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PRESENTATION

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

Good morning, everyone. I'm Kristine Liwag, the aerospace and defense analyst at Morgan Stanley. Today, we're hosting Raytheon Technologies with CEO, Greg Hayes.

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And Greg, thank you very much, and welcome to our Morgan Stanley Virtual Laguna Conference. I'll turn it over to you.

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

Okay. Thank you, Kristine, and good morning, everyone. I'm sure everyone would agree that it'd be nicer to be in Laguna Niguel this morning than on the telephone doing these webcasts. But next year, I'm confident we'll all be back together. I've just got a few opening comments to start things off and then we'll move into Q&A.

But of course, like Kristine, I'll have to make the lawyers happy by reading a disclaimer here. I may make some forward-looking statements here, such as comments on future plans, objectives, expected performance. These are, of course, subject to risks and uncertainties that could cause our actual results to differ materially. And you should consult our SEC filings for a description of those risks and uncertainties. Okay. Mr. Jimenez, our GC, will be happy.

All right. First of all, let me start out and say we're not going to issue guidance for the year, given all the uncertainty in the recovery of commercial air traffic. But I will reiterate what we said on the last earnings call, Q3 earnings should be more or less in line with Q2 earnings. Free cash flow, on the other hand, should be positive in Q3. And that's a little bit better than our break-even thinking of a couple of months ago. And for the year, we still see free cash flow of around $2 billion. So no surprises, in fact, a little bit of good news on the cash front.

Okay. With that, we're almost 6 months into being Raytheon Technologies. And now in the midst of this pandemic, with commercial aerospace is facing its very challenging time, it's more clear than ever that the balance of commercial and defense in the aerospace space actually works. To that end, we're focused on 4 things: the health and safety of our people first; of course, meeting our customer commitments; continuing to drive technological innovation, that means investing in the future; and finally, just as importantly, eliminating structural costs in our businesses so that we emerge a stronger, higher-margin business when the air traffic does recover over the next few years.

I would tell you the commercial aero team has jumped on this crisis, and they're driving about $2 billion in cost reduction and $4 billion in cash conservation actions this year. These cost actions include the elimination of more than 15,000 positions across our commercial aerospace and corporate organizations. That's roughly a 20% reduction in SG&A at Pratt and about a 12% reduction at Collins. Those headcount reductions are nearly double the previous estimate of around 8,500 that we gave you back in July. And we're not done yet looking for further ways to reduce structural costs in all of our businesses.

There's no doubt, of course, the long-term earnings power of RTX is substantial. We continue to be well positioned to deliver value over the long term. And we're going to continue to take a look at structural costs, not just on the commercial side but on the defense side as well. As far as liquidity, we're in a strong position. We closed Q2, as you know, with about $7 billion of cash, $26 billion of net debt. And we've also got revolvers in place of up to $7 billion, so no issues there.

On top of that, we've closed 3 divestitures that were required for merger approval. So we received another $2 billion of net proceeds from those transactions. So liquidity, not an issue at all. I think, importantly, we remain committed to the $18 billion to $20 billion of capital returning to shareowners over the next 4 years. We certainly have enough cash and liquidity to maintain the dividend and to begin modest share buyback soon.

At the end of the day, Raytheon and UTC came together for 3 simple reasons. It was technology, talent and balance. I would tell you the defense side of our business remains resilient and strong. Both the RIS and R&D had a combined book-to-bill of about 1.2 in the second quarter. And we've got a record backlog of $73 billion on the defense side of our business.

And we continue to progress on some of our great franchises. In the second quarter, as you know, RMD booked a $2.3 billion order for TPY-2 radars to the Kingdom of Saudi Arabia and a $300 million order for Standard Missiles-3 from the Missile Defense Agency on top of a $1.4 billion order for a number of classified programs.

So great start to the year. It's very strong. I would tell you, the best news is on the defense side is we continue to grow that business. And in fact, this year, we'll probably add or hire about 80 to 100 people. So big reduction on the commercial side, strong growth on the defense side. I think you should also note that our defense technologies and advanced solutions are well aligned with the National Defense Strategy, and we can talk more about that. On the commercial side, of course, Pratt, the combined GTF fleet, has now reached over 5 million revenue flight hours and Collins remains on track to achieve their $600 million of gross cost synergies from the acquisition of Rockwell Collins back in '18.

So we have strong businesses, great franchises, great technologies. And each of our businesses is a leader in their respective market. And we already see the potential for significant revenue synergies by combining the technologies across the business to generate some game-changing solutions for our customers. So I believe we truly are stronger together.

With that, let me stop and turn it over to Kristine for some questions.

QUESTIONS AND ANSWERS

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

Thanks, Greg, and thank you for providing that color. What is your expectation on the timing and shape of the recovery? You most recently said that you thought commercial air traffic wouldn't return to 2019 levels until at least 2023. Is this still your current thinking?

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

Yes. I mean I don't think anything has changed in terms of the shape of the recovery. We see a gradual return to flight across all of the commercial markets but probably not a full return to 2019 levels until somewhere around 2023. Now whether that's the beginning of '23 or the end of '23, it really depends upon the timing of the vaccine.

I would tell you, as of 9/4, September 4, commercial air traffic is down about 45% globally versus a low of 80% back in March. And China, of course, leading the recovery, they're down about 5% domestically but still down 74% internationally. Europe is down 43% but down versus 90%. And North America, as you know, is down about 39%, off of a low of 75%. So it's going to be a slow recovery. But we think it's about in line with what we have seen.

Just in terms of our own fleet of GTF-powered aircraft, we're extremely confident in the GTF program. We continue to do the durability upgrades. And even in the midst of the pandemic, we see roughly 75% of the A320neo powered or GTF-powered fleet flying. That's up from 65%. And if you look at the A220, the old CSeries, that's being reused roughly 85%. That's up from 75%. The older A320s, the V-powered, they're still up about 60% or they're down about -- I'm sorry, they're flying at about 65% from -- of capacity. That's up from 45% back in March. So positive signs but still a long way to go.

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

Thanks. And at this time, we're now over 2/3 through 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?

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

Yes, sure. So let me give you all a little bit of data here just to give you some color on what we're seeing. And I would tell you, it's broadly in line with what we had expected. So through August quarter-to-date, MRO, that's our repair organization inputs at Collins, are down a little over 50%, so slightly better than the down 55% we saw in the second quarter but more or less in line with our expected recovery trajectory. Also at Collins through August, commercial spare parts orders, again this is where most of the money is made, we're down about 65%. That's also slightly better than what we saw play out in the second quarter.

At Pratt, we see third quarter V2500 inductions into the engine center. That's down about 60% and in line with what we saw in Q2. So we're only seeing about 30 shop visits a month versus the 90 that we had seen last year. So as a whole, I would say Collins commercial aerospace aftermarket and Pratt's large commercial engine aftermarket are trending about where we had expected, so no surprises.

Maybe just a couple of comments on the defense side. We continue to see defense business' performance in line with the outlook that we previously communicated with Q4 being the strongest as we deliver on this record backlog, also had exceptional bookings for the first half of the year and some very large contracts. So that will tamp down in the back half here. But we feel good about the prospects of those businesses. So again, no surprises but just everything generally in line with a very slow commercial recovery.

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

Thanks for that color Greg, maybe switching gears on cost. How are you progressing on your cost and cash actions in Q3? Is there an opportunity for you to achieve more than $2 billion in cost and $4 billion in cash actions in 2020? Should we think about these actions as variable? Or will they be more permanent in nature?

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

All right, Kristine. Let me try and dissect that down into the various questions. First of all, in the second quarter, you'll recall, we realized about $600 million in benefit of cost reduction. Our original thoughts back in April, when we closed the deal, is we'd only see about 10% of that $2 billion. So we went from a $200 million to a $600 million savings. We should see another 30%, another $600 million, here in Q3 with the balance, the final 40%, in Q4.

I think it's important to keep in mind that when we gave those estimates, for instance, back in July, about the $2 billion, that was assuming we take out about 8,500 people or so. Given the slope of the recovery, I think the folks have taken a more aggressive look at headcount. And we're really -- we're pushing through trying to exceed that $2 billion. I'm not ready to give you a number yet. There's a lot of other moving pieces here. But we're going to look for additional savings this year. And again, you're not going to see a big benefit in addition to the $2 billion just because of timing of layoffs. You just don't get a big run rate. But it should generate significant earnings growth next year by having those run rate savings for the full year.

I would tell you the other piece of the puzzle here that we're still trying to sort through is we operate in a number of high-cost locations. And those plants are really -- have a difficult time today, the overhead structure, the cost structure with the significantly reduced volume. So one of the things that we're looking at is which factories make sense for the long term, where can we have the best cost position long term, recognizing we've got some very, very talented folks in all of these locations. And so we're going to go through a process over the next few months of trying to figure out how we can reduce structural costs. But I think we're just getting started on, I would say, the bigger cost actions beyond the $2 billion.

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

I see. I guess a follow-on to that. In your Q2 earnings call, what you said is that you are evaluating further actions and structural changes to your businesses. And you've alluded to that in your previous comment. And you're adjusting for a more prolonged recovery timeline. Can you just provide more color on what these actions are specifically and when they'll begin?

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

So some of the actions, as I said, have already begun. I think when we just originally we're going to have about a 10% to 12% reduction in SG&A at Pratt, Chris Calio came to me a month or so ago and said, "This is tougher than what we had thought. We're going to need to take more folks out." And so they will be doing that over the course of the next few weeks. So again, we already started to do some of that.

But the problem, of course, if you think about closing a facility or moving a facility, it is a multiyear effort. The paybacks are generally pretty good to about 3 or 4 years for the investment. But you've got a lot of stakeholders to consider. You've got unions that have to be consulted. You've got to make sure that receiving locations are ready. So we're going to be thoughtful about how we do this. We don't want to screw anything up. But we want to make sure that when this pandemic does end, whenever that is, that we're actually in a position to have a lower cost structure than when we started.

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

I see. That's really helpful, Greg. And switching gears to your customers. What are you hearing from your airline customers? How much are they deferring maintenance and managing green time? How should we think about the impact of older planes, accelerated engine retirements and availability of surplus material?

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

Okay. Well, obviously, we all -- those are a series of really good questions, Kristine. Let me talk about the airlines. They're obviously in a cash conservation mode right now. And they're doing what they can to defer maintenance and manage their expenses. So if you think about it, give you [the Vs] as an example, about 65% of the fleet is flying today versus last year. And yet the inputs into our overhaul shop are down 65%.

So we know people are deferring maintenance. That is they're using up green time on engines. Even if they have engines that need to be overhauled, they're sitting them down and taking it and changing out engines and putting them on aircraft that can continue to fly. So we know that this is a practice. And we're working with all of our customers obviously to try and make sure that we can get through all of this together. And I would tell you is this is really -- it has to be a joint effort. We have to work with them to try and help them reduce maintenance costs in the near term.

What will happen, of course, as we've seen in prior downturns, is we will get a big slug of aftermarket and these engines will all come back. They're time-based overhauls. And that should provide a bow wave of aftermarket activity once the airlines are back on their feet. But again, that is not a today or tomorrow story, that is going to be several years out. And So We're just going to continue to work with them as best we can. Obviously, keeping the fleet flying is the most important thing.

And again, I would say there's also a -- there's a bifurcation of the market and I think everybody is aware of. Narrow-bodies are coming back much more quickly. We see that in China. We see it in Europe. We see it in the U.S., whereas the widebody franchises are having a much more difficult time because they support international travel, which is still down significantly more than domestic. Fortunately, we don't have a lot of engines out there on the widebody. Those are old PW4000 fleet that was on some 330s and some early 777s and 47s. We expect most of those to be retired during the course of the next couple of years.

We had already expected that though. I mean those are engines that are averaging 22, 23 years of age. Usually at 25 years of age, you don't see the engine come through the shop anymore. So there will be some additional retirements. I would tell you all of that has gone into our thinking in terms of where the aftermarket is today though and what the recovery slope looks like. The good news is, as we continue to ship GTF-powered aircraft, we're replacing the fleet of retired engines faster. But we're actually adding more to the fleet than the retirements coming out. So I think it will all be fine. And again, it's all kind of contemplated in our view of how this recovery looks.

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

Thanks again for this great color, Greg. Maybe now on defense, how is the pandemic impacting the defense side of the business? Can you give us an update on what you're seeing in the legacy Raytheon and the defense portions of legacy UTAS?

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

Yes. It is obviously a bright spot in the business. And if you think about Raytheon Technologies, the defense portfolio or defense businesses will generate about 2/3 of our sales this year, 1/3 will be commercial aero. Now that's a little different than the balance we had originally thought, which is going to be somewhere around 50-50 or maybe 55-45 with defense in the lead. So defense has continued to grow.

As I said in my opening comments, $73 billion of backlog. And I think again we continue to see good traction on the international side of the business. And I think you'll notice with peace breaking out in the Middle East to some extent or at least a normalization of relations, we see opportunities on the international side to provide our partners over there with some of the same technology that we've been providing to the Kingdom of Saudi Arabia and to Israel. So I think there is a strong trend on the international side.

DoD budgets, your guess is as good as mine what happens here in November in terms of the budgets, the continuing resolution. I would say the good thing about our portfolio is we are very strongly aligned with the 10 key technology road maps for the National Defense Strategy. And whether it's Roy's business in intelligence and space or Wes' business in the sensors and missiles, all of those things are going to be necessary. And we've got some great new products, like LTAMDS, that's just getting delivered back in the second quarter, which will replace all the Patriot missile defense systems that we've had for the last 30 years.

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

And I guess we can't really talk about defense without maybe asking specific election questions. So any thoughts on the upcoming elections and the outcome on the defense budgets? I know you touched on that a little bit and there's uncertainty. But I was hoping you could provide a little bit more color. And how are you faring on the fiscal year '21 DoD budget process right now?

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

Yes. I would -- so two different questions. I think what we're hearing from DoD is that they should expect -- we should expect a flat budget for '20 -- fiscal year '21, which begins in October. What that means is actually it's down about 2.5% on an inflation-adjusted basis. So again, right now, we have seen no surprises in the defense authorization bill. Everything remains on track. And keep in mind, Kristine, we're not relying on big platforms, right? We supply systems to almost all the platforms, whether it's radars or other sensors.

And the other piece of this, which is the real growth piece of the business is on the space side. The ability to bring technologies from the space side of our business, specifically sensoring technology, is actually proving to be a very, very profitable area of the business. And unfortunately, we can't talk a lot about what it is. But I would say simply is that we have a tremendous business in space, even though again we don't do the satellite buses, we don't do the launch vehicles. We do the brains, which is this actual sensing equipment, which is kind of performing incredibly well.

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

Thank you for providing all the detail on defense. Switching gears again, can you give us an update on how integration is progressing in this environment? Does COVID-19 mean that you'll realize synergies sooner for both Collins and the merger? Or does it delay your ability to realize benefits? And what is your updated view on the total cost to achieve synergies? And if I could tack one more, sorry, this question is getting a little long, but how are revenue synergies progressing?

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

So let's start out with the cost synergy piece, which I would tell you is progressing incredibly well. So the biggest chunk, and we'll get over $200 million of those. What we talked about is $1 billion of gross synergies. We're obviously tracking to a much higher target internally, recognizing that all the ideas that have been generated will all result in the savings we expect. But we feel very confident hitting the $1 billion-plus of gross synergies.

For this year, again it'd probably be about $200 million. Most of those are in the people side of corporate as we merge the 2 corporate offices and we completed the separation of Carrier and Otis, a lot of redundancy. So most of that is already in the bag. I think all those folks have been notified. And they're leaving during the course of the rest of this year.

I think about the other big chunks of savings opportunity, the biggest one will be on the procurement side. Obviously, the total bill for procurement is about $26 billion, $27 billion, got about $10 billion of that is indirect. And we're going through line item by line item, making sure that we get the best deals from both sides. Again, we'll start to see those synergies a little bit this year. But most of those won't come until next year on the indirect side.

On the product side, again lots of opportunities. I can give you a couple of examples. One is simply on machining and castings. By combining the buying power of our legacy aero businesses with legacy Raytheon businesses, we're able to add volume from legacy Raytheon to some of the higher volumes that Pratt and Collins saw in the machining centers as well as on the castings side. So again, we'll start to see those savings next year and the year after.

And the longer-term savings really are around footprint. So just to give you some more data, we've got about 31 million square feet of office space at RTX. Obviously, today, we're not utilizing very much of it. Our goal initially was to reduce that by about 10% or 3 million square feet by consolidating offices and exiting leased buildings, et cetera. I've challenged the team to think about this very differently in terms of how we go to work.

And from that perspective, I think we can see maybe a 20% or 25% reduction in office footprint long term. By long term, I mean over the next 4 to 5 years as we exit leases and move folks around to lower-cost locations. Again, when you're working remotely, I guess, everything is a low-cost location, everything is a high-cost location. But the fact is we don't need all the office space that we have. And we'll continue to see opportunities there.

On the revenue synergy side, we've got over 100 revenue synergy opportunities already identified. Kelly Ortberg, who works for me, used to run Rockwell Collins, he's also on our Board now, he is leading this effort with the 4 business unit presidents: Wes, Roy, Chris and Steve. They're meeting often as are their advanced technology teams to go through these ideas. The first one that comes out of the box is probably future vertical lift, where again we can combine packages and technology.

And a lot of these synergies are really from the legacy Collins side initially with the comms and GPS networks, marrying those up with the sensors in Wes' and Roy's business. But there's many, many more. I think, in high-temperature materials and some of the things that Pratt has seen over time will be beneficial to Wes' missile business. So lots to go. Again, I don't have a dollar value for you yet. But clearly, when we get to next year, we have a chance to get the business unit presidents in front of investors, we can articulate, I think, a much more definitive goal.

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

Great. And maybe going into capital deployment, given the near-term challenges, are you still expecting $18 billion to $20 billion of capital return to shareholders over 4 years? And just to warn you, I have a kind of a three-part follow-up questions on that.

So the first part would be will you continue to pay a dividend? Second, when will you consider reinstating share buybacks? I mean your share price is pretty cheap. Would you reconsider buying back shares this year? And the third part to that would be what about M&A? I understand that M&A activity has largely been brought to a halt. But valuations are attractive in the market. What is your thinking about potential M&A opportunities?

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

Well, let me hit the M&A first. We are -- we continue to be in the market for bolt-on M&A of small technology companies. And we continue to look for places where we have perhaps opportunities to buy technology versus inventing it ourselves. But those are not big acquisitions. I'm not talking about anything over -- it would be well less than $0.5 billion in total spending this year, so no big M&A. And I think again, M&A in the near term, even in the medium term, is going to be difficult.

And look, the portfolio that we have assembled here, we don't need additional heft to be successful to leverage scale. In fact, we will probably be looking at divesting a few of the other businesses that are on the margin probably don't belong as part of Raytheon Technologies. But some of that's going to take some time because you don't want to sell into this market either. So we'll be disciplined on the M&A side. But there is no big M&A in our future.

As far as the dividend, I would tell you, in my mind, it's sacrosanct. We went through a lot of work with Toby O'Brien, our CFO, and the team, looking at all the downside scenarios and presented that to our Board back in April. And I think everybody agreed we have got the financial flexibility to continue to pay the current dividend and to grow the dividend as earnings recover. So that is our -- that is our commitment is the dividend will remain in place, I mean, unless something completely unforeseen happens. But even in a big downside scenario, we don't see any issue with having liquidity to pay the dividend.

As far as share buyback, look, I'd love to back up the truck yesterday and buy back a ton of shares. Again, we haven't got liquidity. We've actually got borrowing capacity if we wanted to. But I just think this is not the time with our airline customers and the OEM customers having such difficulty for us to go out and buy back a lot of shares. Having said that, as we do some of these divestitures, I would expect that we would be using some of those proceeds for share buyback. As well as we get better clarity in 2021 about the shape of the recovery, I would hope to have -- to have some modest share buyback next year and then accelerate it into '22 and '23 as the recovery accelerates. Does that help?

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

That sounds great. Thank you for all that color and for keeping track of all my three-part questions here. And maybe, Greg, I mean, I think we wouldn't have a full RTX call without a GTF question, so -- and I think this is our last question, too, because of the time.

Does COVID-19 change your expectation on when you'll hit full rate of production for the GTF? And also, have you seen or do you expect to see GTF cancellations? And what will be the impact on your learning curve if you do push out volumes? And where are you right now for margins on the GTF? And then where do you see cash breakeven on the program?

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

That's a long question there, Kristine. Well, let me just say this, obviously we expected to hit full rate production early next year. And that's now been pushed out as both -- well, specifically on the A320 and the A220 fleet, we've seen those reduced by about 40%. The good news, if there is any, I think, in the last 18 months, our market share has gone to about 55% on the neo. Of course, we've got 100% of the A220 that were sole-sourced there. So it's obviously going to take a little bit more time to get to full run rate production. The learning curve that we had expected is about 88%, so a 12% reduction every time you double volume. And we have been on that curve since really the inception of the program. Obviously, we're still on the curve. It's just going to take longer because the volume is not there. But I don't see any issue on the cost side.

As far as GTF cancellations, we haven't seen any. Obviously, Airbus is working with the customers as we are to make sure that we can continue to support the fleet that's out there as well as to continue to support the new deliveries this year and next, although they will be modest. Negative engine margin, obviously, it's a lot lower than we expected because of the decrease in deliveries. But unfortunately, what's offsetting some of that big benefit is the fact that you've got all this over-absorption in the shop. That's the structural cost that I was talking about.

If we add all those pieces together, the overhead under-absorption with the lower negative engine margin, you still see about $100 million net benefit to negative engine margin this year. So again, we're continuing down the cost curve. Cash flow breakeven, we had said kind of mid-2020s. That will probably be pushed out a year or so. Again, if we can get after these costs, these factory costs, we can pull that back in around 2025. But a lot of work yet to do.

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

Well, great. Greg, this pretty much wraps up the questions that we have. And I've been pulling some from the web as well. So thank you very much for spending the time to speak to us today. And this concludes our presentation.

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

Thank you so much, Kristine. And take care, everyone. Be safe.

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

Take care. Bye, Greg.

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

Bye-bye.
