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Raytheon Company (RTN) CEO Tom Kennedy on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release *Slides*

EPS of $3.08 beats by $0.24 | Revenue of $7.45B (9.40% Y/Y) beats by $160.85M

Earning Call Audio

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Raytheon Company (NYSE:RTN) Q3 2019 Results Conference Call October 24, 2019 9:00 AM ET

Company Participants

Kelsey DeBriyn - Vice President of Investor Relations

Tom Kennedy - Chairman and Chief Executive Officer

Toby O'Brien - Chief Financial Officer

Conference Call Participants

Sheila Kahyaoglu - Jefferies

David Strauss - Barclays

Peter Arment - Baird

Seth Seifman - JP Morgan

Robert Spingarn - Goldman Sachs

George Shapiro - Shapiro Research

Cai Von Rumohr - Cowen and Company

Carter Copeland - Melius Research

Ron Epstein - Bank of America Merrill Lynch

Peter Skibitski - Alembic Global Advisors

Operator

Good day, ladies and gentlemen. And welcome to the Raytheon Third Quarter 2019 Earnings Conference Call. My name is Ditamara and I will be your operator for today [Operator Instructions].

I would now like to turn the call over to Ms. Kelsey DeBriyn, Vice President of Investor Relations. Please proceed.

Kelsey DeBriyn

Thank you, Ditamara. Good morning, everyone. Thank you for joining us today on our third quarter conference call. The results that we announced this morning, the audio feed of this call and the slides that we'll reference are available on our Web site at raytheon.com. Following this morning's call, an archive of both the audio replay and a printable version of the slides will be available in the Investor Relations section of our Web site.

With me today are Tom Kennedy, our Chairman and Chief Executive Officer and Toby O'Brien, our Chief Financial Officer. We'll start with some brief remarks by Tom and Toby, and then move onto questions.

Before I turn the call over to Tom, I'd like to caution you regarding our forward-looking statements. Any matters discussed today that are not historical facts, particularly comments regarding the Company's future plans, objectives and expected performance and the proposed merger with UTC, constitute forward-looking statements. These statements are based on a wide range of assumptions that the company believes are reasonable, but are subject to a range of uncertainties and risks that are summarized at the end of our earnings release and are discussed in detail in our SEC filings. And with respect to the proposed merger and related matters in the definitive merger proxy statement filed with the SEC on September 10, 2019.

With that, I'll turn the call over to Tom.

Tom Kennedy

Thank you, Kelsey. Good morning, everyone. Raytheon again delivered strong performance in the third quarter. We achieved record sales of $7.4 billion, up 9.4%. And our bookings, sales, operating income, EPS and operating cash flow, all exceeded our expectations. We continue to see strong global demand for innovative solutions. Book-to-bill in the third quarter was a healthy 1.27. And for the second time this year, we achieved record backlog, which rose to $44.6 billion at the end of the quarter, an increase of $3 billion year-over-year.

Given our continued strong bookings and the opportunities we see in the fourth quarter, we are again increasing our bookings outlook for the year by another $1.5 billion. It is worth noting that since the beginning of this year, we've increased our bookings outlook by a total of $3 billion over our original expectation, and we expect a full year book-to-bill ratio of greater than 1.1.

We are pleased with our bookings performance this year, which positions us well for a strong growth in 2020. Additionally, we are also increasing our guidance for sales, operating income and EPS. Toby will discuss additional details about our third quarter performance along with our updated guidance and additional color on our 2020 outlook in a few minutes.

And let me update you on our proposed merger of equals with United Technologies Aerospace Businesses. Two weeks ago at our special meeting, we reached an important milestone. Raytheon shareholders overwhelmingly approved the merger with 96% of the voted shares in favor of the merger. I am pleased that both our shareholders and the shareholders of UTC voted in favor of our powerful strategic combination.

Shareholder approval reflects a significant step on our path to unite to world-class companies with complementary technologies, and it supports our view that this merger of equals will create additional growth opportunities while delivering benefits to our shareholders, customers and employees. Integration planning for the merger is progressing well, and the merger remains on track to close in the first half of 2020.

One of the strengths Raytheon will be bringing to the combined company is our diversified portfolio of advanced technologies that are well aligned with our customers' needs. So let me spend a few minutes discussing these innovative technologies and how we are able to turn them into compelling and advanced solutions and franchises for our customers.

The newest example of this is our clean sheet offering for the next generation air and missile defense radar competition. Last week, we were pleased to be selected by the U.S. Army to develop the lower tier air and missile defense sensor, which extends Raytheon's position as a world's premier air and missile defense radar capability provider for decades to come.

We expect LTAMDS to have a potential lifetime value around $20 billion from sales to domestic and international customers. LTAMDS will operate on the Army's integrated air and missile defense network. Our winning LTAMD solution is 360 degree active electronically scanned array radar powered by Raytheon manufactured gallium nitride, a substance that strengthens the radar single and enhances its sensitivity.

Over the years, we have invested significantly in the AESA GaN technology and advanced manufacturing capability, positioning the company as the global leader in advanced AESA technology and product development. Our innovative solution also showcased advanced abilities and ease of maintenance and sustainment for the end-user, the soldier.

Our Patriot franchise was also strengthened in August with the Kingdom of Bahrain, signing an agreement to purchase our Patriot system. This Letter of Offer and Acceptance allow the U.S. government to begin contract negotiations with our Patriot team. Bahrain will become the 17th nation to procure Patriot. With the U.S. Army's approval, all 17 of these Patriot partners will have the opportunity to add of our ESA 360 degree capability LTAMDS radar to each of their fire units. This will enhance the performance and extend the life of their systems for many decades.

In addition, the capabilities of the LTAMDS radar also opens up the market for standalone forward-deployed applications. Our leadership in radars was also extended with the completion of the first system-level test of the Enterprise Air Surveillance Radar at Wallops Island test facility by the U.S. Navy and Raytheon in August.

EASR is the newest sensor in the Navy's SPY-6 family of radars for aircraft carriers and frigates. It provides simultaneous insight air and anti-surface warfare, electronic protection and air traffic control capabilities. The radar has a highly scalable design and the innovative technology allows it to deliver increased performance, higher reliability and sustainability and lower total ownership cost. Upon completion of the system-level testing by the end of the year, EASR will shift to low rate initial production. As a reminder, AMDR, our Navy radar franchise for the new DDG 51 destroyers recently transitioned into low rate initial production.

Another area where we are using our innovative technology to meet the needs of our global customers is in the area of counter UAS. Recently, our Coyote Block 2 counter drone unmanned aircraft system scored direct hits on multiple aerial targets in U.S. Army test flights. Coyote Block 2 is a new high-speed kinetic interceptor that will counter hostile drones. It is compatible with Raytheon's Ku-band Radio Frequency System or KuRFS radar. The Block 2 system is on track to be full rate production ready in 2020.

In the area hypersonics, we are also advancing technology to develop new capabilities for our customers. In September, we announced that Raytheon will build and deliver to control, actuation and power conditioning subassemblies that can control flight of the U.S. Army's new Common-Hypersonic Glide Body missile.

All of our businesses are at the forefront in developing new and updating existing technologies. And one in particular, SAS, has seen good advancements, both in terms of growth and in terms of innovative technology offerings. During the quarter, SAS had very strong performance, growing sales more than 14% year-over-year and exceeding margin expectations. Over the last few years, we have seen SAS capture a number of new franchise programs. And during the quarter, we made great progress on these new franchises. In the electronic warfare market, this past August, SAS delivered the first next-generation jammer mid-band engineering and manufacturing development pod to the U.S. Navy to begin ground and aircraft integration testing.

And in October, we delivered the second pod. Raytheon will deliver a total of 15 EMD pods for mission systems testing and qualification, as well as 14 pods for airworthiness certification. Beyond the good growth, we are seeing on our EW programs at SAS, we are also seeing strong growth in our space and ISR program, such as the NextGen OPIR and recent classified franchise program wins.

In July, SAS was selected as a radar supplier for the B-52 bomber radar modernization program, displacing the incumbent and extending our airborne radar franchise. Under the contract, Raytheon will design, develop and produce and sustain AESA radar systems for the entire U.S. Air Force B-52 fleet. With improved navigation reliability, mapping and detection range, the advanced radar upgrade will ensure the aircraft remains [Technical Difficulty] and beyond.

Finally, and as I thinking about my next few years, one of my key roles in the new Raytheon Technologies will be to work with Greg Hayes to driver our combined innovative technologies into business solutions for our customers. My focus has always been to make sure we are taking our best technology, accelerating it to the businesses and embedding it in our advanced products, while making these innovative solutions relevant to our customers. A key priority for me at the future Raytheon Technologies will be to deliver technology synergies and drive technology improvements across all of our businesses and products.

Before concluding, I'd like to take a moment to briefly touch on U.S. Defense Budget. As most of you know, we are again operating under a continuing resolution through November 21st, and our guidance has taken this into account. We encourage lawmakers to work swiftly to get the Defense Appropriations Bill enacted before the end of the calendar year. This is in the best interest of our customers and industry.

Bottom line, the company's performance is strong. We're well-aligned with the advanced technologies needs of our customers. And we have the opportunity to shape the future of aerospace and defense with our proposed merger. I want to thank the Raytheon team worldwide for helping secure the strong position for our company, customers and shareholders. And let me turn it over to Toby.

Toby O'Brien

Thanks Tom. I have a few opening remarks, starting with third quarter highlights, and then we'll move onto questions. During my remarks, I'll be referring to the Web slides that we issued earlier this morning.

Everyone would please turn to Page 2. We are pleased with the strong performance the team delivered in the third quarter with bookings, sales, operating income, EPS and operating cash flow, all better than our expectations. We had strong bookings in the third quarter of $9.4 billion, resulting in a book-to-bill ratio of 1.27, and ended the quarter with a record backlog of $44.6 billion.

Sales for the quarter were also a record at $7.4 billion, up 9.4% with growth across all of our defense businesses. Business segment operating income of $901 million grew 6.9% in the quarter. Our EPS from continuing operations was $3.08, up 36.9%, which I'll give a little more color on in just a moment.

We had strong operating cash flow in the third quarter of $1.3 billion, which was better than our prior expectations. This was due to the timing of collections on some of our larger contracts, which were previously expected in the fourth quarter.

Operating cash flow was higher than last year's third quarter due to the $1.25 billion discretionary pension plan contribution we made in the third quarter 2018, and the timing of collections in the third quarter 2019. At a high level, we are increasing our full year 2019 outlook for sales, operating income and EPS, as well as making other updates. And we're raising our bookings outlook by $1.5 billion for the full year. I'll provide more color on guidance in a few minutes.

Turning now to Page 3. Let me start by providing some detail on our third quarter results. Company bookings continue to be strong. For the third quarter, bookings were $9.4 billion, which were approximately $700 million or 8% higher than the same period last year. These strong bookings position the company well for future growth.

For the quarter, international was 34% of our total company bookings. Again, backlog at the end of the third quarter was a record $44.6 billion, up $3 billion or 7% compared to last year's third quarter. Approximately 39% of our backlog is comprised of international programs.

We now move to Page 4. We had strong third quarter 2019 sales growth of 9.4%, higher than the guidance we set in July, primarily due to better-than-expected performance at our IDS, IIS and SAS businesses.

Looking now at sales by business. IDS had third quarter 2019 net sales of $1.8 billion, up 18% compared with the same quarter last year. The increase from Q3 2018 included sales associated with the recognition of previously deferred costs on an international air and missile defense system program awarded in the third quarter 2019.

IIS had net sales of $1.9 billion. The 6% increase compared to Q3 2018 was primarily due to higher net sales on classified programs in both cyber and space. And as we've previously discussed, we expect IIS's growth rate to continue to moderate in the fourth quarter of the year due to the planned ramp down and transition on the Warfighter FOCUS program.

Missile Systems had third quarter 2019 net sales of $2.2 billion. The 4% increase from the third quarter 2018 was primarily driven by higher net sales on classified programs. In the third quarter 2019, SAS had net sales of $1.9 billion, up 14% compared with the same quarter last year. The increase in net sales for the quarter included higher net sales on classified programs, Protected Communications Systems programs and the Next Gen OPIR program. Overall, we're very pleased with our total company sales growth for the quarter, which is up 9.4%.

Moving ahead to Page 5. We delivered strong operational performance in the quarter. Our operating margin was 16.2% for the total company and 12.1% on a business segment basis, better than our expectations. Total business segment operating income is up year-over-year for both the quarter and year-to-date.

So now looking at business margins. IDS third quarter 2019 operating margin was strong at 16.1%, better than our expectations and in line with last year's third quarter. IIS operating margin of 8.7% was up 10 basis points compared to last year's third quarter, better than expectations. The third quarter included a non-cash gain of $14 million on an investment.

Missiles' operating margin was 10.1% in the quarter with last year's third quarter benefiting from higher net program efficiencies. SAS's third quarter 2019 operating margin was strong at 14%, better than our expectations and 80 basis points higher than last year's third quarter. The improvement in operating margin was largely driven by a favorable change in program mix. We continue to expect both total business segment and total company operating income to increase in Q4.

Turning now to Page 6. Third quarter 2019 EPS was $3.08, better than expected, primarily driven by higher sales volume and the timing of productivity improvements. Third quarter 2019 EPS was higher than last year's third quarter, driven by operational improvements, primarily from higher sales volume, as well as pension related items. You may recall that last year's third quarter results included an unfavorable $0.80 per share impact related to the pension plan annuity transaction.

On Page 7, we've increased our full year 2019 net sales and narrowed the range. We are raising the low-end by $300 million and the high end by $100 million. And we now expect net sales to be between $29.1 billion and $29.4 billion, up 7.5% to 8.7% from 2018. The increase versus our prior guidance is driven by IDS, IIS and SAS.

We increased total business segment operating income, raising the low end by $45 million and the high end by $15 million from our prior guidance. We now expect our total business segment operating income to be in the range of $3,525 million to $3,615 million.

From a total company point of view, we remain focused on operating profit and margin improvement going forward. As we've done in prior years, during the quarter, we updated our actuarial estimates related to our pension plans. As a result of this update, the FAS/CAS operating adjustment for the year was reduced by $9 million and the retirement benefits non-service expense for the year improved by $38 million. Taken together, they have a favorable total year impact of approximately $0.08 per share with $22 million or $0.06 per share recorded in the third quarter 2019 and $7 million or $0.02 per share expected to be recorded in the fourth quarter 2019.

We've increased our full year 2019 EPS, raising the low end by $0.20 and the high end by $0.10 from our prior guidance. We now expect our EPS to be in the range of $11.70 to $11.80. I'll discuss this in a little more detail in just a moment. We continue to see our 2019 operating cash flow outlook between $4 billion and $4.2 billion.

On Page 8, we've provided you with the 2019 financial outlook EPS walk to bridge our prior view in July to our current EPS guidance. At the midpoint, we are increasing our EPS outlook by $0.15 from July, driven by $0.09 from operations led by the higher sales volume we are seeing and $0.08 from improved pension. This increase is partially offset by higher merger-related expenses of $0.03 versus what we were expecting in July.

On Page 9, we've included guidance by business. We've increased the full-year sales outlook at IDS, IIS, SAS and for the total company to reflect a combination of stronger bookings to-date and fourth quarter expectations. And at Missiles, we continue to see strong growth. We see their full year 2019 sales growth in the 7% to 8% range.

Overall, we're pleased with the company's sales growth. The strong margin performance we saw at IIS and SAS in the third quarter and their improved margin outlook for the remainder of the year offset the margin performance of missiles. This reflects the strength of our balanced portfolio.

Before moving on to Page 10, given our year-to-date bookings strength and our expectations for a strong fourth quarter, we are now raising our full year 2019 bookings outlook by $1.5 billion to a range of between $32.5 billion to $33.5 billion. The increase is driven by strong demand from our global customers, and positions us well for continued growth in 2020.

On Page 10, we have provided guidance on how we currently see the fourth quarter for sales, earnings per share and operating cash flow from continuing operations. We expect our fourth quarter sales to be in a range of $7.8 billion to $8.1 billion and EPS from continuing operations is expected to be in a range of $2.93 to $3.03. We expect operating cash flow to be in a range of $2.3 billion to $2.5 billion.

Now turning to our initial outlook for 2020 on Page 11. As we sit here today, we currently see the book-to-bill ratio above 1, and would expect to achieve another record backlog year. We also see strong sales growth for 2020 for the underlying Raytheon business of 6% to 8% over our 2019 outlook. And while we expect growth across all of our businesses, we would expect IDS and SAS, our highest margin businesses, to have higher growth rates than the others.

Before concluding, I want to touch on two additional points. First, earlier this month, Vista Equity Partners, our joint venture partner in Forcepoint, exercised their put option to require Raytheon to purchase their interest in Forcepoint. As a result, the parties are currently engaged in the formal process under the joint venture agreement to determine the fair value of their interest. We will provide additional information after the transaction is completed.

And second, the collaborative merger efforts and integration planning between Raytheon and United Technologies are well underway and continuing to progress, including the affirmative shareholder votes two weeks ago. We look forward to the next steps in the process, including continuing to work closely with regulatory authorities in U.S. and other jurisdictions to secure the required clearances and approvals for the merger.

We continue to expect the merger to close in the first half of 2020. And post closing, we look forward to Raytheon Technologies delivering strong free cash flow growth and deploying a significant amount of its free cash flow to its shareholders in the form of share repurchases and dividends.

In summary, we had another strong quarter. Our bookings, sales, operating income, EPS and operating cash flow, were all above our expectations. We remain well positioned with both our domestic and international customers' priority areas. We increased our full year 2019 outlook for bookings, operating income and EPS, increased the sales growth range to 7.5% to 8.7% and have a strong foundation for continued sales growth of 6% to 8% in 2020.

With that, Tom and I will open the call up for questions.

Question-and-Answer Session

Operator

[Operator Instructions] The first question is from the line of Sheila Kahyaoglu. Please go ahead.

Sheila Kahyaoglu

Just on LTAMDS is so relevant at the moment. Tom, maybe could you provide some color on that program. How you expect this program, how it interacts with the core Patriot franchise just the opportunity internationally you mentioned $20 billion, and then maybe the radar offering how that plays into the missile option?

Tom Kennedy

Yes, it was a great win for the company and also for the future of the company moving through the years forward. This is the new radar. We'll replace all the radars for the Patriot system. It provides 360 degree capability. And so we're seeing threats that evolve that is in our requirement, I believe, by many countries, including the United States now. So this significantly changes the capability of the Patriot system, significantly enhancing it.

The radar does use our GaN technology and advanced GaN capability. It has a lot of great new capabilities beyond the radar operation, especially in the area of the ability to maintain this system. It's a lot easier to maintain than the prior system. And we were getting significant requests already from the international marketplace. So obviously we'll have to get released from the U.S. government. But the demand signal has been building up here for probably the last five years or more. And I think this gives us a great capability to meet that demand moving forward.

One point I would like to make is very similar to the THAAD program where have the TPY-2 radar. In addition to selling the TPY-2 as part of the THAAD system, we also sell the TPY-2 as a forward deployed radar. And we really believe based on the customer feedback that this LTAMDS radar will also meet that market and being able to provide forward deployed radars that are not necessarily part of the Patriot system itself. In other words, a standalone radar offering for a -- and demanding 360 degree market that's out there today.

Toby O'Brien

And Sheila, this is Toby. I'll just add a couple of things. I mean this, I think Tom this in his opening remarks. But this extends your question about how this plays with Patriot today. So this is an extension that's going to carry Patriot on for decades as a franchise for Raytheon and Raytheon Technologies. Tom mentioned the $20 billion opportunity. I think that's probably a little conservative. We're going to continue to execute all our existing Patriot backlog. And then as Tom mentioned, we see demand already from foreign sales. There's going to be about 250 radars that will be subject to this upgrade. Bahrain, that Tom mentioned in his opening remarks, that's the 17th nation that will have Patriot. And this is really the premier franchise for the company, and it's going to be here well past our time for sure.

Operator

Your next response is from David Strauss. Please go ahead.

David Strauss

You guys have had a, I think prior you'd given a 2020 operating cash flow forecast of $4.6 billion. The numbers in the S-4 would have implied something, I think, a little bit even higher than that. And you now have a sales number that looks like it's coming in well above the S-4. So could you talk about maybe what we're looking at potentially for 2020 operating cash flow relative to that prior forecast? Thanks.

Toby O'Brien

David, I'm not going to get into specific cash flow numbers for 2020, and I'll tell you why. So we provided some insights into the underlying business focused on, we look at strong book to bill next year, another record backlog in the sales growth. We didn't get into specifics around income or margin, or cash flow for that matter, really because with the pending merger, there's going to be a lot of things that are going to impact it compared to business as usual.

That said, what I can tell you -- and I'll go a little bit broader than cash flow. From a underlying operational point of view, nothing has changed as it relates to how we're thinking about margins, our operating profit, our underlying ability to generate cash flow in 2020 and beyond. We still see opportunities there to grow our operating profit, expand margins, deliver strong free cash flow. And I think in a relative to the $4.6 billion from confirmation or affirmation, it's still a number. We're not backing off of that. But we'll give more precise numbers obviously post merger closing.

Operator

Your next response is from Peter Arment.

Peter Arment

Congrats on LTAMDS, maybe I'd just come back to it. Toby, what was factored into the S-4 kind of forecast? And then maybe just thinking about the contract structure here where you're funding 30% development costs. How do we think about that? Thanks.

Toby O'Brien

Sure. Let me start with the second part of the question first. So you know the contract vehicle here, it is a OTA or an -- and other transaction authority, which doesn't work the same as a traditional contract in many ways. So essentially the way to think of it, we're performing R&D, research and development and customer will be reimbursing us for a portion of that effort. And there will also be some related capital to support it as well.

As far as the projections in the S-4, if you think about this initial effort, this $384 million under the OTA that goes out into 2022 and all of our projections are factored. So the majority of this, the comment Tom made and I reinforced around the $20 billion, the majority of that would be on beyond the five year window that you saw in the S-4.

Operator

Your next response is from the line of Robert Spingran. Please go ahead.

Robert Spingarn

Just a clarification on LTAMDS given those questions. But is this the kind of thing, Toby, you say beyond 2022 is a good number in 10 radars a year, just trying to size it, 20 a year. And then my primary question is just on Missile Systems, and the margins there have been under pressure for a while now. And I think we saw some charges there after the fact as we went through your 10-Qs. So Tom, could you dig into what's happening at Missile Systems and how you get back to I guess it's a 13% implied number for Q4.

Toby O'Brien

So Rob, I'll hit the LTAMDS question first. So it's kind of hard to put a number on number of radars a year. We still need to get approval for any international sale through the U.S. government once we get through the OTA and these initial production representative units. But again, I'd just remind everyone there's 250 units that are out there that would be eligible to upgrade.

And given the capabilities that these systems have, we would expect that if not all, the majority of those would be ultimately upgraded. And it may not be coming across -- I did say it's our premier franchise. We're really excited about this and the benefits that it brings to the company. And I'll let Tom start on the Missiles question and then I'll...

Tom Kennedy

Toby may be excited about it. But I can tell you I'm very, very excited about it. I mean, this radar has capability that has not been seen on a battlefield in any place in the world, and I think it's just going to change the entire dynamics relative to integrated air and missile defense for the U.S. forces and also its coalition partners.

And then let me switch over into missiles. You're right. We're not happy about where the margins are right now with missiles. You can imagine that both Toby and I are taking a lot of interest in this area. We have made some major changes in the leadership out at Missiles. And we're already starting to see improvements in certain areas.

And the fundamentals do remain strong. They have a strong business. We have two multi-years that were finalized the negotiations with, one is on the Standard Missile-6 and the other one is on the SM-3 Block 1B. And in addition to that we're negotiating kind of almost like a three lot but its three years of production on the SM-3 Block 2A. And in addition to that, we're in final negotiations on the SM-2. Like the whole Standard Missile family is being bought left and right. And so a lot of opportunity in the future in production.

The missile company has had some productivity issues on some programs, which we believe we're on a road to clean up. But they also have got a quite a bit of classified business on board, which is a lot of development business, which has inherently lower margins. So by getting these multi-years in and these other production programs in, we'll increase the base, the production base with the higher margin content, which we believe will help us moving forward.

In addition, we are significantly concentrated on the productivity improvements across all their programs, even their development programs. And so we're taking the best practices from across the company and applying them. One of my passions is program management excellence and we're all over that, and making sure that we're not missing anything in any of the areas.

We have done quite a bit of work in leaning out our manufacturing facilities and upgrading them, and bringing in robotics and automation across the board to drive productivity improvements. We have done and completed all deep dives on any of these problem programs and we have them on the road back to recovery, which means on the road back to higher margins.

So we do believe there is a solid path forward to getting back to the 13%-plus margins that this business traditionally has had. But we're going to drive beyond that and we're not going to be happy with what they achieved best in the past. We're going to continue to drive margins as high as possible. And I believe, looking at their business base in the out years and their mix starting to change relative to the heavy amount of production coming on board that we will attain that greater than 13% margins for that business.

Toby O'Brien

So Rob, let me just add a little bit specific here to Q4 part of your question. So I think you're right in sizing Q4, the high 12% into the 13% range. So given that, maybe a little bit of color on Q3 to try to help bridge to Q4. So as Tom said, below our expectations for the quarter, but we also acknowledge and recognize we're not going to turn things around overnight or within a quarter.

That said, I think it's important to note that within Q3, we did have about a 50 basis point impact to the margins from some investments in the quarter to position the Company on a couple of competitive awards, which were not previously contemplated in the guidance. So things came up in the quarter in a favorable way that led us to make these investments, number one, and again, about 50 basis points worth. If you back that out and you look at Q3, we probably would have been in the high 10% range.

And then the way I think about it, given that we're not going to solve things in a quarter. If I look at Q2, which admittedly was strong for the business compared to how they started the year, and you kind of take the average of Q2 and Q3, excluding the investments I referred to, they performed in the 11% range, give or take.

So bridging 11% to Q4, it's really about half and half between mix improvement and net productivity improvement. The mix improvement in part we expect to be driven by a couple awards, one international one domestic where we would see some inventory liquidation, and those are production type awards that would naturally carry higher margins with it, and then again as I said, the other half coming from improved productivity.

We do expect beyond the fourth quarter, Missiles margins to improve year over year into 2020. I won't repeat everything that Tom said. But we do believe there is a path over the next call it 12 months, 18 months to get this business performing back where we know it can.

Operator

You next response is from Seth Seifman.

Seth Seifman

Toby, I wondered if you could talk a little bit in the S-4 there's some really nice margin expansion, if you exclude the FAS\/CAS as we move from 2019 into '20. Should we be thinking about that same level of margin expansion with the higher sales base? And then you talked about the mix changing with IDS and SAS growing relatively fast. Is that the key driver or are there other things that we should focus on?

Toby O'Brien

So look, I'm not going to get into program details or specificity around that. But what I can tell you, just as a reminder, the S-4 information that was used to evaluate the merger, right, that's relatively dated. We've provided top line updates to how we're thinking of 2020. And again, that 6% to 8% is off of a higher outlook for 2019 than we were previously expecting.

We do intend, and we will continue on focusing on expanding both the absolute profit contribution the business has as well as working to expand margins. We went back and looked in the last couple, three years going back to '16 we've done a pretty good job at increasing that segment profit contribution to the Company. It's a 20%-plus increase, about 6.5% compound growth over the last three years.

So I think we have the formula there. I did mention that IDS and SAS are growing more relatively speaking than the other businesses next year, even though we expect growth across all of them and they are the highest margin businesses we have in the portfolio right now. So I think that bodes well for 2020 and beyond.

Operator

Your next response is from George Shapiro.

George Shapiro

Can you walk us through where you stand in terms of Warfighter sales? I know you were expecting them to come down all through the year, but the strength in the margin and the growth this quarter suggests that maybe they continued to lag. And then the second part, one for Tom. With Vista putting the option to you, would you probably wind up selling or getting rid of Forcepoint before the merger closes? Thanks.

Toby O'Brien

Sure, George. Let me start with the Warfighter. So for 2019 total year, we do expect Warfighter to be down about 40% year-over-year, which is about $400 million. A bit of a disproportionate amount of that coming in the fourth quarter I think in the $125 million to $150 million range, so maybe a third of that decrease. I think the IIS team has done a good job maximizing through the transition period the continuation of that effort.

And sitting here today looking at Warfighter and the related scope -- follow-on scope for next year, probably going to be down another third. So in absolute terms, I think maybe $400 million contribution to revenue next year, down $200 million or a third from the levels in '19. But again, as we've said, as expected, right, we knew what the transition looked like and how it was going to play out and things are continuing on that way.

IIS keeps performing well even unrelated to Warfighter, right. They're executing across the portfolio in a strong way. They've had a couple one-time type of events, but even without that their margin performance for the year is better than last year. So I'll kind of leave it with that and let Tom jump in on Forcepoint.

Tom Kennedy

On Forcepoint, as Toby mentioned in his opening remarks, Vista Equity Partners, did exercise their put option to require Raytheon to purchase their interest in Forcepoint. And so we soon will own 100% of Forcepoint. And our plans have not changed. From the day one, we still plan to expect to monetize Forcepoint to create value for our shareholders and then we saw some -- there's a lot of optionality relative to how we do monetize that. But it all remains in play in terms of monetizing the asset.

Operator

Your next response is from Cai Von Rumohr.

Cai Von Rumohr

So could you tell us how big classified was in terms of sales and bookings in the third quarter and expected for the year? And also Lockheed mentioned on their call that they expect counter-hypersonics awards to pick up, that they have been lower. And maybe be a little bit -- us some guidance in terms of what you expect in that area.

Tom Kennedy

For the third quarter, 21% of the total sales was classify and also 21% of the bookings was classified. And so it is a major part of the company. And just one note here is the classified work is -- we use the term here, it's the seed corn for our future. In other words, it's the funding that helps us develop that technology we have and take it forward.

And then in the area of the counter-hypersonics, it's an area that we have actually been getting contracts and a lot of it's been in the classified area for the last five years. So it is a big part of our business, and it's not just on the missile stuff. As I mentioned before, the hypersonics includes the complete fire control chain, including the sensors that are required to be able to detect the hypersonic missiles, the command and control that takes that information, determines what weapon to release to impact that hypersonic missile it's going after against.

And so it's distributed across the entire Raytheon company right now and across every one of our businesses has some type of counter hypersonic work that is going on. So it is a big part of our efforts here at Raytheon and growing, and thus also the whole hypersonic area by itself is growing for us.

Toby O'Brien

And I think, Cai, I think you asked about total year for classified too. And think of it very similar to Q3 right around call it 20% plus or minus a point one way or the other for both the bookings and sales, and based upon the outlook for the year we'll have a record year for classified sales this year as well.

Operator

Your next response is from Carter Copeland.

Carter Copeland

Just expansion a little bit on LTAMDS. I wondered if you could maybe dive into that whole self-funded R&D piece there and if that has any implications for IP or competition or lack thereof overtime, how does that compare long term to where you've been with Patriot.

Toby O'Brien

So I'll give you my answer and then Tom can jump in, right. So as part of the OTA, there is an arrangement around IP rights, for lack of a better way to say it. I feel very good about the deal that we ultimately struck here. I think it gives the government what they want and it gives us what we want. And I would say it this way, based upon what I know today, I feel really confident in our ability to achieve that $20 billion plus of opportunity to install LTAMDS as upgrades on the 250 fire units worldwide.

Tom Kennedy

And I think one of the other differences with this program, and I'll attribute it to the structure of the contract is we're going to be able to move much faster and in terms of getting a system through development and into production than we could on traditional contracts. And I think that's going to help us vis-à-vis our whole game here is to get through the development program, get it into production, into the hands of our customers which then creates additional demand, both domestically and internationally. So I think all over. I think we're in a very good track with the LTAMDS and having the right IP to be able to retain our position for the next several decades.

Operator

Your next response is from Ron Epstein. Please go ahead.

Ron Epstein

So one question, two parts, second part is related to the first. So in the post LTAMDS thing, we got that, right. So that's great. What's the next thing on the horizon that you're looking for? What are the next big prizes out there? And then the second question is just assuming everything goes through with RTX, what can you bid for that you couldn't bid for today with the new capabilities you'll have?

Toby O'Brien

Let me take that. There is a whole range of new advanced systems that we're pursuing, a lot of them under the umbrella of classified. So it's very hard for us to kind of go in and describe them, but I'll give you two very large ones. One is the Precision Strike Missile, the PrSM missile that replaces the existing ATACMS system that's out there today. That is a program that we're heavily engaged in. The Army has already down-selected to two contractors: one is Raytheon and the other one, Lockheed. So we're competing against the Lockheed on this.

And we believe we have a very solid offering that meets the Army's requirements. With the INF treaty going away, the Army is very, very interested in this program, and is actually expanding the range of the missile beyond the, I would call it, the initial solicitations range. Good news is we have a solution set that allows us to achieve that expansion.

So we feel we're very good position on that. And then the other one is the Long-Range Standoff missile for the Nuclear Triad which we have been heavily engaged and again another area where the government has down-selected to two contractors: one is Raytheon and one is a Lockheed. And we've already received like $900 million for our effort just to be in the competition and we've developed some great technologies. It's very highly classified program. So I can't really talk a lot about it, but it is very large dollar value moving forward. And so we're actively engaged in both of those programs on the missile side.

At IDS, the business that won the LTAMDS program, they have several radar programs that they're pursuing. And actually they just won a major one. We didn't really talk about it in our notes, but they won this called Solid State Module - Replacement win. Its value is up to about $2.3 billion, but it's to go back and replace and update all the way what's called the early-warning radars like PAVE PAWS and whatnot with new technology, GaN based radar technology.

And so we won that program and we'll be working with the Air Force to incrementally upgrade each one of their early warning radars over the next five to eight years. That's about a $2.3 billion win there. So there's just a ton of these new development programs out there. Our biggest job here is -- Toby and myself is to really look at that. And we have a very good process that we look at in terms of determining what we're going to go do relative to what we're going to go bid on because there's a tremendous amount of opportunities on it. We're looking at is the opportunity of strategic fit, do we have the core competencies to execute to that opportunity. And we talked a lot about margins.

We also look if we're going to get acceptable type margins out of the program. It's just a one-off program where it's all development and we essentially lead with one article and it has low margins. Several of those we haven't bid in the last couple years. And we've just let our competitors go off and develop systems that give low margins. And then the other one is do we have the right technical and cost discriminators, do we have the differentiators to go win. So we have a very well-defined process. All I can say is there's a lot of opportunities that were running through the process.

And we're having to make some pretty hard decisions here about what to pursue and not to pursue. It's a great time for the Company. We made the right bets back in 2004 relative to where we made some technology investments over the years and those technology investments have given us the differentiators and discriminates to better these next-generation capabilities that the Air Force, the Army, and the Navy need, and we're in a very great position to go after a lot of these opportunities.

Kelsey DeBriyn

Ditamara, we have time for one more question, please.

Operator

Next response is from Peter Skibitski.

Peter Skibitski

Maybe your SAS kind of results and guidance already kind of addressed this, but how are you thinking about DOD's new space architecture that's kind of emerging and the opportunity set there, the market size, and as it relates to SAS?

Tom Kennedy

Well, it turns out, it relates to both SAS and IIS. IIS on the ground segment and SAS on the sensor side and also on part of that architecture, and we've been playing heavily into it. I think the area that has us very, very interested in because it's kind of new is the whole area of contested space and how that plays into this overall new space architecture. And as you can imagine, it's a new area. There's a lot of classified work. And if you look at SAS is probably the most classified business that we have and then you have IIS with I think the second the business with a lot of classified work in that area.

Toby O'Brien

And just to kind of put a wrapper around it for SAS. As we mentioned earlier, it's effectively neck and neck with IDS as our highest growing business this year. It's got the second highest margins. We're real pleased with what they've been doing, not only in space but in ISR as well. So they're having a real good year and positioned well to continue that into 2020.

Kelsey DeBriyn

That's all the time we have today. Thank you for joining us this morning. We look forward to speaking with you again on our fourth quarter conference call in January.

Operator

Thank you for calling us today. This concludes today's conference call. You may now disconnect.