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RTX.N - Q1 2021 Raytheon Technologies Corp Earnings Call

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OVERVIEW:

Co. reported 1Q21 sales of \$15.3b and GAAP EPS from continuing operations of \$0.51. Expects 2021 sales to be \$63.9-65.4b and adjusted EPS to be \$3.50-3.70. Expects 2Q21 sales to be \$15.5-16.0b and adjusted EPS to be \$0.90-0.95.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Raytheon Technologies First Quarter 2021 Earnings Conference Call. My name is Deborah, and I will be your operator today. As a reminder, this conference is being recorded for replay purposes.

On the call today are Greg Hayes, Chief Executive Officer; and Neil Mitchill, Chief Financial Officer. This call is being carried live on the internet, and there is a presentation available for download from Raytheon Technologies website at www.rtx.com. Please note, except where otherwise noted, the company will speak to results from continuing operations, excluding net nonrecurring and/or significant items and acquisition accounting adjustments, often referred to by management as other significant items.

The company also reminds listeners that the earnings and cash flow expectations and any other forward-looking statements provided in this call are subject to risks and uncertainties. RTC's SEC filings, including its forms 8-K, 10-Q and 10-K, provide details on important factors that could cause actual results to differ materially from those anticipated in the forward-looking statements.

(Operator Instructions) With that, I will turn the call over to Mr. Hayes.

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

Okay. Thank you, Deborah, and good morning, everyone. Before we jump in, I'd just like to take a couple of minutes to acknowledge the news that most of you saw yesterday of Dr. Kennedy's retirement as Executive Chairman of the Board effective June 1 of this year. As you've all heard me tell the story, it was just over 2 years ago that Dr. Kennedy called me to suggest that we merge our 2 companies. You could see then that in combining our talent, technologies and capabilities that we would have the breadth and scale to meet any industry challenge in aerospace and defense.

Little did either of us realize then, of course, how quickly a global pandemic would put that value proposition to the test. And yet here we stand today 1 year post merger, and we've made substantial progress not only in integrating their 2 heritage companies, but also managing through an unprecedented downturn in commercial aerospace, all the while identifying new technology synergies and establishing an operational rhythm that allows us to meet many of the goals sooner than what we had expected just a year ago.

So I want to thank Dr. Kennedy for his leadership, partnership and stewardship throughout this merger and congratulate him on a distinguished 38-year career with Raytheon. We wish you well, Tom.

I'd also like to officially welcome Neil Mitchill in his new role as Chief Financial Officer, though most of you, of course, already know Neil. He's not new to the call. Toby O'Brien stepped down earlier this month, and we thank him for all of his contributions as we form Raytheon Technologies.

Many on this call also know that Neil was our interim CFO at UTC prior to the merger. And since then, he's led the IR and financial planning functions. I'm very pleased to have him as our CFO, and I look forward to working together as we continue the integration and cost initiatives that will capture the full value of the Raytheon Technologies company.

Lastly, I'd also like to welcome our new Head of Investor Relations, Jennifer Reed. Jennifer, for the past year, has led our integration team. She was Vice President of Integration. She was responsible for the financial and operational planning activities related to the merger and do a wonderful job, and we'll hear more about that later.

So I think that completes the HR section of the call. Let me move on to the numbers. Let's take a look at Slide 2, please.

So as I mentioned, earlier this month, embarked the 1-year anniversary of the merger's closing. And I'm proud of the major accomplishments and progress made by our employees and business leaders, who came together from across our businesses to execute as a single team. Our ability to adjust to the unique circumstances and stay nimble in this very dynamic operating environment has served us and our investors and customers well.

With that, let me take you through the performance and some highlights from the quarter. I'm pleased to say that we've had a really strong start to the year. And we're seeing continued momentum with signs of economic recovery and incremental improvements in domestic aerospace markets, with international markets, of course, remaining challenged. As you saw from the press release this morning, we delivered strong quarterly sales, adjusted EPS and free cash flow, all of which exceeded our expectations from earlier this year.

And while it is still early in the year, the rate of vaccine distribution and signs of travel recovery within key domestic markets, specifically the U.S. and China, are better than what we expected just 3 months ago. In the U.S., daily TSA traffic has averaged about 1.4 million people a day since the beginning of April, nearly double the levels of January of this year.

So we're headed in the right direction with key metrics improving, but we continue to monitor recovery indications around the world and engage with our customers as they prepare for this recovery. On the defense side, happy to say our backlog remains robust at more than \$65 billion.

These encouraging trends in commercial aerospace and our Q1 performance gives us confidence to raise the low end of our full year sales range by \$0.5 billion to \$63.9 billion, bringing our new sales range for the year at \$63.9 billion to \$65.4 billion.

We're also going to raise the low end of our full year adjusted EPS range by \$0.10 to \$3.50. That's up from \$3.40. So the new range that we expect for the year is somewhere between \$3.50 and \$3.70. We're going to also maintain our free cash flow outlook for the year of at least \$4.5 billion, and Neil will give you a little color on all this later in the call.

On the capital deployment front, after a better expected start to earnings and cash in Q1, we're also going to increase our share buyback plan by \$0.5 billion. It will take it up to \$2 billion for the year. During the first quarter, of course, we did resume our share buyback, and we repurchased about \$375 million of our stock, giving us a good start to our full year commitment.

You also probably saw yesterday that we increased our dividend by more than 7% yesterday to \$0.51 from \$0.475. Since the merger last April, we've already returned over \$3.2 billion to shareholders between share buyback and dividends. And we remain on track to return at least \$18 billion to \$20 billion to shareholders from the first 4 years following the merger.

We also continue to execute well on our synergy programs during the quarter. We achieved nearly \$200 million of incremental RTX merger synergies, bringing the total since the merger of up to \$440 million. And given our strong synergy capture to date and the growing opportunities that we see in the pipeline, we're going to increase our cost synergy target by \$300 million, from \$1 billion to \$1.3 billion, and I don't think we're done yet. Collins, importantly, also achieved an incremental \$40 million in acquisition cost synergies in the quarter, bringing their total acquisition-related savings to \$510 million since the deal closed in November of 2018.

Lastly, we continue to strategically shape our portfolio with a focus on higher growth, higher technology businesses. We did close on the Forcepoint divestiture earlier this year. That brought in about \$1.1 billion in gross tax -- gross proceeds without the tax benefit. And we will continue to be disciplined in M&A as we evaluate both strategic acquisitions as well as strategic divestitures.

And with that, let me turn it over to Neil. Mr. Mitchill.

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Thank you, Greg. I'm happy to be on the call today in my new capacity as CFO, and I look forward to our continued partnership as we continue to capture the full value of RTX.

With that, I'm on Slide 3. Let me take you through our financial results. I'm pleased with where we landed for the quarter, exceeding expectations on our key metrics. And as we've mentioned previously, Q1 will be the last quarter of tough compares for our commercial aero businesses resulting from the onset of the pandemic last year.

Q1 sales were \$15.3 billion, above the midpoint of the outlook we provided in January. Adjusted EPS was \$0.90 per share, ahead of our expectations, driven by better-than-expected operating profit at all 4 of our businesses as well as favorability in some corporate items. On a GAAP basis, EPS from continuing operations was \$0.51 per share and included \$0.39 of net nonrecurring and/or significant items and acquisition accounting adjustments. Free cash flow of \$336 million exceeded our expectations primarily due to better-than-expected working capital timing, most notably the timing of collections across the businesses.

So with that, let me take you through the segment results. Starting with Collins Aerospace on Slide 4. Sales were \$4.4 billion in the quarter, down 32% on an adjusted basis and down 31% on an organic basis driven primarily by the expected adverse impact of COVID-19 on the commercial aerospace industry.

By channel, commercial OE sales were down 45%, again, driven principally by the impact of the current environment. Commercial aftermarket sales were down 43% driven by a 39% decline in parts and repair, a 66% decline in provisioning and a 32% decline in modifications and upgrades. Sequentially, however, commercial aftermarket sales were up 11% driven by growth in parts and repair and modifications and upgrades. Defense sales were down 3% on an adjusted basis but up 4% organically. Organic growth was driven by F-35 as well as growth in several avionics product lines.

Adjusted operating profit of \$332 million was down \$952 million from prior year and better than our expectations for the quarter driven by continued cost control and favorable sales mix. On a year-over-year basis, cost control as well as lower E&D and SG&A were more than offset by lower commercial aftermarket and OE sales volume.

Looking ahead to the rest of the year. With a solid start in Q1 and improving trends on the commercial side, we are increasing the low end of Collins' sales outlook from a prior range of down high to low single digit to a new range of down mid- to low single digit. And based on our first quarter cost containment measures and those improving trends on the commercial side, we're also increasing the low end of Collins' operating profit outlook by \$75 million to a new range of down \$200 million to up \$25 million.

Shifting to Pratt & Whitney on Slide 5. Sales of \$4 billion were in line with expectations. Year-over-year sales were down 24% on an adjusted basis and down 25% on an organic basis also driven by the expected adverse impact of the current environment on the industry. Commercial OEM sales were down 40% driven by lower deliveries across most of Pratt's large commercial engine and Pratt Canada platforms. Commercial aftermarket sales were down 35% in the quarter driven by an expected decline in shop visits. But growth in the GTF aftermarket volume was more than offset by the impact of a reduction in legacy large commercial engine shop visits of 38% and a 28% reduction in Pratt Canada shop visits.

In our military business, sales were up 1% on higher F135 aftermarket, partially offset by lower volume across certain development programs. Pratt's adjusted operating profit of \$40 million was down \$475 million from the prior year. Significant aftermarket volume reductions and fixed cost headwinds more than offset continued cost containment measures, including reductions in G&A and E&D.

Looking ahead, with a solid start in Q1 and improving trends on the commercial side of the business here, too, we are also increasing the low end of Pratt's full year sales outlook from a prior range of flat to up mid-single digit to a new range of up low to mid-single digits. And we are increasing the low end of Pratt's operating profit outlook by \$50 million to a new range of down \$75 million to up \$25 million.

Turning now to Slide 6. First, I'll remind everyone that the percentage of completion reset at the merger date continues to impact the compares for both sales and operating profit at the legacy Raytheon businesses. With that, Raytheon Intelligence & Space sales were \$3.8 billion, up 2% versus the prior year on an adjusted pro forma basis and better than our expectations for the quarter driven by higher volume in sensing and effects, particularly airborne ISR. Operating profit in the quarter was \$388 million, down \$11 million year-over-year on an adjusted pro forma basis and a little better than expected due to higher sales volume. It's worth noting that sequentially, the ROS at RIS improved 110 basis points to 10.3%. RIS had bookings in the quarter of \$3.7 billion, resulting in a backlog of \$19.2 billion. Significant bookings included approximately \$1.4 billion on classified programs as well as several other notable awards. Our Q1 book-to-bill was 1.08.

And looking ahead, we remain confident in our full year outlook for RIS with sales growing low to mid-single digit and operating profit growing \$125 million to \$175 million versus adjusted pro forma 2020.

Turning now to Slide 7. Raytheon Missiles & Defense sales were \$3.8 billion, up 3% versus prior year on an adjusted pro forma basis and better than expected due to higher volume across multiple mission areas. Adjusted operating profit was \$496 million, also better than expected and down \$43 million year-over-year on an adjusted pro forma basis due to the absence of a favorable prior year contract settlement and the EAC reset impact that I mentioned. RMD's bookings in the quarter were approximately \$2.5 billion, resulting in a backlog of \$27.7 billion.

Significant bookings in the quarter included an award of approximately \$520 million for AMRAAM for the U.S. Air Force, the Navy and international customers and an award of about \$250 million to provide Patriot engineering services support for the U.S. Army and international customers. It's also worth noting that RMD's industry team was down-selected for the Next Generation Interceptor award, and we expect to book that award in the second quarter for over \$1 billion. Book-to-bill was 0.68 in the quarter as expected, as we continue to deliver against the previously awarded multiyear production contracts.

Before moving on, I'd also like to make a comment on the previously disclosed ongoing DOJ investigation into cost accounting matters at legacy Raytheon Company's former Integrated Defense Systems business, or IDS, which is now part of RMD. As you'll see in our upcoming 10-Q filing later today, the investigation includes potential civil liability for defective pricing for 3 contracts entered into between 2011 and 2013 by IDS. We provided for our best estimate related to this matter in connection with the finalization of purchase accounting during the quarter.

Additionally, as part of the same investigation, we recently received a second subpoena relating to a different IDS contract from 2017. We do not currently believe the resolution of this matter will result in a material impact to our financial condition, and we will continue to cooperate fully with the government's investigation.

So turning back to RMD's full year outlook. We continue to expect RMD sales to grow low to mid-single digit and operating profit to grow \$25 million to \$75 million versus adjusted pro forma 2020. And finally, for your reference, we've included an updated outlook for each segment in the webcast appendix.

With that, moving to Slide 8, let me update you on how we see the current environment as we look ahead at the rest of the year. Starting with our merger synergies. As Greg said, we are increasing our gross merger cost synergy target to \$1.3 billion. And that's due to higher expected synergy capture in our corporate office and segment consolidation as well as additional opportunities we've identified in the supply chain and footprint consolidation and in IT. And keep in mind, that's on top of \$600 million of Rockwell Collins acquisition synergies.

Additionally, we continue to see the benefits of the cost actions we took last year. We're making solid progress on the structural cost reduction actions we previously announced while, at the same time, working additional opportunities to drive further cost out of the business.

And moving to the commercial side of the business, the shape of the commercial aero recovery remains critical to our outlook. As Greg mentioned, we're encouraged by the pace of the vaccine distribution, and we're seeing signs of increasing travel demand, particularly on many domestic routes. However, we continue to watch Europe and international border reopenings.

While we've seen slightly better-than-expected results to start the year, particularly at Collins as customers prepare for a strong summer travel season as well as evidence of increasing future travel demand, we still need to see this demand translate to strong sequential growth in RPMs and ASMs as we head into the -- into and through the peak summer travel season. As such, the second quarter remains a critical period in determining the recovery profile for the rest of the year. Looking longer term, we continue to expect that it will take until at least 2023 for commercial traffic to return to 2019 levels.

For the defense side of our business, we continue to expect both domestic and international program growth to remain robust as evidenced by our over \$65 billion defense backlog. Our strength with international customers, our innovative technologies and our positions in high-growth areas gives us confidence in our ability to grow these businesses even in the current domestic budget environment. And finally, our financial strength is underpinned by the strength of our balance sheet and supports our capital deployment commitments.

Moving to Slide 9. Following our strong start to the year, we remain confident in our full year outlook. And as Greg mentioned, we are bringing up the low end of our sales range by \$500 million and bringing up the low end of our adjusted EPS range by \$0.10, with about \$0.06 coming from the segments and the remainder coming from improvement in some corporate items.

Now let me just give you a little color on Q2. At the company level, we see sales in the range of \$15.5 billion to \$16 billion, adjusted EPS in the range of \$0.90 to \$0.95 per share and we see sequential improvement in free cash flow. It's also worth mentioning that we've included an updated outlook for some of the below-the-line items and an updated pension outlook that includes the impact of the latest COVID relief bill in the webcast appendix.

And so with that, I'll hand it back to Greg to wrap things up.

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

Okay. Thanks, Neil. So no surprise here as we think about our 2021 priorities. First and foremost, it's going to be to continue to support our employees, our customers, suppliers and communities, all the while continuing to invest in new technology and innovation to drive industry leadership for the long term. I am confident in the outlook for our company. RTX is well positioned to deliver strong sales, earnings growth and cash flow for not just this year but for the foreseeable future.

Before we get to Q&A, just a note, we are going to have an Investor Day coming up on May 18. So you'll get a chance to hear from our business unit leaders as well as on our transformation initiatives from Mike Dumais. I look forward to sharing a lot of information also on our revenue synergies and our long-term growth strategies with you at that meeting.

So with that, let's turn it over to Q&A. Deborah?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from the line of Carter Copeland with Melius Research.

Carter Copeland - *Melius Research LLC - Founding Partner, President and Research Analyst of Aerospace and Defense*

Greg, I'm going to resist the urge to ask a numerical question and instead ask you about -- in light of Toby's departure and Tom's announced retirement and we're 1 year on into the merger, this is the biggest integration in the history of aerospace and defense mergers. And you've been obviously trying to do a lot of that virtually.

With respect to what still needs to be done and what has yet to be accomplished, where do things stand in that regard, and where do you want them to go? Have things surprised you along the way that have led to any change relative to where the plan was? Just anything you can give us to help us understand where that is in its process, aside from the cost synergies and some of the numerical pieces, but more the integration of the 2 companies culturally.

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

Yes. Carter, it's something that we have spent a lot of time on over these past 12 months. We're fortunate I got Jen Reed sitting here with me, who has been leading that integration effort.

I would tell you, we've realized over \$400 million of cost synergies, but there is a lot of work yet to do. We've done many of the hard things in terms of reducing staff, making sure the policies are consistent but, again, not done with that.

I think the biggest opportunities we still have are on the digital front, where we have a lot of work to do to reduce the number of data centers. We just made a big investment to try and reduce the data centers from more than 30 to less than a dozen. We're also working on what we call the digital thread, that is, how do you connect everything from product development through operations, supply chain and sustainment.

And lastly, I would tell you, it is rolling out our common operating system. You'll hear more about this in May, but we do need a common operating system. We have 178 manufacturing facilities around the world, and we had to work to do to consolidate those yet. We're making good progress, but it is going to take us some time. It will take us a full 4 years to realize the \$1.3 billion of synergy savings.

We made good progress on identifying savings related to procurement, both product and non-product cost reduction. All of those things are on track. But I would just remind you, it's too early to declare victory. And just like Collins has got now over \$500 million of synergies on their way to \$600 million, there's still work to do there. And it's -- we're not going to declare victory.

Carter Copeland - *Melius Research LLC - Founding Partner, President and Research Analyst of Aerospace and Defense*

And did you find anything in the process that has, I guess, surprised you? I'm just thinking about some of the charges in the legacy Raytheon defense segments and the comments you made around the DOJ subpoena regarding the pricing. I mean are these things surprising to you?

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

Well, look, first of all, just to be clear, these are contracts from 2011 through 2013. So there's always surprises like that out there when the DOJ suggested that we defectively priced some contracts. We've been doing an investigation, been working with the DOJ and I think we've appropriately provided for those exposures, as Neil mentioned.

I wouldn't call that a big surprise. What I would tell you, people think about the culture, and it was not that different between the aerospace businesses at legacy UTC and the defense business at Raytheon. The fact is many of our customers on the defense side were the same and the cultures were the same. I think, again, that has been a pleasant surprise in terms of how easily we have been able to integrate the 2 businesses culturally, and that process will continue. But I would tell you, it is going remarkably well for what is probably the largest aerospace and defense merger ever.

Operator

Your next question comes from the line of Robert Spingarn with Crédit Suisse.

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Senior Aerospace and Defense Analyst*

Neil, for you, you're essentially guiding to EPS of around \$0.90 in each quarter this year, at least if I think about what you said for Q2 against Q1. Why isn't there more improvement from the first half to the second especially given the buyback and maybe even a slightly lower tax rate? You mentioned Q2 is going to be key for assessing the pace of the recovery. So could you elaborate a little bit on what you're expecting? Or is this just a conservative second half guide?

Neil G. Mitchill - *Raytheon Technologies Corporation - CFO*

No, I don't think it's that. I think there's still 3 quarters ahead of us. So I need you to keep that in mind as we look at the rest of the year. We did see some promising uptick as we were in March of first quarter at Collins and Pratt. Some prebuy, I would call it, for the airlines ahead of the summer travel season.

But let me give you a little bit more color on Q2 specifically. We do see segment operating profit growth somewhere between \$0.03 and \$0.07 for Q2, if you think about that sequentially. We do have some headwinds on the corporate side. So one of the things that we benefited from in the first quarter was reduced corporate expenses, in part on interest as we had better-than-expected cash flow. And so that will lower our interest for the year as well as we are being more efficient with our synergy investment spend. But those -- that spending on the synergy investment will pick up here in the second quarter. And so you got a few -- \$0.02, \$0.03 of headwind on that front in the second quarter as well.

As it relates to the second half of the year, we'll have to wait and see a bit. But certainly, the back end of our plan contemplated a real strong summer travel season. And that's why I think Q2 is going to be so important.

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Senior Aerospace and Defense Analyst*

And then just on the cash flow cadence throughout the year. You touched on it there, but if you could just go into perhaps a little bit more detail?

Neil G. Mitchill - *Raytheon Technologies Corporation - CFO*

Sure. As you know, our cash flow tends to be back-end loaded as we ramp and then deliver through the year. As I think about the first quarter, our free cash flow was better than we expected, probably by about \$600 million, all of that attributable to improved working capital.

If I break that down for you, think about \$300 million of that coming from better-than-expected customer collections. We were happy to see some customers pay early at the end of the quarter. We had a couple of hundred million dollars of improvement in disbursements timing and \$100 million better improvement -- better-than-expected performance on inventory. So still a long ways to go to get to our full year \$400 million working capital improvement but good progress.

And as I think about Q2, I would expect to see clearly some sequential growth, probably at least doubling, and then more of that in the back half of the year as the sales continue to ramp and collections as they seasonally do ramp up.

Operator

Your next question comes from the line of Jon Raviv with Citi.

Jonathan Phaff Raviv - Citigroup Inc., Research Division - Director & Senior Analyst

On the -- some that's going back to DOJ items. Can you clarify the estimates that we'll see in the 10-Q? Those are not material? And the second subpoena, you do not expect to be material either? And just any kind of color on any connective tissue or any narrative or rhythm or theme, I'd say, between these items. For instance, are they all FMS or tied to a particular person or team or incentive structure? And then any comments on what the functional impact of those settlements is going to be on the ongoing business for which -- on those contracts referenced, the '11 to '13 and also the '17 item.

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

Jon, I appreciate the question. I'm not sure we can really answer it. I will say, this is an ongoing investigation by DOJ. We have begun our own investigation. And as we discover facts, we have been sharing all of those facts with the DOJ.

I would tell you, again, the dollar amounts are not going to be material in our view today. These -- again, these are older contracts, where it was alleged that we defectively priced some contracts. Again, I can't get into much more detail than that. But again, we've looked into it. We think there is potential liability for defective pricing. Clearly, we've provided for that this quarter. And we're going to continue to work with DOJ to bring these things to a resolution.

I would tell you, these investigations take time. We're still going through doing some work. But we don't believe there's going to be any ongoing impact to any of the businesses as a result of these investigations. We think these were one-off events that occurred -- should not have occurred, but they did. And we're going to clean it up and move on.

Operator

Your next question comes from the line of Ron Epstein with Bank of America.

Ronald Jay Epstein - BofA Merrill Lynch, Research Division - Senior Equity Analyst

So just maybe on Pratt. I think in the hearing on Thursday on F-35, Pratt was mentioned 39 times. So I guess the question is this. How are you guys remedying the issues that the Air Force has with the F135 engine? And do you fear that kind of all this rhetoric around the engine could offer an entrée for GE to try to get a second engine in there? Because they've been raising their rhetoric on that, at least they have been with the investment community.

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

Well, Ron, first of all, it's nice to be mentioned 39 times. No publicity -- or all publicity is good in some respects. But I would tell you, the issues -- and I think Matthew Bromberg, who's President of our Military Engines business, explained this pretty well. We've actually done a good job on the production or the OEM front in terms of delivery in engines. We ended the year on contract. In fact, there were about 50 engines sitting at the final assembly line for the F-35 today.

Unfortunately, where we didn't do a great job was at the sustainment center. And we did not provision enough in terms of test equipment and personnel to deal with the volumes that we saw coming into the shop. As a result, there are about 20 aircraft today that are sitting there that do not have a serviceable engine.

Now one of the solutions, I think Matthew pointed this out last week in his testimony, we can take some of those engines from the final assembly line and put them over at the sustainment center and solve this problem tomorrow. But as you know, the color of money for procurement is different than it is from operations and maintenance, so it's not that easy.

But we have committed and working with the customer with the JPO to put the equipment in place necessary to service the engines such that we get back on, I'll say, contract performance levels by the end of this year. A lot of work to do. But again, we were caught by surprise in terms of the amount of hours that were being flown. We were surprised at the scope of the work that was required on some of these. But again, we will catch up.

As far as does this give an entrée to GE to build the F136 engine, I can't answer that question completely. I would tell you, though, that is a multibillion-dollar, multiyear effort to bring that engine back in line. And I think, again, given the cost challenges on the program, it seems unlikely that any of the services are going to spend that kind of money for an extra engine when, in fact, our engine is actually performing quite well in service. We're meeting the reliability targets, meeting the fuel burn targets. It's -- look, the issue with the F-35 is not capability, it's sustainment cost. And that is the other thing that we committed to work with the JPO on, is how do we reduce, working with Lockheed, the sustainment cost because that will ultimately be the bigger cost than the initial procurement.

Operator

Your next question comes from the line of Sheila Kahyaoglu with Jefferies.

Sheila Karin Kahyaoglu - Jefferies LLC, Research Division - MD

Maybe I'll ask one on Collins. Decrementals are still in the 40% range there. What are the moving pieces of that? And how do we think about the trajectory of margin improvement in that business just given commercial OE start/stops on 787 and the MAX?

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Thanks, Sheila. I'll take that one. So you saw the decrementals today, 47% at Collins, slightly better than what we were seeing last year, so that's good. The cost containment actions that we've implemented are taking hold and continuing.

As you think about the rest of the year, we continue to see the incrementals being very strong, probably in the 75% range if you'd average Q2 to Q4. But as you look at Q2, they should be in excess of 100% because you'll recall that last year, Q2 was our deepest quarter.

I'm happy with what the team is doing there in terms of maintaining that cost control around E&D, SG&A in the factories. It took some difficult steps last year, as you know. And as we started the year, the Collins team has done a nice job of containing the growth in those costs. We will see a little bit of that come back in the second half of the year at Collins as we reinstate merits and furloughs are reduced and volume picks up. But it should be a really good story for the back 3 quarters of the year.

Sheila Karin Kahyaoglu - Jefferies LLC, Research Division - MD

So that -- Neil, can you just comment on what's going on with the MAX and the 87, what kind of rates you expect for the year?

Neil G. Mitchell - Raytheon Technologies Corporation - CFO

Yes, sure. So starting with the 787, we are aligned with the Boeing production schedule. So you can think about that being around 5 ship sets per month.

On 737, also aligned with Boeing. I think they're out there with 161 deliveries expected for the year. As we've talked about, Sheila, we have produced and delivered a fair amount of that, 1/3 to 1/2 of that. So the uptick in the 737 OE deliveries will start in the back half of the year.

Operator

Your next question comes from the line of Seth Seifman with JPMorgan.

Seth Michael Seifman - JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst

So maybe just a follow-up on Sheila's last question. The guidance for Collins would seem to imply kind of this continuation of the mid-7s margin that we saw in the first quarter, but there's potential for an error recovery and continued efforts on efficiencies. And so why wouldn't we see that margin expand off of that level as we move through the year?

Neil G. Mitchell - Raytheon Technologies Corporation - CFO

Yes. Thanks, Seth. I'll take that. The -- you're right, as you think about the guide for the rest of the year for Collins, particularly given some of the strength we saw here in the first quarter, those margins are contained in that range. However, I will say we're being really smart about the timing of when we spend our E&D and when we reinstate some of the discretionary spending.

So those will be natural offsets to what we expect to see in terms of aftermarket growth. But as that aftermarket growth comes, I would expect, if it's better than our plan, then you'll see it drop through.

Seth Michael Seifman - JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst

Okay. And then just on that, I think you mentioned the sequential aftermarket growth in the quarter, 11%. Can you talk about what pieces of the aftermarket are showing the most strength right now and where you expect that for Collins for the remainder of the year?

Neil G. Mitchell - Raytheon Technologies Corporation - CFO

Sure. Yes. It's coming from the 2 places you'd expect it, parts and repair and mods and upgrades. Provisioning is lagging a little bit. But again, that tracks more closely to the commercial OE deliveries. So I'm not surprised to see that. But we are seeing, I'll call it, cautiously encouraging signs as we exited March and started April on the repair intake in particular.

Operator

Your next question comes from the line of Noah Poponak with Goldman Sachs.

Noah Poponak - Goldman Sachs Group, Inc., Research Division - Senior Equity Analyst

Neil, could you just add a little more color to that last question there, just with this -- all of these questions about how the guidance implies some flattish things through the year despite some signposts for improvement with the aftermarket being the shorter-cycle lever? Just how did you tackle how to decide what to include for the aerospace aftermarket given the signposts are positive but it is still uncertain?

And then could you also tackle what happened with your pension cash flow input? It looks like those changed less than maybe we thought, based on how the inputs were revised there.

Neil G. Mitchell - Raytheon Technologies Corporation - CFO

Sure. Let me try to build upon the aftermarket. As I think about the year and we think about the recent IATA data on RPMs, January and February were a little bit of a slow start. That definitely picked up in March. When I think about the change in the RPM forecast that we and the industry are looking at today, I think we're pretty well aligned. It looks a little bit different today than it did 3 months ago. Clearly, the domestic routes, U.S. and China, in particular, are much stronger, so that's helping us. But on the international side, it's a little slower than we thought.

On the ASK or ASM side, the available seat miles, those are tracking pretty consistently with what we saw in January or thought we would see in January. I think the thinking that we've had as we look at the rest of the year, and there's still a long way to go, is that we really need to see those ASMs and corresponding RPMs increase here in the second quarter. And we're thinking about a 40% sequential growth in RPMs from Q1 '21 to Q2 and then again to Q2 to Q3. And then corresponding on the ASM side, think about 25% to 30% sequential growth between Qs 1 and 2, and 2 and 3.

If we see that kind of growth, then we will likely see a stronger second half. But I think at this point, it's just too early to call that. So that's how I'm thinking about that a little bit more. Shifting to...

Noah Poponak - Goldman Sachs Group, Inc., Research Division - Senior Equity Analyst

If I could just interject there really quickly, just to make sure I have it correctly? Your guidance does not imply those types of sequential moves -- or really, really close. So am I hearing you correctly that the signposts are saying that could be what happens? But just given how much uncertainty there still is with the virus and the vaccine rollout and restrictions to travel, you're feeling the need to keep the guidance fairly conservative in case things are more volatile than that?

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

Yes. I think you said that exactly correctly, Noah. I mean the fact is there's still a lot that has to go right in the back half of the year in these next 8 months of the year. And so while we're optimistic, based upon the vaccine rollout here and what we've seen in China, there is still a tremendous -- I mean keep in mind, 40% of Collins' aftermarket is widebody. And that market is down significantly. It is not recovering nearly as fast as what we thought it was going to.

So domestic market is better, international markets worse. Overall, though, still confident in the full year guidance. And to Neil's point, if the recovery happens faster, if the vaccine rollout -- and we start to see travel to Europe, for instance, in the summer season start to improve, these numbers could be better, and you'll see that in the bottom line.

And so again, we debated. We could -- there could be upside on the top line and bottom line, but it's April. And so when we see you guys in May, we'll talk about it again. You'll have a chance to talk to Steve Timm and to Chris Calio to see what they're seeing in the marketplace. And then we'll have a better view, obviously, by the end of the second quarter. But right now, we're optimistic but still cautious.

Neil G. Mitchell - Raytheon Technologies Corporation - CFO

Yes. And let me take the pension question, too. So -- and thanks for bringing it up. So yes, we did put out some new numbers there. As you know, the relief bill that was passed reduced pension funding. We currently don't see the need to do any domestic funding in the near term as a result of that bill. You'll recall that we prefunded \$800 million in 2020. That would have been our 2021 contribution. So there's nothing in '21 that changed as a result of the bill.

However, looking forward, we do get a little bit of improvement. So we'll have to fund a little bit less into our pension plans. We'll get a little bit less on the CAS recovery. It's about \$75 million next year and I think \$50 million in 2023. So good news here.

The last thing I'll add is we got a little bit of a P&L benefit here in Q1 as we've rolled this lower CAS cost into our forward pricing. Probably about 70 basis points of margin improvement at the RMD segment is where it really showed up. Going forward for the rest of the year, I don't expect to see much more of that, and we've rolled that into our forward pricing.

Noah Poponak - *Goldman Sachs Group, Inc., Research Division - Senior Equity Analyst*

How far into the future did it take down the domestic funding?

Neil G. Mitchell - *Raytheon Technologies Corporation - CFO*

It's pretty far out. I'd say, for the next 3 to 5 years right now. And of course, that depends on a lot of other assumptions that could change, but all things equal, for the next several years at least.

Operator

Your next question comes from Myles Walton with UBS.

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

I just wondered if you can speak on how -- where we left off on RMD. It outperformed on margins. And Neil, thanks for the clarity on the pension contribution there. But still, I think it was running hot and obviously no change to the full year. And then maybe talk about the bookings trends there, which obviously look lighter, and when you think that could turn around given more confidence to at least stability in the segment from a revenue perspective run rate.

Neil G. Mitchell - *Raytheon Technologies Corporation - CFO*

Sure. No problem. So yes, as you saw, 13.1% RMD margins in the quarter. We are very happy with that. As I mentioned just a minute ago, I think about 70 basis of that is a little pension tailwind that won't repeat.

We also had about 40 basis points, I'd say, of international mix, some acceleration of award timing that came through with CFR liquidation. That helped RMD here in the first quarter.

And so if you kind of adjust for those 2 items, you'll see continued margin progression, again, as the productivity improves through the year. So we're still seeing that margin growth that we would expect absent those couple of items. And I'm sorry...

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

And the bookings trends?

Neil G. Mitchell - *Raytheon Technologies Corporation - CFO*

The bookings trends, yes. So listen, a year ago and in the past 18 months, RMD has had some significant multiyear buys. So as we burn down the backlog there, our book-to-bill is a little bit lower. But later this year, we do expect Next Generation Interceptor. We talked about that. That will be

over \$1 billion booking that we'll book here in the second quarter, LRSO and some other international Patriot awards that are forthcoming later in the year. So all in all, I still expect, on a full year basis, a book-to-bill of about 1.0 for RMD and RIS for that matter.

Operator

Your next question comes from the line of Peter Arment with Baird.

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

Greg, good sequential improvement from Pratt & Whitney on the kind of the large engine inductions. How are you thinking about at least planning or visibility-wise in the second half or at least as we move forward from the recovery? And then also maybe you could just highlight how Pratt Canada is doing just given that we're seeing kind of a resurgence in biz jet flying activity?

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

Yes, Peter. So if you think about engine induction Vs, I think we had about 118 Vs into the shop in the first quarter, which is exactly on plan. And we accept -- that will accelerate, we think, throughout the year as domestic travel recovers. Right now, only about 60% of the V fleet is flying. Again, that -- it will come back, and compare that to the GTF-powered fleet, which is in the high 80s.

So again, there's a little bit of a lag in demand. But we fully expect we're going to see a big sequential -- or a sequential improvement. We're not going to get back to 1,000 engines this year, probably not for 2 more years on the V. But we're clearly going to trend that way as people need more lift in these domestic markets. So that's actually very encouraging.

As far as the rest of the aftermarket, still talking about Pratt Canada. Again, good traction in their aftermarket. We're seeing biz jet flying hours are up, as you would imagine, significantly. That's translating into some higher aftermarket. Keep in mind, most of the engines that we have out there, they were on a power-by-the-hour arrangement. So we don't actually recognize the revenue or the cost until we see those engines come back in. So flight hours are up, aftermarket is up. But it's not as much as you might think just because of the nature of the contracts.

The one area at Pratt Canada that continues to be a challenge is in the regional marketplace, the PW100, PW150 for regional transport. That market has been slower to recover. It's, again, something we expect to see next year but certainly not a big uptick this year.

Biz jet deliveries engines are very solid. Helicopter engine deliveries, solid. It's really just the regionals that are the challenge right now for Pratt Canada.

Neil G. Mitchell - *Raytheon Technologies Corporation - CFO*

Peter, just -- it's Neil. Just to go back and -- on the Pratt shop visits. We still expect Q2 to Q4 shop visit growth within the 25% to 30% range. So all that's holding, as Greg mentioned, good start to the first quarter, and then we'll see that back half growth.

The other point I would throw out there is we're watching Europe obviously, but the majority of that V fleet and our planning around those shop visits, I'd say, 80% or more, 85% or more is not in the Europe region. So we feel pretty good about that outlook.

Operator

Your next question comes from the line of David Strauss with Barclays.

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

So I think you mentioned that the Collins aftermarket was up 11% sequentially. I would imagine January, February weren't very good. Can you talk about what you saw in March in terms of how quickly the airlines can turn it back on, and then maybe also what you're seeing in April?

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

Yes. Dave, I don't know that we want to get into month-by-month compares. I would say that, directionally, that is absolutely correct. January and February were a little scary because, again, we saw an uptick in China in the virus, and the U.S. was going through the last wave. And so the air traffic was not picking up as fast as what we had expected it to. That all turned around in March. With the vaccine rollout, with China getting the pandemic under control, things got remarkably better.

And what surprised us a little bit was typically when we see a recovery in RPMs, it's usually 3 to 6 months before we see a recovery in demand for parts and repair. But in this case, because you've got so many parked aircraft out there, think about 11,000 out of 30,000 around the world are parked today, and yet demand is coming back very quickly in the U.S. and in China.

The airlines are actually being proactive in getting the aircraft ready for service in the summer selling season. And that's really what drove March, what's driving April and I think which will benefit second quarter as the airlines are not waiting to see the RPMs. They see it in their advanced bookings, and they know they need the lift. This is a very different kind of recovery than what we have seen in the past.

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

Okay. And I wanted to ask about the legacy Raytheon businesses and the margin expectation there. So those businesses were around 13% on average, blended together pre the accounting adjustments and all of that. Is there anything structurally in terms of anything different about how we should think about where those margins can get to as you're able to start booking EACs again?

Neil G. Mitchell - *Raytheon Technologies Corporation - CFO*

Yes. Let me give you a couple of thoughts. I mean, first of all, you got to keep in mind that as we implement all these synergies, which are great, they do come with a give-back to our customer, which is great because it also makes us more competitive. So that's a factor that you got to think about in the margins. But both those businesses are laser-focused on driving productivity and cost reduction throughout their businesses.

We do see the opportunity for margin expansion. It's going to be a great question for Wes and Roy in our upcoming Investor Day in May, where they'll talk a little bit more about that. We've talked about the EAC reset. We do expect that to be -- that issue to be largely behind us as we exit the year.

So you could see a little bit more margin expansion throughout this year. But these are great businesses as we get into longer-term production contracts. On the RMD side, in particular, you'll see margin expansion there. But you do have a replenishing of some of the programs. And so we've had the Patriot missile program, a very good program for us. That will get replaced with the LTAMDS in the future. So it'll be a little bit of a mix shift as the margin sort of transitions between those early LRIP contracts, when you get into late ['23 and '24] and we get out of the more mature programs that we've been in today, but a lot of potential there.

Operator

Your next question comes from the line of Robert Stallard with Vertical Research.

Robert Alan Stallard - *Vertical Research Partners, LLC - Partner*

I just wanted to follow up on Peter's question about Pratt & Whitney and the other side of the engine portfolio there. I was wondering if you could tell us what you've been seeing on some of the older aircraft variant -- engine variants that are out there and how freighters has perhaps been helping those older aircraft out.

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

Yes. So if you think about the -- so the freighters, if you think about Pratt's installed base of 11,000-plus engines or so, about 10% of that is freighters. Those are old PW4000, those are the 94-inch 767s and 747s. That has actually been a pleasant surprise, I would tell you, because freighter traffic, as everybody knows, is up significantly year-over-year given the push of e-commerce and global supply chain. So as we think about the aftermarket for Pratt, it's not all bad news. Freighters traffic is good.

At the same time, we started to see some retirements of some of the older engines out there. Not a significant number this year but pretty much in line with what we had expected, especially I think on the 112-inch. That's the 777 that we saw JAL retiring their fleet. Not a surprise that 12 months before we originally -- or we had thought they were going to retire it, but that will be putting those aircraft down. But those engines will still end up in service someplace else, probably in a freighter configuration.

So again, it's -- the older stuff is still out there. It's still a meaningful piece of the aftermarket. I think it's like 20% -- 25%.

Neil G. Mitchell - *Raytheon Technologies Corporation - CFO*

About 25%, yes, so it's still very significant. And frankly, that cargo traffic that you all know is considerably higher than it was even pre-pandemic, has helped the shop visits at Pratt in '21.

Robert Alan Stallard - *Vertical Research Partners, LLC - Partner*

And a quick follow-up, if I may. I mean it's the tough question, but how sustainable do you think this freight demand is likely to be?

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

Look, I -- as I look at how sustainable is e-commerce and this trend towards global supply chains, I think this is here to stay. The fact is global supply chains are stretched thin today, and freighters are the most efficient way to get parts from point A to point B. So I think this is not just a temporary phenomenon.

Operator

And your final question comes from the line of Cai von Rumohr with Cowen.

Cai von Rumohr - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Yes. So at our conference in February, Toby talked of 15% to 30% growth in commercial aftermarket at Collins over Q2 to Q4. That kind of seems like it fits with your full year guide. But it implies that commercial aftermarket moves up from the first quarter by something like \$250 million if it's an orderly build.

Could you give us some more color on kind of maybe the margin headwinds we look at? Because you had this huge profit gain at Collins on basically lower volume sequentially from Q4 to Q1. And as Seth brought out, your guide for the rest of the year assumes basically not much margin improvement at all sequentially, and yet you should have very strong growth in your more lucrative part of your business.

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Thanks, Cai. Just a couple of thoughts here. So as I think about the sequential growth in commercial's aftermarket -- Collins' commercial aftermarket for the rest of the year, it's a little bit lower than what we talked about in the first quarter. And that's because we've derisked that a bit by the performance we've seen. So think about 5% in Q1 to Q2, maybe 10% Q2 to Q3 and another 5% or 8% in the -- 3 to 4 in terms of growth.

In terms of thinking about the strength that you saw in the first quarter, a lot of really good work on the cost containment. E&D and SG&A combined about \$60 million of improvement. And that will come back because the team is phasing that investment during the year because we've tried to be very prudent about the discretionary elements of our spending until we see the recovery take a stronghold. So that's what I can share with you there. Appreciate the question.

Operator

I would now like to turn the conference back over to Mr. Hayes for closing remarks.

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

Okay. Thank you, everyone, for listening in today. I know it's a busy earnings day out there, but I appreciate everybody's time. Jennifer and Neil and the whole IR team will be available all day today to answer your questions. And we look forward to seeing you or talking to you on the 18th of May. Take care. Bye-bye.

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Bye.

Operator

This does conclude today's conference call. Thank you for participating. You may now disconnect your lines.

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