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United Technologies Corporation (UTX) CEO Greg Hayes on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-22-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $2.21 beats by $0.18 | Revenue of $19.5B (18.09% Y/Y) beats by $190.77M

Earning Call Audio

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United Technologies Corporation (NYSE:UTX) Q3 2019 Earnings Conference Call
October 22, 2019 8:30 AM ET

Company Participants

Greg Hayes - Chairman and CEO

Akhil Johri - EVP and CFO

Carroll Lane - VP, IR

Conference Call Participants

Carter Copeland - Melius Research

Julian Mitchell - Barclays

Kristine Liwag - Bank of America Merrill Lynch

Steve Tusa - J.P. Morgan

Nigel Coe - Wolfe Research

Sheila Kahyaoglu - Jefferies

Jeffrey Sprague - Vertical Research Partners

Peter Arment - Robert W. Baird & Co.

Doug Harned - Bernstein

Robert Spingarn - Credit Suisse

Rajeev Lalwani - Morgan Stanley

Operator

Good morning, and welcome to the United Technologies Third Quarter 2019 Earnings Conference Call. On the call today are Greg Hayes, Chairman and Chief Executive Officer; Akhil Johri, Executive Vice President and Chief Financial Officer; and Carroll Lane, Vice President, Investors Relations.

This call is being carried live on the Internet, and there's a presentation available for download from UTC's website at www.utc.com. Please note, except where otherwise noted, the company will seek to results from continuing operations, excluding restructuring cost and other significant items of non-recurring and/or nonoperational nature, often referred to by management as other significant items. The company also reminds listeners that earnings and cash flow expectations and any other forward-looking statements provided in this call are subject to risks and uncertainties.

UTC's SEC filings, including its Forms 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. In addition, in connection with the proposed Raytheon merger to be discussed today, UTC has filed with the SEC a registration statement which includes a prospectus of UTC and joint proxy statement of UTC Raytheon that will contain important information about UTC Raytheon the merger and related matter.

Once the call becomes open for questions, we ask that you limit your first round to one question per caller to give everyone the opportunity to participate. You may ask further questions by reinserting yourself into the queue as time permits.

Please go ahead, Mr. Hayes.

Greg Hayes

Okay. Thanks Denial, and good morning, everyone.

Let me start out by apologizing for the consistency of these calls for the last year or so. But as you guys saw in the press release this morning, it was another really good quarter for UTX.

Our reported adjusted EPS of $2.21 and that's up 15% versus the prior year and a continuation of the performance that we've seen for the last year. Sales are up 18% with an organic growth of 5%. And importantly, margins expanded in each of the four segments.

Free cash flow $2 billion in the quarter really, really good number. So based on our year-to-date performance, we're going to raise our outlook for the year once again. And we now expect adjusted EPS of $8.05 to $8.15 for 2019. That's up from our prior expectation of $7.90 to $8.05.

Akhil will take you through the puts and takes to that in just a minute. We're also going to raise our free cash flow outlook and we now expect $5.3 billion to $5.7 billion for the year. And again, that's up from our prior expectation of $4.5 billion to $5 billion.

Just to note $500 million of that increases from a portion of expected portfolio separation costs, primarily the tax related payments that will probably get pushed out into 2020. The remainder is good news from operations.

So, no surprise here 2019 is shaping up to be a really good year for UTC. And the businesses are focused on driving results and meeting customer commitments.

Beyond delivering on the current year, we continue to execute on our strategic portfolio initiatives. And those of course include the integration of Rockwell Collins, the separation of Otis and Carrier in the standalone public companies, and lastly, of course the merger with Raytheon.

So, looking at the results in Q3, Collins continues to deliver great performance with legacy Rockwell, once again exceeding our expectations. Adjusted EPS accretion in the quarter from Legacy Collins was $0.16.

For the full year, we now expect to see around $0.60 of accretion from Rockwell Collins that's up about $0.10 from our prior expectations, and about $0.25 up from our outlook coming into the year, really good performance.

This performance is really highlighted by accelerated costs synergy capture, which only strengthens our confidence in our ability to realize at least $600 million in acquisition related costs synergies by year four. The team is also targeting a pipeline of over a $1 billion in sales synergies, of which over 175 million are already been captured in orders.

Okay, maybe just a second on the spin, we continue to make good progress on day one operational readiness and the public company management teams are now largely in place.

As I said last month, we continue to target April 1st as the spin date for both businesses. That is, of course subject to the timing of the tax rulings from the U.S. and Canada, which we continue to expect to receive by year-end or shortly thereafter. However, no surprises with the portfolio separation, we remain on track.

Finally, earlier this month, we were very pleased that both UTC and Raytheon share owners overwhelmingly approved the combination of our aerospace business and Raytheon. We’re going to continue to work closely with regulators for approvals required for the transactions, and we're making good progress on forming the management teams for Raytheon technologies.

No surprises so far, which is really the good news. I am very excited about the opportunity the merger is going to create it for a best-in-class technology driven, global aerospace and defence system provider. And we continue to expect the transaction to close shortly following the completion of the portfolio separations.

So, with that, let me turn it over to Akhil and Carroll to take it to the results, and I'll be back to wrap it up and then we'll take some Q&A. Mr. Johri?

Akhil Johri

Thanks, Greg. So, I'm on slide two. For the third quarter, reported sales of $19.5 billion were up 18%, including 5% organic growth. And that's on top of 8% organic growth last year in the third quarter. We also had 14 points of M&A benefit, mainly the Rockwell Collins acquisition. Foreign Exchange was a 1-point headwind in the quarter.

Adjusted EPS was $2.21, up 15% versus the prior year. On a GAAP basis, EPS was $1.33 down 14% versus prior and included $0.06 of restructuring and $0.82 of net non-recurring charges, the largest of which was $0.73 related to the portfolio separation activities.

Free cash flow for the first nine months of 2019 was $4.7 billion, up 48% or approximately $1.5 billion compared to 2018. This strong year-to-date performance gives us confidence in the increased free cash flow outlook for the year that Greg mentioned earlier.

As a reminder, we expect significant outflows in Q4 from the tax and transaction costs related to the portfolio separation actions. Overall, there is no change to our estimate of $2.5 billion to $3 billion for the total onetime portfolio separation cash costs.

However, within that, tax costs will be lower than the $2 billion we were expecting earlier. And debt redemption and other transaction costs will be slightly higher.

Turning to slide three, you see the drivers of our organic growth in Q3. Looking at the commercial businesses first, in the Americas sales were flat, Otis up low single digits and Carrier down slightly.

On an encouraging note, award activity for Otis in North America remains strong in the quarter, on very high levels already. For Carrier transport refrigeration was down year-over-year off a hard compare. Within EMEA sales were also flat in the quarter. The economic outlook across Europe remains mixed and weaker than our expectations coming into the year.

Activity levels in the Middle East remain very low for both Carrier and Otis. In Asia, sales were up 7%, China sales were up 11% including mid-teens growth at Otis. Importantly, this was the eighth consecutive quarter of positive price mix in Otis new equipment orders in China.

On the aerospace side, commercial OEM sales were down 1% driven by Collins Aerospace, which was down 8% on an organic basis. Growth in new platform sales there was more than offset by the expected declines in legacy platforms. Pratt & Whitney commercial air OEM sales were up 13% organically.

For commercial aftermarket, sales were up 11%. We continue to see healthy air traffic and strong fleet utilization. At Collins aerospace commercial aftermarket sales were up 20% organically. Provisioning for the legacy UTAS business was up over 30% driven by continued MRO demand and airline activity. Pratt & Whitney saw commercial aftermarket growth of 6%.

Organically military sales were up 15% at Pratt & Whitney and 14% at Collins Aerospace, driven by both OEM and aftermarket strength across key platforms.

Now, before I hand it over to Carroll, just a few comments on our updated 2019 outlook and the moving pieces. As you saw, we have improved our adjusted EPS and free cash flow outlook range for 2019.

We have also tightened our sales range for 2019 and now expect total reported sales of $76 billion to $76.5 billion versus our prior outlook of $75.5 billion to $77 billion. This updated sales range reflects the adverse impact of the stronger U.S. dollar, as well as a reduced organic sales outlook for Carrier, more on that in a minute.

At the UTC level, we continue to expect organic sales growth of 4% to 5% given the strength in the aerospace businesses.

Now at the segment operating profit level, a reduced outlook at Carrier is offset by the continued strength at Collins Aerospace. Like last quarter, we've included a chart in the appendix on slide 12, with updated sales and profit walks for both those businesses as a reference.

So, what's happening at Carrier? In Q3, we saw continued weakness in orders in the refrigeration business, higher distributor inventory in the U.S. residential HVAC channel and a softer EMEA market. We now expect organic sales for Carrier to be down low to mid-single digit in the fourth quarter with low double-digit decline in the refrigeration business.

We have reduced Carrier’s full year sales expectations by approximately $500 million and profit expectations by the corresponding approximately $125 million. The change in profit also includes nearly $25 million of negative impact from the significantly lowered discount rates used for revaluation of long-term liabilities, including warranty.

However, looking beyond the short-term challenges fundamental growth drivers for Carriers and markets remain intact, Carrier continues to have significant value creation opportunities through their focus on innovation, G&A reduction and portfolio optimization.

On the positive side, we see a $125 million improvement in the full year adjusted operating profit outlook for Collins Aerospace, driven by continued strength in commercial aftermarket, both at Heritage UTAS and Rockwell Collins, higher military sales and higher synergies from integration efforts.

Both Otis and Pratt continue to perform well. And we have raised the low end of their respective operating profit growth outlooks.

Below the segment operating profit lines, we now expect a full year tax rate of approximately 22.5% compared to our prior range of 23% to 24%. There are other puts and takes that are slightly negative, of significance we realized a pension curtailment gain of $98 million in the third quarter that was adjusted out of earnings as you saw.

However, as part of those actions, we were also required to true up the 2019 pension expense discount rate based on the discount rate, which resulted in a $0.04 headwind to our non-service pension income for the year, mainly in the fourth quarter.

With that, let me turn it over to Carroll.

Carroll Lane

Okay, thanks Akhil. I’m on slide four. I'll be speaking of the segments at constant currency as we usually do. And as a reminder, there's an appendix on slide 15, with additional segment data you can use as a reference.

All right, starting with Otis, Otis sales were $3.3 billion in the quarter, that’s up 4% organically. New equipment sales grew 2%, high-teens growth in China was partially offset by low single digit declines in North America and EMEA. Service sales growth was broad-based and was up 6% in the quarter. New equipment orders grew 6% in the quarter with growth across all major regions.

Orders in the Americas were up 10% that was driven by the timing of major project bookings in North America, Asia, excluding China and Europe. So orders up mid-single digits in the quarter. And China orders grew 5% as the business continues to benefit from favorable pricing and mix. And that's the sixth consecutive quarter of value growth in China.

Operating profit was up 7% of constant currency driven by strong volume growth, as well as favorable price and mix and both new equipment and service. This marks the fourth consecutive quarter for operational profit growth at Otis and it's largely from consistent improvement in the profitability of the service business.

Foreign exchange translation was a two-point headwind to sales and earnings. And given the strong year-to-date performance, we expect that Otis will finish at the high end of their constant currency profit growth range, that's approximately 75 million. The profit growth and actual FX will be in the range of 0 to 25 million.

Turning to slide five, Carrier sales were flat organically in the quarter. Transport refrigeration was down 6% with container down more than 20% and commercial refrigeration down 5%.

Global HVAC sales were flat with North America residential down 1% and global commercial HVAC up 1%. Global fire and security were up 2%.

Carrier equipment orders contract at 11% organically in the quarter and was primarily driven by a decline in refrigeration orders.

Transport refrigeration orders were down 68% driven by higher than average cancellations cover coupled with tough compares in North America truck trailer. You'll recall the orders for transport refrigeration were up more than 90% in Q3 of 2018.

Commercial refrigeration orders were down 5% in the quarter, the fire and security product orders were down 2%. Global HVAC orders were up 6% with both North America residential and global commercial HVAC up mid-single digits. In constant currency operating profit was up 1% in the quarter. Pricing benefits and material productivity net of tariff impact was partially offset by lower volume and mix.

Foreign exchange translation was a one-point headwind to earnings. As Akhil referenced, volume is expected to be down in the fourth quarter and as a result, we are lowering Carrier's outlook for the full year. We now expect organic sales to be flat with operating profit down 100 million to 125 million at actual currency.

Okay, Shifting to Pratt & Whitney on slide six. Sales of 5.3 billion we're up 11% on an organic basis, and 10% on a reported basis. Commercial OEM sales are up 17% on Pratt & Whitney Canada engine shipments and a favorable mix of large commercial engine sales.

Commercial aftermarket sales were up 6%. Early GTF shop [ph] contributed to the growth, as well as V 2500 overhauls returning to expected levels, with inductions up 10% versus the prior year. Favorable aftermarket content and Pratt & Whitney Canada also contributed to the growth.

Military sales were up 15% driven by the continued ramp of the F135 program and strong aftermarket demand. Operating profit of 471 million was up 15%. Results benefited from commercial engine mix, continued GTF cost reduction and drop through on higher commercial aftermarket and military volumes.

These tailwinds more than offset the absence of prior year commercial aftermarket contract adjustments, and higher E&D and SG&A. So, looking ahead, we expect Pratt & Whitney to grow full year operating profit by 225 million to 250 million.

Turning to Collins Aerospace systems on slide seven, sales in the quarter were $6.5 billion, up $2.5 billion on a reported basis and up 7% organically. Operating profit of $1.2 billion was up $568 million. On a pro forma basis, which includes results for Rockwell Collins in the third quarter of 2018, Collins Aerospace delivered operating profit growth of 23% on 6% higher sales.

The pro forma sales growth reflects continued strength in the commercial aftermarket and defence channels, partially offset by lower commercial OEM volume and commercial aftermarket sales were up 17%.

The passenger traffic investment -- passenger traffic as well as investments and initial provisioning, and demand for modifications and upgrades all remain strong. Military sales were up mid-single digits driven by higher F35 volume and aftermarket demand.

Commercial OEM sales were down low single digits driven by declining volumes on legacy programs as Akhil referenced earlier.

Operating profit growth was driven by the contribution from Rockwell Collins dropped through on higher organic sales as well as synergy benefits. And this growth was partially offset by mix headwind and higher SG&A spend.

Given the continued end market strength and solid execution accounts, we now expect full year reported sales growth of approximately 55% with organic sales up mid to high single-digits versus our prior outlook of mid-single-digits.

And we now expect Collins Aerospace operating profit to be up $1.85 billion to $1.875 billion for the full year. That's an increase from our prior expectation of $1.7 billion to $1.75 billion.

And with that, I'll hand it back over to Greg.

Greg Hayes

Thanks, Carroll. So, as always, a few moving pieces but overall, I would tell you, we're very pleased with our third quarter results, and we're confident in our improved adjusted EPS and cash outlook for 2019.

While the macroeconomic environments show varying degrees of strength through our commercial businesses depending upon the region, we continue to see growth in commercial air traffic as well as favorable trends in defense spending, the combination of which benefits both Pratt and Collins Aerospace as you've seen in this quarter. We do have some near-term pressure at Carrier, but I'm confident that Dave Gitlin and team are taking the right actions to position the business to drive long-term shareholder returns.

We see solid long-term growth fundamentals in the commercial end markets driven by urbanization and growing middle class and regulatory changes; all drivers that will translate into growth for Carrier as well as Otis.

Across to all of UTC, we remain focused on the key priorities which remain unchanged. First and foremost, it's executing on customer commitments. Continuing to innovate, continuing to take cost out and to be disciplined in capital allocation.

I remain very excited about the future for Otis and Carrier, as standalone public companies, and for the future of UTX, as we merge with Raytheon to become Raytheon Technologies.

So, before we go to Q&A, just a couple of personnel announcements, something we don't typically do here. I think as some of you probably have already heard, Carroll Lane, this is his last earnings conference call after about three years in the seat, have done a great job.

Carroll, call sign Kujo for those of you that follow that type of thing will become President of our Commercial Engine business at Pratt & Whitney reporting to Chris Calio and that'll be effective about the first of the year, assuming we let him go then.

Carroll has done a great job; I hope all of you have a chance to thank him for that. And we wish him well as we hand him the keys to the future of Pratt & Whitney. Good luck.

Secondly, just in perhaps more importantly, Akhil Johri will be stepping down as CFO of UTC on November 1st. For Akhil, this caps a 31-year career at UTC. And everybody, I'm sure will miss him; I will personally miss him both for his sage advice, as well as for his calming influence. Our goal, however, is to make you miss him not so much by ensuring a seamless transition.

Akhil, as you know, has been instrumental in the transformation of the UTC portfolio and he's been a great partner. If there is a better CFO in Corporate America, I haven't met him. That includes me. So Akhil, thank you and good health to you and Sashi in retirement and I'm sure you guys will keep busy. Best of luck.

So, with that, effective November 1st, Neil Mitchill, formerly the Chief Financial Officer of Pratt & Whitney will assume the job of Acting CFO, Neil will hold that role until the merger is complete with Raytheon sometime early next year shortly after the separation of the commercial businesses.

Neil joined us in 2014 from Pricewaterhouse, where he was a senior partner. Many of you know Neil from his time at Pratt. And before that as Controller of UTC. So again, we wish both Neil well, and the whole team as we go through these transitions. Our goal again, is to make this as seamless as possible. So, best of luck to all of you.

And with that, let me open up the call for questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Carter Copeland with Melius Research. Your line is now open.

Carter Copeland

Hi, good morning guys. And congratulations, Carroll on the move and Akhil, it's been an absolute pleasure to work with you over the year. So, we wish you the best in retirement and you will be missed.

Akhil Johri

Thank you. Thanks, Carter.

Carter Copeland

Just some clarification around the aftermarket strength, Greg. I mean, obviously, ADS-B and that mandate has had a big impact on sales growth this year. Can you give us a sense of what your updated thoughts on that contribution are?

And I wonder if you have any insight, there's clearly some indirect sales benefit for that upgrade cycle where, you have an airplane in there and you do some other work while you do that mandate work. And I wondered if you might have any insight on how much indirect benefit you've had from ADS-B in addition to the direct. Thanks.

Greg Hayes

Thanks, Carter. First of all, what's important as you look at the third quarter results at Collins? The ADS-B mandate actually was not a driver of growth. It really was provisioning, in support of aircraft that are already out there. So, we saw decent parts growth, ADS-B was relatively flat. But the provisioning it was what drove this strength which is, again, it's episodic. So, I wouldn't get excited about 30% provisioning growth, it's not going to repeat itself here in the fourth quarter.

At the same time, the ADS-B mandate is certainly is driving growth. It's been a key driver of some of the good news that was not really expected on the Collins acquisition this year. And keep in mind that an ADS-B mandate, it has to be completed in the U.S. here by the end of the year and in Europe by June of next year. So, we'll get a little bit of a benefit, but it's a pretty tough compare, as we think about next year for Collins, both on ADS-B as well as just the overall strength in the aftermarket.

So, again, no drama. I think it's all what we had expected. As far as ancillary business associated with an ADS-B mandate, again, this is kind of a one-off thing. And we really haven't seen anything that would indicate that we're pulling through a lot of additional work as this mandated change have been occurring.

So, I think it's really just - it goes to the fact there is a huge demand for spares and for provisioning as people are looking for capacity. Capacity is at an all-time high. And with the 737 Max continuing to be grounded, people are flying older planes a lot longer. We expect obviously, that trend is not going to continue once the Max gets back in the air.

So again, good news for us this year, but a little bit of headwind next year.

Carter Copeland

Great. Thanks for the color, Greg.

Greg Hayes

Thanks, Carter.

Operator

Thank you. And our next question comes from Ronald Epstein with Bank of America Merrill Lynch. Your line is now open.

Kristine Liwag

Hi, good morning, guys. This is Kristine Liwag calling in for Ron. There was news earlier this week about the Airbus A220 program. Can you provide any details on how we should think about the progress of the engine in that program and the progress of the fixes?

Greg Hayes

Yeah, hey Christine. Maybe it's just a quick word. We did have a couple; we had an issue that we found on the GTF engine on the A220. That's the 1500 PW1500. It's the same engine that's on the Embraer 195. As a result of this issue, we're actually had a mandated inspection period for the airlines. And so, what you saw earlier this week, one of the major operators actually put their fleet down for about a day and a half to go through and updated all the inspections. That went off without a hitch and we continue to have an accelerated inspection on this engine.

Keep in mind, this has nothing to do with the A320 fleet, which is the PW1100 which is the vast majority of the fleet. There is probably about 100 of these engines out there in service today.

We're working through the root cause analysis. I don't have anything to report other than the fact that we remain confident in the engine, clearly anytime you've got an issue like this, we're on top of it. The guys are working through it.

Akhil Johri

It's not a safety - it's not a safety issue, first and foremost, that's an important thing to remember. This is just an increased inspection routine that we have. There is an AD out there for that and Pratt has instructed or asked the operators; we feel badly about what they're going through, but they still have to just have increased inspections on for this issue. But no other concerns at this point.

Kristine Liwag

Great. Thanks for the color.

Operator

Thank you. Our next question comes from Julian Mitchell with Barclays. Your line is now open.

Julian Mitchell

Hi, good morning. And I wish Carroll and Akhil all the best and thank you for the help. In terms of I guess my question really around the outlook at Carrier, sales are guided to be down in Q4, probably down through much of next year just given what will happen at the refrigeration business. So, just wondered what your outlook was for that that revenue line in the coming quarters?

And also, do you feel that you're doing enough on the cost base? I saw restructuring spending was up almost double in the nine months at Carrier where you've got a pretty big EBIT, decline in Q4, should we see even more acceleration and restructuring coming up in that business?

Akhil Johri

So, first, just to give you a bridge for what has changed in Carrier, it's isolated largely to two businesses. One is the transport, the commercial – the refrigeration business in total, but transport refrigeration specifically.

Julian, if I was to break down the $500 million decline in sales from our prior outlook, 100 million of that is just FX, right, dollars being stronger. 200 million is on the refrigeration business and about 150 on the residential HVAC business, which is going to be flattish now compared to our expectation of mid-single digit growth. So not a decline, just a mid-single -- a flat growth profile there.

Transport refrigeration is where the biggest drama is and that's because some of it is just because we had tougher compares, some of it is just declines in the backlog that we have seen both on the container and the North American truck trailer side, and some weakness in Europe truck trailer.

Now that business, I have lived through that at least four short cycles in the last 20, 25 years and I'll tell you that goes down sharply, but it comes back pretty sharply as well. The redeeming feature of that business is that the underlying growth of refrigerated trade continues unabated at 3% per year type of levels. And even if you believe that this short-term perturbation we are seeing, I'll give you just one example and it can apply to container as well, but if you look at the North America truck trailer market today, it's about 46,000 units we expect for this year. 15 years ago, that market on average was somewhere in the mid-30s. So, 33,000 to 35,000 units. That would suggest the compound annual growth rate of 2% in terms of capacity of the market, when the underlying trade has been growing at 3%.

So, even if there is some short-term adjustment, and there is some decline that happens in North America truck trailer next year, it will come back, whether it's the second half of next year or whether it's 21. But it will come back and come back strong. We saw the same phenomena in containers. So, I'm not too worried about that.

The good news on the residential HVAC side is, I think the fundamentals for end market remain pretty strong. We have been impacted more by the two-step distribution that we have. So, the inventory in the channel is higher than what we would have liked and that's impacting short term Carrier's sales. Overall, again, not a big concern and restructuring certainly is being ramped up.

Greg Hayes

Yes, let me just pile on there a little bit, it's a couple of points. So, we have been taken out a lot of costs, we've reduced over 1000 headcount at Carrier in the last few months and that will continue on is Mr. Gitlin and company adjust the workforce to the size of the market.

Obviously, it's a challenge when sales are dropping in these very profitable businesses and we know the sales will come back. As Akhil says, the fundamentals remain very strong. And I think, even in the U.S., resi was essentially flat in the quarter, off of a pretty tough compare from last year where we saw pretty good growth of that market. So, there is no panic here at Carrier, I mean, the business remains strong.

I think the thing to keep in mind is margin still expanded by 30 basis points, even with all of the drama in the marketplace and just as importantly, the market in China, we actually saw decent growth. And I think that's, like 5% growth in commercial, which is pretty solid. Otis, the same thing. They saw really good strong growth in orders and even saw positive sales again, as we've talked about, so the fundamentals of both the commercial businesses remain really good and I hate, I don't want people to get too worried about this refrigeration piece which, again to Akhil's point, it's very cyclical, but it does come back whether it's container or whether it's truck trailer, Europe or the U.S. and the high confidence and Dave and team will work through this.

Julian Mitchell

Great. Thank you.

Operator

Thank you. And our next question comes from Steve Tusa with J.P. Morgan. Your line is now open.

Steve Tusa

Hey, good morning. So, just on this ADS-B thing, and I'm not an aerospace analyst, so maybe I'm not as much of an expert as the other guys. But Honeywell talked about it as being like, extremely minor, like less than maybe 50 basis points of growth on their total aerospace business over the last couple of years. I mean, you talked about it as being a tough comp, but is that you guys are maybe even a bigger aerospace, more diverse aerospace business.

So, is that kind of the right kind of framework for how big that is? Because it just seems like it's like being talked about or it's just should not be that big of a deal?

Akhil Johri

Steve, yeah, ADS-B mandate is driving about $250 million to $300 million of sales this year, right with good margins. So that's what you have to assume. I think on a normal basis, you would probably see $60 million to $70 million of sales from that aspect of that product line, so that -- so it is significantly higher.

Again, you can do the math better than I can, in terms of the total aerospace impact, but that's the level of sales that we are expecting. Some of that will continue next year as well, as Greg said, because there is still the European mandate, which goes through till June of next year, but we will see a step down next year and then see a little bit more of a step down to normal levels in 2021.

Steve Tusa

Yeah, so like maybe like a little less than $100 million a year for the next couple of years, type of step down?

Akhil Johri

Yeah, next year could be a little more than that in 2020, because you may go from like $300 million to $100 million $150 million type of a number, again we will give more guidance and specificity in January. But then the year after it will be more somewhere in the 60 to 75 type of range in 2021.

Steve Tusa

Okay, and then just picking on Carrier here a little bit. Lennox yesterday reported 20% growth in their independent channel, and our checks kind of suggests that they're kind of aggressively moving in that direction, because they're having a hard time kind of regaining the share they lost at the high end.

Are you guys seeing any of that - I know you guys are mostly independent, and I mean, they've attacked you before in like commercial. So, are they trying to kind of pick away at some of your some of your independence there, is that partly the reason why you guys are kind of more flattish and kind of into the fourth quarter little more cautious?

Akhil Johri

No, I think it's more a function of -- you saw the Watsco results as well. I think those results weren't that different from say the Lennox also in terms of the quarter or the distribution out in the -- with the end consumers. The thing I look back at Steve is the -- how is our market share doing, right, ultimately, that's the real test of what -- whether we are winning or not in the market, we have got a pretty good position.

And the good news in the U.S. residential market, as you know is that there is good data available. AHRI provides us with the total industry shipments, we know our shipments, we don't know what other peoples are, but we at least know what the total industry is doing and what we are doing.

And as when we look at that on a 12-month rolling basis, 12 month for a year, because the quarter maybe up or down, but when you look on a 12 month basis, our total splits business Ducted and Ductless is up about 15 basis points in terms of share from a reasonably high level already.

On the furnaces, we are probably down a little bit, 30 basis points or so, 30 to 40 is what I've seen. So, it's I think it's not like we are irrespective of what the others may be doing or seeing. We certainly know what we are seeing and from that perspective, the shares are not that different than what we have seen historically, and our shares are pretty good in that market.

Steve Tusa

One more just very quickly, just to clarify this ADS-B headwind, I mean, there's plenty to offset that there's other products that are ramping and I mean, you guys are obviously absorbing the max way better than others that are calling it out as more of an excuse. So, there's obviously other things that will offset this, this ADS-B is kind of not to be isolated in the context of other platforms that are growing for you guys. Correct?

Greg Hayes

Yeah, look. Yeah, that's exactly right. The 2020 we would still expect to see growth on commercial aftermarket with Collins, I'm going to stop right there because I'm not going to give guidance for it. But I would say the ADS-B mandate is just part of one of the many moving pieces. And what is a very large commercial aftermarket for Collins.

Steve Tusa

Great. Thanks a lot, guys. Thanks for the details, always.

Operator

Thank you. Our next question comes from Nigel Coe with Wolf Research. Your line is open.

Nigel Coe

Thanks. Good morning, guys.

Greg Hayes

Good morning, Nigel.

Nigel Coe

I think we've covered ADS-B here in quite a bit of depth. So, Akhil first of all, thanks for the help, you'll be missed. And good luck with the next move. What I'm going to Otis and touch on the service strength, 6% growth in service is by sales standards very, very strong and it's very, very poor based across geographies.

So, maybe just touch on what's driving that, how you view the durability of that kind of growth rates, and then maybe touch on Europe, which also saw missing digit growth, what we've seen in terms of price and volume in that region?

Akhil Johri

Yeah, that's actually the most encouraging part of the Otis story. The improvements we are starting to see in the service side, which is where a lot of our investments were focused in terms of digitalization of that business overall, are starting to bear fruit.

And the best thing about Nigel, as you said was the broad-based nature of the growth in service, it was across geographies, it was across all major countries. And it's across the three categories, maintenance, repair and modernization all grew and I think the credit goes not just, the focus that Judy and the team have put on it but also the investments that we have made in ensuring that the mechanics finally into the modern age with the digital tools that they need and have.

The repair business is doing particularly well and that's again part of the tools that we have given, the new app that the team has put in put forth, which makes it easier for both the customers and our mechanics and our service sales people to offer value added suggestions to improve the performance of elevators and buildings and all that is starting to show in the number.

So, productivity was pretty good in Europe, per say this is been now the second quarter in a row where we have seen actually profit growth in Europe, after several years of decline, as you know.

So, China is now four quarters a profit growth after a few years of decline and Europe two quarters of profit growth year-over-year after many years of profit declined. So, it’s all pointing in the right direction.

Nigel Coe

So just a bit quick follow up, obviously the 30 bps of margin expansion this is very good news but with positive price mix in China, positive mix on after market, low steel prices why can't margin expand more than 30 basis points going forward.

Akhil Johri

The new equipment growth clearly margins, the growth where it is coming is repair and the modernization side, so there is a little bit of a mix negativity if you will, in the Otis service side. The service contribution is going in absolute dollars and margin is expanding as a percent, but we also are continuing to make strategic investments that you know right, there is still more of these handheld tools being given to additional service technicians, there is still some pricing pressure on the new equipment side as we've talked about.

So, I think China is seeing price mix improved, but in North America on the other hand, on the new equipment side there is certainly increasing pricing pressure. So, we're happy that Otis is showing profit growth, that’s the first step and margins are expanding. I won't get too far add up ourselves and start to expect 100 to 200 basis points of margin expansion.

Greg Hayes

I think just to be very clear. We think margins can expand, continue to expand or market-leading today or like 15.5% this quarter, actual FX good progress. But to Akhil's point, we still have investments to make, we still have ERP systems that need updating. We have digital tools that need updating and I think again steady margin progression is the store that you're going to hear for obvious for the next several years ago and when Judy is out, talking about the other story for the coming years I think that will be key messages.

We will get margin expansion but most importantly we're going to get top line. And every time you sell an elevator you service that 80% of the time and that's the annuity, we want to continue to invest in. So, fundamentals are strong but were not going to get ahead of ourselves here in terms of curtailing investment just up score year or two and again steady progresses is the word.

Nigel Coe

That's great. Thank you very much.

Operator

Thank you. And our next question comes from Sheila Kahyaoglu with Jefferies. Your line is now open.

Sheila Kahyaoglu

Thank you and congratulations to Akhil and Carroll. Maybe this first one for you, since you're taking over this business. How do you think about what's going on with the GTF, maybe if you could update us on how is the business trending as commercial deliveries were down in the quarter, what engine models were driving that?

Carroll Lane

The GTF program overall is doing extremely well got over 4 million revenue flight hours on the engine dispatch liability 99.8%, so overall feeling very good. If you think about the shipments, yes, you can look at the quarter, but more importantly year-to-date shipments to customers nearly 30% on GTF. So, feeling very good about our progress there. Feeling very good about our cost take out on the engine that's clearly an ingredient to our success going forward.

So, I think overall and holistically, we're feeling good about our market share. Good around the cost take out, good around the profitability, and we've got plenty of work to do in supporting our customers, but pretty positive at this point.

Sheila Kahyaoglu

Great, thanks. And then maybe just a follow-up, I'm not an elevator analyst, but on Otis what are you seeing in the service portfolio. What do you think in terms of attrition rates and maybe investments needed there, Greg or Akhil?

Akhil Johri

The attrition rates actually have been part of the reason why we're seeing growth in the portfolio as I've often talked about before, Sheila. I think the first step is to ensure that the portfolio keeps growing quarter-after-quarter and we're close to 2.05 million units now at some point, Judy will start rounding that up to 2.1.

But just a little shy from that, but the good news is that the portfolio grew across geographies. The only place where we are being a little more selective right now is in China where we've adopted a strategy of smart service growth where we are trying to make sure that we are not just taking service contracts for the sake of service contract, but that they are profitable service contracts over the long-term. And we are continuing to look at the portfolio carefully from that perspective.

But really encouraging news is that there is good service growth. If you screwed China, the growth in portfolio from Q2 to Q3, compared to last year, almost similar levels encouraging. And that's the basic secret sauce, as Greg said, right. You install elevators so that you can keep servicing them for years to come.

Sheila Kahyaoglu

Thank you.

Operator

Thank you. Our next question comes from Jeff Sprague with Vertical Research Partners. Your line is now open.

Jeffrey Sprague

Thank you. Good morning, everyone. Congrats, Carroll. Akhil will be very much missed. Hopefully we see on the beach somewhere else.

Greg Hayes

On the beach.

Jeffrey Sprague

On the beat or on the beach. I don't know. I don't want to see him on the beat. I'm hoping to see him on the beach. Hey, a couple questions from me. So, there is kind of continued discussion of investment at Otis and Carrier. And obviously, Judy and Dave are going to have their own decisions to make once they're fully independent.

But should we think these businesses are exiting the portfolio at kind of a representative run rate of investment required relative to kind of their forward plans? Or should we be thinking about they need to step up investment once these businesses are separated?

Greg Hayes

Well, look Jeff, I think we made a conscious decision four years ago to step up investments in the commercial business. E&D and Carriers specifically, we've taken it up. It's over $500 million today. I think that's a rate that's sustainable. It's about 2.5% of sales. And they're going to have to continue on with that. I certainly don't see any pullback there, but I don't see a need for a big step up in investment.

I think what you're going to see at Carrier is two things. One is a renewed focus on SG&A and that is the biggest pool of costs that they have that they can work on. And Dave and team has started working on that today.

The second piece is on the portfolio. And again, more from Dave on that in the coming months. But I think optimizing the Carrier portfolio has a huge opportunity to create value for shareholders to get to a more focused portfolio than what we have today. And again, you can quiz Dave on all those pieces and what they're thinking. And it really is a decision for the next management team. But I would tell you that in our view, significant opportunity.

As far as Otis, we had started again making investments four years ago in the service tools and in the IT infrastructure, specifically the Global Service Systems, the GSS to give us the data, give us the ability to service these elevators more efficiently. And those investments are starting to pay off, but they're a long way from done in terms of the payback.

So, I would expect the level of investment to remain about the same, but I would expect the payback to improve dramatically over the coming years. And again, that's what's going to drive margin expansion.

Akhil hit on this repair. Repairs were up really solid in the quarter and part of it, we can attribute to the fact that the service mechanics now have an app on their phone, which let them sell repair directly to the building operator when they're out doing regular maintenance. Those are sales that we probably otherwise wouldn't have gotten. And I think that's just an indication of the opportunity set in front of us.

The other thing is, and we touched on this before is improving the cancellation rate. And the cancellation rate two years ago was north of 7% on existing elevators is down around 6%. That's a very, very profitable way to grow. Earnings is to reduce your cancellation rate, which means you don't have to replace them with lower margin new business.

So, again, I don't see that as an investment. I think again, or an additional investment that's just a continuation of what we've been doing, which should yield benefits for the next several years.

Jeffrey Sprague

Is there any evolving thought on how the kind of post separation balance sheets of Carrier and Otis might look? And I kind of asset kind of in the spirit of, sure refrigeration will cycle back up. But we could be going into a little bit more challenging macro environment.

Greg Hayes

So, look, let's be very clear. As we look at the separation of the two businesses, they'll probably be about $18 billion of debt between Otis and Carrier with obviously more of it going to Carrier, because of its size. But the goal is for both of those businesses to be investment grade coming out of the chute.

And one of the things obviously that we would be concerned about is can they survive in a potential recession scenario; we don't see one. But we're going to make sure that they have the financial wherewithal that if we do see -- I would say a normal business cycle correction here sometime in the next couple of years, that they won't lose their investment grade rating.

And that's again the key to the capital allocation to those two businesses in terms of the amount of debt, the amount of cash that they're going to have on their balance sheets, it splits so we're cognizant of that, we'll be out with the rating agencies next month. Now the next 30 days and we're back to you guys early next year with the final look.

Jeffrey Sprague

Great. Thanks for the color.

Operator

Thank you. [Operator instructions] Our next question comes from Peter Arment with Baird. Your line is now open.

Peter Arment

Yes, thanks. Good morning, Greg. Congrats. Akhil and Carroll. And Greg, only one six-part question here. Just quickly on the - just if you could just update us on your thoughts how the BE Aerospace businesses doing inside Collins and also just on the synergies itself. The UTC playbooks always been to exceed these targets but is any of these just timing related and pull into the left. Thanks again, Greg.

Greg Hayes

Yes, so the BE Aerospace side obviously last year was a pretty tough year at BE after the acquisition by Rockwell ahead of the close. I would tell you that most of those issues are behind us. We have seen really good progress. Dave Newsom, who runs that business doing a nice job. The orders that had been deferred last year are being fulfilled, margins are coming back to what we expected. So that business actually is doing that was even better than what we had expected for the year and part of this the $0.60 of accretionary we're getting obviously coming from the BE Aerospace.

As far as the synergies go, we are pulling synergies to the left, obviously, we had the $600 million goal, we'll be close to $200 million -- 250, in synergies this year. Now, are we going to take up the synergy target beyond 600? Not today.

I think this is the same playbook that you would expect from UTX which is - get our feet under us, there's always more ideas out there to take cost out and I would expect as Kelly and team go through this process over the next two, three years, there will be more and more ideas that will be generated.

But after three years or so, we hit the 600 million, everything else kind of flows into just normal cost reduction actions anyways, but there remains a basket load of opportunities on the Collins aerospace side with the footprint that they have and the product geography they have to continue to drive cost out.

Peter Arment

Appreciate the details. Thanks, Greg.

Operator

Thank you. Our next question comes from Doug Harned with Bernstein. Your line is now open.

Doug Harned

Thanks. Good morning. I wanted to, I wanted to look at Pratt, and then you raise your outlook for commercial le and aftermarket combined. And can you talk a little bit about what led to that if we think about the legacy engine, aftermarket growth benefits from the gear turbofan some of the early work on that and then reduction in costs on the OE side, how would you balance those different pieces?

Akhil Johri

So the mix Doug is what is helping that particular line that you are referring to in the in the outlook, and the fact that we are seeing more favorable customer makes inside the GTF and OE deliveries and the fact that costs are coming down as we expected or in line with our expectations is what is driving that growth to be slightly better than what we expected. That at the highest level, that's probably what it is some better customer. Carroll anything?

Carroll Lane

The aftermarket Doug remains very healthy. So, no real change to trend there. UV 2500s we talked about we're up year-over-year. Remember, we started in a bit of a hole on the V-2500 with some operational issues in the network earlier in the year. We are recovering from those we made good progress, there's demand for well over 1000 shop visits on the V-2500, not clear that will get to serve all them maybe closer to 975.

So, you think about the aftermarket and total is probably more like low to mid-single digits, as we kind of close out the year. The Legacy models in obviously the shop visits were down we expect those to be down to the fours and the twos, but the content remains pretty solid. So overall very, very good aftermarket.

Akhil Johri

The other thing we don't often talk about is the strength in the Pratt Canada business. And that's also reflected in that line to some extent, Doug, and you see good shipments, engine shipments there. We see good aftermarket growth there. So always good on the small engine company side as well.

Doug Harned

So sort of all the way around and the Vs, I mean, you were really pushing capacity limits on MRO. Now, I would expect, I mean, this is -- should be a lot of upward pressure, I assume.

Carroll Lane

Well, it's a pretty tightly coupled system. So, you start out in a hole, it's just an issue of getting them through the shops, but the team has made a ton of progress on that front, and we're now up to the kind of monthly run rate for inductions that we would have expected. So that's good news.

Doug Harned

Okay, great. Thank you.

Operator

Thank you. Our next question comes from Robert Spingarn with Credit Suisse. Your line is now open.

Robert Spingarn

Good morning.

Greg Hayes

Good morning.

Robert Spingarn

Just sticking with the -- with the geared turbofan for a minute and Pratt, you did mention the -- the early shop visits are starting to come through. I'm curious how the where has been there relative to expectations? I know you're just getting into this at this point.

Then separately, was there any opportunity for the geared turbofan on this new Gulfstream aircraft? I understand it's a derivative of the 650 and it uses that engine, but might there have been an opportunity since you're on some of the other products?

Carroll Lane

Well, I'll core the first part. Rob, we are getting the engines into the shops as we bring up these -- the prior configurations, the current configurations, which is going to extend the life of the, of the engine. And so far, it says, it is early, but nothing from wear modes or anything like that nothing out of the ordinary, I think pretty much as expected. So that's something that over time, you have to keep an eye on because those were modes, by definition emerge over time, but at this point, we're feeling like it's pretty much situation normal there.

Greg Hayes

I would just add to that, one of the obviously the biggest concern when we launched this engine five years ago was the gear system. And we have seen a lot of these engines come back, we've had an opportunity to go through those gear systems. And I would tell you the wear is much less than expected, in fact, much more robust design and that was probably necessary. But the fact is, the gear system works as advertised.

And so, if you're thinking about things to worry about with the engine that isn't one of them. Obviously, we're still working through the retrofits of the combustors and a couple of the seal issues, but in terms of the actual long-term durability of the engine went to the gear, not an issue.

As far as Gulfstream on the 7,000 -- 700 rather. We did not offer an engine for that. We do have of course the engine on the new 500 and 600 Gulfstream, which are going into service now, which is a Pratt Canada PW815, if I got that number, right?

And we continue to work with Gulfstream on additional opportunities, but we did not participate in the bid, because quite frankly a GTF a gear does not work a long-range business jet. And even PW815, while it's got the same architecture is the gear, does not have a gear upfront, the way, the rest of the GTF family does.

Robert Spingarn

Okay. Thank you all.

Operator

Thank you. Our next question comes from Rajeev Lalwani with Morgan Stanley. Your line is now open.

Rajeev Lalwani

Good morning. Just a quick one for me, for you, Greg. You talked earlier about $150 million or so of revenue synergies. Can you talk about where that's coming from and then how that's working and implications for RTX as we look forward and your confidence there?

Akhil Johri

Yes, Rajeev, hi. This is Akhil. I think a couple of examples which are very real and very encouraging is the forward leaning organization that Rockwell Collins brought to the table, they have lots of -- thousands of people actually sitting very close to the airline customers, and are able to pick up opportunities that may not have been possible otherwise for the UTAS organization.

And so one of the examples of this attributes two large projects that we are talking about in the 175 million, one of them was just simply -- now that we have a bigger bag of offerings that these sales people have out of the Collins Aerospace, there was an opportunity, which came up for a product that UTAS makes out of their sensors business before. And when the airline was looking for that, we were able to offer that opportunity out of the UTAS -- the heritage UTAS product line. And that created sales, which UTAS would not have seen before and Rockwell Collins did not have an opportunity to offer before.

So that's part of the thing that we saw as in the synergy bucket. And that alone is about $80 million of revenue we would not have seen otherwise. And there is other examples of that, but it's leveraging their reach, Rockwell Collins reach and generating additional business.

Greg Hayes

And if you think about the Raytheon side again, the thing that most excites I think Dr. Kennedy and myself about the merger is the technology. And the fact is Raytheon has premier technology in cyber that is primarily dedicated to DOD and the military customer, we see an opportunity to take that cyber capability and move it into the commercial aerospace arena, which today Raytheon would not have a channel to do that.

The same in terms of coordinating on the new air traffic control system with a shared GPS mixture married up with Raytheon radars to allow airplanes to fly much closer together and airspace. That would be allowed today.

We're going to have to do that if we're going to see that air traffic growth that we expect in the U.S. And I think again, those are the types of big synergy opportunities. And there will be others. Some of that will be in the ISR space, some of it will be in the material space as we think about hypersonic and other new defense technologies.

But again, these they don't happen overnight. But what was encouraging about the Rockwell Collins synergies is the guys are out there and they're incentivized to find these things. And Kelly, or Bergen team are driving these every day. And we'll have the same type of organization at the new Raytheon technologies to drive these technology synergies and revenue synergies near term.

Rajeev Lalwani

Great, thanks. And best of luck, Carroll and Akhil.

Akhil Johri

Thanks.

Operator

Thank you. Ladies and gentlemen, this concludes our question-and-answer session. I would now like to turn the call back over to Greg Hayes for any closing remarks.

Greg Hayes

Okay, thanks, Daniel. I just want to thank everybody for calling in today. Obviously, Carroll and the IR team will be available all day to answer your questions. Thanks for listening and we'll talk to you guys early next year. Take care.

Operator

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