United Technologies Corporation (UTX) Management Discusses Q2 2013 Results - Earnings Call Transcript

Executives

Gregory Hayes - Chief Financial Officer, Senior Vice President

Jay Malave - Director, Investor Relations

Analysts

Jeff Sprague - Vertical Research

Howard Rubel - Jefferies

Shannon O'Callaghan - Nomura Securities

Joe Nadol - JPMorgan

Ron Epstein - Bank of America/Merrill Lynch

Sam Pearlstein - Wells Fargo

Peter Arment - Sterne Agee

Cai von Rumohr - Cowen & Company

Robert Stallard - Royal Bank of Canada

Julian Mitchell - Credit Suisse

Doug Harned - Sanford Bernstein

United Technologies Corporation (UTX) Q2 2013 Earnings Call July 23, 2013 9:00 AM ET

Operator

Good morning and welcome to the United Technologies' second quarter conference call. On the call today are Greg Hayes, Senior Vice President and Chief Financial Officer and Jay Malave, Director of Investor Relations. This call is being carried live on the internet and there is a presentation available for download from UTC's website at www.utc.com.

Please note, the company will speak to results from continuing operations, except where otherwise noted. They will also speak to segment results adjusted for restructuring and one-time items as they usually do. The company also reminds listeners that the earnings and cash flow expectations and any other forward looking statements provided in this call are subject to risks and uncertainties. UTC's SEC filings, including its 10-Q and 10-K reports, provide details on important factors that could cause actual results to differ materially from those anticipated in the forward-looking statements.

Once the call becomes open for questions, we ask that you limit your first round to two questions per caller to give everyone an opportunity to participate. You may ask further questions by reinserting yourself in the queue and we will answer as time permits.

Please go ahead, Mr. Hayes.

Gregory Hayes

Okay, thanks, Bob, and good morning, everyone. As you saw in the press release this morning, UTC reported second quarter earnings per share of $1.70, that's up 5% versus 2012 with better than expected segment operating profit growth and higher net gains. Second half profit grew by 15% led by strong performance at Climate Controls and Security, and also with the benefit of the Goodrich and IAE acquisitions.

Gains in the quarter receded restructuring by $0.05 as compared to $0.04 last year and taxes were a $0.13 headwind to earnings growth. You recall that last year we had about 23% effective tax rate in the second quarter as compared to about 28% this quarter. So the solid first half of the year, given an uneven economic environment.

We have accelerated restructuring, positioned the business now for further growth. Additional restructuring savings, combined with good orders momentum and easier compares in the back half, give us confidence to increase the bottom end of the EPS guidance range, so you saw the press release. We now expect earnings per share of $6 to $6.15. That's growth of 12% to 15%, an increase with our prior guidance of $5.85 to $6.15.

We continue to expect double-digit earnings growth despite these uneven end markets. In the U.S., the potential fed tightening caused some volatility in the markets, but we still believe the economy is recovering and we are seeing strengthen in the leading sectors. Auto sales were up 8% in the first half and are growing at the fastest rate in five years. Housing starts are 24% higher year-to-date. And, in commercial construction, the Architectural Billing Index has shown expansion in eight of the last nine months, so good progress in the US.

Europe, of course, a little different store with unemployment now over 12% in the PMI or Purchasing Managers Index consistently below 50, and we didn't plan for much growth in 2013, but the fact of the matter is, we are actually still seeing a slight contraction in sales in Europe. Year-to-date sales are down about 3% across our commercial businesses.

On the other hand, we do see continued strength in China, and we are all cautiously watching the economic indicators coming out of China. We talked about some falling imports, exports, tightening of credit markets, lower GDP forecasts, so whether it's 7% or 7.5%, GDP growth, is still one of the fastest-growing markets. Because fixed investments has continued to grow and that's driving very strong order growth at both Otis and CCS.

Aerospace, we continue to see strong growth in the commercial aviation industry. RPM's up 5.6% in the month of May, airlines are now projected to earn over $12.7 billion for the year. While we continue to see pressure in the military, and particularly at Sikorsky, the overall aerospace industry remains very healthy.

Okay. Let's talk about orders for a second. We are on slide two for those of you following along on the webcast. I talked about economic uncertainty remains, but as you can see on slide two, overall our orders positioned us well for growth in the second half of the year. Just as a reminder, we talk orders at constant currency as we normally do.

Otis as we mentioned very strong quarter, 22% growth in new equipment orders. That was led by China with 35% growth. That's 32% growth in China year-to-date for Otis, so very strong recovery.

Climate Controls and Security global equipment orders grew for the third straight quarter. This reflects the strength in the U.S. economy where residential HVAC orders were up 19%, but partially offset by Europe, which was down about 4% across the CCS businesses.

Turning to Aerospace, a very encouraging sign of Pratt & Whitney, after five quarters of contraction, legacy Pratt & Whitney large commercial spare orders grew 15%, organically. And importantly, this included growth across all three major engine families PW2000, PW4000 and the V2500.

Aerospace Systems, we saw growth for the second straight quarter with orders up 4% on a pro forma basis. We're still looking for more recovery in the back half, but it's good to see growth of both Pratt and UTAS on the commercial spares side.

So, in summary, despite the uneven end markets strength in the U.S. emerging markets in commercial aerospace are going to offset the softness that we are seeing in Europe and defense. Our orders momentum still points towards recovery in the back half, but as I said in June, with year-to-date. organic sales down slightly we are now probably going to see organic revenue growth of about 3% for the full year, which is at the low end of our prior range, so total sales are now expected to be just around $64 billion for the year.

Turning back to Q2 results and on slide three, total sales and segment profit increased 16% and 15%, respectively. That's driven of course by Goodrich and IAE acquisitions and the strong operating performance of CCS.

Organically, sales were flat versus prior year following a 2% decline in the first quarter. CCS had another strong quarter, 7% operating profit growth and margin expanded to 120 basis points as they continue to realize savings from the integration of carrier in FNS and capitalize on their operating leverage.

Overall, segment operating margins at UTC declined 20 basis points with the strength at CCS more offset by headwind from pension and the decline in the military business at Sikorsky.

Goodrich and IAE acquisitions continue to exceed our expectations and contributed $0.20 of earnings in the quarter. As I mentioned, earnings per share of $1.70 include $0.05 gains in excess of restructuring. $0.19 of the gains in the quarter came from the sale of the Pratt & Whitney Power Systems business and some small tax settlements. These are more than offset by $190 million we invested in restructuring, including $93 million at Pratt & Whitney as we continue to reduce the cost base there.

Foreign currency, small impact of about $0.01 in the quarter. Free cash flow, 101% of net income. We repurchased an additional $335 million of stock and we expect to buyback a similar amount here early in the third quarter.

So I will stop here for a second and let Jay take you through the segment results, looking back and talk about full year. Jay?

Jay Malave

Thanks, Greg. Turning to Page four. Otis sales improved 4% at constant currency in the quarter led by solid high-single digit growth in new equipment and continued growth in service sales. New equipment sales were up in all regions led by double-digit growth in China and Russia. Operating profit was up 1% at constant currency. Solid growth in China and other emerging markets was offset by continued weakness in developed Europe and transition costs associated with the factory transformation in North America.

New equipment order growth was strong, up 22% at constant currency with double digit growth in Americas and Asia led by a 35% improvement in China. Orders in Europe were down mid-single digit. Given continued pressure in Europe and a significantly weaker Yen, we now expect full year profit growth at Otis of $75 million to $100 million versus the prior range of $100 million to $150 million. We expect profit improvement to come in the second half based on conversion of a higher new equipment backlog, especially in China, continued savings from restructuring and completion of the factory transformations in North America.

On slide five. Climate Controls and Security increased profits to 7% in the quarter on 1% lower sales, resulting in another sharp increase in margins, up 120 basis points from prior year to 16.9%. Organic sales were up 1% with mixed results across geographies. Europe was down mid-single digit amid continued economic weakness in the region, while Americas was up low single-digit, driven by 13% growth in the residential HVAC business. China was also up mid-single digit, while Asia overall was flattish, driven by a decline in Australia. Transicold was up 11%. While the organic growth in the quarter was modest, this was the first quarter of growth in over a year and we anticipate acceleration through the remainder of the year.

On profit, CCS had another solid quarter of earnings growth driven by strong conversion on the higher organic sales, restructuring and productivity, including continued savings from the consolidation of carrier and fire and security and lower commodity cost. Global commercial HVAC orders were flattish with 10% growth in Asia offsetting declines in North America and Europe.

Orders for global fire and security products were up mid-single digit while the fuel businesses were down a similar amount. Transicold orders were up 5% and commercial refrigeration orders in Europe were down 5%. With solid results in the first half and anticipated organic improvement, we now expect profit growth to be in the range of $175 million to $200 million, up from $150 million to $200 million on low-single digit organic sales growth at CCS.

Turning to aerospace on slide six. At Pratt & Whitney, sales and profit increased 5% in the second quarter. Higher sales were driven by the consolidation of IAE and transfer of the AeroPower business. Organically, sales were down 6% year-over-year due to lower military engine shipments, partially offset by higher large commercial engine OEM sales. Large commercial spare sales were up 2% organically over last year's second quarter. On a pro forma basis, including consolidated IAE sales in both quarters, large commercial spare sales were up 5%. Profit growth was driven by the benefits from the IAE consolidation, restructuring savings, and lower E&D, partially offset by lower organic sales and higher pension costs. In addition, the absence of favorable one-time items in last year's second quarter offset the benefit of a commercial contract closeout this quarter

As Greg mentioned, Pratt & Whitney, large commercial spares orders were up 15% organically. Based on year-to-date sales however, we now expect large commercial spares to be flattish for the year organically from up mid-single digits.

Pratt & Whitney's proactive cost reduction and restructuring measures give us confidence in its full year profit growth outlook of $100 million to $150 million and mid-single digit sales growth.

UTC Aerospace Systems delivered another solid quarter with operating profit of $532 million and sales of $3.3 billion. On a pro forma year-over-year basis, sales were up mid-single digit with commercial OEM, up double digits and commercial aftermarket, up mid-single digit, partially offset by declines in military OEM and military aftermarket of mid-single digit and low-single digit, respectively.

Orders for commercial spares grew 4% on a pro forma year-over-year basis. Compared with the first quarter, profit was up 4% on 2% higher sales, driven by solid conversion on sales growth and continued synergies capture.

With the first half of the year complete, we now expect full year sales to be around $13.5 billion, the low end of our previous guidance range of $13.5 billion to $14 billion. We continue to expect operating profit of around $2.1 billion in spite of lower sales due to continued cost containment and better than expected synergy traction.

Turning to Sikorsky on slide eight, operating profit decreased 24% and 3% lower sales. During the quarter, Sikorsky shipped a total of 62 aircraft, including 47 based on military platforms and 15 commercial. Sales decrease was driven by lower military aftermarket volumes as well as unfavorable military aircraft mix, partially offset by higher commercial volumes.

The profit decline was driven by lower sales as well as headwinds from the multi-year 8 margin reset and higher pension and export compliance costs. For the full year, we continue to expect profit to be down $100 million $150 million and low single digit sales growth. We expect profit improvement in the second half and benefits of higher aircraft volumes and restructuring savings.

With that, let me turn it over to Greg to wrap up.

Gregory Hayes

Okay. Thanks, Jay. So, I am happy to report that with the completion of the Rocketdyne divestiture in June, we are now done with the major portfolio transformation. Entire organization took on a huge task over the last two years, complete two significant acquisitions, integrate new organizations, divest over $4 billion worth of businesses and paid down $7 billion of debt.

I'll tell you that team executed flawlessly. We now have a portfolio that's well-positioned for long-term growth and we've capitalized on the big the urbanization and commercial [aerospace].

Some other highlights in the quarter, we announced significant wins across our aerospace businesses at the Paris Air Show. Pratt & Whitney announced orders for over 1,000 engines and claim orders for the launch of the second-generation Embraer regional jet. Customers see the advantage of our engine and have placed firm and option orders now for over 4,500 engines.

UTAS Aerospace Systems business is also well positioned with the electric system, cell, wheels and brakes and other systems at Embraer. They also secured new long-term MRO contracts from several airlines and supported Airbus in the certification A400M.

Sikorsky continues to see strong international demand announcing orders for 11 S-76D search and rescue helicopters for Japan, and 6 additional S-92 for the Chinese oil and gas market.

On the commercial side, our business has continued to win key orders. Otis was awarded the largest elevator contract ever in India. We sold 670 elevators and escalators for the Hyderabad Metro. Otis also won a contract to install 255-unit at Tianjin 117, which is nearly 600 meters, will be one of the tallest buildings in China.

CCS was rewarded the contract in the quarter with China resources land to provide HVAC, fire detection system in residential and commercial buildings across China over the next two years. So, the investment in innovative products is paying off. We are delivering real value to our customers and securing keywords that will drive top line growth well into the future.

Okay. Let's take a look at rest of 2013. As I mentioned, we now see earnings of $6 to $6.15. That's the top end of our prior range and represents earnings growth of 12% to 15%. Our relentless focus on cost reduction will allow us to delivery double-digit earnings growth. We continue to invest in restructuring as well. We spent about $240 million in the first half of the year and the businesses have good payback projects in the pipeline.

With almost $435 million of one time gains realized to-date on a pretax basis, we now expect about $450 million of both gains and restructuring for the full year. That's up from our prior estimate of $350 million each. So you can expect about $100 million of restructuring in each of the next two quarters.

Strong cash flow, of course, remains the hallmark of UTC and we continue to expect free cash flow to equal or exceed net income for the year. We paid down $1.2 billion of debt in the second quarter. That's almost $1.6 billion in the first half and we have an additional $1 billion due in the fourth quarter. So we will pay down about $2.5 billion of debt this year.

We are also buying back shares. The remaining $335 million in our original share repurchase plan will be completed here early in the third quarter and we expect to do a little bit more towards the end of the third quarter or early fourth quarter assuming cash flow remains strong.

So portfolio transformations behind us, we are focused on integration and execution and we are seeing a gradual recovery in our end markets. The order book supports a resumption of organic growth in the back half and we are confident in the revised EPS guidance.

So with that, Bob, let's open up the call for questions, if we can.

Question-and-Answer Session

Operator

Our first question is from Carter Copeland of Barclays. Please go ahead.

Carter Copeland - Barclays

Hello, Carter.

Operator

Mr. Copeland, if you wouldn't mind checking your mute button. Moving on to our next question in queue from Jeff Sprague of Vertical Research. Your line is open. Please go ahead.

Jeff Sprague - Vertical Research

Just a couple of questions. Greg, first just on share repurchase. So you are going to blow through your placeholder really quick but it still sounds like you are kind of soft cuddling in the back of the year? Can you just give us some thought on how cash looks in the back half? Your effort to maybe repatriate some foreign cash that you talked about and why there wouldn't be room for that that repu to come up a little bit more?

Gregory Hayes

Yes. So this year was the soft peddling in the share buyback. We are going to take it up. I think the question is how much. I said we are having $200 million, $300 million, $400 million, and it will really depend upon strong cash flows in the back half of the year. As you know, CapEx is at a ramp. We spent a little over $600 million year-to-date, and we have got plans for about $1.7 billion. So there is still a call on cash in the back half of the year which is a little higher than what we expect.

We will also, as I said, are paying down about $2.5 billion of debt and you recall going into the year, we talked about only about $1 billion of debt due. So I think we have been aggressive on the debt paydown. We have got CapEx in front of us but we still have room to take share buyback up and we have still got that $1 billion placeholder out there for M&A.

Not a lot going on, but there is always the possibility something could still happen for the year. So I think we are in line to do more share buyback and clearly if the M&A doesn't happen, it gives us a little bit more room but I am just going to tell you, there is other calls on cash right now.

Jeff Sprague - Vertical Research

Right, got it. Understood. Also, could you just give us your quick take on what your pension tailwind looks like for next year? If you were to snap a line today at these interest rates?

Gregory Hayes

So obviously there is going to be tailwinds next year in the pension. There is a lot of things going on there. First of all, you have got the fact that four years ago, we decided to sell the plant so we have taken the tough actions and that gives us tailwind. We also have losses for 2008 that come off. And you have got (inaudible) about 4.6% on a discount rate versus 3.% last year.

You guys know how to do the math. That's about $28 million to $29 million (inaudible) basis points. So there is definite tailwind from pension next year. Again, it is a little early because there is other assumptions that go into the pension number for tailwind and all that but for the most part, there will be pretty good tailwind next year.

Jeff Sprague - Vertical Research

Then, finally, and I will move on, but just on China Otis, can you just give us a little more color on where you are seeing the strength? Is it broad or is it less than China? And, just what's going on kind of competitively with pricing in particular.

Gregory Hayes

Yes. So, we talked about it. Orders on a constant currency basis were up 35%. I think HVAC were 39% orders growth and sales were up about 20%. We also saw pretty good traction on the service business with sales up 25%, so good strength there. Pricing remains tough, but the margins are holding up in China, because we continue to be able to take cost out of the supply chain and leverage on the higher volumes.

As I think about specifically from a market perspective, where we are seeing the growth, residential was obviously the key. It is the biggest market for Otis elevators and it is very, very strong still despite some of the cooling measures, we've also seen the commercial office buildings start to improve. Social housing has kind of leveled off. I think, Otis would tell you today that the market is going a lot faster than what we had anticipated going into the year and I think these order rates more than support that.

Operator

Thank you. Our next question in queue is from Howard Rubel of Jefferies. Your line is open.

Howard Rubel - Jefferies

Good morning. Thank you. Nice numbers. A couple things, Greg, and kind of rattle through them. One on interest expense, I can never seem to get it right. You are refinancing, you are taking some charges for doing some things. Could you just give us a range of what you think you could look for interest expense for the full year?

Gregory Hayes

Howard, for the year we are in the range of about $950 million is what we would expect it should be for the year.

Howard Rubel - Jefferies

Okay. You took some fairly substantial actions at Pratt to lower cost. Could you talk about some of the benefits from the operating leverage that you expect in the second half of the year and going forward given the change in mix and other things?

Jay Malave

Yes. So, back half of the year Pratt's good. Obviously, the spares are not going to be as we had expected originally going in. And, we talked about kind of 5% growth or so in spares going into the year, probably more like flattish given how low the first half was, but again good orders momentum. We should clearly get some traction out of spares in the back half of the year.

We took out I think about 575 people took advantage of the voluntary early retirement program that we just offered. That will help again in the back half of the year, add some earnings growth to Pratt. We are taking some other actions around the business as well to take advantage of some of the cost reduction opportunities out there.

R&D is coming down as we had expected about at probably $75 million $500 million. I think it was down about $14 million in the second quarter, $35 million in the first, so we are half way there in terms of the R&D reduction, so a lot of good things going on at Pratt. Spares are coming back and this is a tough year at Pratt. We got this big trough, because military engines are coming down significantly. Although mill spares that had held up pretty well and you've got an increase in the commercial shipments which as you know come with a little bit of a bill.

Howard Rubel - Jefferies

You changed management at Pratt commercial, kind of separated the organization into two. What are the marching orders for the two gentlemen going forward on that?

Gregory Hayes

Yes. So, (Inaudible) call, because he led that business, he is President for the last seven years. He is the guy that has been at the forefront of the GTF marketing campaign. On that side he's done a hell of a job, but it's a huge job. And, I think what we have decided to do, what Dave Hess and Alain have done is to split that up between an aftermarket focus and an OEM focus, so Dave Brantner is going to take over. He is head of the OEM side of the Commercial Engine business, President there.

Then Matthew Bromberg, who is Head of our strategy development group for the last couple of years, who is going to lead the aftermarket, and his focus is simply on making sure we have a flawless launch on the GTF and making sure that we capture the aftermarket channel going forward on all of these GTF orders that we won. So, again, I think it makes a lot of sense [Greg] is going to focus on getting engines delivered, getting cost down, winning new campaigns and Matthew is going to focus on that moving that aftermarket and continuing to drive growth in the aftermarket.

Howard Rubel - Jefferies

I just have one last question. 787 has had some challenges in operation are very minor ones, but some of it comes back to working on and enhancing the reliability of the electrical system. What are you doing there and can you talk some of the improvements you've made already?

Gregory Hayes

Yes, Howard, as you know I think with any new airplane, there is always teething problems and we have had a couple of issues of the electric power system and we worked closely with Boeing during the production hiatus. I think we took the opportunity to go out there and to improve reliability of some of our power panels where we had a couple of issues. There is just constant teething problems, but again, because the 787 has got so much publicity, I think people are hearing a lot more about it but the fact is, this plane is as reliable and more reliable than the 777 was when it was introduced into service. Our systems are doing very, very well. So, well here, we have got a lot of systems, nine major systems on the aircraft. Each one might have a minor glitch but I think, overall, The Boeing Company would tell you that are working very closely with them to get all these things behind us.

Operator

Our next question in queue is from Shannon O'Callaghan of Nomura. Your line is open.

Shannon O'Callaghan - Nomura Securities

Hey, Greg, a couple of things in CC&S. Maybe can you just give us a sense of how you are thinking about the second half there. Transicold, you had revenues up 11%, but orders I think you said up 5%. That looks like make it slows a bit. Can you gauge the different components of the CC&S in the second half?

Gregory Hayes

I think we go through all of the CCS businesses. Obviously, Transicold is an important part but not the only part but we did see decent order growth in the second quarter and sales were up mostly because of the very easy compare last year. You recall, last year, on the container side, we didn't get any orders, I think, from May through September in that business.

So the compares get very east in the back half of the year and we continue to see pretty good traction on the container side. Also on the truck trailer side, both North America and Europe are seeing good order growth. Europe, surprisingly, is strong, given where the economy is but that's all coming from cold chain expansion in the Eastern European area. So that business is doing well. The thing about res in the U.S., again, very strong orders growth, good revenue growth. We think that trend is going to continue and it will support a very strong back to the year.

So if you think about it, first half of the year, we didn't get much growth out of CCS in total, but we did get growth in some key markets. Again, China was another place where we saw good growth at CCS. Orders, I think, on commercial HVAC were up about 15%, 16%. F&S products were up over 30%. So there is good momentum in the emerging markets despite the fact that Europe, overall, was down 1%, I guess, on commercial and a couple of points on the F&S business.

So lots of moving pieces. We have taken the revenue guidance down for CCS. We now expect probably around 3% organic revenue growth for the full year which still indicates pretty solid growth in the back half of the year.

Shannon O'Callaghan - Nomura Securities

Okay, great, thanks. Then just so taking up the restructuring. In terms of the payback, what kind of year-over-year savings do you now expect in '14 from the actions you are taking?

Jay Malave

One of these programs run average about two years, Shannon. So this year we are talking about incremental $100 million plus. So you are probably looking next year in that range of another $100 million of these actions.

Shannon O'Callaghan - Nomura Securities

So that total, in terms of the total $450 million, how much year-over-year sales growth?

Gregory Hayes

So it gives us about $100 million of benefit this year because we have taken a lot of these actions in the first half year and a lot of them are on the quicker payback, like the voluntary early retirement program that we have done at Pratt. So the other headcount actions we have taken at CCS and UTAS. Some of the other things that we are still doing in the back half will be a little bit longer payback, probably 1.5 to two years. So its going to be $100 million this year and then $100 million to $125 million next year of savings. So it will be probably $250 million of runrate savings by the end of next year.

Operator

Our next question in the queue is from Joe Nadol from JPMorgan. Your line is open.

Joe Nadol - JPMorgan

Just following up actually on the restructuring. Greg, are you seeing the same payback opportunities now on some of these new projects that you were a year ago or two years ago when you look just across the company and you look going forward, do you think there is continued opportunity and the same kind of quality opportunities as we look into next year as you have seen in the past?

Gregory Hayes

Joe, we came into this year thinking we probably do $150 million to $200 million of restructuring. The fact is, restructuring is a way of life here at UTC. It's how we drive productivity. I will tell you, that we just continue to come up with good payback programs. There are some things out there that some of these structural factory, the actions that take a little bit longer.

Obviously, some of the UTAS actions that we are taking as we consolidate Goodrich, it will take a little bit longer to payback, but on average even with all that said we are still looking at two years or less payback for all of these programs.

Joe Nadol - JPMorgan

Okay. Could you provide an update on CMH? There were some, they were media flurry the last few days. Just with some implications that they are still not taking helicopters. I know that's not new, but just an update on the program. And, I guess underlying the question, what is your level of confidence that this does not turn into a much, much bigger deal down the road?

Gregory Hayes

I would tell you, I feel better about CMH today than we have probably in the last year. We are gaining momentum with the customer. I think, importantly, we are going to start pilot training in August, so another month. We've got four helicopters up in Shearwater, Canada. That's going to serve pilot training. We've got another five helicopters that are sitting up in Hartford, New York, ready to be delivered. Two more in flight test.

The 8 that we talked about going into the year, I think we've got a solid plan to deliver those. Still some issues obviously to work through with our customer, but I think again, we are seeing positive momentum. I don't think we are going to see a big, big bad news item coming out of here. I think here you saw some things in the really impressed with the seeking 50 years into service and it's been a great helicopter, but again 50 years and they are starting to have some issues with that helicopter. We got the best military helicopter sitting right there ready to go, so I think it's all pretty positive right now. Rick has really done a great job with the whole team and starting to sing around.

Joe Nadol - JPMorgan

Okay. Then just one more quick one. On UTAS spares, do you still expect high single-digit or 10% I thinks is your exact guidance. I know you dropped the sales guidance a little bit there or to the lower end of the range, but specifically on spares.

Gregory Hayes

So spares at UTAS, I think, were up about 4% on a pro forma basis in the quarter. They were up. For the full year, we had talked about 10%. That's probably going to be more like 7% or so by the time we get all done, just because we haven't seen the first half growth, but continue to see pretty solid growth.

Now looking at parts versus provisioning, remember we sell both spare parts as well as end items. Spare parts in the quarter were up over 10%. Provisioning was down about 10%, so still provisioning is a little bit lumpy. I talked to the guys yesterday. They see that we have got line of sight on the provisioning number to hit the full year, so pretty confident we are going to get in the mid-7% maybe 8% range.

Joe Nadol - JPMorgan

Okay. Very good. Thank you.

Operator

Thank you. Our next question in queue is from Ron Epstein of Bank of America / Merrill Lynch. Your line is open.

Ron Epstein - Bank of America/Merrill Lynch

Just a couple. On the Pratt orders, can you describe in more detail where you've seen them coming from? Is it you are seeing from the freighter market or where has the order activity pick up come from?

Gregory Hayes

I think, obviously, freighters is an important part, but I think most of the orders could actually come on the commercial airline side. As Jay mentioned, I think we talked about in the script, PW2000 spares were up significantly. The 4000s were up over 15% and Vs were up almost 15%, so we're really seeing strength across the board.

Inductions into the engine centers are down year-over-year and content hasn't really improved, but we know as these planes keep flying, the customers need parts and that can go only so long and the glue we've been talking, this one is a four quarters, five quarters or six quarters, eventually spares come back and I think that's what we saw this quarter and we expect that kind of momentum to continue into the back half of the year.

Ron Epstein - Bank of America/Merrill Lynch

Is there any regional strength maybe you are seeing that starting to come out? North America, the Europe and Asia, if you could characterize that?

Jay Malave

Ron, Pratt legacy fleet is more concentrate in North America and Asia, so we saw that pretty much across the board there. The V2500 fleet is a little bit more broad-based excluding Europe. Again, there wasn't any one particular region. It really stood out one way or the other. It's pretty even.

Ron Epstein - Bank of America/Merrill Lynch

Okay. Great. Then Maybe one more, Greg, if you don't mind. A much bigger picture question. Now that the portfolio reshaping, I guess the settle down, what has to happen for you guys to feel comfortable again about maybe adding something else to the mix, right? Is there a bias towards aero? Is there a bias towards industrial? I mean, how should we think about, and I know this is a longer term question about where you want to go with the portfolio over the next several years?

Gregory Hayes

As we said, the portfolio, at least for the near term, is set. I think, we are 55% Aero, 45% commercial. Eventually, we would like to probably get back to kind of a 50/50 split. But, for right now, we like the hand we have got. Especially with what's going on, on the other commercial Aero side. So the focus right now is really at execution. The next deal, I would tell you, that again as you think about the 50/50 split, it will probably be on the commercial side. I know, Geraud has some ideas, [Major] has some ideas. Nothing really imminent though, and I think, again we have got a lot on our plate right now and we would like to handle that. Urbanization continues to drive and will drive strong organic growth for years to come on the commercial side and also help on the Aero side. So I wouldn't look for anything big coming out of UTX for a few years.

Operator

Our next question in queue is from Sam Pearlstein of Wells Fargo.

Sam Pearlstein - Wells Fargo

Just back on the restructuring. The incremental $100 million, can you talk about which segments those are in? Then, related what are the favorable items that are coming in to offset that, that weren't unexpected earlier?

Gregory Hayes

So most of the favorable items, we have actually already seen them. We had a gain this quarter from Pratt power to sales Pratt power systems. We also had a couple of small tax settlements out there with the IRS that gave us a little bit. There maybe one or two more small divestitures on the CCS side that might generate a little bit more gain. So the gains are pretty much done.

As far as the actual spend in the back half of the year, I think you will see that across the business here, UTAS, again we have talked about this, they have got about $100 million spend planned for the year. They have got some work to do to get to that $100 million, but they have got a lot of projects lined up. Pratt continues to look for things on the aftermarket side to do in terms of consolidation. More to come there.

Obviously, Otis in Europe has some work to do with sales continuing to atrophy there on service side. Pedro and team, I know, are looking for ways to take some structural cost out of Europe. So I would expect more to come there. Really, again, everywhere we look we find opportunities to reduce cost. It's amazing what Geraud and the CCS team have done as they brought F&S and Carrier together. They are on a run rate to probably take $200 million of cost out of the business, which is credible. So always opportunities and it will be spread across all businesses.

Sam Pearlstein - Wells Fargo

Okay, and then you talked about for Otis, the profit being a little bit worse because of Europe and the weaker Yen. Are those about equal and is there anything that's a positive move that's offsetting?

Jay Malave

Well, Sam, if you look at the move from the midpoint to the midpoint and you are talking about $38 million, two thirds of that was the currency that was driven by the yen. Then the other third was essentially the net weakness from Europe, partially offset by higher restructuring and some rebuilding in China.

Sam Pearlstein - Wells Fargo

Okay, and then the last question is, you had talked, I guess, in the last month about the F100 court case. I guess, as we look out into the remainder of the year, is there an additional reserve that we should be looking for or any sort of a cash impact as we go forward?

Gregory Hayes

No, and no. For those of you that, what we are talking about here is the FEC or Fighter Engine Competition that started in 1983. I think just (inaudible), that that's not my fault. So the whole issue here is, we had the case. We had won it at the trial court. Government appealed it. It was remanded back to the trial judge.

Right now, based upon outside legal counsel and our review, we believe that we will prevail on appeal. So we have not taken any reserve associated with this and we would not expect to have any cash impact on this for quite some time. The way these court cases work, I have my General Counsel sitting here, it will probably be a year and half or so before we ever get any resolution on this thing again. It has been going on for 30 years.

So we continue to believe the government wasn't harmed and as you take a look at the 10-Q which we are going to file on Friday, we will have expanded disclosure in there. So you can go through all that and if you have any questions, give us a call but bottom line is, we think we are going to prevail on appeal.

Operator

Thank you. Our next question in queue is from Peter Arment of Sterne Agee. Your line is open.

Peter Arment - Sterne Agee

Just first question, I guess on Pratt & Whitney, I get the margin there really from the consolidation and some of the restructuring gains, but I was surprised just given the amount of commercial engine ramps, particularly in large commercial. Is that the level we should be expecting for the second half with a sequential uptick?

Gregory Hayes

On the OE?

Peter Arment - Sterne Agee

On the OE side. Yes.

Gregory Hayes

The OE should be growing a little bit in the second half. In the quarter, we had higher shipments, particularly in the wide-bodies with the GP7000 and A380. And, for the year, we are expecting GP7000 to still be up year-over-year, so we will see some growth there. Even now I don't know if it will be significantly higher than where it is today. I think, what we did in the quarter is generally speaking, probably where you would be.

Peter Arment - Sterne Agee

Okay. That's helpful. Then just a quick one on Sikorsky, I get that domestic DoD pressures. Can you just give us an update or color on some of the major international pursuits that are out there?

Gregory Hayes

I think, Sikorsky continues to make good progress on the international side. We are working with Turkey on a relatively large opportunity there with the Turkish Utility Helicopter program. We expect to get something finalized by the end of the year there.

The India navy contract has been a little bit of a disappointment just because it keeps pushing out to the west, but we've had good traction in Brazil. We've had good traction in Columbia and the Middle East. So, again, there's lots of foreign military opportunities out there and Sikorsky continues doing more than its fair share.

Operator

Thank you. Our next question in queue is from Cai von Rumohr of Cowen & Company. Your line is open.

Cai von Rumohr - Cowen & Company

Can you comment, give us some color on the impact at carrier of the blistering heat wave we've had in the U.S. and Europe in July?

Gregory Hayes

It's good to own a air conditioning company when it's hotter. We talked about this, Cai, the orders were up almost 20% in the quarter of res side.

Cai von Rumohr - Cowen & Company

Yes, but you basically didn't see the heat wave in June. You saw it in July, which is.

Gregory Hayes

So, sales were up 12%, 13% order were even more. The fact is, it takes some time to actually see that come through the channel. It's two-step distribution, so we sell into through our major distributors who then sell up to dealers, so we would expect to see some level of good news yet here in the July-August. I think, orders have continued to be pretty good.

Cai von Rumohr - Cowen & Company

In Paris you were kind of talking about things being somewhat better, and it looks like things were definitely more than somewhat better, particularly on the 4000s. Was there sequential improvement as I read that you went through that quarter and kind of give us any color on what you are seeing in July?

Gregory Hayes

Sequentially, in the quarter, sales were up about 50% and orders were up over 30%, sequentially.

Cai von Rumohr - Cowen & Company

Talking about attached to PW4000.

Gregory Hayes

That was just in total. On 4000 itself I would have to get back to you on that, Cai.

Jay Malave

I think, Cai, that the fact as we started to see orders pick up April and May, I think it just accelerated into June. We had a very good month in June of bookings, but it's hard to point at any one thing in particularly other than just kind of pent-up demand that we've been talking about for the last year.

So, again one month or one quarter is not a trend make, but we feel pretty good about the back half of the year. Frankly, we are seeing here the 23rd of July I think orders are okay here, but I don't think I want to be giving order data on a weekly basis here pretty lumpy.

Cai von Rumohr - Cowen & Company

Just in terms of color, did this sort of sequential improvement continue in July is best you can tell?

Jay Malave

Cai, I'll have to get back to you on that. I don't really recall. I focus more on second quarter and third quarter, but we'll take a look and see if there is anything significant there.

Cai von Rumohr - Cowen & Company

Terrific. The last question, you mentioned that military after market was weak at Sikorsky, maybe give us a broader view of kind of the impact you are seeing or expect to see from sequestration and basically military aftermarket across the company.

Gregory Hayes

Yes, so military sales or military aftermarket sales were down about 25% at the Sikorsky in the quarter and orders were down about 40%. It is hard to delineate between just the budget cuts and what's going on as the overseas continuity operations wind down versus sequestration.

There has been some impact from sequestration just because it is taking us longer to get orders processed through the government to get contracts amended and things like that done. But it’s a pretty tough environment on the aftermarket side but not surprising, the overseas continuity operations, the fund is down about half and Sikorsky, of course, is the big gun of this year of the Afghanistan campaign. So some of that is just natural and a little bit is also from sequestration.

Operator

Our next question in queue is from Robert Stallard of Royal Bank of Canada. Your line is open.

Robert Stallard - Royal Bank of Canada

Greg, just a couple of quick balance sheet questions. You have got around $5 billion of cash on the balance sheet. Do you think that’s a good safe number to keep going forward? Or do you see an opportunity to bring that down going forward?

Gregory Hayes

The issue of the $5 billion, Rob, as you know, as most of that is sitting overseas. It's not all of that right now. We use that cash on a daily basis. We have got an inter company lending program where we lend out to the businesses for working capital needs. That’s not $5 billion. You have also got a lot of cash, over $1 billion sitting in China that continues to grow as the businesses there continue to generate strong cash flows but hard to get at.

So how much do you really need? Probably half of what's on the books. The other half it, it's just hard to get at and quite frankly from a tax perspective, very expensive to bring back to the U.S. We talked a lot about this. One of the benefits of the foreign cash is it does give the opportunity to make investments overseas and to do acquisitions overseas. So when you think about the M&A agenda, that’s probably where to look next.

Robert Stallard - Royal Bank of Canada

Okay, and then secondly on the balance sheet. You mentioned you have got about another $1 billion of debt you want to pay down this year. if you look at it over the longer term, what's your thinking on debt repayment on say, a five year period?

Gregory Hayes

We have got over a $1 billion that’s due in December. It’s the eighteen month floating rate note that we issued last May. That will actually get paid off. Then I would say, there is no debt payments due next year, although I would expect we will probably do another $1 billion of paydown next year and probably another $1 billion of paydown the following year.

We are trying to get back into that solid A range with the rating agencies. So again, I think, I would model $1 billion, $1.5 billion of paydown each over the next few years and there is not much due after that. But again, I think, we will continue to deleverage and so we see an opportunity to do something more significant on the M&A side.

Operator

Our next question is from Julian Mitchell of Credit Suisse. Your line is open.

Julian Mitchell - Credit Suisse

I just had a question on Otis profits. I am looking at the guidance. It seems that you are assuming around flattish margins year-on-year in the second half. After that, it would be down about 70 bips in the first half. I just wondered, does the guidance embed any sequential or year-on-year improvement in your European aftermarket volume or price?

Gregory Hayes

No, in fact, I think Europe, in the first half has been a drag over probably over $40 million of headwind here in the quarter, or first half rather, from Otis's service business in Europe but we think they are starting to stabilize although there is still a little bit of pressure, particularly in Southern Europe. Year-to-date, Otis, essentially flat earnings.

We have taken the guidance down to $75 million to $100 million. Piece of that was currency, a piece of that's Europe. But with this very strong orders momentum that we say here in North America as well as China, the back half of the year should be very good progress. There should get back on the path for earnings growth and should be able to hold margins as well.

Julian Mitchell - Credit Suisse

Okay, thanks and then on the overall business, I think you mentioned 3% organic sales growth for the full year. You are running at about minus 1% in the first half. So does that mean we should expect mid-single digit organic sales growth already in Q3? So otherwise you will need double-digit growth in Q4?

Gregory Hayes

Yes, it will pick up probably in that mid-single digits in Q3 and Q4 will be even a little better. Again, to think about these Otis orders that we are getting to date, it's about a six months turnaround time for the European groups or for the China orders. The other businesses little bit longer cycle than that. Spares, again, order rates are good.

Talking about spares at Pratt were up 15% organically, sales only up 2%, so very strong book-to-bill, so sales will pick up again as we move into the third quarter. Then lastly, I'd just remind you that CMH will deliver in the fourth quarter. We got eight helicopters. That's about $400 million of revenue out of Sikorsky just in the last quarter.

Julian Mitchell - Credit Suisse

Thanks. Then just lastly a quick one, the CapEx is up about 50% the last six months. is that sort of a good run rate for the second half as well?

Gregory Hayes

Yes. In fact it's going to pick up even a little bit more. I think we spent over $600 million first half of the year. We got $1.7 billion plan, and that's really being driven by the a aerospace guys as they continue to a ramp up or facilitize for the ramp up in production that we are seeing on the commercial aero side and the new GTF platforms.

Operator

Thank you. Our next question in is from Doug Harned of Sanford Bernstein. Your line is open.

Doug Harned - Sanford Bernstein

I am interested in UTAS. You talked about provisioning being down a little bit, but I would think going forward with 787 growth you would see some real benefits from provisioning going forward pretty soon. So, I am interested in how you look at the 787 and UTAS right now both, in terms of provisioning but also in terms of any impact we might see with respect to margin on OE deliveries.

Gregory Hayes

Yes. So, provisioning, obviously was a little bit slower in the first half of the year than what we had expected because of the production delays echoing. But, again, as mentioned before, we see pretty good provisioning picking up in the back half of the year, especially with all these new customers, come online. I think Boeing, is going. I think right now we are at seven a month. They are on track to get to 10 a month. We are going to support that and that's actually going to drive some good provisioning orders.

Keep in mind, about half of our customers are on care program where we actually do the provisioning ourselves and then charge a flight hour payment to the airline, so we're not getting quite a pick up that we had historically on some of the new program introductions, but from a return on investment standpoint it's a really good program. Benefits both, the airlines and UTAS, so good back half of the year.

On the OE, side it's still a pretty tough story. We've got about $6.5 million of OE content and the margins are awful, and we got a lot of work to do on cost reductions yet on 787 that we talked about this. We are working with the Boeing Company, trying to identify cost reduction opportunities to take cost out for them and us some money, but it's a tough slog right now and there's a lot of work to do on cost reduction, particularly aero structure side of the business.

Doug Harned - Sanford Bernstein

I am also interested. When you look broadly at the whole business, you've done quite a bit of restructuring over the last couple of years. It looks like it's been very successful in terms of delivering better margins, getting cost down. But now when you look ahead, you've gotten some very encouraging orders in this last quarter. Do you see a point here, where you are transitioning really a different way to think about the company in terms of more growth potentially less restructuring, because you may not need to get your fixed cost base down much more? When could you get comfortable there?

Gregory Hayes

I think as soon as we've turned the corner on organic growth, but I think as we exit the year, but if we do as we expect, which should be kind of 5% or 6% run rate going out of the year. I think we'll need to do further structural cost reduction while it never goes away. I think, again, although focus will be on delivering on the organic growth and that just gives us huge operating leverage.

I could imagine, CCS grew profits in the first half of the year and really no revenue growth, so cost takeout. That's really been the story in the first half of the year, but I got to tell you it's a lot more fun to see the top line growing and to focus on satisfying customer demands and restructuring, but restructuring never goes away. We're always looking for productivity and room to grow margins.

Doug Harned - Sanford Bernstein

Are you comfortable that with restructuring efforts you have done and you have underway right now, you haven't done anything to your base that would constrain your growth, you are basically getting to the point where you are prepared for it? Is that correct?

Gregory Hayes

That's exactly right. I think on the aerospace side, specifically we moved some work to lower cost locations trying to consolidate work across the UTAS business. There's still more work to do for the Goodrich and Hamilton Sundstrand consolidation standpoint, but we feel very comfortable with where we are with the footprint.

Doug Harned - Sanford Bernstein

Okay. Very good. Thank you.

Gregory Hayes

All right. And thanks very much.

Jay Malave

Alright, well thanks to everyone. I appreciated that you are listening in on the call. We will, obviously, be around later in the day, so if you have any, to answer any of your specific questions but I really appreciate you all listening. So have a great summer. Thank you.

Operator

Thanks. And again, thank you, ladies and gentlemen, for your participation in today's conference. You may now disconnect. Have a great day.

Executives

Gregory Hayes - Chief Financial Officer, Senior Vice President

Jay Malave - Director, Investor Relations

Analysts

Jeff Sprague - Vertical Research

Howard Rubel - Jefferies

Shannon O'Callaghan - Nomura Securities

Joe Nadol - JPMorgan

Ron Epstein - Bank of America/Merrill Lynch

Sam Pearlstein - Wells Fargo

Peter Arment - Sterne Agee

Cai von Rumohr - Cowen & Company

Robert Stallard - Royal Bank of Canada

Julian Mitchell - Credit Suisse

Doug Harned - Sanford Bernstein

United Technologies Corporation (UTX) Q2 2013 Earnings Call July 23, 2013 9:00 AM ET

Operator

Good morning and welcome to the United Technologies' second quarter conference call. On the call today are Greg Hayes, Senior Vice President and Chief Financial Officer and Jay Malave, Director of Investor Relations. This call is being carried live on the internet and there is a presentation available for download from UTC's website at www.utc.com.

Please note, the company will speak to results from continuing operations, except where otherwise noted. They will also speak to segment results adjusted for restructuring and one-time items as they usually do. The company also reminds listeners that the earnings and cash flow expectations and any other forward looking statements provided in this call are subject to risks and uncertainties. UTC's SEC filings, including its 10-Q and 10-K reports, provide details on important factors that could cause actual results to differ materially from those anticipated in the forward-looking statements.

Once the call becomes open for questions, we ask that you limit your first round to two questions per caller to give everyone an opportunity to participate. You may ask further questions by reinserting yourself in the queue and we will answer as time permits.

Please go ahead, Mr. Hayes.

Gregory Hayes - Chief Financial Officer, Senior Vice President

Okay, thanks, Bob, and good morning, everyone. As you saw in the press release this morning, UTC reported second quarter earnings per share of $1.70, that's up 5% versus 2012 with better than expected segment operating profit growth and higher net gains. Second half profit grew by 15% led by strong performance at Climate Controls and Security, and also with the benefit of the Goodrich and IAE acquisitions.

Gains in the quarter receded restructuring by $0.05 as compared to $0.04 last year and taxes were a $0.13 headwind to earnings growth. You recall that last year we had about 23% effective tax rate in the second quarter as compared to about 28% this quarter. So the solid first half of the year, given an uneven economic environment.

We have accelerated restructuring, positioned the business now for further growth. Additional restructuring savings, combined with good orders momentum and easier compares in the back half, give us confidence to increase the bottom end of the EPS guidance range, so you saw the press release. We now expect earnings per share of $6 to $6.15. That's growth of 12% to 15%, an increase with our prior guidance of $5.85 to $6.15.

We continue to expect double-digit earnings growth despite these uneven end markets. In the U.S., the potential fed tightening caused some volatility in the markets, but we still believe the economy is recovering and we are seeing strengthen in the leading sectors. Auto sales were up 8% in the first half and are growing at the fastest rate in five years. Housing starts are 24% higher year-to-date. And, in commercial construction, the Architectural Billing Index has shown expansion in eight of the last nine months, so good progress in the US.

Europe, of course, a little different store with unemployment now over 12% in the PMI or Purchasing Managers Index consistently below 50, and we didn't plan for much growth in 2013, but the fact of the matter is, we are actually still seeing a slight contraction in sales in Europe. Year-to-date sales are down about 3% across our commercial businesses.

On the other hand, we do see continued strength in China, and we are all cautiously watching the economic indicators coming out of China. We talked about some falling imports, exports, tightening of credit markets, lower GDP forecasts, so whether it's 7% or 7.5%, GDP growth, is still one of the fastest-growing markets. Because fixed investments has continued to grow and that's driving very strong order growth at both Otis and CCS.

Aerospace, we continue to see strong growth in the commercial aviation industry. RPM's up 5.6% in the month of May, airlines are now projected to earn over $12.7 billion for the year. While we continue to see pressure in the military, and particularly at Sikorsky, the overall aerospace industry remains very healthy.

Okay. Let's talk about orders for a second. We are on slide two for those of you following along on the webcast. I talked about economic uncertainty remains, but as you can see on slide two, overall our orders positioned us well for growth in the second half of the year. Just as a reminder, we talk orders at constant currency as we normally do.

Otis as we mentioned very strong quarter, 22% growth in new equipment orders. That was led by China with 35% growth. That's 32% growth in China year-to-date for Otis, so very strong recovery.

Climate Controls and Security global equipment orders grew for the third straight quarter. This reflects the strength in the U.S. economy where residential HVAC orders were up 19%, but partially offset by Europe, which was down about 4% across the CCS businesses.

Turning to Aerospace, a very encouraging sign of Pratt & Whitney, after five quarters of contraction, legacy Pratt & Whitney large commercial spare orders grew 15%, organically. And importantly, this included growth across all three major engine families PW2000, PW4000 and the V2500.

Aerospace Systems, we saw growth for the second straight quarter with orders up 4% on a pro forma basis. We're still looking for more recovery in the back half, but it's good to see growth of both Pratt and UTAS on the commercial spares side.

So, in summary, despite the uneven end markets strength in the U.S. emerging markets in commercial aerospace are going to offset the softness that we are seeing in Europe and defense. Our orders momentum still points towards recovery in the back half, but as I said in June, with year-to-date. organic sales down slightly we are now probably going to see organic revenue growth of about 3% for the full year, which is at the low end of our prior range, so total sales are now expected to be just around $64 billion for the year.

Turning back to Q2 results and on slide three, total sales and segment profit increased 16% and 15%, respectively. That's driven of course by Goodrich and IAE acquisitions and the strong operating performance of CCS.

Organically, sales were flat versus prior year following a 2% decline in the first quarter. CCS had another strong quarter, 7% operating profit growth and margin expanded to 120 basis points as they continue to realize savings from the integration of carrier in FNS and capitalize on their operating leverage.

Overall, segment operating margins at UTC declined 20 basis points with the strength at CCS more offset by headwind from pension and the decline in the military business at Sikorsky.

Goodrich and IAE acquisitions continue to exceed our expectations and contributed $0.20 of earnings in the quarter. As I mentioned, earnings per share of $1.70 include $0.05 gains in excess of restructuring. $0.19 of the gains in the quarter came from the sale of the Pratt & Whitney Power Systems business and some small tax settlements. These are more than offset by $190 million we invested in restructuring, including $93 million at Pratt & Whitney as we continue to reduce the cost base there.

Foreign currency, small impact of about $0.01 in the quarter. Free cash flow, 101% of net income. We repurchased an additional $335 million of stock and we expect to buyback a similar amount here early in the third quarter.

So I will stop here for a second and let Jay take you through the segment results, looking back and talk about full year. Jay?

Jay Malave - Director, Investor Relations

Thanks, Greg. Turning to Page four. Otis sales improved 4% at constant currency in the quarter led by solid high-single digit growth in new equipment and continued growth in service sales. New equipment sales were up in all regions led by double-digit growth in China and Russia. Operating profit was up 1% at constant currency. Solid growth in China and other emerging markets was offset by continued weakness in developed Europe and transition costs associated with the factory transformation in North America.

New equipment order growth was strong, up 22% at constant currency with double digit growth in Americas and Asia led by a 35% improvement in China. Orders in Europe were down mid-single digit. Given continued pressure in Europe and a significantly weaker Yen, we now expect full year profit growth at Otis of $75 million to $100 million versus the prior range of $100 million to $150 million. We expect profit improvement to come in the second half based on conversion of a higher new equipment backlog, especially in China, continued savings from restructuring and completion of the factory transformations in North America.

On slide five. Climate Controls and Security increased profits to 7% in the quarter on 1% lower sales, resulting in another sharp increase in margins, up 120 basis points from prior year to 16.9%. Organic sales were up 1% with mixed results across geographies. Europe was down mid-single digit amid continued economic weakness in the region, while Americas was up low single-digit, driven by 13% growth in the residential HVAC business. China was also up mid-single digit, while Asia overall was flattish, driven by a decline in Australia. Transicold was up 11%. While the organic growth in the quarter was modest, this was the first quarter of growth in over a year and we anticipate acceleration through the remainder of the year.

On profit, CCS had another solid quarter of earnings growth driven by strong conversion on the higher organic sales, restructuring and productivity, including continued savings from the consolidation of carrier and fire and security and lower commodity cost. Global commercial HVAC orders were flattish with 10% growth in Asia offsetting declines in North America and Europe.

Orders for global fire and security products were up mid-single digit while the fuel businesses were down a similar amount. Transicold orders were up 5% and commercial refrigeration orders in Europe were down 5%. With solid results in the first half and anticipated organic improvement, we now expect profit growth to be in the range of $175 million to $200 million, up from $150 million to $200 million on low-single digit organic sales growth at CCS.

Turning to aerospace on slide six. At Pratt & Whitney, sales and profit increased 5% in the second quarter. Higher sales were driven by the consolidation of IAE and transfer of the AeroPower business. Organically, sales were down 6% year-over-year due to lower military engine shipments, partially offset by higher large commercial engine OEM sales. Large commercial spare sales were up 2% organically over last year's second quarter. On a pro forma basis, including consolidated IAE sales in both quarters, large commercial spare sales were up 5%. Profit growth was driven by the benefits from the IAE consolidation, restructuring savings, and lower E&D, partially offset by lower organic sales and higher pension costs. In addition, the absence of favorable one-time items in last year's second quarter offset the benefit of a commercial contract closeout this quarter

As Greg mentioned, Pratt & Whitney, large commercial spares orders were up 15% organically. Based on year-to-date sales however, we now expect large commercial spares to be flattish for the year organically from up mid-single digits.

Pratt & Whitney's proactive cost reduction and restructuring measures give us confidence in its full year profit growth outlook of $100 million to $150 million and mid-single digit sales growth.

UTC Aerospace Systems delivered another solid quarter with operating profit of $532 million and sales of $3.3 billion. On a pro forma year-over-year basis, sales were up mid-single digit with commercial OEM, up double digits and commercial aftermarket, up mid-single digit, partially offset by declines in military OEM and military aftermarket of mid-single digit and low-single digit, respectively.

Orders for commercial spares grew 4% on a pro forma year-over-year basis. Compared with the first quarter, profit was up 4% on 2% higher sales, driven by solid conversion on sales growth and continued synergies capture.

With the first half of the year complete, we now expect full year sales to be around $13.5 billion, the low end of our previous guidance range of $13.5 billion to $14 billion. We continue to expect operating profit of around $2.1 billion in spite of lower sales due to continued cost containment and better than expected synergy traction.

Turning to Sikorsky on slide eight, operating profit decreased 24% and 3% lower sales. During the quarter, Sikorsky shipped a total of 62 aircraft, including 47 based on military platforms and 15 commercial. Sales decrease was driven by lower military aftermarket volumes as well as unfavorable military aircraft mix, partially offset by higher commercial volumes.

The profit decline was driven by lower sales as well as headwinds from the multi-year 8 margin reset and higher pension and export compliance costs. For the full year, we continue to expect profit to be down $100 million $150 million and low single digit sales growth. We expect profit improvement in the second half and benefits of higher aircraft volumes and restructuring savings.

With that, let me turn it over to Greg to wrap up.

Gregory Hayes - Chief Financial Officer, Senior Vice President

Okay. Thanks, Jay. So, I am happy to report that with the completion of the Rocketdyne divestiture in June, we are now done with the major portfolio transformation. Entire organization took on a huge task over the last two years, complete two significant acquisitions, integrate new organizations, divest over $4 billion worth of businesses and paid down $7 billion of debt.

I'll tell you that team executed flawlessly. We now have a portfolio that's well-positioned for long-term growth and we've capitalized on the big the urbanization and commercial [aerospace].

Some other highlights in the quarter, we announced significant wins across our aerospace businesses at the Paris Air Show. Pratt & Whitney announced orders for over 1,000 engines and claim orders for the launch of the second-generation Embraer regional jet. Customers see the advantage of our engine and have placed firm and option orders now for over 4,500 engines.

UTAS Aerospace Systems business is also well positioned with the electric system, cell, wheels and brakes and other systems at Embraer. They also secured new long-term MRO contracts from several airlines and supported Airbus in the certification A400M.

Sikorsky continues to see strong international demand announcing orders for 11 S-76D search and rescue helicopters for Japan, and 6 additional S-92 for the Chinese oil and gas market.

On the commercial side, our business has continued to win key orders. Otis was awarded the largest elevator contract ever in India. We sold 670 elevators and escalators for the Hyderabad Metro. Otis also won a contract to install 255-unit at Tianjin 117, which is nearly 600 meters, will be one of the tallest buildings in China.

CCS was rewarded the contract in the quarter with China resources land to provide HVAC, fire detection system in residential and commercial buildings across China over the next two years. So, the investment in innovative products is paying off. We are delivering real value to our customers and securing keywords that will drive top line growth well into the future.

Okay. Let's take a look at rest of 2013. As I mentioned, we now see earnings of $6 to $6.15. That's the top end of our prior range and represents earnings growth of 12% to 15%. Our relentless focus on cost reduction will allow us to delivery double-digit earnings growth. We continue to invest in restructuring as well. We spent about $240 million in the first half of the year and the businesses have good payback projects in the pipeline.

With almost $435 million of one time gains realized to-date on a pretax basis, we now expect about $450 million of both gains and restructuring for the full year. That's up from our prior estimate of $350 million each. So you can expect about $100 million of restructuring in each of the next two quarters.

Strong cash flow, of course, remains the hallmark of UTC and we continue to expect free cash flow to equal or exceed net income for the year. We paid down $1.2 billion of debt in the second quarter. That's almost $1.6 billion in the first half and we have an additional $1 billion due in the fourth quarter. So we will pay down about $2.5 billion of debt this year.

We are also buying back shares. The remaining $335 million in our original share repurchase plan will be completed here early in the third quarter and we expect to do a little bit more towards the end of the third quarter or early fourth quarter assuming cash flow remains strong.

So portfolio transformations behind us, we are focused on integration and execution and we are seeing a gradual recovery in our end markets. The order book supports a resumption of organic growth in the back half and we are confident in the revised EPS guidance.

So with that, Bob, let's open up the call for questions, if we can.

Question-and-Answer Session

Operator

Our first question is from Carter Copeland of Barclays. Please go ahead.

Carter Copeland - Barclays

Hello, Carter.

Operator

Mr. Copeland, if you wouldn't mind checking your mute button. Moving on to our next question in queue from Jeff Sprague of Vertical Research. Your line is open. Please go ahead.

Jeff Sprague - Vertical Research

Just a couple of questions. Greg, first just on share repurchase. So you are going to blow through your placeholder really quick but it still sounds like you are kind of soft cuddling in the back of the year? Can you just give us some thought on how cash looks in the back half? Your effort to maybe repatriate some foreign cash that you talked about and why there wouldn't be room for that that repu to come up a little bit more?

Gregory Hayes - Chief Financial Officer, Senior Vice President

Yes. So this year was the soft peddling in the share buyback. We are going to take it up. I think the question is how much. I said we are having $200 million, $300 million, $400 million, and it will really depend upon strong cash flows in the back half of the year. As you know, CapEx is at a ramp. We spent a little over $600 million year-to-date, and we have got plans for about $1.7 billion. So there is still a call on cash in the back half of the year which is a little higher than what we expect.

We will also, as I said, are paying down about $2.5 billion of debt and you recall going into the year, we talked about only about $1 billion of debt due. So I think we have been aggressive on the debt paydown. We have got CapEx in front of us but we still have room to take share buyback up and we have still got that $1 billion placeholder out there for M&A.

Not a lot going on, but there is always the possibility something could still happen for the year. So I think we are in line to do more share buyback and clearly if the M&A doesn't happen, it gives us a little bit more room but I am just going to tell you, there is other calls on cash right now.

Jeff Sprague - Vertical Research

Right, got it. Understood. Also, could you just give us your quick take on what your pension tailwind looks like for next year? If you were to snap a line today at these interest rates?

Gregory Hayes - Chief Financial Officer, Senior Vice President

So obviously there is going to be tailwinds next year in the pension. There is a lot of things going on there. First of all, you have got the fact that four years ago, we decided to sell the plant so we have taken the tough actions and that gives us tailwind. We also have losses for 2008 that come off. And you have got (inaudible) about 4.6% on a discount rate versus 3.% last year.

You guys know how to do the math. That's about $28 million to $29 million (inaudible) basis points. So there is definite tailwind from pension next year. Again, it is a little early because there is other assumptions that go into the pension number for tailwind and all that but for the most part, there will be pretty good tailwind next year.

Jeff Sprague - Vertical Research

Then, finally, and I will move on, but just on China Otis, can you just give us a little more color on where you are seeing the strength? Is it broad or is it less than China? And, just what's going on kind of competitively with pricing in particular.

Gregory Hayes - Chief Financial Officer, Senior Vice President

Yes. So, we talked about it. Orders on a constant currency basis were up 35%. I think HVAC were 39% orders growth and sales were up about 20%. We also saw pretty good traction on the service business with sales up 25%, so good strength there. Pricing remains tough, but the margins are holding up in China, because we continue to be able to take cost out of the supply chain and leverage on the higher volumes.

As I think about specifically from a market perspective, where we are seeing the growth, residential was obviously the key. It is the biggest market for Otis elevators and it is very, very strong still despite some of the cooling measures, we've also seen the commercial office buildings start to improve. Social housing has kind of leveled off. I think, Otis would tell you today that the market is going a lot faster than what we had anticipated going into the year and I think these order rates more than support that.

Operator

Thank you. Our next question in queue is from Howard Rubel of Jefferies. Your line is open.

Howard Rubel - Jefferies

Good morning. Thank you. Nice numbers. A couple things, Greg, and kind of rattle through them. One on interest expense, I can never seem to get it right. You are refinancing, you are taking some charges for doing some things. Could you just give us a range of what you think you could look for interest expense for the full year?

Gregory Hayes - Chief Financial Officer, Senior Vice President

Howard, for the year we are in the range of about $950 million is what we would expect it should be for the year.

Howard Rubel - Jefferies

Okay. You took some fairly substantial actions at Pratt to lower cost. Could you talk about some of the benefits from the operating leverage that you expect in the second half of the year and going forward given the change in mix and other things?

Jay Malave - Director, Investor Relations

Yes. So, back half of the year Pratt's good. Obviously, the spares are not going to be as we had expected originally going in. And, we talked about kind of 5% growth or so in spares going into the year, probably more like flattish given how low the first half was, but again good orders momentum. We should clearly get some traction out of spares in the back half of the year.

We took out I think about 575 people took advantage of the voluntary early retirement program that we just offered. That will help again in the back half of the year, add some earnings growth to Pratt. We are taking some other actions around the business as well to take advantage of some of the cost reduction opportunities out there.

R&D is coming down as we had expected about at probably $75 million $500 million. I think it was down about $14 million in the second quarter, $35 million in the first, so we are half way there in terms of the R&D reduction, so a lot of good things going on at Pratt. Spares are coming back and this is a tough year at Pratt. We got this big trough, because military engines are coming down significantly. Although mill spares that had held up pretty well and you've got an increase in the commercial shipments which as you know come with a little bit of a bill.

Howard Rubel - Jefferies

You changed management at Pratt commercial, kind of separated the organization into two. What are the marching orders for the two gentlemen going forward on that?

Gregory Hayes - Chief Financial Officer, Senior Vice President

Yes. So, (Inaudible) call, because he led that business, he is President for the last seven years. He is the guy that has been at the forefront of the GTF marketing campaign. On that side he's done a hell of a job, but it's a huge job. And, I think what we have decided to do, what Dave Hess and Alain have done is to split that up between an aftermarket focus and an OEM focus, so Dave Brantner is going to take over. He is head of the OEM side of the Commercial Engine business, President there.

Then Matthew Bromberg, who is Head of our strategy development group for the last couple of years, who is going to lead the aftermarket, and his focus is simply on making sure we have a flawless launch on the GTF and making sure that we capture the aftermarket channel going forward on all of these GTF orders that we won. So, again, I think it makes a lot of sense [Greg] is going to focus on getting engines delivered, getting cost down, winning new campaigns and Matthew is going to focus on that moving that aftermarket and continuing to drive growth in the aftermarket.

Howard Rubel - Jefferies

I just have one last question. 787 has had some challenges in operation are very minor ones, but some of it comes back to working on and enhancing the reliability of the electrical system. What are you doing there and can you talk some of the improvements you've made already?

Gregory Hayes - Chief Financial Officer, Senior Vice President

Yes, Howard, as you know I think with any new airplane, there is always teething problems and we have had a couple of issues of the electric power system and we worked closely with Boeing during the production hiatus. I think we took the opportunity to go out there and to improve reliability of some of our power panels where we had a couple of issues. There is just constant teething problems, but again, because the 787 has got so much publicity, I think people are hearing a lot more about it but the fact is, this plane is as reliable and more reliable than the 777 was when it was introduced into service. Our systems are doing very, very well. So, well here, we have got a lot of systems, nine major systems on the aircraft. Each one might have a minor glitch but I think, overall, The Boeing Company would tell you that are working very closely with them to get all these things behind us.

Operator

Our next question in queue is from Shannon O'Callaghan of Nomura. Your line is open.

Shannon O'Callaghan - Nomura Securities

Hey, Greg, a couple of things in CC&S. Maybe can you just give us a sense of how you are thinking about the second half there. Transicold, you had revenues up 11%, but orders I think you said up 5%. That looks like make it slows a bit. Can you gauge the different components of the CC&S in the second half?

Gregory Hayes - Chief Financial Officer, Senior Vice President

I think we go through all of the CCS businesses. Obviously, Transicold is an important part but not the only part but we did see decent order growth in the second quarter and sales were up mostly because of the very easy compare last year. You recall, last year, on the container side, we didn't get any orders, I think, from May through September in that business.

So the compares get very east in the back half of the year and we continue to see pretty good traction on the container side. Also on the truck trailer side, both North America and Europe are seeing good order growth. Europe, surprisingly, is strong, given where the economy is but that's all coming from cold chain expansion in the Eastern European area. So that business is doing well. The thing about res in the U.S., again, very strong orders growth, good revenue growth. We think that trend is going to continue and it will support a very strong back to the year.

So if you think about it, first half of the year, we didn't get much growth out of CCS in total, but we did get growth in some key markets. Again, China was another place where we saw good growth at CCS. Orders, I think, on commercial HVAC were up about 15%, 16%. F&S products were up over 30%. So there is good momentum in the emerging markets despite the fact that Europe, overall, was down 1%, I guess, on commercial and a couple of points on the F&S business.

So lots of moving pieces. We have taken the revenue guidance down for CCS. We now expect probably around 3% organic revenue growth for the full year which still indicates pretty solid growth in the back half of the year.

Shannon O'Callaghan - Nomura Securities

Okay, great, thanks. Then just so taking up the restructuring. In terms of the payback, what kind of year-over-year savings do you now expect in '14 from the actions you are taking?

Jay Malave - Director, Investor Relations

One of these programs run average about two years, Shannon. So this year we are talking about incremental $100 million plus. So you are probably looking next year in that range of another $100 million of these actions.

Shannon O'Callaghan - Nomura Securities

So that total, in terms of the total $450 million, how much year-over-year sales growth?

Gregory Hayes - Chief Financial Officer, Senior Vice President

So it gives us about $100 million of benefit this year because we have taken a lot of these actions in the first half year and a lot of them are on the quicker payback, like the voluntary early retirement program that we have done at Pratt. So the other headcount actions we have taken at CCS and UTAS. Some of the other things that we are still doing in the back half will be a little bit longer payback, probably 1.5 to two years. So its going to be $100 million this year and then $100 million to $125 million next year of savings. So it will be probably $250 million of runrate savings by the end of next year.

Operator

Our next question in the queue is from Joe Nadol from JPMorgan. Your line is open.

Joe Nadol - JPMorgan

Just following up actually on the restructuring. Greg, are you seeing the same payback opportunities now on some of these new projects that you were a year ago or two years ago when you look just across the company and you look going forward, do you think there is continued opportunity and the same kind of quality opportunities as we look into next year as you have seen in the past?

Gregory Hayes - Chief Financial Officer, Senior Vice President

Joe, we came into this year thinking we probably do $150 million to $200 million of restructuring. The fact is, restructuring is a way of life here at UTC. It's how we drive productivity. I will tell you, that we just continue to come up with good payback programs. There are some things out there that some of these structural factory, the actions that take a little bit longer.

Obviously, some of the UTAS actions that we are taking as we consolidate Goodrich, it will take a little bit longer to payback, but on average even with all that said we are still looking at two years or less payback for all of these programs.

Joe Nadol - JPMorgan

Okay. Could you provide an update on CMH? There were some, they were media flurry the last few days. Just with some implications that they are still not taking helicopters. I know that's not new, but just an update on the program. And, I guess underlying the question, what is your level of confidence that this does not turn into a much, much bigger deal down the road?

Gregory Hayes - Chief Financial Officer, Senior Vice President

I would tell you, I feel better about CMH today than we have probably in the last year. We are gaining momentum with the customer. I think, importantly, we are going to start pilot training in August, so another month. We've got four helicopters up in Shearwater, Canada. That's going to serve pilot training. We've got another five helicopters that are sitting up in Hartford, New York, ready to be delivered. Two more in flight test.

The 8 that we talked about going into the year, I think we've got a solid plan to deliver those. Still some issues obviously to work through with our customer, but I think again, we are seeing positive momentum. I don't think we are going to see a big, big bad news item coming out of here. I think here you saw some things in the really impressed with the seeking 50 years into service and it's been a great helicopter, but again 50 years and they are starting to have some issues with that helicopter. We got the best military helicopter sitting right there ready to go, so I think it's all pretty positive right now. Rick has really done a great job with the whole team and starting to sing around.

Joe Nadol - JPMorgan

Okay. Then just one more quick one. On UTAS spares, do you still expect high single-digit or 10% I thinks is your exact guidance. I know you dropped the sales guidance a little bit there or to the lower end of the range, but specifically on spares.

Gregory Hayes - Chief Financial Officer, Senior Vice President

So spares at UTAS, I think, were up about 4% on a pro forma basis in the quarter. They were up. For the full year, we had talked about 10%. That's probably going to be more like 7% or so by the time we get all done, just because we haven't seen the first half growth, but continue to see pretty solid growth.

Now looking at parts versus provisioning, remember we sell both spare parts as well as end items. Spare parts in the quarter were up over 10%. Provisioning was down about 10%, so still provisioning is a little bit lumpy. I talked to the guys yesterday. They see that we have got line of sight on the provisioning number to hit the full year, so pretty confident we are going to get in the mid-7% maybe 8% range.

Joe Nadol - JPMorgan

Okay. Very good. Thank you.

Operator

Thank you. Our next question in queue is from Ron Epstein of Bank of America / Merrill Lynch. Your line is open.

Ron Epstein - Bank of America/Merrill Lynch

Just a couple. On the Pratt orders, can you describe in more detail where you've seen them coming from? Is it you are seeing from the freighter market or where has the order activity pick up come from?

Gregory Hayes - Chief Financial Officer, Senior Vice President

I think, obviously, freighters is an important part, but I think most of the orders could actually come on the commercial airline side. As Jay mentioned, I think we talked about in the script, PW2000 spares were up significantly. The 4000s were up over 15% and Vs were up almost 15%, so we're really seeing strength across the board.

Inductions into the engine centers are down year-over-year and content hasn't really improved, but we know as these planes keep flying, the customers need parts and that can go only so long and the glue we've been talking, this one is a four quarters, five quarters or six quarters, eventually spares come back and I think that's what we saw this quarter and we expect that kind of momentum to continue into the back half of the year.

Ron Epstein - Bank of America/Merrill Lynch

Is there any regional strength maybe you are seeing that starting to come out? North America, the Europe and Asia, if you could characterize that?

Jay Malave - Director, Investor Relations

Ron, Pratt legacy fleet is more concentrate in North America and Asia, so we saw that pretty much across the board there. The V2500 fleet is a little bit more broad-based excluding Europe. Again, there wasn't any one particular region. It really stood out one way or the other. It's pretty even.

Ron Epstein - Bank of America/Merrill Lynch

Okay. Great. Then Maybe one more, Greg, if you don't mind. A much bigger picture question. Now that the portfolio reshaping, I guess the settle down, what has to happen for you guys to feel comfortable again about maybe adding something else to the mix, right? Is there a bias towards aero? Is there a bias towards industrial? I mean, how should we think about, and I know this is a longer term question about where you want to go with the portfolio over the next several years?

Gregory Hayes - Chief Financial Officer, Senior Vice President

As we said, the portfolio, at least for the near term, is set. I think, we are 55% Aero, 45% commercial. Eventually, we would like to probably get back to kind of a 50/50 split. But, for right now, we like the hand we have got. Especially with what's going on, on the other commercial Aero side. So the focus right now is really at execution. The next deal, I would tell you, that again as you think about the 50/50 split, it will probably be on the commercial side. I know, Geraud has some ideas, [Major] has some ideas. Nothing really imminent though, and I think, again we have got a lot on our plate right now and we would like to handle that. Urbanization continues to drive and will drive strong organic growth for years to come on the commercial side and also help on the Aero side. So I wouldn’t look for anything big coming out of UTX for a few years.

Operator

Our next question in queue is from Sam Pearlstein of Wells Fargo.

Sam Pearlstein - Wells Fargo

Just back on the restructuring. The incremental $100 million, can you talk about which segments those are in? Then, related what are the favorable items that are coming in to offset that, that weren’t unexpected earlier?

Gregory Hayes - Chief Financial Officer, Senior Vice President

So most of the favorable items, we have actually already seen them. We had a gain this quarter from Pratt power to sales Pratt power systems. We also had a couple of small tax settlements out there with the IRS that gave us a little bit. There maybe one or two more small divestitures on the CCS side that might generate a little bit more gain. So the gains are pretty much done.

As far as the actual spend in the back half of the year, I think you will see that across the business here, UTAS, again we have talked about this, they have got about $100 million spend planned for the year. They have got some work to do to get to that $100 million, but they have got a lot of projects lined up. Pratt continues to look for things on the aftermarket side to do in terms of consolidation. More to come there.

Obviously, Otis in Europe has some work to do with sales continuing to atrophy there on service side. Pedro and team, I know, are looking for ways to take some structural cost out of Europe. So I would expect more to come there. Really, again, everywhere we look we find opportunities to reduce cost. It's amazing what Geraud and the CCS team have done as they brought F&S and Carrier together. They are on a run rate to probably take $200 million of cost out of the business, which is credible. So always opportunities and it will be spread across all businesses.

Sam Pearlstein - Wells Fargo

Okay, and then you talked about for Otis, the profit being a little bit worse because of Europe and the weaker Yen. Are those about equal and is there anything that's a positive move that's offsetting?

Jay Malave - Director, Investor Relations

Well, Sam, if you look at the move from the midpoint to the midpoint and you are talking about $38 million, two thirds of that was the currency that was driven by the yen. Then the other third was essentially the net weakness from Europe, partially offset by higher restructuring and some rebuilding in China.

Sam Pearlstein - Wells Fargo

Okay, and then the last question is, you had talked, I guess, in the last month about the F100 court case. I guess, as we look out into the remainder of the year, is there an additional reserve that we should be looking for or any sort of a cash impact as we go forward?

Gregory Hayes

No, and no. For those of you that, what we are talking about here is the FEC or Fighter Engine Competition that started in 1983. I think just (inaudible), that that's not my fault. So the whole issue here is, we had the case. We had won it at the trial court. Government appealed it. It was remanded back to the trial judge.

Right now, based upon outside legal counsel and our review, we believe that we will prevail on appeal. So we have not taken any reserve associated with this and we would not expect to have any cash impact on this for quite some time. The way these court cases work, I have my General Counsel sitting here, it will probably be a year and half or so before we ever get any resolution on this thing again. It has been going on for 30 years.

So we continue to believe the government wasn't harmed and as you take a look at the 10-Q which we are going to file on Friday, we will have expanded disclosure in there. So you can go through all that and if you have any questions, give us a call but bottom line is, we think we are going to prevail on appeal.

Operator

Thank you. Our next question in queue is from Peter Arment of Sterne Agee. Your line is open.

Peter Arment - Sterne Agee

Just first question, I guess on Pratt & Whitney, I get the margin there really from the consolidation and some of the restructuring gains, but I was surprised just given the amount of commercial engine ramps, particularly in large commercial. Is that the level we should be expecting for the second half with a sequential uptick?

Gregory Hayes - Chief Financial Officer, Senior Vice President

On the OE?

Peter Arment - Sterne Agee

On the OE side. Yes.

Gregory Hayes - Chief Financial Officer, Senior Vice President

The OE should be growing a little bit in the second half. In the quarter, we had higher shipments, particularly in the wide-bodies with the GP7000 and A380. And, for the year, we are expecting GP7000 to still be up year-over-year, so we will see some growth there. Even now I don't know if it will be significantly higher than where it is today. I think, what we did in the quarter is generally speaking, probably where you would be.

Peter Arment - Sterne Agee

Okay. That's helpful. Then just a quick one on Sikorsky, I get that domestic DoD pressures. Can you just give us an update or color on some of the major international pursuits that are out there?

Gregory Hayes - Chief Financial Officer, Senior Vice President

I think, Sikorsky continues to make good progress on the international side. We are working with Turkey on a relatively large opportunity there with the Turkish Utility Helicopter program. We expect to get something finalized by the end of the year there.

The India navy contract has been a little bit of a disappointment just because it keeps pushing out to the west, but we've had good traction in Brazil. We've had good traction in Columbia and the Middle East. So, again, there's lots of foreign military opportunities out there and Sikorsky continues doing more than its fair share.

Operator

Thank you. Our next question in queue is from Cai von Rumohr of Cowen & Company. Your line is open.

Cai von Rumohr - Cowen & Company

Can you comment, give us some color on the impact at carrier of the blistering heat wave we've had in the U.S. and Europe in July?

Gregory Hayes - Chief Financial Officer, Senior Vice President

It's good to own a air conditioning company when it's hotter. We talked about this, Cai, the orders were up almost 20% in the quarter of res side.

Cai von Rumohr - Cowen & Company

Yes, but you basically didn't see the heat wave in June. You saw it in July, which is.

Gregory Hayes - Chief Financial Officer, Senior Vice President

So, sales were up 12%, 13% order were even more. The fact is, it takes some time to actually see that come through the channel. It's two-step distribution, so we sell into through our major distributors who then sell up to dealers, so we would expect to see some level of good news yet here in the July-August. I think, orders have continued to be pretty good.

Cai von Rumohr - Cowen & Company

In Paris you were kind of talking about things being somewhat better, and it looks like things were definitely more than somewhat better, particularly on the 4000s. Was there sequential improvement as I read that you went through that quarter and kind of give us any color on what you are seeing in July?

Gregory Hayes - Chief Financial Officer, Senior Vice President

Sequentially, in the quarter, sales were up about 50% and orders were up over 30%, sequentially.

Cai von Rumohr - Cowen & Company

Talking about attached to PW4000.

Gregory Hayes - Chief Financial Officer, Senior Vice President

That was just in total. On 4000 itself I would have to get back to you on that, Cai.

Jay Malave - Director, Investor Relations

I think, Cai, that the fact as we started to see orders pick up April and May, I think it just accelerated into June. We had a very good month in June of bookings, but it's hard to point at any one thing in particularly other than just kind of pent-up demand that we've been talking about for the last year.

So, again one month or one quarter is not a trend make, but we feel pretty good about the back half of the year.

Frankly, we are seeing here the 23rd of July I think orders are okay here, but I don't think I want to be giving order data on a weekly basis here pretty lumpy.

Cai von Rumohr - Cowen & Company

Just in terms of color, did this sort of sequential improvement continue in July is best you can tell?

Jay Malave - Director, Investor Relations

Cai, I'll have to get back to you on that. I don't really recall. I focus more on second quarter and third quarter, but we'll take a look and see if there is anything significant there.

Cai von Rumohr - Cowen & Company

Terrific. The last question, you mentioned that military after market was weak at Sikorsky, maybe give us a broader view of kind of the impact you are seeing or expect to see from sequestration and basically military aftermarket across the company.

Gregory Hayes - Chief Financial Officer, Senior Vice President

Yes, so military sales or military aftermarket sales were down about 25% at the Sikorsky in the quarter and orders were down about 40%. It is hard to delineate between just the budget cuts and what's going on as the overseas continuity operations wind down versus sequestration.

There has been some impact from sequestration just because it is taking us longer to get orders processed through the government to get contracts amended and things like that done. But it’s a pretty tough environment on the aftermarket side but not surprising, the overseas continuity operations, the fund is down about half and Sikorsky, of course, is the big gun of this year of the Afghanistan campaign. So some of that is just natural and a little bit is also from sequestration.

Operator

Our next question in queue is from Robert Stallard of Royal Bank of Canada. Your line is open.

Robert Stallard - Royal Bank of Canada

Greg, just a couple of quick balance sheet questions. You have got around $5 billion of cash on the balance sheet. Do you think that’s a good safe number to keep going forward? Or do you see an opportunity to bring that down going forward?

Gregory Hayes - Chief Financial Officer, Senior Vice President

The issue of the $5 billion, Rob, as you know, as most of that is sitting overseas. It's not all of that right now. We use that cash on a daily basis. We have got an inter company lending program where we lend out to the businesses for working capital needs. That’s not $5 billion. You have also got a lot of cash, over $1 billion sitting in China that continues to grow as the businesses there continue to generate strong cash flows but hard to get at.

So how much do you really need? Probably half of what's on the books. The other half it, it's just hard to get at and quite frankly from a tax perspective, very expensive to bring back to the U.S. We talked a lot about this. One of the benefits of the foreign cash is it does give the opportunity to make investments overseas and to do acquisitions overseas. So when you think about the M&A agenda, that’s probably where to look next.

Robert Stallard - Royal Bank of Canada

Okay, and then secondly on the balance sheet. You mentioned you have got about another $1 billion of debt you want to pay down this year. if you look at it over the longer term, what's your thinking on debt repayment on say, a five year period?

Gregory Hayes - Chief Financial Officer, Senior Vice President

We have got over a $1 billion that’s due in December. It’s the eighteen month floating rate note that we issued last May. That will actually get paid off. Then I would say, there is no debt payments due next year, although I would expect we will probably do another $1 billion of paydown next year and probably another $1 billion of paydown the following year.

We are trying to get back into that solid A range with the rating agencies. So again, I think, I would model $1 billion, $1.5 billion of paydown each over the next few years and there is not much due after that. But again, I think, we will continue to deleverage and so we see an opportunity to do something more significant on the M&A side.

Operator

Our next question is from Julian Mitchell of Credit Suisse. Your line is open.

Julian Mitchell - Credit Suisse

I just had a question on Otis profits. I am looking at the guidance. It seems that you are assuming around flattish margins year-on-year in the second half. After that, it would be down about 70 bips in the first half. I just wondered, does the guidance embed any sequential or year-on-year improvement in your European aftermarket volume or price?

Gregory Hayes - Chief Financial Officer, Senior Vice President

No, in fact, I think Europe, in the first half has been a drag over probably over $40 million of headwind here in the quarter, or first half rather, from Otis's service business in Europe but we think they are starting to stabilize although there is still a little bit of pressure, particularly in Southern Europe. Year-to-date, Otis, essentially flat earnings.

We have taken the guidance down to $75 million to $100 million. Piece of that was currency, a piece of that's Europe. But with this very strong orders momentum that we say here in North America as well as China, the back half of the year should be very good progress. There should get back on the path for earnings growth and should be able to hold margins as well.

Julian Mitchell - Credit Suisse

Okay, thanks and then on the overall business, I think you mentioned 3% organic sales growth for the full year. You are running at about minus 1% in the first half. So does that mean we should expect mid-single digit organic sales growth already in Q3? So otherwise you will need double-digit growth in Q4?

Gregory Hayes - Chief Financial Officer, Senior Vice President

Yes, it will pick up probably in that mid-single digits in Q3 and Q4 will be even a little better. Again, to think about these Otis orders that we are getting to date, it's about a six months turnaround time for the European groups or for the China orders. The other businesses little bit longer cycle than that. Spares, again, order rates are good.

Talking about spares at Pratt were up 15% organically, sales only up 2%, so very strong book-to-bill, so sales will pick up again as we move into the third quarter. Then lastly, I'd just remind you that CMH will deliver in the fourth quarter. We got eight helicopters. That's about $400 million of revenue out of Sikorsky just in the last quarter.

Julian Mitchell - Credit Suisse

Thanks. Then just lastly a quick one, the CapEx is up about 50% the last six months. is that sort of a good run rate for the second half as well?

Gregory Hayes - Chief Financial Officer, Senior Vice President

Yes. In fact it's going to pick up even a little bit more. I think we spent over $600 million first half of the year. We got $1.7 billion plan, and that's really being driven by the a aerospace guys as they continue to a ramp up or facilitize for the ramp up in production that we are seeing on the commercial aero side and the new GTF platforms.

Operator

Thank you. Our next question in is from Doug Harned of Sanford Bernstein. Your line is open.

Doug Harned - Sanford Bernstein

I am interested in UTAS. You talked about provisioning being down a little bit, but I would think going forward with 787 growth you would see some real benefits from provisioning going forward pretty soon. So, I am interested in how you look at the 787 and UTAS right now both, in terms of provisioning but also in terms of any impact we might see with respect to margin on OE deliveries.

Gregory Hayes - Chief Financial Officer, Senior Vice President

Yes. So, provisioning, obviously was a little bit slower in the first half of the year than what we had expected because of the production delays echoing. But, again, as mentioned before, we see pretty good provisioning picking up in the back half of the year, especially with all these new customers, come online. I think Boeing, is going. I think right now we are at seven a month. They are on track to get to 10 a month. We are going to support that and that's actually going to drive some good provisioning orders.

Keep in mind, about half of our customers are on care program where we actually do the provisioning ourselves and then charge a flight hour payment to the airline, so we're not getting quite a pick up that we had historically on some of the new program introductions, but from a return on investment standpoint it's a really good program. Benefits both, the airlines and UTAS, so good back half of the year.

On the OE, side it's still a pretty tough story. We've got about $6.5 million of OE content and the margins are awful, and we got a lot of work to do on cost reductions yet on 787 that we talked about this. We are working with the Boeing Company, trying to identify cost reduction opportunities to take cost out for them and us some money, but it's a tough slog right now and there's a lot of work to do on cost reduction, particularly aero structure side of the business.

Doug Harned - Sanford Bernstein

I am also interested. When you look broadly at the whole business, you've done quite a bit of restructuring over the last couple of years. It looks like it's been very successful in terms of delivering better margins, getting cost down. But now when you look ahead, you've gotten some very encouraging orders in this last quarter. Do you see a point here, where you are transitioning really a different way to think about the company in terms of more growth potentially less restructuring, because you may not need to get your fixed cost base down much more? When could you get comfortable there?

Gregory Hayes - Chief Financial Officer, Senior Vice President

I think as soon as we've turned the corner on organic growth, but I think as we exit the year, but if we do as we expect, which should be kind of 5% or 6% run rate going out of the year. I think we'll need to do further structural cost reduction while it never goes away. I think, again, although focus will be on delivering on the organic growth and that just gives us huge operating leverage.

I could imagine, CCS grew profits in the first half of the year and really no revenue growth, so cost takeout. That's really been the story in the first half of the year, but I got to tell you it's a lot more fun to see the top line growing and to focus on satisfying customer demands and restructuring, but restructuring never goes away. We're always looking for productivity and room to grow margins.

Doug Harned - Sanford Bernstein

Are you comfortable that with restructuring efforts you have done and you have underway right now, you haven't done anything to your base that would constrain your growth, you are basically getting to the point where you are prepared for it? Is that correct?

Gregory Hayes - Chief Financial Officer, Senior Vice President

That's exactly right. I think on the aerospace side, specifically we moved some work to lower cost locations trying to consolidate work across the UTAS business. There's still more work to do for the Goodrich and Hamilton Sundstrand consolidation standpoint, but we feel very comfortable with where we are with the footprint.

Doug Harned - Sanford Bernstein

Okay. Very good. Thank you.

Gregory Hayes - Chief Financial Officer, Senior Vice President

All right. And thanks very much.

Jay Malave - Director, Investor Relations

Alright, well thanks to everyone. I appreciated that you are listening in on the call. We will, obviously, be around later in the day, so if you have any, to answer any of your specific questions but I really appreciate you all listening. So have a great summer. Thank you.

Operator

Thanks. And again, thank you, ladies and gentlemen, for your participation in today's conference. You may now disconnect. Have a great day.