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PRESENTATION

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Good morning, everyone. Welcome back to day 2 of the Barclays Industrial Select Conference. I'm David Strauss, aerospace and defense analyst at Barclays. And we're thrilled to have Raytheon Technologies here today to kick us off. And we have Greg Hayes, CEO of Raytheon Technologies here.

And just in terms of housekeeping items. On your screen, you should see audience response questions. We would appreciate if you took the time to fill those out. And we're going to share the results with everyone once the conference is over.

So with that, I'm going to turn it over to Greg. He has a couple of minutes of opening remarks, and then we'll get into the Q&A portion of the session. Greg, it's all yours. Thanks.

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

Thank you, David, and good morning, everyone. It's hard to believe a year ago, we were in Miami doing this, and now here we are all at home sequestered for the duration.

Before I get into any comments and I'll keep them brief, I just want to remind everybody about forward-looking statements and comments about future objectives and performance. These are obviously subject to risks and uncertainties, and that could cause actual results to differ greatly. And you should look at our most recently filed 10-K for a description of those risks or uncertainties. And so now the lawyers are happy and we can start.

Let me just give 2 seconds on 2020. Obviously, an awful year for the commercial airline industry, but a good year for us in terms of our transformation of the portfolio. We've got Otis and Carrier spun off. We completed the merger last April. And things have actually gone much better than I would have expected considering we have over 100,000 people working remotely across the company today.

We ended the year about where we thought, a little bit better on sales, a little bit better on EPS and a lot stronger on cash. So I think that all bodes well. Obviously, a little disappointed on the RIS/RMD side. Our military bookings were not what we thought they would be at the end of the year, but we'll see that come back later this year. So again, really strong.

On the defense side, overall, $67 billion of backlog. On the commercial aero side, I would say the team did a pretty good job. They took out over $2 billion of cost, implemented about $4.7 billion of cash, cash conservation methods, and then allowed us to end the year with about $9 billion of cash on the balance sheet, which is good news and will allow us to start share buyback here in the first quarter.

On the integration, I think again things going really well. We saw about $240 million of run rate savings on the integration last year. We'll see another $600 million plus this year. That's on top of what we're seeing from the Rockwell Collins synergies, which is about $170 million last year and another $80 million, $85 million plus this year.

So we're in a good spot financially, solid balance sheet, solid backlog. And all I can say is I'm looking forward to 2021 being a lot better year than 2020. But with that, David, I'll turn it back to you.

QUESTIONS AND ANSWERS

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

All right. Terrific. So let's talk a little bit about 2021. So what are you -- I mean, there's only so much you can control in this environment. What are your priorities as you think about 2021?

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

Well, I think, obviously, the first priority that all of us have here is to make sure that everybody that's coming to work, everybody has to be at work, our essential workers are safe, right? So safety remains the #1 priority. It's almost table stakes in my mind.

I would say the corollary to that, of course, is continuing to meet customer demand. And we saw some hiccups last year in the supply chain. Obviously, some challenges in terms of meeting customer demand in the pandemic. But so far, so good in terms of we're able to deliver engines, we've been able to deliver on our contracts and we've been able to effectively work from home.

I mentioned integration, that will remain a priority for the year. We can get over $600 million of targeted savings this year. We've got all the programs identified, a lot of work yet to do, but we'll get that done. And then, I think, finally, it's really going to be around what we're going to do with cash, capital redeployment. We talked about on the call about $1.5 billion of share buyback this year. It's kind of a starting point for us. We'll see where the year goes.

Obviously, the stock, we still believe is undervalued relative to intrinsic value. So we'll continue down that path. We're still, I would tell you, David, focused on this $18 billion to $20 billion that we committed to originally with the merger. And over the first 4 years of the merger, we're going to get $18 billion to $20 billion back. Share buyback will be a piece. The dividend will be a piece, that's about $3 billion a year. And hopefully, things go well. We'll continue to increase the dividend as we go through these next few years.

But again, those are the kind of the high level. It's about employees, it's about customers and really investing for the future.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

I wanted to touch on the cost savings side and integration side of things. So where have you seen -- I guess, touching first on the cost savings side. What exactly have you done? How much do you think it's structural? And on the integration side, how much upside potential you see ultimately out of the Raytheon integration? And what this all means in terms of getting the, first of all, the aerospace business is back to kind of pre-pandemic margins, and then also the Raytheon businesses back to kind of pre-merger levels in terms of margins.

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

Yes. There's lots of pieces in that question, but let me start on the integration piece. When we came together, we merged the 2 businesses. Corporate office was the biggest opportunity from an immediate headcount standpoint.

And so we've reduced corporate headcount in the combined companies with over 600. There's still a few hundred more positions that will come out as we complete some of the integration work. And so most of that first year savings was structural in terms of people going out the door.

As you think about the big actions this year, the biggest cost savings is going to be from the curtailment of the legacy defined benefit pension plan at Raytheon, and that will give us roughly $300 million plus of savings this year. And again, that's structural. That's every year going forward. We've eliminated that or sunset it after 2022. So that was good news.

We're continuing to take costs out of the corporate office. Again, there's a lot of opportunity there. The biggest opportunity in integration this year is going to be though in supply chain. And if you think about it, we spend about $27 billion a year in supply chain. About $10 billion of that is indirect, another $7 billion -- $16 billion, $17 billion is direct. We expect to save about $0.5 billion through integration-related activities, cost reduction in the supply chain this year. And again, that's mostly identified and that's entered into long-term agreements. That's taking the best contract terms from both companies and matching them up and getting the savings. So all of that continues a pace as we had expected.

I would tell you the $1 billion is just a placeholder. I would fully expect that we're going to overdrive that as we have with all the other acquisitions and mergers that we've done. And as we get closer to the midpoint of this year, I think we'll have a better feel in terms of how high that number can go. But clearly, there's upside to the $1 billion, and that's why I've always called it kind of $1 billion-plus of savings.

In terms of the defense business is getting back to, let's call it, pre-merger levels. I think you'll start to see that in the back half of this year. Not to get into the cost accounting, but obviously, when we merged the businesses, since UTC was the acquiring company from an accounting standpoint, we had to change all of the EACs and all the contracts at legacy Raytheon and zeroed them all out.

And so the good news that we had typically seen every quarter in EAC adjustments at Raytheon, that was all wiped out in purchase accounting. That starts to rebuild once we get past the 1 year anniversary. So starting in the second quarter, you should start to seeing natural progression in margins as we start to recognize good news on EACs, again, at the legacy Raytheon businesses.

As far as the legacy aero businesses, margins will improve this year. I think what we had said was first quarter really tough, right, because last year's first quarter, it was a record for the aero businesses. Once we get past first quarter, you're going to start to see as we see a recovery in air traffic and in the aftermarket, really good incremental margins.

I think decremental margins at Collins are 50%, 55%. We would expect incremental margins to be north of 80% as we move into the back half of this year.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Let's touch on that a little bit more. I guess in terms of Collins, I've been a little bit surprised in the cyclicality of the margins. I guess I would have never thought that Collins would get close to breakeven during this.

Obviously, the incremental sound like great news. But what -- I mean, what has driven that cyclicality? I mean is it the interiors business? Maybe you can give a little bit of color on how the individual -- I think there are 6 individual businesses within Collins, Goodrich and BEAV and so on, how those businesses individually have performed and what you're expecting on the other side?

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

Yes. I think, David, you hit at it. I mean the biggest impact, obviously, is going to be at Collins is in the aftermarket business. And so if you think about Collins aftermarket, without going into the individual businesses, about 45% of that aftermarket comes from wide-bodies, which has been the most impacted segment of the aero market. Another 40%, 45% comes from narrow-bodies and the rest from business jets.

Obviously, we saw a big drop in aftermarket. And we saw it, and I'll remind you, back in 2019, we had the ADS-B updates, upgrades, which was about over $250 million of margin. That did not repeat last year, so that was obviously a headwind. And that is software. And you know what the margins look like on software. So really bad.

So that was -- that came out of the Avionics business. On the interiors business, really, really devastated last year because that is a wide-body business. And as we saw the aircraft deliveries declined, we saw some of the retrofit business just evaporate. And that is also a highly integrated business in terms of we do all the manufacturing, whether it's in the Philippines or whether it's in North Carolina, and we build all the seats. We install them. There wasn't really opportunity to take out, I would say, the fixed cost in that business. It's not like you're buying things from the supply chain that you can just turn off.

And so while we eliminated a large number of our folks in the factories, we still had all of that overhead. So interiors business, devastated. We expect that, that will start to recover later this year, but that will be the slowest of the Collins businesses to recover.

And again, keep in mind that even in the interiors business, what you do on the OE side, the margins aren't that great. But when you're doing the retrofits, especially premium seating, that is a very, very high value-added work, higher-margin work. And so again, that probably doesn't come back into '23 or '24.

Clearly, we'll start to see a resurgence. 737 MAX will come back. We'll start to see a pickup there, top and bottom line. But the business is really -- it was surprising how devastating the loss of the aftermarket is. But when your aftermarket margins are very high and you don't have an ability to take out a lot of the fixed costs, that's why we saw the decrementals in there around 50%, 55%.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Let's move on and talk a little bit about the outlook for the aftermarket. So appreciate you gave us a ton of color. I wasn't quite expecting that much color on the call. But I think when you boil it down, you were talking about a 10% sequential recovery in the aftermarket, Q2, Q3, Q4.

I guess, first question, how you arrived to that? And then second of all, how do you feel about that today? I mean we're not that far past the call, but maybe what you've seen. I'm tracking flight activity, and we've seen a pretty big drop-off around the world here over the last couple of weeks. So number one, how you ride that? And number two, how you're feeling about things today?

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

Well, there was no magic to the outlook. I would tell you, it's pretty much based on what the IATA forecast was for traffic recovery, for RPM recovery and just more importantly, available seat mile recovery. What's happening right now, of course, is planes are flying, but they're not flying very full. So we don't expect to see an increase in available seat miles until the back half of the year, where you might see an increase in RPMs in the summer season.

But we factored all of that in. We've been talking to the airlines about when do we need to see overhaul, when our engine is going to come back. We're looking at repair input every day. We're talking to the maintenance folks. And we know the planes are out there flying. We know that they have to come in for service. We know we're going to start to see some of that free up.

The whole thing, of course, is based on vaccine availability. And right now, it looks like the rollout, while not great to start, we've got what, 10% of the populations had their first shot already here in the U.S., and we fully expect that by the summer flying season, June, July, that vaccines will be widely available and people will start to fly again, at least domestically. And that means domestically here, domestically in Western Europe and domestically in China. And so we really -- there's going to -- we've kind of bifurcated the recovery. We've got this domestic piece that we think will recover relatively rapidly starting this year going into '22 and then fully back in '23.

And then the widebody piece of this probably not starting to recover until late this year and then into '23 and '24, perhaps, before we see a full recovery. But again, it's -- I'm not sure if the timing is exactly right. So we said second quarter, we're going to see a 10%, on top of that, another 10% or 1/3 of that, another 10% in the fourth quarter. We may be off by a quarter. It's one of the reasons when we gave guidance for the year, we talked about $3.40 to $3.70. It's a pretty wide range for us. But it really, it all boils down to when does that recovery occur. If it happens as we expect, it will be towards the top end. If it happens later in the year, we'll be towards the bottom end of the range. But that's -- it's just highly variable, and we're just keeping an eye on it.

But look, I feel pretty good about where we are in the U.S. on the vaccine. Obviously, China has had a bit of a resurgence. There have been some lockdowns there that has caused their domestic travel to slow down again. Europe, it's variable, I would say, there. But fully expect again that by June, July, you probably ought to see vaccines widely available around the developed economies.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Switching over to talk about the MAX. Can you just remind us of the importance of that platform to your overall aerospace businesses? And kind of where you are today on the MAX and what exactly you're baking in, in terms of recovery, production recovery on the MAX this year?

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

So I think we said this on the call, but we're fully aligned with Boeing. And we believe I think they've got about 162 aircraft in the build plan for the year.

Now because we continue to deliver inventory even last year as the plane production was shut down, we won't expect any revenue bump from MAX production until the back half of the year. We've delivered about 1/3 of the full year inventory on 737.

And just remember, that's a roughly $2.5 million of shipset of sales to Collins for every 737 that gets delivered, and margins are pretty good on that as well. So part of this back half recovery will be based on the MAX. But again, don't expect that in the first half that, that inventory is all sitting on the shelves up in Washington State.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

I wanted to touch on the GTF. So of all the engine platforms I track, the GTF utilization is actually the best out there in terms of what's come back during the recovery. Can you just level set us on where we are with the installed base in terms of the retrofit activity? How much of the fleet is up to kind of the current spec? What else is left to do there?

And you started to talk about the GTF aftermarket being a positive. I mean when does that really become a -- become meaningful and really begin to help you out relative to the new engine loss side of things?

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

So let's just level set everybody in terms of where we are with GTF. So we've delivered roughly 1,800 engines out there that are in service today. As you mentioned, the GTF-powered A320 fleet, the utilization has been remarkably good during the pandemic. About 85%, we believe, of the fleet is flying on a regular basis, and that's pretty good. That's only about 2% lower than it was a year ago.

So utilization is good. Dispatch reliability for the last 12 months has been 99.97%. So all those teething problems that we talked about for the last several years seem to be behind us. We have upgraded about 96% of the fleet during the past year, such that all of those fixes that we talked about, all of the reliability upgrades, 96% of those are now incorporated. And so all of that bodes pretty well in terms of starting to see kind of a return to normalcy.

Now the problem, of course, is that those 1,800 engines, the average age is about 2 years. And we typically don't see aftermarket until you get to about year 5. So I wouldn't expect that we're going to see a significant bump from GTF aftermarket until we get into the '24 -- late '23, '24, '25. And the program again should be breakeven by 2025, given the progression of the aftermarket and as we continue to drive cost down on the OE.

So I think that's all very positive. I think the Pratt team did a really good job last year. We didn't stop any of the overhaul activity, even though people weren't sending as many engines in. We got everything upgraded for the most part. So I think, at least knock on wood, all the GTF issues that we've been talking about seem to be behind us, and the engine is performing really well.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

And how are you progressing on the new engine, on new production on the loss side of things? How is that progressing?

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

Well, obviously, we expected to deliver 1,000 engines last year. We only delivered about half as many. So we've built 2,000 engines. As you double production, you're going to come down a learning curve of about 87%. But it's going to take us a couple more years now to double production again. But we're still coming down the curve. It's just the curve is flattening out here as production volumes have flattened out.

The other problem, of course, is, and I hate to talk about it, it's the fixed overheads again. And as you go from 1,000 engines to 500 engines, while the losses go down $1 million an engine, you still have all that overhead sitting there. So we're not going to see a big improvement until we get back to, I would tell you, the 2019 production levels back to that kind of 1,000 engines, where we get kind of the normal cost reduction curve kicking back in.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Let's switch over to the defense side of the house. So you touched on the legacy Raytheon businesses a bit in your opening remarks, the bookings maybe been a little bit disappointing. You're guiding to low single-digit to mid single-digit growth out of those businesses this year. Obviously, you're well aware of the potential for the budget to flatten out or maybe even decline here. Raytheon's had pretty good success winning on Patriot and THAAD and a whole bunch LTAMDS.

I mean a year or so close to year-end to being closer to those businesses, how do you feel about the potential to continue to see top line growth there in a more difficult budget environment?

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

Yes. Look, it's the $64,000 question, what happens to defense spending in the next 4 or 5 years? As far as 2021 goes, I don't think anybody has much concern. We've got the defense authorization act that was passed. So we kind of know what's going to happen at least through October.

And as I think about it, we talk about low to mid single-digit growth this year. That's really -- by the time you get to past the first quarter and the accounting around the EACs, you're probably going to see kind of that 5%-ish growth through the back half of the year. And we feel pretty good about this year, just based on that $67 billion of backlog. But we've also got some big programs ramping up. You mentioned LTAMDS. That's out there. You've got the Next Generation Jammer, the number of classified ISR and space programs that are in the backlog that we'll be executing on. So I feel pretty good about the growth prospects this year and getting back to that margin trajectory that we saw pre merger.

As you go out in the future, the question is, what are the priorities of DoD going forward? Obviously, as you think about the national defense strategy, the biggest threat to national security remains China. And it is a challenge, I think, for us from a conventional weapons standpoint. The fact of the matter is they can deny us access to China with conventional weapons. And we have to think about how are we going to defend South China Sea, how do we defend the Pacific Ocean in this new world. And that's going to mean space-based sensing systems. It's going to be new types of effectors or missiles. I'm talking about hypersonics, talking about directed energy. We've got laser and high-powered microwave. All of those things, I think, are going to be reassessed as we go forward.

Obviously, there's this whole nuclear modernization, modernization of the nuclear triad that was begun several years ago. That remains, we believe, a priority, although I certainly could see where that, the spending on that could be pushed out a little bit.

I think we're in a good spot there. We've got the long-range strike option, which is the new cruise missile for the B-21 Bomber. We think that platform remains solid in the defense outlook. But again, I think we're going to have to make sure that we are positioned to take advantage of this changing view of technology.

Again, I think there's probably no company better positioned than ours to take advantage of, think about space-based sensing, if you think about undersea-based sensing, talking about some of the new effectors or missiles out there, some of these newer technologies. I feel pretty good in the next 4 or 5 years, we're going to have a good hand here. But that means some of the conventional systems may see a slowdown, and we'll have to just keep an eye on that.

But I don't think defense spending goes down. I just don't think it continues to go up. I think it's going to be a flat environment for the next 4 or 5 years.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

So we got a couple of minutes left. I want to touch on the cash flow outlook. Maybe from a working capital perspective first. Talk about the -- it looks like ex the onetime positives on the Raytheon side in 2020, you got about $1 billion or so working capital headwind. What was that? I mean with a lot of companies impacted by lower aerospace volumes, we actually saw a bit of a working capital tailwind. So what was the headwind there? And it looks like you're calling for a pretty nice reversal on the working capital side in '21. What exactly is driving that?

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

So if you think about 2020 working capital, it was actually an outflow of about $300 million. And that's actually understates it by about $800 million because we also got, as you recall, progress payments increased from 80% to 90%. That drove another $800 million of cash into the business and receivables coming down.

So we actually saw, I would say, on an adjusted almost $1 billion of outflow last year. Most of that, almost all of it on the commercial aero side. As you think about holding working capital balances, flat this year instead of being a tailwind. If we just hold it flat, that's $1.1 billion -- $1 billion, $1.1 billion of tailwind this year. So that looks to be a good opportunity.

I'd also tell you that we had a lot of inventory in the supply chain that came in last year. We shut things down back in March and April. As I look at like Rockwell Collins or Collins Aerospace rather, from June through the end of the year, they took about $1 billion of inventory out. So it wasn't like we were sitting in our hands. I think we did a pretty good job of trying to alleviate some of the working capital headwind.

As I mentioned, we cut back on CapEx. We did all this cost reduction. We actually got about $4.7 billion of cash reductions out, that not on the working capital side, obviously, but in CapEx, E&D and headcount side.

So feel pretty good about cash flow as we think about this year when we talk about $4.5 billion of cash flow this year. And still on track to get back to that $8 billion to $9 billion of free cash flow every year, as we think -- as we had committed to prior to the merger as soon as we see recovery in commercial aerospace. So I would think by '23, '24, we'd be back in that range.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. I wanted to ask you about potential M&A in terms of capital deployment. You did Blue Canyon, a relatively small deal. But what are your thoughts around M&A? And then wanted to see if you had any comments around Lockheed in their potential acquisition of Aerojet. Obviously, Aerojet's a pretty big supplier into your defense side of the portfolio.

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

Yes. So as we think about M&A for the next couple of years, I don't see, and I said this before, I don't see any big strategic hole that we need to fill with an acquisition. We will look for fill-in technology like Blue Canyon, which gave us a small satellite bus company capability that we didn't have before. I think that will be a great acquisition over time, as all these low earth orbit satellites get launched. But I don't see any other really needs in the portfolio. I do see some things that we're going to probably divest over time. We've talked about that. There are some of our businesses that lower margin, lower growth probably don't fit. So I think you'll see more on the divestiture side than you'll see on the acquisition side. But certainly, no big deals.

As far as Lockheed's, the potential acquisition of Aerojet Rocketdyne, we obviously have some concerns about that. They are a huge supplier to us. And if that merger actually happens, you don't have an independent supplier in the solid rocket motor side. And also, I think it gives us pause as we think about the competitive landscape going forward. So we're going to make our concerns known to the DOJ and the Department of Defense, and we'll see how this whole thing plays out.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Well, Greg, unfortunately, we're out of time. But thanks again for your support of the Barclays conference. You've been a long-time attendee. And hopefully, next year, we'll be in person and in Florida. And thanks again. Enjoy the rest of your day.

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

Thank you, David. I hope to see everybody in Miami next year. Take care.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Thanks, everyone.
