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PRESENTATION

Kristine Tan Liwag - *Morgan Stanley, Research Division - Equity Analyst*

Good morning, everyone. I'm Kristine Liwag, Head of Aerospace and Defense Research at Morgan Stanley. Thank you for joining us today for our session with Raytheon Technologies.

Before we begin, let me start with our standard disclaimer. For important disclosures, please see the Morgan Stanley research disclosure website at www.morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley sales representative.

With that, I am very pleased to welcome this morning, Greg Hayes, Chairman and CEO of Raytheon Technologies. So without further ado, welcome Greg. Thank you for being here.

Gregory J. Hayes - *Raytheon Technologies Corporation - President & CEO*

Good morning, Kristine, and thank you for inviting me. Hopefully, next year, we'll be doing this in Laguna again as opposed to through Zoom. So again, it's great to be back in front of the group. It's been an interesting year, 1.5 years, at least, with the pandemic.

Before I get into any of my comments, so again, our own disclosure that we have to make here to keep the friends at the SEC happy. Just to remind everybody, that our forward-looking statements that we'll be making here, which are, of course, subject to all the risks and uncertainties inherent therein. So please take a look at our 10-K and 10-Qs for all of the relevant disclosure.

All right. That's out of the way. So let's focus, if we can, just on the financial outlook for the year. As you know, back in July of second quarter earnings, we took our full year earnings guidance up to \$3.85 to \$4 a share. That is on the back, of course, of continued strong recovery in commercial aftermarket, which is as we had expected, but also continued strength in our defense businesses. And I think all of that bodes well for this year. And even as we go into 2022, things continue to be on track to continue to increase earnings well into next year.

We won't talk about '22 specifically today. I'm sure people are starting to think about that. But what I would say is that the trends that we saw in commercial aero in the first and second quarter have continued into the third. Despite the delta variant, air traffic in the U.S. remains relatively robust, down a little bit, but still relatively robust. And the airlines continue to be prepared for the recovery as it unfolds here in the third and fourth quarter.

On the defense side, I would just point out, we had a very strong second quarter, especially in bookings. Book-to-bill at our RMD business is, I think, over 1.5 and over 1.1 at the RIS business, some very large bookings, specifically around the long-range strike option program at RMD. So, we feel like we're winning where we should be winning, and our win rate continues to be very strong. And the defense outlook is not the draconian outlook that people originally had thought of when Biden was elected almost a year ago now. So again, strong defense fundamentals, and we can talk more about that.

On the commercial side, as I said, is still recovering as we had expected. Lastly, I would just point out, we are sitting here today, forecasting about \$1.5 billion of synergies related to the merger of Raytheon and UTC. It's up from the \$1 billion we originally thought, and I believe there's still more to come there. We continue to focus on rolling out our operating system, our core operating system to improve our factory performance, improve our on-time deliveries. We are seeing some challenges in the supply chain. I think everybody is out there. But we're managing through it and don't

expect any impact for the year. So strong fundamentals, strong franchises and a strong outlook and very, very encouraged by all of that along with a great team. So with that, Kristine, back to you.

QUESTIONS AND ANSWERS

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Thanks, Greg. And I could start off with this first question. Let's start with your thoughts on the timing and shape of recovery in commercial traffic given the recent COVID variants. We're starting to see some pullback in travel, particularly as many international borders remain closed or restricted. And even in the domestic side, which has been strong, we're starting to see a slowdown, particularly in China. Has the summer travel season fared as you expected? And has this changed your view on the remainder of 2021?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

So that's an interesting question, Kristine. I think we have heard from the airlines that there has been some softness here in forward bookings. Anybody who's been to the airport lately here in the U.S., you probably wouldn't notice it because planes remain relatively full for the domestic routes, perhaps not as full as they might have been absent the delta variant. But traffic has remained relatively strong. And even if RPMs are down a little bit, revenue passenger miles, available seat miles continue to show strong growth. And that's what's driving, again, the aftermarket business at both Collins Aerospace as well as at Pratt. So, U.S. domestic, again, I think, again, delta variant seems to be at least understood. And again, I think the President's mandate last week in terms of the vaccine is only going to strengthen the outlook as we go into the fourth quarter. So, we're not discouraged yet. I think, again, it's a -- we'll see if there's any big, big change. But so far, things remain on track. I think the challenge, as you point out, is -- it's about the international routes. And again, we still see international travel down significantly through the end of this year and probably even into next year as the vaccine rollout is very slow around the world. Europe, obviously getting better and not quite as robust as the U.S. recovery, but we're starting to see traffic pick up in Europe. China, as you know, is, of course, down a little bit as the delta variant spread there. But still, again, relatively strong. And the airlines continue to want to make sure that they've got the capacity, they've got the parts they need when traffic comes back. And so that bodes fairly well, I think, for the rest of this year.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Great. Thank you, Greg. And I guess now we're 2/3 over Q3. Can you provide us an update on what you're seeing across your commercial businesses? How do your spares orders and MRO input trends look across Collins and Pratt? And also, how would you describe the aftermarket trends so far this year as your business continues to recover?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

Yes, it's a good question. So interestingly -- well, maybe not interestingly, not much changed from what we had expected when we talked about second quarter earnings. For Pratt, what drives the aftermarket -- Pratt & Whitney that is, of course, V2500 shop inductions. And right now, I think we're on track from Q3 to have about 145 to 150 shop visits. Spare orders are up about 25% through August versus the average in Q2. So a good, robust recovery on the V2500. That powers, of course, the older version of the A320s. Continue to monitor the impact on flight hours, but so far, so good there.

Pratt Canada, well, the other piece of Pratt that's impacted by this, very strong business jet hours. I think NetJets is pretty well sold out. So that's great for that part of the business. The one part that's still lagging at Pratt Canada is on the regional turboprop side, a little soft. But again, I think whatever softness we see there will be made up on the business jet side. So again, overall, pretty much on track to what we had expected.

At Collins, growth rates for July, we're just seeing the final August numbers, look to be in line again with what we had expected. That's up roughly 5% sequentially from Q2. And keep in mind, Q2 is a lot stronger than we had originally expected. So, trend lines remain positive, and in line with what our forecasted earnings are for the full year.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Thank you Greg, that's really helpful. And switching gears, what are your thoughts on commercial OE side in terms of overall volumes and market demand? And specifically, what are your thoughts on Airbus' recent announcements on production rate increases?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

So that is a question I think that everybody in the airline industry is trying to understand is, obviously, the heart of the market, as we all know, in commercial aero is the narrowbody. And Airbus has been very aggressive in trying to claim share in that as Boeing has struggled with some of the issues around the 737 MAX. And the fact is if we think about pre-pandemic, there was -- between Boeing and Airbus, they were building about 110 airplanes a month. If Airbus really goes up to 75 airplanes a month as they are predicting, that would mean that Boeing's market share would be down somewhere around 35%. And I think that's something that the Boeing Company is not going to want to see. So we'll have to see how this whole thing unfolds. But right now, obviously, Airbus has an advantage. They've had the newer aircraft, and they have had less challenges than the Boeing Company. But the 737 will come back. It remains a very important part of our business on the Collins Aerospace side, as does the A320. But I think, again, the production rates will creep up and probably back to that 110 a month. And the question will be how much is Boeing and how much is Airbus? But I think above that and then you get into problems in terms of the residual value of some of the aircraft. And so the leasing companies, I'm sure, are going to push back. I think the other challenge that we see today is on the 787. Again, a great airplane. But Boeing again is having some issues in the factory that they're trying to work through. So a little bit of softness, I would tell you, on the Collins side of the business in the back half of the year because of that -- nothing that we're not going to be able to deal with. But that is the one, I say, question mark out there is when the 787 gets back up to run rate production. As you know, it's down to about 5 a month, down from 12. So hopefully, we'll see that recovery as we see the -- after -- or the wide-body recovery in traffic over next the couple of years.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Yes. Those are great thoughts on OE. And maybe on the supply side, are you seeing any issues there? And if so, how are you dealing with them? What about inflation? And are you seeing higher costs across your facility and supply chain? And how do you see -- or how long do you see higher inflation persisting?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

I wish I could tell you exactly how long this transitory inflation was going to last, but I think there's a lot smarter people than me trying to figure that out. Let me just add on supply chain. We are, like every other large company, we are facing challenges on supply chain, full stop. We're not immune to that. I would tell you that given the scope of the operations, we're able to mitigate most of those challenges. About a month or so ago, we know that as COVID that was causing a shutdown of some of our suppliers in Malaysia. We were able to deal with that through our supply chain organization. And we have, I think, 41,000 suppliers across the world. 28,000 of those are nonproduct, but 13,000 product suppliers. But we have a pretty robust process around supplier quality assurance and supplier readiness, too. We're taking a look at that on a daily basis to make sure that we're going to get things when we need them. But I would tell you, the shortages out there are real, especially on the logistics side. And inflation, especially on the commodity side, is real. And we're starting to see it on the labor side as well. So, we're pushing back on labor inflation. And we're looking for ways to get productivity, both in our own workforce and helping the supply chain. But there are challenges out there.

Clearly, with the raw materials, copper, aluminum, steel, nickel, all of the other precious metal prices going up, we're going to see a little bit of pressure in the coming years, I think. It will take a while to make its way to the customers in terms of price increases, but mostly because we have long-term supply agreements in place. But I would tell you there is pressure out there. I think hopefully, the Fed and those in Washington will do

what they need to do to make sure we don't get unchecked inflation. It's hard to imagine a 5.5% inflation year-on-year. It's a big number compared to what we've dealt with over the last decade. So just something to keep an eye on.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Great. Maybe switching to defense. Can you provide more color on the outlook for defense budgets and its impact on your defense businesses, including Collins and Pratt? And can you talk a bit more about recent wins, how they're contributing to revenue and backlog growth in the short and medium term?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

Sure. So I was just in Washington yesterday visiting our friends at the Pentagon, talking about not really fiscal year '22 so much because I think that's pretty well understood what's going to happen there. But really, it's the 5-year outlook beyond that, which is going to get released next spring. And what we were told is to plan for relatively flat budgets adjusted for inflation, which is essentially what we had been expecting to hear. The good news in all of that is modernization funding remains a priority. The Army has got roughly 31 modernization programs out there. We're laser-focused on helping them there. Same in the Navy, a lot of good work going on. Air Force, the same thing. So in all the conversations I've had, I think everybody said, we need to figure out how to fund modernization, whether it's nuclear modernization, whether it's space-based modernization, naval and hypersonic modern defenses. All of those things are important. And I think the challenge that the DoD has is what are we not going to do? And there's some things, some decisions they're going to have to make on some older platforms. And right now, I think we feel pretty good about the outlook. As I mentioned in my opening comments, we had very strong bookings. You've got almost \$2 billion for LRSO. You had the next-generation interceptor missile, over \$1 billion. We've had over \$1 billion in classified bookings as well, mostly related to space-based program, space-based sensing. So we feel pretty good about where we are. But I always -- I warn people, nobody anticipated sequestration 10 years ago, so we have to make sure that we help our customer afford all of these initiatives that they have out there.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Thanks Greg, and I guess, given a flat budget scenario for defense, coupled with COVID, what gives you the confidence of your \$10 billion plus free cash flow guidance for 2025? How much visibility do you have?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

You know Kristine, that's a great question. It's one of the things as Neil and I were preparing for our May investor conference and we started rolling up the numbers, that was a target for us that we thought we absolutely had to establish as a baseline for the business. And really, we went back and looked, what was the forecast before the merger in terms of what was the run rate in 2019 and where can we go from there? And I think, again, building up on the defense side, program by program, with all the things that we know, all the things that are in backlog, \$65 billion in defense backlog, another \$80 billion or so in commercial backlog, we can see where the sales are going to be and these are long-cycle businesses. We're assuming a full recovery in commercial aero by 2024. We expect to see, again, defense budgets move up about in line with inflation. But the fact of the matter is with that baseline of sales and what we know we can do from a cost takeout standpoint, and I think Neil took everybody through that, taking out -- taking all that into consideration, we feel very comfortable we're going to hit that \$10 billion. And that's after investing roughly \$3 billion in R&D and \$3 billion in CapEx. So it's not like we're shortchanging the business. We actually feel very, very confident in that \$10 billion. Work to do. And we're going to continue to get the synergy savings. We need to continue to get the procurement savings. We need to rollout the operating system, drive operational efficiencies. All of those things are within our control. And we can do those, we know how to do them, and I'm confident in that \$10 billion.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Thanks Greg, and on that operational portion, how are you progressing on synergies? And when can we expect to see substantial contribution for those to the top line and the bottom line? And on the cost side, can you talk about all your initiatives on both the synergy side as well as other structural cost-reduction projects?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

Sure. So on the synergy side, as I mentioned, we started out at \$1 billion. And today, we're at about \$1.5 billion. And I see room even higher than that over the next year or so. So far, I think we've achieved about \$400 million in gross cost synergies year-to-date. It's enabled us to increase our target for the year to about \$600 million. So again, we're seeing the benefit today. Keep in mind, these are growth synergies, though. We do have to give on the defense side. We give a big chunk of that back in the rates. But again, that only helps in terms of affordability of our programs to the Pentagon. So that feels pretty good.

On the structural cost side, there's lots of things to do. I think the literally hundreds of different opportunities out there. Just recent successes include some lean events. We're focused on reducing manufacturing touch time by over 75% on the A320neo nacelle. Now this doesn't seem like a lot, but when you're making literally hundreds of nacelles every year to take out 75% of the touch labor, it's not easy, but we do it through lean events, we do it by doing the time-based standard work. And literally, we're doing that on products across the portfolio every single day. So that is hopeful. I think CORE, this operating system gives us the backbone or the baseline to enable cost reduction. I would also tell you that we've got some big plans in terms of reducing office space with the office of the future. We're on track to reduce our office footprint from 32 million square feet down to about 24 million. Again, all those things are going to give us the kind of cost savings and operational lift that's necessary to get to that \$10 billion.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Thanks Greg, and can you also give details around your new CORE operating system? How is the rollout progressing? How should we think about operational efficiencies there? And will CORE contribute to your margin expansion plans?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

Yes. So as you think about CORE, and at United Technologies, we talked about our ACE operating system. I know Raytheon legacy talked about their company's Six Sigma continuous improvement program. This is really -- CORE is just a marriage of those 2 that gives us a common language. We've laid out a plan this year to complete about 83 milestones in terms of the rollout across all of our factories this year. Keep in mind, we have more than 200 factories to do this in. So far, we've got about 75% of that work done through the end of August. We're on track to get it all done this year. It's a start, and there's still a lot of work to do. The key, of course, is training everybody in the basics of what CORE is. So that when you go into a factory, you know what you're going to do first thing in the morning. You're going to have a 5-minute standup meeting. You know how you're going to elevate issues in the factory progressively to make sure that you continue to hit the takt times that we have established for all of our products. So we're getting there. Again, like anything else, it's a learning issue. We've got to teach our people how to do it, we've got to reinforce it and then we're going to measure it. And again, if you think about where that margin expansion is going to come from, whether it's at Pratt, whether it's at RMD, whether it's at Collins, the CORE operating system will be a key part of that because, again, product costs, a big chunk of product cost, first, comes from supply chain. But the others are our own touch labor, and we have to do a better job in the factories, and that's what we're focused on.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

That's really helpful color, Greg. And maybe switching gears now to M&A. What areas of the portfolio are you looking to fill in? And are you seeing any attractive valuations out there?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

There are no attractive valuations in M&A, Kristine. I think that goes without saying. If I think about the portfolio, so this year, you'll see us do more divestitures than acquisitions. So, we recently signed an agreement to divest our legacy service business in our RIS business. That should be complete by the end of the year. At the start of the year, we divested the Forcepoint business, legacy Raytheon Cyber business. And then on the flip side, we added FlightAware a couple of weeks ago where we signed a deal to acquire FlightAware, which gives the Collins team another avenue to do health monitoring and prognostics, providing data services to the airline industry. Like we do with ARINC, like we do with the IMS business there, this just gives us another vehicle to provide value to our customers in aerospace. Again, it's aftermarket, it's diagnostic, it's prognostics. The other thing you saw we did an announcement to acquire a space-based electronics company SEAKR out of Colorado. Again, I think that's where you're going to see the M&A dollars go. These aren't big, big, big numbers. But it really goes to we want to be in the space business, we want to be not just in sensing, but we want to be in all of the components that make up that ecosystem in space. So, we bought Blue Canyon earlier this year, a small LEO satellite provider. You'll see more in the space-based side. You'll probably see more on the commercial aftermarket, again, in diagnostics and things like that. But no other big holes that we have to fill in.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Great. Hopefully, valuations get better.

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

Well, if valuations get better that means our stock prices all go down. So, that's probably not something we'd want to see.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Well, great. And Greg, on capital return to shareowners, how are you thinking about the mix given your recent dividend increase and the timing of share buybacks? How should we think about dividends and buybacks in relation to your \$20 billion target?

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

Yes. It's a great question. So right, so we're taking the -- earlier this year, we always said \$18 billion to \$20 billion in the first 4 years. Now we're up to \$20 billion. I think the backbone of capital redeployment is going to be the dividend. That costs us about \$3 billion a year. You saw we took it up recently by about 7%. I expect we'll continue to take the dividend up as we see commercial aero recovery over the next couple of years. And we're targeting a payout ratio somewhere around 45% or so. We're a little higher than that today. But you should see nice dividend increases over the course of the next couple of years. On top of that, of course, there is share buyback. I think what you'll see here is we probably, by the end of the third quarter, we will have done about \$2 billion of share buyback. Stock has been a little weak lately as concern over COVID has been out there. We've been trying to take advantage of that and buy opportunistically. I know Neil has got a 10b-5 program in place so that we can continue to buy if we see weakness in place or weakness in the stock price. So we like the stock as a way to return capital. But again, the baseline is going to be the dividend. And we want a very strong dividend that is competitive in the industry as well.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Well, great. Thank you very much, Greg. (Operator Instructions) It looks like we've got one last one, Greg, probably perfect for the timing of our session.

What are you most excited about? You've highlighted everything is tracking to plan. You've got visibility with aerospace and defense. So what are you most excited about here? And if you could share your feelings, that would be great.

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

Well, look, I think what's most exciting to me is the fact that the team came together 15 -- more like 18 months ago, figured out how to survive a pandemic. And here we are 18 months later, on the cusp of really breakout growth in terms of top line and bottom line. And so as I think about it, we've got this great technology machine. We've got this great cash-generating machine. And it's all coming together with the team. So I would tell you, I'm proud of the team. I'm proud of what we have accomplished. And as I look forward, the technology road maps that we've established are going to give us a huge competitive advantage, whether it's in space, cyber space, whether it's in sensing systems, whether it's in effectors or aircraft engines or aircraft systems. I think we have a great portfolio. And so I think it is that opportunity that I see in front of us over these next few years that make me most excited.

Kristine Tan Liwag - Morgan Stanley, Research Division - Equity Analyst

Well, great. Well, thank you very much for your thoughts, Greg, and thank you for joining us here at Virtual Laguna. I 100% agree with you. I do think that we need to have this in actual Laguna instead of Zoom. Great. Well, Greg, thank you very much for joining us today. And this concludes our session with Raytheon Technologies.

Gregory J. Hayes - Raytheon Technologies Corporation - President & CEO

Thank you very much.

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