader geopolitical and macroeconomic environment.

So with that backdrop, let me tell you how this translates to our financial outlook for the year on slide eight. At the RTX level, we expect another year of solid growth and adjusted sales, segment operating profit, and earnings per share, along with continued strength and free cash flow.

Before I get into the details, let me share with you a couple of key assumptions embedded in our outlook as it relates to the two dispositions we announced last year. First, with respect to the Raytheon cybersecurity business, we have assumed that this transaction will close here in the first quarter. Therefore, on a reported basis, we will see about a $1.3 billion year-over-year reduction in reported sales, and about an $80 million year-over-year headwind to operating profit. The Collins ‘24 outlook still includes the actuation business as we continue to work on the business disposition.

So with that, starting with sales at the RTX level, we expect full-year 2024 sales of between $78 billion and $79 billion, which translates to organic growth of between 7% and 8% year-over-year. From an earnings perspective, we expect adjusted EPS of between $5.25 and $5.40, and that's up 4% to 7% year-over-year. And we expect to generate free cash flow of about $5.7 billion for the year. And despite only being up $200 million year-over-year, there were strong operational improvement.

So let me take you through the moving pieces. First, we're expecting strong segment profit growth and working capital improvement to drive $2.3 billion of improvement year-over-year. Embedded in that is about a $100 million headwind on higher CapEx in ‘24 as we continue to invest in capacity expansion, digital transformation, and operational modernization. Payments related to powder metal impacts are expected still be a headwind of about $1.3 billion. We’ll also see a net headwind of about $500 million, primarily from higher interest expense principally from the debt we issued to fund the ASR. And finally a headwind of about $300 million from lower pension cash recovery.

Now let me turn to our EPS walk, starting at the segment level, operating profit growth of about 16% is expected to result in approximately $0.72 of EPS growth at the midpoint of our outlook range. With respect to pension while markets have improved since our call in October there will still be a headwind of about $0.36 year-over-year. And as I just mentioned, given the increased debt outstanding, interest expense will be a $0.30 headwind.

A lower average outstanding share count resulting from our recent ASR will provide a tailwind of about $0.37. And finally, our tax rate in ‘24 is expected to be approximately 19.5% versus the 18.5% in 2023. This combined with higher corporate investments in digital transformation will result in a $0.16 headwind year-over-year. All of this brings us to our outlook range 5.25 to 5.40 per share.

Okay with that let’s go to slide nine, to get into our outlook by segment where we expect continued organic sales and earnings growth across all three businesses. Starting with Collins we expect full-year sales to be up mid to high-single-digits on both an adjusted and organic basis, primarily driven by both widebody and narrowbody commercial or reproduction ramps and continued commercial aftermarket. Military sales at Collins are expected to be up low to mid-single-digits for the year. With respect to Collins adjusted operating profit, we expected to grow between $650 million and $725 million versus last year. This is primarily driven by drop through on higher volume across all three channels, as well as higher pricing and the benefit from continued costs reduction initiatives.

Turning to Pratt & Whitney, we expect full-year sales to be up low-double-digits on an adjusted and organic basis versus prior year driven by higher OE deliveries in Pratt’s large commercial engine and Pratt Canada businesses, as well as continued growth in shop visits across legacy large commercial engines, GTF, and Pratt Canada. Military sales at Pratt are expected to be up mid-single-digits driven by higher F-135 sustainment volume as heavy overhauls continue to ramp.

As a result, we expect Pratt's adjusted operating profit to grow between $400 million and $475 million versus last year primarily on commercial aftermarket drop through and military growth, which will be partially offset by higher large commercial OE deliveries. And at Raytheon, on our organic basis, we expect sales to grow low to mid-single-digits versus 2023, as we deliver our backlog and continue to see supply chain improvement.

Adjusted operating profit at Raytheon is expected to be up between $100 million and $200 million versus prior year driven by drop through on higher volume and improvement in productivity, which will be partially offset by mix headwinds. Keep in mind we'll see about $80 million of year-over-year headwind from the divestiture of the cybersecurity business this year.

And to wrap up our outlook at the RTX level, higher intercompany activity will increase sales eliminations by about 10% year-over-year. And we've included an outlook for some of the below the line items and pension in the webcast appendices. Finally, let me make a few comments on our 2025 financial commitments. As you know, there have been some significant changes in the macro environment since we first established these long-term targets, impacts ranging from Russian sanctions, elevated inflation, issues with labor availability, and of course the associated disruptions throughout the supply chain.

And we continue to take incremental actions to further reduce costs, realign our business units, increasing pricing, and investing in productivity improvements to combat these headwinds. Other factors underlying our long-term assumptions however have been also positive, such as the pace of the commercial air recovery and demand for our defense products and services. All that said despite those puts and takes we continue to expect Collins and Pratt to be within the sales and operating profit 2020 to 2025 growth targets we discussed last year at our Investor Day.

However, because of the recent performance at Raytheon, we are recalibrating our outlook for this segment. When taking into account divestitures, we now expect the 2020 to 2025 annual growth rate for adjusted sales to be between 3% and 3.5% that's down slightly from our previous expectation of 3.5% to 4.5% for the same period and driven largely by the initiatives we talked about upfront it will take some time to convert over the next couple of years. As you know, demand remains strong and our robust backlog will continue to support significant top-line growth going forward.

Similarly, with respect to Raytheon's adjusted operating profit growth, given the continued productivity challenges we described, we now see Raytheon's 2020 to 2025 annual growth rate to be between 1% and 2.5%, which is down from our prior outlook of between 5.5% to 7.5%. As a result of this segment change, we now see the RTX level adjusted sales annual growth rate from 2020 through 2025 to be between 5.5% and 6% on an organic basis, that's down slightly from our prior outlook of between 6% and 7%.

And taking into account the adjustment to Raytheon's operating profit outlook, we now see overall RTX adjusted margin expansion to be between 500 and 550 basis points between 2020 and 2025. And that's down from our prior outlook of between 550 and 650 basis points.

However, importantly, there is no change to our RTX 2025 free cash flow target of $7.5 billion, as we remain confident in the significant cash generating capability of our businesses and we are continuing to drive structural cost reduction and working capital improvements as we invest in the business and deliver on our commitment to return $36 billion to $37 billion of capital to share owners with the date of the merger through ‘25.

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

Greg Hayes

Okay, thanks, Neil. On slide 10, let me just wrap this up. I know we've covered a lot of ground today, but I know there's some key takeaways that everybody should focus on here. Obviously, 2023 was a challenging year. The earnings performance of our Raytheon business obviously was disappointing, as was the Pratt powder metal issue. But importantly, demand remains strong across both of our commercial and defense markets. 11% organic growth in 2023 is just the beginning.

With the strength of our $196 billion backlog, we're confident that we'll continue to see strong organic sales and earnings growth, along with accelerated free cash flow generation over the coming years. I believe we have the best positioned A&D portfolio, industry-leading franchises, and robust demand for our products and technologies. This positions us well for the future.

Secondly, we're intensely focused on execution to support our customers and to drive operational performance improvement. We're clearly going to face challenges this year with the continued ramp of the supply chain and the impact of higher costs. But everyone at RTX is working tirelessly to overcome these obstacles and ensure that we deliver on our commitments.

Lastly, we're staying disciplined and managing the business to continue investing in differentiated technologies and innovation, strengthening our balance sheet all while continuing to return significant capital to our share owners.

I want to close again by thanking all the RTX employees, who have been working diligently every single day over the last year to deliver on our mission to create a safer, more connected world.

With that, let's go ahead and open it up for questions.

Question-and-Answer Session

Operator

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

Robert Stallard

Thanks so much. Good morning.

Chris Calio

Good morning.

Greg Hayes

Good morning, Rob.

Robert Stallard

Chris, inevitably a first question on the GTF situation. It does sound like some things have moved since your update in October. And I think you mentioned that the scheduling of the AOG looks like it's going to be slightly different profile and also there could be a related cash impact of that? So I don't know if you could give us some more color on that to development?

Chris Calio

Yes, you bet Rob and good morning. So we did say here this morning that we do expect the peak to continue to be here in Q1 in terms of AOGs and then tread downward thereafter. Again, we think that peak is going to come down a bit since our initial assessment, because really two reasons. One, timing of the AED has shifted a bit to the right. And then two, customers took some proactive fleet planning and decided to, in some cases, accelerate some of their removals. They were doing their fleet planning for the year. They were pairing engines and doing all those things to make them more efficient.

So again, peak here in Q1, trend downward after that and then it'll be more of a steady state as we talked about in our October and September guides on the matter. You mentioned a little bit on cash being pushed out. Again, that was the dynamic time as we're going through and having discussions with our customers on special support. We've made some progress on special support. I think we've talked about that upfront. We've signed several agreements with our customers, some important customers with large fleets. But the timing of that cash just simply moved out from the second-half of

'23 into '24. Same total aggregate amount from 6 to 7, but the timing moved a little bit to the right for the reasons I talked about.

Robert Stallard

Thanks, Chris.

Chris Calio

Thank you.

Operator

Thank you. Our next question comes from the line of Cai Von Rumohr of Cowen. Your question, please, Cai.

Cai Von Rumohr

Yes, thanks so much. So your cash flow hit from the powdered metal issue is $300 million higher in '20 than you said. Can you tell us how big was the impact in '23 and are we still going to be at $3 billion and therefore there's a plus of $300 million pickup in '25? Thanks.

Neil Mitchill

Hey, Cai. Good morning, it's Neil. Yes, and I'll take that one. So, you know, as Chris was just talking about when we closed out '23, for a variety of reasons, the cash flows shifted to the right. So the impact in '23 for powdered metal related dispersion was essentially zero. So we moved about half of that into 2024, that's the $1.3 billion that you're seeing. Still holding a $1.5 billion in our '25 outlook. And then we see the rest spilling into early 2026. So we'll continue to work, obviously, the agreements with our customers, and that will drive the ultimate timing of the payments, but you can see our assumptions that we've laid out there.

Cai Von Rumohr

Thank you very much.

Neil Mitchill

You're welcome.

Operator

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

Sheila Kahyaoglu

Good morning, everyone. I can't help, but compare and contrast given GE just reported this morning and they're talking about margins being flattish in aerospace based on OE mix and LEAP services mix? So, you know, just looking at Pratt, can you talk about the dynamics there given GTF volumes are growing, early GTF shops as it's climbed higher? So what drives margins 100 basis points higher? What's embedded into the guide? Neil, you gave great color on the revenue assumption. Can you give some assumptions on maybe the aftermarket specifics on the margins as well as the military overalls increasing? Is that beneficial?

Neil Mitchill

Sure, thanks Sheila. Let me share a couple of other details that we didn't get into in the prepared remarks. So we did talk about the overall sales of Pratt being up in the low-double-digit range, you know, $400 million to $475 million of operating profit. The aftermarket sales are going to be up sort of low-teens. So the drop through on the aftermarket is going to be the principal driver of the year-over-year profit increase. We talked a lot about expanding the margins on our, you know, both our legacy and GTF aftermarket as we increase the volumes there. And so some of that will start to show up in ‘24 and that's a driver of drop through.

On the OE side, we think the sales are going to be up in the mid-teens range. The good news there, as we look at engine productions, which think about that as up about 20%, we'll see about a headwind of maybe $125 million associated with that higher volume. So we're getting much better absorption as the volumes return back to levels that we had seen pre-pandemic and that we've been capacitized to. So I think that's another place that we're going to get some margin expansion.

And then again, I'm not sure we got into this, but military will be up in the mid-single-digit range. I'd say again, we had 5% growth on the top line there. And of course, that comes with good drop through too, you know, as we get into 2024. So that's the Pratt story as we look into 2024, just a little more color there.

Sheila Kahyaoglu

Great. Thank you.

Neil Mitchill

You're welcome.

Operator

Thank you. Our next question comes from the line of Myles Walton of Wolfe Research. Your question, please, Myles?

Myles Walton

Thanks, good morning. I was wondering, maybe Neil, if you can comment on the offset to the lower implied earnings drop through from the ‘25 guidance? What was the offset to allow you to maintain the cash flow there? And maybe Chris, what by the end of, say, ‘24 would you have achieved in terms of incorporation of fully life parts into the fleet? Just as a metric, maybe we can sort of monitor by it? Thanks.

Neil Mitchill

Thanks, Myles. Good morning. Let me start, let me maybe start to frame the answer to that question with a little bit of an updated walk between ‘23 and ‘25 on free cash flow to get to the $7.5 billion. And then I'll talk about, you know, what obviously offset the reduction in the profit as part of that. So, as we look from ‘23 of $5.5 billion, that $2 billion increase is going to come principally from, you know, what I would call operational growth, about $4.8 billion, $2.9 billion of which is going to come from the pre-tax segment operating profit, and you pointed out that, that will be lower than our prior guide, and that's around the midpoint.

The remaining growth is going to come from working capital improvement, about $2.2 billion, about half of which we will deal with here in ‘24 as we look to hold our inventory flat. So our ‘23 headwind operationally was about $600 million, so we're looking year-over-year to improve that. And then we'll have about a half of the, I'm sorry, $400 million of CapEx between ‘23 and ‘25, so that'll be a headwind.

And then I just talked about the $1.5 billion powdered metal impact and about $1 billion headwind that split pretty evenly between -- sorry pretty evenly between interest and improvement in taxes and then finally a few $100 million of pension headwind. All of that should get you to $7.5 billion. So what's changed as we look out to 2025, there's been really three things that are different. The first is we've got about $1 billion net of tax lower operating profit baked into this long-term guide. But that's been offset by about $700 million of improvement in taxes, most notably on the back of improvements in our R&D position, as well as a $200 million based on the assumptions we see today with respect to our pension outlays. And then a little bit of additional working capital. So those are the key drivers.

Chris Calio

And I'll talk to you now about the full life incorporations. As we said upfront, I think we had made this commitment early on in September, October timeframe, full life powder metal parts in OE, so at our customers final assembly lines, starting this year. So that's a good thing. Keep in mind the OE engines have the latest build standard and so when you add in the full life parts to those you get the maximum time on wing for the customers and also keep in mind that means that the full life parts will go into our spare engines, which are going out to lift the fleet again, maximizing the time on the wing.

On the MRO side, what we said was we were going to start the incorporation in Q2 of this year. We actually started that a little bit earlier. We've found opportunities to put full life parts into MRO where we think it makes the most sense from a time on link perspective. As we said early on in the year, we're not going to get all of our shop visits with full life parts. We're going to ramp throughout the year where we don't incorporate the full life parts into MRO. We're going to continue to obviously inspect those parts with the angle scan inspection that we developed and they will be put back into service until the next inspection interval.

And keep in mind, one of the things that we've been doing is just looking at the build standard and the interval for each of these engines that are coming in. There are opportunities to sort of match up just based on the condition of the engine and where it is and where it flies in terms of the environment. A part that's been inspected that's not at full life, match it up with an engine that's going to be coming in for another reason around that same time, so you're not actually driving you know an incremental visit. So again that's sort of the algorithm that we're kind of going through each and every day with the Pratt team to sort of maximize our allocation in the full life parts. But the MRO will be a ramp throughout the year. I think ultimately we'll get to roughly the same place that we had assumed we would had we started in Q2, but it'll be a ramp throughout the year. And all of that's been factored into our outlook.

Myles Walton

Thank you.

Operator

Thank you. Our next question comes from the line of Peter Arment of Baird. Please go ahead, Peter.

Peter Arment

Thanks. Good morning, everyone. Hey, Chris, on Raytheon, you talked about some of the headwinds. Could you maybe give us a little more color on just where we are in terms of the profile of the fixed price development programs and whether we're peaking now? And then kind of related to all this just is when should we start to see more of that mixed shifts from more of the FMS that you kind of talked about where we could see some better pricing flow in terms? Thanks.

Chris Calio

Yes, okay. Thanks Peter. So again as we talked about the productivity issues at Raytheon, about 70%, as we said upfront, were in the fixed price development programs. And I'll characterize some of these, Peter, as in some cases these are contracts that we took on that maybe weren't in our core capability suite, and we signed up for requirements and other specifications that were really, really difficult. And so it's taken us some time to continue to work through those. In some cases, what we're doing, Peter, is we're taking subject matter experts from across the company and just adding resources to these programs. It adds a little bit of expense, obviously, but I think in the long-term, it gets the capabilities of the customer faster and ultimately is better financially for us and for the customer.

And then in some cases on these fixed price development programs, we're having discussions with customers about either restructuring specifications or altering the requirements in a way that still get capability that's needed and that's helpful. But you can get to them, frankly, in a shorter period of time and with a better financial profile. Those conversations continue to go. I'll tell you that we will, got a handful here that we're still going to be powering through in 2024 and see that horizon getting better in the next 12 to 18 months as we go through certain milestones, Peter and satisfy some contractual requirements. We then get into a different phase of the agreement and feel better about our ability to go and execute.

Neil Mitchill

Chris, maybe I would add Just a couple of the financial points around our assumptions, financially going into 2024. As you think about the $100 million to $200 million profit increase, the first thing I would say is in ‘23, we had about a $240 million headwind associated with these negative productivity. As you said two-thirds, 70% associated with these fixed-price development programs, principally a couple of them. As we look to ‘24, our assumption is that our absolute value of productivity is zero. So we'll see about a $200 million improvement year-over-year. We'll see about $100 million at the midpoint from volume and a little bit of headwind as the lower margins roll through the backlog in ‘24.

And that's what we've contemplated both in the ‘24 and the ‘25 outlook. All of that gets you down to our guide, of course, is that $80 million ahead I talked about. And as you kind of look into ‘25, our productivity assumption is about $100 million step up. So again, this business at one-time generated $300 million, $400 million, $500 million a year of productivity. But we need some time for that to play through to see those kinds of margins. But 2025 would not mark the peak of where we see Raytheon's margin potential.

Peter Arment

Appreciate it. Thanks, Chris, yes.

Chris Calio

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, everyone.

Chris Calio

Hey, Noah.

Noah Poponak

Neil, just want to make sure I have the -- I guess, the starting point and the implied margin correct in this new $500 million to $550 million, ‘20 to ‘25, so given restatements and the like. So I'm looking at 2020 segment operating margin all in of $8.2 implying that the ‘25 is $13.2 to $13.7, so is that correct? And then can you just talk a little more about getting there from this ‘24 guidance it would seem to either require a pretty nice step up in the Raytheon defense margin or acceleration in the incrementals at Pratt and Collins or all of the above?

Neil Mitchill

Thanks, Noah. So as you kind of look at the multi-year outlook here, what we've done at the top end is we've tightened up the range a little bit for the RTX sales and margin. We still see Collins and Pratt being within the ranges we talked about. Frankly, the drivers are all the same that we talked about six months ago and the last quarter as well. The aftermarket is going to fuel that. We're going to get better absorption and we'll see the benefits of lower spending on investments we've been making to drive cost reduction and the benefit of that cost reduction.

So if you put all that, that's going to put Pratt and Collins in that range, probably closer towards the middle of the high-end of that range. And then we just talked about the Raytheon pieces altogether. So I think at the midpoint, when you take into account the dispositions that we've either completed or have announced, you'll see that our margin assumption at the RTX level is about the same as where we were projecting before these tweaks for the Raytheon recalibration.

Noah Poponak

Okay, and just to make sure I have your -- you said to Myles correct, in the $5.7 million of free cash this year and the $7.5 million next year, each of those assumes about $1 billion of positive change in working capital each year, is that right?

Neil Mitchill

That's correct. And as you think about from ‘23 to ‘24, inventory is going to essentially, our plan is to stay flat, that will be about 80% of what generates that year-over-year working capital benefit in ‘24. And then as you look to ‘25, you know, we'll see continued improvement in inventory, as well as the benefit of customer advances. So we've realized a lot of customer advances over the last couple of years. They will burn down. And then as we see these international orders come back in, you'll see that pick up in the year ‘25.

Noah Poponak

Okay, thanks very much.

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.

Doug Harned

Good morning. Thank you. It sounded, from what you said, Chris, that you made some good progress on the AOG profile here for the GTF. But when you look at your customer base, you may have some who find that a high number of AOGs could put their financial performance at risk. Whether or not those issues are caused by Pratt, you could easily be targeted for responsibility. You already have the earlier go-first lawsuit. So how do you think about the risk for you with airlines that could be in a stressed financial position? And maybe more difficult perhaps than how you might normally compensate a customer?

Chris Calio

Yes, thanks Doug. I mean, first of all, I'll tell you that we are engaging with our customers each and every day to try to figure out how best to support them, whether that's through induction, whether that's through special support, whether that's the spare engine allocation, whatever it may be. And you're right, Doug, there are some customers out there, 10 to 12, I think, as we've talked about before, they're going to be more impacted than others. There's some that are all Pratt fleets, whether it be GTF and V2500. So again, working very hard with them to come up with a compensation structure relative to the powdered metal AOG situation. That's fair, and that can give them a little bit of lift.

Obviously, it won't make up for all of the disruption that they're having in their fleet and all of the things that they've got to do to accommodate for these removals. But again, doing the best we can to come up with a fair set of compensation structures to help out during these trying times. And then, of course, communicate with them consistently about what we're seeing in terms of the assumptions that we're talking about here. Full life incorporation, MRO, MRO output, all the things that are going to drive better fleet support for them.

So obviously don't want to be in a position where we're putting our customers in harm's way and where they're going to be very upset with us and want to take action. But I'll tell you, we've got a track record of coming to agreement with our customers on some of the more difficult problems we've faced. I'm confident we're going to be able to do it again.

Doug Harned

And if I can, are you seeing any improvement in the time, the induction time to get these engines in the shop as part of this AOG profile?

Chris Calio

Right now, Doug, the wing-to-wing turnaround time remains consistent with what we had talked about previously. I will tell you, and we kind of alluded to this earlier, we are continuing to aggressively pursue with our aftermarket partners. Again, we've got some Tier 1 aftermarket providers as part of the GTF aftermarket network trying to come up with, you know, what I would call light or medium type work scopes that can take the, you know, in shop time, down further. Again, trying to maximize the time on wing, just depends on the operator, depends on the condition of the engine, but we're aggressively pursuing a number of work scopes that can take the in-shop time down.

In addition, I think you've heard us talk about this before, we've industrialized a significant number of repairs on the GTF, I want to say about 1,300 in 2023. We've got another significant step up here in 2024 [Technical Difficulty]

Operator

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

David Strauss

Thanks. Good morning.

Chris Calio

Good morning.

David Strauss

Wanted to ask, what exactly is the bottleneck, Chris, to be able to ramp up production of full-life discs, given that I think the powdered metal switch occurred a while ago I guess I'm just kind of confused there why it's not easier to ramp up the production of these full-life discs? And then could you touch on what you're expecting for large commercial engine deliveries in ‘24 and your confidence in being able to meet Airbus's requirements? Thanks.

Chris Calio

Sure. So, you know, as we talked about, David, the powdered metal value stream, we're asking it, both our own shops and our supply chain, to step up significantly here so that we can incorporate into MRO, as we talked about earlier, and in OE. So much more than that value stream clearly had anticipated mid-year last year. Again, we feel like we've got pretty adequate forging capacity within our own four walls and with the supply chain. But again, we've got to continue to ramp up inspection capacity. We've got to ramp up machining capacity, all critical parts of that value stream.

And I'll tell you, as you ramp up, and we saw this in 2019 as we were ramping and we're ramping up again here, as you take these parts to a volume that our supply chain wasn't necessarily anticipating and that we weren't necessarily anticipating, you've got to continue to double down on the fundamentals, the quality, the yield, the tooling, and the maintenance, all the things that are instrumental in enabling that volume jump. So, again, I would say we've made solid progress thus far in our, you know, generally tracking to where we thought we would be. But again, we've got to continue to step up throughout the year, especially as we want to increase the number of full life parts we put into MRO.

To your question about Airbus, I think Neil said it before, up about 20% year-over-year here in ‘24. And again, we have discussions with Airbus all the time. They understand the fleet condition. They understand where we're ramping on powdered metal parts and the like. And so, we feel good about our ability to meet the commitment we made to them here in 2024.

David Strauss

Thanks very much.

Operator

Thank you. Our next question comes from the line of Ronald Epstein of Bank of America. Please go ahead, Ronald.

Ronald Epstein

Hey, good morning, guys.

Chris Calio

Good morning, Ron.

Ronald Epstein

Just change the subject a little bit. Everybody seems to be talking about the powdered metal thing. And Collins, Collins outlook looks really good. Can you give some color around how much of that is being driven by widebody and interiors and if you're starting to really see a pickup there. Because the one thing that we're all kind of waiting for is the pickup in the widebody market. And that interior's business is generally a good leading indicator of what's going on.

Greg Hayes

Let me start, Ron, and maybe Chris can add something. Let me give you a couple details first. On the aftermarket side at Collins, we expect that to be up high-single-digits to low-double-digits, I'd say 10% or more. On the OE side, mid to high-single-digits. And we're going to see, as everyone knows, about 40% incrementals there. And yes, wide body is going to be a big driver. So as we've seen a lot of narrow body, I'll call it catch up in growth over the last couple of years, we do expect that to shift to the widebody.

Now keep in mind on the widebody OE side for Collins, the margins are a bit thinner there, but it does set us up for good longer term projections, especially as you get into ‘25 and ‘26 and beyond, as that comes off warranty and converts to aftermarket. Around the interior business, I think Steve Tim had said this back in June, that business is growing, but it's nowhere near levels of 2019. And so we don't see that coming back until about 2026. So the good news is, you know, there's a lot of runway there. And we are seeing a lot of activity there. So I think that will be a growth driver. But clearly, we're starting to see a bit more of a shift from narrow body into wide body as we go into the next couple of years.

Chris Calio

Yes, maybe the only thing I would add to that, Ron, is that Steve and team are very focused on the transformation within interiors. I think there's some opportunity to consolidate sites, to continue to remove ERP systems. As you know, there's been an integration that's been going on in that interiors business in particular. So I think a lot of good work on continuing to transform the cost footprint in the interiors business. So when that volume continues to come back, it'll be at the types of margins that you would expect.

Ronald Epstein

Got it. Got it. And have you guys seen any airlines, any customers yet requesting retrofits and upgrades to interiors on their existing widebody fleets?

Greg Hayes

You know, Ron, that's actually an ongoing process. We're in the process of working with a number of airlines as they are going through their retrofit. And keep in mind, that is a three- to five-year process to upgrade these things. So we are still finishing out things that we had signed up for back in 2018, 2019. But again, as Neil said, the business is coming back. But given the long cycle nature of these upgrades, you're not going to see a heck of a lot of that in ‘24, more than ‘25 and certainly more than ‘26.

Ronald Epstein

Got it, cool. All right, thank you very much.

Chris Calio

Welcome. Sure.

Operator

Thank you. Our final question comes from the line of Seth Seifman of JP Morgan. Your question please, Seth.

Seth Seifman

Yes, thanks. So, good morning. Maybe just following up on Collins and kind of the growth outlook for this year when we think about how much OE production rates are rising. We think about the strengths in the aftermarket. What's the potential for upside on the top line there? And I guess how much is a drag on the military business? It's a pretty significant chunk of the portfolio and given the growth rate in the second-half and what you're forecasting overall for ‘24, it seems like maybe this isn't a business that's really a military business that's going to participate in the budget growth and outlay growth that we're seeing now?

Greg Hayes

Good morning, Seth. Let me start, I wouldn't characterize the defense business within Collins as a drag. I think the defense business in ‘23 was flat at the top line and it experienced a lot of the same issues we've been talking about on the Raytheon side in terms of the impacts of inflation, the delays in the supply chain. But as we look to ‘24, we're going to see, I'd say, healthy growth there, low to mid-single-digits as we catch up and the supply chain catches up and we burn down the overdue there. And I think we're really well positioned on a lot of strategic platforms.

Remember, we moved businesses from the Raytheon segment into the Collins Mission Systems business to create more synergistic opportunity there. And I think that's really taking hold and there's a lot of good proposal activity there. So I think it's a great fit. It's in the right place in Collins. More broadly, I think just talking about the aftermarket potential at Collins, very strong, but we just put up some significant numbers there with aftermarket of 26% and provisioning up 42% on a full-year. So clearly there's been a surge in aftermarket over the last year, and so we're dealing with some very difficult compares.

And on the OE side, we'll start to see that growth moderate, but again, still on the back of some really strong 17% growth in ‘23. So I think Collins is well positioned and I think the defense business is a good fit and it's in the right place there for it right now.

Chris Calio

Again, I'll just add, much like the interiors, I think Steve and team have a plan to continue to drive structural cost reduction within Collins to help, you know, margin expansion. We've talked about, you know, moving engineering presence to best cost locations by 2025 by significant number, same with manufacturing hours. So a lot of Center of Excellence activity going on in Collins that will continue to help with their cost footprint and support the margin expansion.

Seth Seifman

Great. Thanks very much.

Chris Calio

Thank you.

Greg Hayes

Okay. Thank you, everyone, for calling in and listening today. As always, Jennifer and her investor relations team will be available all day to answer whatever further questions you might have. So with that, thank you and have a wonderful day. Take care.