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PRESENTATION

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. Thank you. Good morning, everyone. My name is Peter Arment, I'm the senior aerospace defense analyst here at Baird. We're very happy to be hosting Raytheon Technologies this morning. And with -- from Raytheon, we have Executive Vice President and Chief Financial Officer, Toby O'Brien.

So Toby, thank you very much for joining us.

Anthony F. O'Brien - *Raytheon Technologies Corporation - Executive VP & CFO*

Morning, Peter. Glad to be here.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And I know before we get into any kind of recap of Q3 or any other comments, I know you need to make a safe harbor statement. So why don't we do that?

Anthony F. O'Brien - *Raytheon Technologies Corporation - Executive VP & CFO*

Yes. I'm going to -- I'll do that, Peter. And then maybe just a couple of minutes of up-front comments and then we can jump into the Q&A, if that's good with you.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Yes. That's great. Thanks, Toby.

Anthony F. O'Brien - *Raytheon Technologies Corporation - Executive VP & CFO*

All right. So first, I need to let everyone know that I may make forward-looking statements such as comments on future plans, objectives and expected performance. These are subject to risks and uncertainties that could cause our actual actions or results to differ greatly. You should consult our SEC filings for a description of those risks and uncertainties.

So with that out of the way, I'd like to start with some brief thoughts on how we thought Q3 went, and I'd say it largely went as expected. We delivered sales that were in line with our expectations. We saw commercial aerospace bouncing around what we think is the bottom of the decline. And our defense businesses performed generally as expected in the quarter.

Our adjusted EPS came in a little better than we expected, and that was really due to the accelerated delivery of our cost actions and defense strength at Collins and Pratt. It's worth highlighting that those businesses have been executing on their cost actions really well.

We also saw a benefit from our cost synergies from the Raytheon merger and the Collins acquisition as well as a lower effective tax rate.

And free cash flow came in exceptionally strong. We were very pleased with the acceleration of our cash actions in the quarter. And we also benefited from the timing of some early collections.

We still have a lot of work to do, but the results for the quarter reflect our focus on driving cost out of the business, on conserving cash and continuing to position ourselves for the commercial aero recovery.

As we move forward, we still see the benefit of our cost actions, both those we had planned for around the merger and also structural cost reductions, which position us as a leaner, more efficient organization headed into the recovery phase.

Looking at Q4, we're on track for the Q4 outlook that we provided on our Q3 call. We continue to see a gradual recovery in our commercial aero businesses beginning in the fourth quarter, combined with an expected ramp at both RIS and RMD, contributing to company sales of between \$16.2 billion and \$16.4 billion for the quarter and adjusted EPS in Q4 of \$0.65 to \$0.70. And we are very confident we'll achieve \$2 billion of full year pro forma free cash flow.

So far in the quarter, we continue to see strength in our cost actions and on collections, which points to having flexibility to consider a discretionary pension contribution.

All in all, the recovery so far has largely progressed as we expected. And we would expect Q4 to continue with this trend.

I also wanted to quickly comment on the news of a vaccine trial data that came out earlier this week. We're encouraged by the progress being made towards a safe and effective vaccine. We remain hopeful that a vaccine will be widely distributed, carving a path towards a return to public confidence and the normalization in air traffic.

And then, lastly, I'm sure you saw our announcement yesterday that we will acquire Blue Canyon Technologies. Blue Canyon Technologies is a leading provider of small satellites and spacecraft systems components and will be part of Raytheon Intelligence & Space. This is a relatively small acquisition for us, about \$350 million net of tax benefits, but it's strategic and it will enable us to deliver a broader range of solutions to support our customer space missions. We expect the transaction to close early in 2021.

So with that, Peter, we can jump into the Q&A.

QUESTIONS AND ANSWERS

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Terrific. Thanks so much for that, Toby, the recap on Q3 and what you're expecting for Q4. And I probably have a bunch of questions kind of related to that today.

But before -- I first want to just touch upon, before the pandemic, we understood kind of the merits of the merger and why you brought the 2 companies together. So I wanted to start with the question on kind of the way your kind of third quarter earnings call ended, one that I think that's on many investors' minds, which is how we should think about the cash flow generation power here at RTX as you exit this recovery?

Putting kind of the pandemic aside, is there anything that you've learned since you've closed the merger that changes your views of the underlying financial strength of Raytheon and your ability to achieve kind of those original free cash flow targets?

Anthony F. O'Brien - Raytheon Technologies Corporation - Executive VP & CFO

Yes. No. Sure. And certainly understand why this is top of mind for folks, right? But let me be very clear. Nothing that we've learned since the close of the transaction has changed our view on the cash flow-generating power of the combined businesses over the long term, period, full stop.

Before the pandemic, the RTX pro forma business generated about \$7 billion of free cash flow in 2019 and we were on track to deliver \$8 billion to \$9 billion by 2021. So if not for the pandemic, we would be well on our way to achieving those cash flow targets.

Now the pandemic obviously shifted the timing to the right. But again, as we all see, we don't have air travel decline by 80% and not see a related or corresponding impact pushing things to the right. But longer term, as we've said, we remain confident in our ability to get back to the levels of cash flow contemplated for the merger when the commercial traffic recovers. And again, that's a when, not an if. Because at the end of the day, air travel will return. Eventually, folks will feel safe to fly again, especially once there's a widely distributed vaccine. And again, as I just commented, the recent developments have been encouraging there.

So in the long term, it will come back, we remain confident in that.

So in the meantime, as we've talked about, we're trying to focus on what we can control, right, including aggressively taking out costs. We've talked about, and you've seen, the \$2 billion of cost and \$4 billion of cash-related actions we implemented earlier this year. On top of that, we talked about on our call the new Pratt facility as well as some more structural actions that we have in the pipeline. We're going to continue to prioritize looking at those investments around future growth.

Our goal, as we've said, is to come out of the crisis stronger than when we entered it. It will take a little time, yes, for sure. But then again, you talk to 10, 12 different folks, you're going to get 10, 12 different views of when we'll have a widespread vaccine and then when folks will be good with flying again.

But as I said, we're confident that when the commercial aero volumes return, our businesses have that same cash-generating power and capability. And all else equal, some of these additional actions we're contemplating here could even improve upon that.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

That's great. And I think that really helps clarify kind of the longer-term expectations for investors. It's really positive to hear that you think the underlying fundamentals of the merger and the business are still intact.

Maybe focusing on some of the insights you shared most recently on your third quarter earnings call around how you're thinking about free cash flow for 2021. Maybe can you just walk us through some of those moving pieces and possibly any additional color that you want to add to it.

Anthony F. O'Brien - Raytheon Technologies Corporation - Executive VP & CFO

Yes. Sure. Sure. So the items that we talked about, and I'll kind of recap them here and highlighted on our call, were really the known items we had heading into '21. So let me start there, right?

And at a high level, first, we had said we'd expect flat operational CapEx as well as flat end-of-year working capital balances from 2020 to 2021.

Finally, our all-in CapEx would be about \$5 million to \$6 million -- \$500 million to \$600 million higher, which would account for the new structural investments, such as the new Pratt facility and as well as investing in the transformation of our work space around the office of the future. But these are things that will drive the structural reductions we've discussed.

The working capital turns will certainly improve as we see volumes come back. But again, we'll look to hold the working capital balances flat.

Now kind of switching gears here for a second, right? There's also the continuation of our restructuring- and merger-related cash cost of about \$500 million to \$600 million, so coincidental to the prior \$500 million to \$600 million in value. And that's in line with our expectations. Merger costs will continue as we need to invest to achieve the \$1 billion of gross cost synergies related to the merger. And restructuring cash continues next year to pay for some of the actions we've announced this year.

You can think of you know when you step back from it, you can think of those items from a cash perspective flat year-over-year when compared to the \$1.2 billion to \$1.4 billion of cash costs that we've talked about this year related to the taxes on the regulatory-related divestitures as well as, again, restructuring and merger costs that we're seeing here in 2020. So really, it's almost effectively a one-for-one replacement that we're looking at here, albeit with the composition being a little bit different for next year.

So the other part we talked about here is expecting about \$200 million of net year-over-year tailwind from our employee-related cost actions. We talked about a 15,000-person head count reduction. The full annualized run rate savings of that is about \$1 billion. But folks need to keep in mind, on a comp basis year-over-year, some of that was and is being realized in 2020. So there is a reduction for that combined with there are some headwinds as we reinstate merit and have fewer furlough days, which all net to the, call it, \$200 million benefit.

And then on the pension side, year-over-year, we see an incremental contribution headwind of about \$850 million. But again, as I said on our Q3 call and mentioned a few minutes ago here today, we'll look to see where cash is coming in for Q4. And so far, so good. Any strength there over and above the \$2 billion outlook that we've talked about will give us flexibility to consider prefunding the pension, which, all else equal, would ultimately improve cash flow next year.

And then I know the big piece here, and finally, the last piece, which we're not going to provide any quantitative input on until January, is the earnings growth we expect next year, right? And we are well positioned for organic growth across the defense portfolio. And on the commercial side, with Collins and Pratt, our expectation is based upon current trend lines that we'd see improvement in the commercial businesses there, including the aftermarket as things play out.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Yes. No. That leads me right into where I was going to go with the next step because -- thank you for the color on that, on the cash flow.

So how are you thinking about -- I guess let's step back on the commercial aero environment kind of the recovery time line. I know you made a comment, I think everyone was pretty excited to see that news on Monday from Pfizer regarding the vaccine. Has that changed your outlook, how you're thinking about the recovery? And what is Raytheon kind of doing in terms of their expected recovery time line?

Anthony F. O'Brien - *Raytheon Technologies Corporation - Executive VP & CFO*

Yes. So I think that the answer is no, that our overall outlook and view hasn't changed. Obviously, a vaccine is a step in the process. And again, as I mentioned, very encouraging news at the start of this week around the potential for some improvement from Pfizer relative to their efforts.

But again, today, we would still expect that it will take until 2023 before the passenger travel levels rebound to pre-COVID levels. And we've also talked about, and after we can go into this a little bit more if you want, a little bit of a lag of 6 to 9 months for air traffic benefits to show up in the aftermarket.

So we continue to monitor the overall situation, not just around a vaccine, again, which had a positive step this week. But the health of the airline, customers, what's happening with retirements, aftermarket behavior, et cetera.

And to your point, we're focused on what we can control, right? And that's really regarding what we can do to take out costs and conserve cash.

So we feel we're doing the right things that are going to position us to come out of the pandemic, ready to capture the upswing on the recovery as volumes start to improve. And again, bottom line, things aren't changing relative to how we see the recovery and we are confident that we will get the benefit of our cost actions, our cash actions and be ready when the air traffic returns.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Yes. No. Your both of those comments really on the cost and the cash side have been really impressive and a lot of hard work.

On -- regarding that 6- to 9-month lag on the aftermarket recovery, maybe you can just talk us through how you're thinking about this lag. Maybe explain a little bit more about -- here to help us understand what's driving it. Is it due to kind of this used serviceable material availability that we -- I think everyone might expect or green time management or retirements? Is there anything else that maybe we should be thinking about?

Anthony F. O'Brien - Raytheon Technologies Corporation - Executive VP & CFO

Yes. Yes. No. That's a fair question and good to maybe talk through a little bit here, right?

So at a very high level, the main reason for that lag, the 6- to 9-month lag, is driven by our historical experience with prior downturns where it took in that 6-month window following passenger traffic growth for similar growth to be realized in the aftermarket.

Now that said, here's how we think of and here's what we're looking at to lead us to that, right? So the first step of the recovery is to see load factors start to increase, right, and for planes to be filled up more than they are today, and therefore, increasing RPMs but not necessarily the number of flights and related ASMs.

After that, we look at passenger recovery given the operators' more confidence to start reinstating flights. So more flights, right, and expanding -- they're effectively expanding their fleets and having a more active fleet.

And then this obviously all ultimately flows through to more aftermarket orders, shop visit inductions, which there -- when those occur, quickly turn into sales and improved volume.

Now the lag is something that I think naturally happens, as I mentioned, as folks begin flying again and airlines and MROs have to start stocking up and working and thinking about overhaul activity.

You mentioned a few other variables here. And yes, we'll see the impact of green time management, right, and continued destocking in the near term as airlines can serve cash as well as the used material, as you mentioned, primarily impacting -- what we think will primarily impact our PW2000, 4000 legacy fleets. But keep in mind, there will be less of an impact on the newer Pratt-powered fleets, think V2500 and GTF, given the relative age of those fleets.

And again, all of this has been in our calculus here today back a few weeks ago on the call and even going back to our call in July.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Yes. No. That's -- that's really helpful color. Regarding -- just I think emerging stronger out of this pandemic, you've talked about some of the restructuring actions, the cost savings and how that's going to have an impact on your business as -- particularly as the market begins to recover.

How do we think about kind of decremental margins in the business, although really thinking about the last 2 quarters versus how we should think about really more incrementals as these volumes start to come back?

Anthony F. O'Brien - Raytheon Technologies Corporation - Executive VP & CFO

Yes. So I think the simple answer is, we would expect -- and I'll go in a little bit of detail here, right, that we would expect as volumes come back, that we would see incrementals at a comparable level as we saw the decrements going down. And again, over time, with the more we do on the cost side of it, the potential for some improvement there.

Folks need to keep in mind that the mix, right, the revenue mix can impact that from a timing point of view as we are on that recovery path before we get to a full run rate.

Now that said, I think a little bit of -- maybe more detail here. Everyone is really looking and rethinking their cost structures, right, because of the pandemic. And again, as we've said, we're looking to be leaner than we were as we headed into the recovery.

I'll talk about for a second, we announced the new Pratt facility in North Carolina. That's going to result in about \$175 million in full annual run rate savings once we're up and running. And I think folks should think of that investment speaking to our confidence in the longer term, right? And again, as we said, it's not a matter of if, but when the recovery takes place.

We've also talked about a 20% to 25% office space reduction as we revamp our thoughts on working remotely versus working in the office environment.

I mentioned, obviously, the 15,000 permanent head count reduction. We also talked about 4,000 contractor reductions at Pratt and Collins. Some of that will come back probably when volume returns, particularly in the direct workforce side of the things. But certainly, there's the SG&A component that won't likely come back.

And then synergies, right? The \$1 billion of gross, \$500 million net related to the merger by year 4. As well as on the Rockwell Collins acquisition, still on track to get to ultimately \$600 million in cumulative savings there.

And we're going to keep working this, right? We're not done here as we just talk about those handful of things. And again, as I mentioned, you can see a timing impact, right, but relative to the mix of revenues and how that plays into the equation. But again, as the volumes return, especially in the aftermarket, as I said up-front here, we'd certainly expect the incrementals to improve at a minimum at the same rate, but if not better rates, given all the cost actions that we're talking about here.

Keep in mind, not to beat a dead horse, right, the 6-month delay in the aftermarket plays into this. And that's my only point about the mix and the timing of things around this. But we're confident in our ability to get the full incremental, if you will, plus the benefit of the cost actions we're taking.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Yes. No. That's really helpful. I mean -- and I think about -- just when I think about that real estate comment when you announced that, that was really kind of highlighted, I think, all the ways you're rethinking about the business going forward. So really helpful color.

Moving on to defense, maybe you could help us understand some of the moving pieces of your kind of defense business. What are some of the headwinds that you saw at RIS and RMD in Q3 that led you to kind of tweak guidance lower a little bit?

And then can you talk about maybe the trends you're seeing in the defense business at Collins and Pratt. Both so far have had strong performance this year. What are you seeing that differentiates them versus kind of the RIS and RMD? And how do you think about the outlook of those defense businesses when we think about 2021?

Anthony F. O'Brien - Raytheon Technologies Corporation - Executive VP & CFO

Yes. No. Absolutely. So I'll start with RIS and RMD. So for us, the quarter, Q3 was, as I kind of mentioned up-front, as expected. And we were pleased with how RIS and RMD performed in the quarter as well as Collins and Pratt defense businesses or military businesses.

We did expect to be down at RIS and RMD from Q3 last year on a tough comp. Couple of things at play here, right? The sales and profit impacted because of the merger and as we talked about having to, as of the merger date, reset our percent complete on our backlog to 0. So it's going to take a little bit of time for that to build back up. Think maybe kind of sort of this time next year, if you will, where we'll be back to more of a relatively normalized view on percent complete for the RIS and RMD backlog.

And then in the quarter, two things. At RIS, in addition to that, and we've known this, we just haven't talked about it lately, there were headwinds because of the wind down and change related to the Warfighter FOCUS program that impacted RIS.

And then we had disclosed last year, as Raytheon, a large inventory liquidation on an international air and missile defense contract at RMD that wasn't comped this year. So a couple of big drivers, if you will, to the quarter.

Now the other thing, too, we are realizing cost reductions at RMD and RIS. We're focused, obviously, on the commercial side here given the pandemic. But we are seeing improvements in the cost structure there that's going to help future margins, make us more competitive.

The synergies, right? There are synergies related to the 4-to-2 consolidation that we've seen and benefited from at RIS and RMD, and again, good for future margins, good for future competitiveness in bids. And it does lower the sales a little bit, right, on cost-type contracts through the quarter -- or through the third quarter.

And then the last thing I'd say, RIS seen a little bit of award delays, I'd say, really tied to timing, not losses, but just timing. So those will come back.

And then when I look at the fourth quarter, we do expect both businesses to have a meaningful step-up in revenue and profit. And it's not inconsistent with what has been demonstrated for both of the businesses in prior years. And that's already included, obviously, in the outlook we gave back on the call.

At RIS, it's really going to be driven by classified programs in our ISR business as well as some cyber and space activity.

And then at RMD, we're seeing growth starting to come from our production backlog conversion. Recall we had multiyear awards late last year, early this year on the SM-3 and the SM-6 programs. Those are ramping up.

And then on some of our international air and missile defense programs, like the KSA TPY-2 award from earlier this year, and even Poland Patriot from prior periods ramping.

And then I think when you look at the RIS and RMD businesses on a full year basis and strip out the impacts of the merger accounting, there was a divestiture that RIS had to do and some of these headwinds. We're still expecting both businesses to grow respectively in the mid-single-digit range this year.

Collins and Pratt, to your point, Peter, I don't want to forget them. They've had very strong performance, as you mentioned. In the case of Collins, that's really coming from key programs, including F-35, comms programs, navigation programs, guidance programs.

And in the case of Pratt, obviously, they're seeing strength on their F135 program, both production and aftermarket, as well as some aftermarket strength on programs like the F117. So real strong performance, not just in the quarter, but all year for the Collins and Pratt defense businesses.

Thinking about '21, I don't want to get too far ahead of ourselves here. And again, we'll provide more color in January, but I can say we would expect all of the defense businesses to grow organically next year. So we feel good about our overall position, our competitive position, our

technologies, our alignment with the National Defense Strategy, and of course, the strength of our defense business is internationally. So from a bigger picture outlook point of view, I'd say nothing's changed there.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

That's terrific color. And in our remaining couple of minutes here, I guess, I'd be remiss if I didn't ask about share buybacks that Greg talked about restating kind of share buybacks next year. And can you talk about the milestone you're looking for here to begin these buybacks. Maybe think about either a cadence or kind of a number that you need to think about when we think about the \$18 billion to \$20 billion in capital back to shareholders over the next 4 years.

Anthony F. O'Brien - Raytheon Technologies Corporation - Executive VP & CFO

Yes. Sure, sure. So we're -- I'll start with the last part of your question. We are committed to returning the \$18 billion to \$20 billion over the 4 years following the merger. Round numbers, call it, close to \$12 billion of that coming from dividends. You think about our current dividend, it's annualized. It's a little under \$3 billion a year. And I think as folks know, we've already declared 3 dividends this year as RTX and I think pretty good, right? We're one of the few companies, which is with the amount of exposure that we have to commercial aero, we've been able to maintain our dividend through the pandemic.

So simple math, right, \$6 billion to \$8 billion has to come from buyback to get to that \$18 billion to \$20 million.

And really, we're looking for more consistency and stabilization in the recovery trends that we've talked about here today, and quite frankly, to get 2020 in the rearview mirror. We've got plenty of cash, as you probably saw from our balance sheet. And again, the recovery has played out, as I mentioned earlier, largely as we expected.

So it's more -- a little bit more consistency or a longer time period for seeing the recovery play out, the trends stabilizing. So I can't necessarily tell you exactly when we'll start or what the exact cadence will be once we get started. But I think suffice to say it is our expectation sitting here today that we will resume buybacks at some point next year.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

I think that's a terrific spot to end on. We thank you again for your participation and long-term support here for the Baird Industrial Conference. Thanks for all the color, Toby. Really appreciate it. I think it's really helpful for investors to hear that recap.

Anthony F. O'Brien - Raytheon Technologies Corporation - Executive VP & CFO

Yes. No. Thanks, Peter. Thanks for inviting Raytheon Technologies here, and always a pleasure to participate.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Okay. Thanks again. This concludes our call. Thank you, everyone, for joining us. Have a good day. Thank you.

Anthony F. O'Brien - Raytheon Technologies Corporation - Executive VP & CFO

You, too, Peter. Thanks.

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