Honeywell Aerospace
Second Quarter 2026 Earnings Conference Call
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Presenters
Sean Meakim, Vice President of Investor Relations
Jim Currier, Chief Executive Officer
Josh Jepsen, Chief Financial Officer

Q&A Participants
Ken Herbert - RBC Capital Markets
Sheila Kahyaoglu - Jefferies
Scott Mikus - Melius Research
Myles Walton - Wolfe Research
Robert Stallard - Vertical Research
Seth Seifman - J.P. Morgan
David Strauss - Wells Fargo
Gautam Khanna - TD Cowen

Operator
Thank you for standing by, and welcome to the Honeywell Aerospace Second Quarter 2026 Earnings Conference Call.

At this time, all participants are in a listen-only mode. After the speaker's presentation, there will be a question-and answer-session. Please be advised that today's call is being recorded.

I'll now turn the call over to Sean Meakim, Vice President of Investor Relations. Please go ahead.

Sean Meakim
Thank you. Good afternoon, and welcome to Honeywell Aerospace's second quarter 2026 earnings call. On the call with me today are Chief Executive Officer Jim Currier, and Chief Financial Officer, Josh Jepsen.

This webcast and the presentation materials, including non-GAAP reconciliations, are available on our investor relations website. Our forward-looking statements are based on our best view of the world and our business as we see it today and subject to risks and uncertainties, including the ones described in our SEC filings.

This afternoon, we will review our financial results for the second quarter, provide an update on full year 2026, and then open it up for questions.

Now, I'll turn the call over to our CEO, Jim Currier.

Jim Currier
Thanks, Sean. Good afternoon, everyone, and thank you for joining us. We'll begin our presentation on Slide 3.

Eighteen months ago, Honeywell announced its intention to separate its aerospace business into a standalone public company. Nine months ago, the Honeywell Board chose me to be CEO, and today, I have the honor of leading our first dedicated earnings call since we completed our spin-off on June 29th. I could not be more energized for the road ahead of us.

We've assembled a great management team, blended together decades of experience at Honeywell Aerospace, with a healthy dose of outside industry perspective, as exemplified by Josh here right beside me. We have a purpose-built Board dedicated to the aerospace and defense industry. From top to bottom, this organization is now singularly focused and incentivized to innovate and grow to better serve our customers, shareholders and all stakeholders.

Today, we'll walk through our performance in the quarter, progress against our value creation strategy and outlook for the remainder of the year.

In the final quarter as part of Honeywell, we continued to see extraordinary demand across our entire business, driven by our compelling technologies and alignment to secular growing end markets. Orders increased by 8% over the past year, and we recently secured the largest selectable win in company history, bringing the lifetime value of year-to-date customer wins to $15 billion.

Against this backdrop of increasing demand, however, our supply base has not been able to ramp in the manner we were expecting earlier this year. After a few years of double-digit output growth, we faced supply chain constraints in the first quarter that resulted in factory volume growth below expectations. At the time, we guided you to expect a steady ramp in our output through the first half, accelerating into the back half.

While we are seeing progress, the ramp has not come through at the pace we had initially laid out. Frankly, I underestimated how long it would take to implement and see traction from the corrective measures we had taken and are taking.

Importantly, the issues remain contained to a handful of material and supplier bottlenecks.
Critical and constrained suppliers represent roughly 2% of our supply base, and the vast majority of our thousands of suppliers are delivering as expected. The issue is not reflective of an underlying health of our operations, and while we have more to do, we have invested over $1 billion in recent years and will continue to invest to increase our resiliency.

Equally important, we are moving with tremendous urgency to address near-term bottlenecks. While we didn't see traction as quickly as expected earlier this year, we are making real, tangible progress. We will walk through the specific actions we are taking in more detail, later in the presentation.

One of my top priorities as CEO is to ensure we execute on our promises to investors. Obviously, today is a far cry from this standard. Going forward, we want to ensure we deliver on our promises, and we are issuing a revised outlook with that in mind.

Despite near-term supply chain disruptions, we have a portfolio of truly market-leading technologies that provide us unprecedented visibility into future sales that will enable us to scale our business to multiples of historical levels.

We are making the necessary process improvements to deliver incremental production capacity, and as our supply chain constraints resolve, we will unlock our ability to service significant pent-up demand, leading to accelerating sales and profit growth in 2027. With this in mind, we are reiterating our 2030 targets. We remain incredibly excited about the long-term outlook for Honeywell Aerospace and confident in our future financial performance.

Josh will provide additional details on our outlook, later in the presentation, and we'll spend more time on our supply chain strategy in a moment. But first, let's turn to Slide 4. I'll discuss how we're delivering on our strategic priorities.

Our strategy is centered on three pillars. We have embedded them across our organization, and they guide our decision-making process, including how we allocate capital.

First, expand leadership in attractive end markets. We are going to grow where there is increasing profit opportunity and where we have a strong right to win because of our differentiated technology and deeply embedded positions. Our defense and space business is helping customers around the world who are seeking to ensure national security.

Much of the worldwide defense fleet and stockpiles have suffered under-investment for several decades and are now being called upon more often because of changing global realities. These dynamics require investments in modernizing for today's combat environment and sustaining operational readiness.

We are upgrading our solutions on marquee platforms where we have substantial content, such as the F-35. At the same time, we are supporting non-traditional defense primes, introducing new solutions with our ability to manufacture at scale and our proven commercial technologies, including navigation and electronic warfare.

Second, invest in differentiated technology platforms. We are advancing our innovation leadership with R&D spending of roughly 10% of our sales, the majority of which is being funded by our customers for collaborative development efforts. Our develop once, deploy everywhere approach to innovation, where we focus on technologies that are scalable across platforms and end markets, means that we maximize the returns on that spending.

Our next generation Anthem Avionics perfectly exemplifies our innovation strategy. This fully integrated flight deck was built using modular architecture so that it can scale all the way from smaller unmanned aircraft to large commercial air transport platforms. It offers increased safety and efficiency by capturing real-time data through a connected software-defined and AI-capable platform. This greatly reduces pilot workload, which is a significant step on the path towards greater autonomy.

During the second quarter, Anthem advanced formal qualification on major subsystems, taking it one step closer to commercialization and demonstrating leadership on forward-fit platforms.

Third, strengthen operational capabilities to unlock further growth. Converting the strong, highly visible demand for our solutions into sales requires supply resiliency, factory throughput, planning discipline and service capacity. Our Honeywell Aerospace Operating System, with a framework designed specifically for our industry, operationalizes the strategy across the organization and drives clear priorities, actions, and outcomes, as well as accountability.

As an example of investment priority, we are growing our own manufacturing capacity with new production lines at our existing facilities. Recently, a new line in Arizona delivered initial operational test units for Assure, our advanced electromechanical actuation system. We are also progressing expansion at our Minnesota facility for critical inertial sensing components for our leading navigational systems.

Now let's move to Slide 5 to dive into our supply chain transformation a bit further. As an independent company, we are deploying an aerospace-specific operating system rooted in continuous improvement, operational excellence and disciplined execution. It will drive standardized planning, decision-making, and improved long-term performance.

As perhaps the most significant benefit of our separation, we now have additional management focus, capital flexibility and organizational agility to use this framework to, strategically, transform how we operate from our factory floor through our supply chain.

Our actions, thus far, just have not been good enough. They have not led to the output inflection that I expected, only a few months ago. As we work urgently to address near-term bottlenecks and return to robust output growth as quickly as possible, we believe the strategic actions underway will create a foundation for greater visibility and performance in 2027, and beyond.

First, we're improving our planning processes. Our senior leaders have been working closely with our suppliers to provide them with better visibility into our future demand. I've met,

personally, with several suppliers in recent weeks and months, and the response has been remarkably positive to the increased transparency and management attention.
We are also better tying our inventory planning to our delivery schedules, which has increased customer confidence in our ability to meet our timing commitments.

Second, we're gaining better control over our supply base to increase the inflow of components. In the first half of the year, we added new sources for over 50 constrained parts, and we plan to add another 50 in the second half of 2026, increasing the number of multi-source components by 15%, this year alone. The additional sources will enable capacity expansion for specific critical materials and position the company for strong output growth in 2027.

At the same time, we've embedded resources at critical suppliers with labor bottlenecks which, as an example, led to a 20% quarter-over-quarter output increase at one key supplier.

Third, we're very focused on increased factory throughput. We introduced a new schedule attainment system as part of our operating framework, which has begun to show operational gains with attainment percentages doubling, year-over-year, and repair and overhaul turnaround times decreasing, materially. In the second half, we're aggressively targeting additional improvement with increased ability to track progress.

And finally, we're integrating our overall approach to operate as one system. Throughout our largest global facilities, we staff dedicated lean experts to support site-level adoption. They're filling in any capability gaps compared to our system-wide standards by utilizing standardized methods and problem-solving tools.

Josh, why don't you add a few comments, given you're newer to the organization?

Josh Jepsen
Thanks, Jim. I've had the pleasure of walking the lines of many of our facilities since starting with Honeywell Aerospace about five months ago and I can say that I have seen, firsthand, how incremental investments will boost output at the site level. From improvements in air and thermal control production in the U.K. to navigation and sensors in Florida, we're taking positive steps that will support material and sustainable increases.

One new initiative is increasing our investment in supplier tooling, 70% of which is going to constrained castings. That will strengthen our supply base. In 2026, we have stepped up our spend in this critical area, which offers fast paybacks. I've also been personally involved in launching the Honeywell Aerospace Operating System, and it will provide the focus and toolset to take successes in certain areas of our organization to our entire footprint.

While we're seeing early improvements and encouraging signs with certain constrained parts, we acknowledge that our progress is coming more gradually than we anticipated earlier this year. After only a few quarters under Chief Integrated Supply Chain Officer Kathy Worthen, we are building the foundation for future growth in 2027 and beyond. Kathy's leadership is enabling us to take a more strategic approach to building a more resilient supply base and while it's early days, the initial impact has been encouraging.

We are confident that the steps we're taking, while challenging in the short term, will position the company for sustainable growth, longer term.

With that, I'll hand it back to Jim on Slide 6 to discuss some of our recent business highlights.

Jim Currier
Thanks, Josh. At our Investor Day in June, we discussed how we're accelerating growth through platform content wins, RMUs, and international defense. In selectable equipment, where aircraft operators choose content for their new aircraft, we've won approximately 60% of the value of potential content on over 4,000 narrow-body aircraft in the last four years. We are continuing that momentum in 2026 with a record award.

Last month, IndiGo, India's largest carrier, selected Honeywell Aerospace avionics and APUs for more than 800 future Airbus A320 family aircraft it has on order. It was the largest selectable equipment win in our company's history and will expand our platform content in one of the fastest-growing commercial aviation markets in the world. Wins like this show how we're accelerating commercial OE momentum, even as awards for next-generation air transport platforms are several years away.

At the same time, we're also gaining additional content for the in-service fleet. Customers select our many RMU offerings to improve aircraft safety, efficiency, and capabilities. Recently, Aeroméxico announced that it will adopt our Surface Alert system solution, known as SURF-A, across its entire Boeing 737 fleet of more than 100 aircraft. SURF-A advances safety by sending pilots aural and visual alerts during taxi, takeoff, and landing, far faster than current technology, if they are on a trajectory to collide with an aircraft or vehicle on the runway.

We continue to see strong momentum for this product as more airlines adopt this innovative safety technology, and as software upgrades to existing Honeywell Aerospace equipment, SURF-A can be rolled out efficiently without disruption to ongoing operations.

In addition to our commercial momentum, we're also seeing growing demand in our international defense business, which is approximately 30% of our total defense and space end market, and where we anticipate high single-digit annual growth, through 2030. International defense budgets are expected to grow quickly amongst U.S. allies in response to new threats.

Our recent acquisition of Civitanavi, a technology tuck-in based in Italy, expands our European manufacturing footprint as customers seek EU origin technology to build up regional capabilities. Civitanavi's navigation solutions, including its ARGO 4000 inertial measurement unit, can provide precise location for missile programs, unmanned platforms and maritime vessels and land vehicles, even when GPS or other satellite signals are jammed or spoofed.

The combination of these features with Honeywell Aerospace's complementary navigation technology, program speed and scale are expected to drive a doubling of Civitanavi sales in 2026, versus the prior year.

We've won over $15 billion in lifetime value, year to date, adding to the more than $90 billion in commercial and defense platform content wins that we've collected in the prior four years, demonstrating continued momentum for our systems and technologies.

Now, I'll turn it back over to Josh on Slide 7 to discuss our quarterly results and updated outlook.

Josh Jepsen
Thanks, Jim. Honeywell Aerospace sales increased 5%, organically, from the prior period to $4.5 billion. Demand for our innovative solutions remains robust, as Jim detailed earlier, and supportive of a significantly higher growth rate. Orders over the past year increased 8% from the prior year for a book-to-bill of 1.1.

Supply constraints are continuing to limit our ability to convert demand into sales across all our end markets, with year-over-year output growth increasing 3% in the first quarter to 4% in the second quarter. We had anticipated a faster ramp, which is pushed to the right, resulting in sales growth being below our own expectations embedded in our prior 2026 outlook.

I'll discuss our profit metrics on a pro forma standalone basis, as if we had been operating independently for the full quarter and comparable period because we believe these numbers are the most representative of our future performance.

However, pro forma standalone adjustments contain estimates for run rate costs, which could vary from our actual experience as a standalone business. In the appendix of this presentation, we have provided historical quarterly adjusted EBIT by segment.

Second quarter adjusted EBIT was $1 billion. Adjusted EBIT declined 2% and trailed sales growth as a result of unfavorable mix, as well as an inventory obsolescence charge of approximately $50 million in the quarter. Excluding the charge, adjusted EBIT would have grown 3%, year-over-year.

Supply constraints shifted the allocation of shipments to our domestic defense and Engines & Power Systems OE businesses, which experienced strong growth and have lower than group average margins. While margin dilutive in the near term, these sales increase our installed base for future aftermarket services and RMUs.

Adjusted earnings per share was $1.78, down from the prior period due to higher taxes as we were separating and lower adjusted EBIT.

On the next slide, I'll discuss the second quarter performance by end market. Commercial OE sales increased 6%, year-over-year, led by double-digit growth in commercial air transport, where customers' build rates increased and our shipments continued to recouple to those rates.

Sales in the commercial aftermarket grew 8% from the prior year with strength in both commercial air transport and business aviation. The conflict in the Middle East and higher fuel prices did not have a material impact on the aftermarket demand in the second quarter.

Business aviation flight hours growth has been particularly robust, growing at a high single-digit rate.

Defense and space sales were up 3% versus the prior year. Continued strong demand drove U.S. sales up a high single digit, despite the wind down of a long-term, non-aero restricted defense program in the Control Systems segment, which we had previously contemplated in our guide.

Domestic performance was partially offset by material shortages that led to a decline in international sales, as we were unable to meet the exceptional demand for our products. International defense budgets are still increasing, driving second quarter orders up strong double-digit rate with a book-to-bill of 1.5, which provides a strong runway for the future.

Let me now turn to our 2026 outlook on Slide 9. We've revised our guidance ranges to align our expectations for the remainder of the year to similar year-over-year output growth levels, attained in the first half. Importantly, the allocation of that output to our various end markets also significantly impacts our top line and margin performance.

While we have confidence in all the actions we're taking to accelerate output near term, we believe it is prudent to set short-term financial guidance that is achievable, without dramatic improvement in supply chain performance. We firmly believe that the changes being implemented today will have a more material benefit on our financial performance in 2027, and beyond.

Although some of our output challenges are more unique to Honeywell Aerospace, as we unlock the business from these constraints, they will act as a source of differentiated growth that is largely within our control.

With that backdrop, we now anticipate organic sales to increase 4%-5% for the full year. Breaking that down by end market, we expect Commercial OE to grow at mid-single-digit rate with Commercial Air Transport continuing to lead while business aviation remains steady.

We anticipate commercial aftermarket growth of low-to-mid-single-digits as we navigate continued constraints in the mechanical supply base. We see this impact most acutely in the spares market as the reduction in available supply at a time when OE build rates are ramping disproportionately impacts our aftermarket volumes. We would also note that the aftermarket comparison versus the third quarter of 2025, which was up 23%, is significantly more challenging than in the first half.

Critically, aftermarket demand remains robust, and we expect to drive solid growth in this end market, longer-term, as our supply chain initiatives begin to yield results and drive output growth.

We expect Defense and space sales to be up mid-single-digits with domestic growth continuing to outpace international, as we push to meet obligations to our U.S. customer base.

We now anticipate pro forma standalone adjusted EBIT to be $4.35 billion-$4.45 billion. The reduction relative to our prior guidance reflects two items: $50 million from inventory obsolescence charges and the remainder from our decision to allocate our limited inventory from higher margin aftermarket international defense to lower margin OE and domestic defense.

While both growth and margin will be constrained by a lower mix of commercial aftermarket and international defense sales, we expect these headwinds to abate over time as output improves. We will continue to work on efficiency and productivity efforts to offset near-term margin pressures.

We are introducing pro forma standalone earnings per share guidance of $7.60-$7.90. You can find the details of the below-the-line expense, tax rate, and share count assumptions supporting this range in the appendix of this deck.

Our second half free cash flow expectations remain unchanged at $1 billion-$1.5 billion, a range which covers potential shifts in working capital timing and policies, as a result of separation. The midpoint of that range on an annualized basis is consistent with pro forma standalone 2025 free cash flow of $2.5 billion and continues to be a good launching point for future free cash flow growth. We anticipate capital expenditures of approximately $650 million.

Our new guidance ranges offers a prudent view of the back half of the year as we build a more resilient supply base that can support higher growth in 2027, and beyond. Actions are already underway, including a four times larger investment this year in multi-sourcing and in-sourcing, compared to last year. The teams are moving with the necessary speed and urgency, and we expect to accelerate growth, next year.

We recognize some of these investments will dampen near-term financial performance in the back half, but we believe these will drive significant value creation for the years to come. This unlock is within our control, and we are committed to delivering on it and meeting our 2030 financial targets.

Looking forward, we expect the actions we're taking today to drive a meaningful step-up in output as our multi-sourcing, in-sourcing and supplier tooling investments begin to deliver results. That output recovery is the primary lever for both growth and margin, next year. Higher volumes will drive top line and margins, and critically, as we relieve component constraints, we can direct more supply to commercial aftermarket. The spares market will feel the impact of these constraints in the back half of this year and as those components free up, we expect the aftermarket to return to strong growth.

On top of this volume and mix recovery, we're pursuing additional cost and pricing actions through our operating system that we expect to contribute to margins in 2027, and beyond.

Together, these dynamics give us confidence that improved 2027 performance will help us achieve our long-term framework.

With that, I'll turn it over to Jim for some closing comments, beginning on Slide 10.

Jim Currier
Thank you, Josh. Honeywell Aerospace is barely a month into its first quarter as an independent company, and we have a tremendous runway ahead of us to create shareholder value. Being on our own, we now have the resources, incentive alignment, and flexibility to drive sustainable above-market growth, supported by $15 billion of wins this year across all end markets and building on the $90 billion of commercial and defense wins, during the past four years.

We have a proud legacy of operational excellence, combined with a purpose-built enterprise-wide system, that will guide this process through a culture of continuous improvement and disciplined decision-making. We are making progress against the strategic priorities that will integrate supplier capacity, factory operations and customer delivery to create predictable, growing throughput.

The mission is exceptionally clear and straightforward: We must and will improve our execution and performance.

We have reset our 2026 guidance at the level our current supply base can deliver, while our long-term targets are unchanged. We have many reasons to believe that both 2027 and beyond will offer accelerated, profitable growth, on top of the items Josh mentioned earlier to drive output.

First, our recent investments in the supply base and innovation will increasingly generate attractive returns as internal and external capacity comes online and new offerings go to market.

Second, we should begin to see the incremental benefit to missiles and munition sales from our framework agreement with the Department of War.

Third, we continue to progress on repricing long-term agreements to align with significant historical cost inflation, over the past five to 10 years.

Fourth, our RMU strategy, such as our upgrades for radio altimeters that meet the FAA's recent mandate for 5G-tolerant equipment, provide growth incremental to and uncorrelated to the end market demand.

And finally, our 2024 acquisitions of CAES and Civitanavi, which are not supply limited and are growing at accretive rates, while demonstrating commercial synergies and margin expansion opportunities.

To conclude on Slide 11, I'd like to zoom out as to why Honeywell Aerospace presents a compelling long-term investment opportunity. We are a premier provider of mission-critical systems across all forms of aircraft, with deep, long-standing customer relationships that span commercial air transport, business aviation, defense, and space. Our portfolio is intentionally platform agnostic, which allows us to participate, broadly, across aircraft types, cycles and programs, while continuing to innovate at the system level.

We have a large, diversified installed base which underpins a resilient and growing aftermarket business and provides strong visibility into recurring revenue and cash flow. That installed base, combined with our technology leadership, positions us exceptionally well as the industry evolves.

At the same time, we are helping our customers solve increasingly complex challenges, from greater electrification to higher levels of safety and autonomy. These secular trends are not short-term in nature. They represent multi-decade opportunities where our capabilities and investments truly differentiate us.

Importantly, we are operating amid a multi-year aerospace and defense upcycle with revenue streams that are increasingly decoupled across OEM, aftermarket and defense markets. This diversification enhances resilience and supports consistent, profitable growth. All of this is enabled by the Honeywell Aerospace Operating System that drives execution, productivity and continuous improvement, supporting both organic sales and free cash flow growth. It also directs our investments, including the substantial spending on our supply chain to boost output.

Combined with a strong balance sheet and disciplined capital allocation framework, these strengths position Honeywell Aerospace to create long-term value as a leading independent aerospace and defense company with the scale, technology and discipline to advance the future of aviation.

Lastly, we understand that we have something to prove as a leadership team, and the 2026 reset adds to that challenge. We appreciate your patience and willingness to stick with us through 2026, as we set up the business for a strong 2027, and beyond.
With that, Sean, let's move to Q&A.

Sean Meakim
Thanks, Jim. Let's cover a couple topics in more detail before we go to those on the line. Josh, let's start with you. Could you maybe walk us from the 2026 guide we provided at Investor Day to the updated outlook we're offering today?

Josh Jepsen
Yeah, Sean, I will. I'd start by saying, structurally, as we've mentioned, nothing has really changed from a structural perspective. Demand remains quite strong and robust. I've had more time to better understand the drivers of the business and our current positioning, and there's two things that I would highlight there.

I think first, we expected acceleration of output from 1Q to 2Q, 2 to 3, and 3 to 4. We saw an increase in 2Q versus 1, but it wasn't what we expected, and we saw a lower ramp, in particular in June. As a result, we're resetting our guidance to provide a more prudent baseline that we can deliver if output remains the same from a growth perspective over the rest of the year, as what we saw in the first half.

And the second thing is we remain committed. We're steadfast in our commitments to the 2030 targets. If we turn to the guide change, specifically, sales growth is down 3%-4% at the midpoint from the prior guide. The vast majority of that is a result of lower mechanical supply and mix, then a little bit of impact from lower output for international defense.

On the EBIT side, down about $300 million at the midpoint from the prior guide, as mentioned, in the 2Q, we saw a $50 million impact from an inventory obsolescence, then in the second half, it's really a mix shift and volume leverage which contribute to a higher decremental. And that mix shift is important as we see a shift from aftermarket to OE and from international defense to domestic, both of those weighing on that.

I think these mix headwinds will abate over time, and as the supply chain capacity improves, and we're going to keep working on that. We've got a lot of actions underway, as we speak.

Sean Meakim
How do we see the guide playing out for the back half of the year?

Josh Jepsen
Certainly helpful to look at the back half, over the last two years. Last year, we grew in the back half about 12%, and when you combine that with this year's outlook for the second half, that's a normalized CAGR of about 7%-8% for the last two, which is in line with our long-term

framework. The guide assumes year-over-year output growth in 3Q and 4Q, similar to what we saw in 2Q. It is worth noting the toughest comp of the year is in the third quarter with a more normalized comp in 4Q. As a result of all that, we'd expect 3Q to be flat to up slightly, versus last year, and fourth quarter to be more in line with the fiscal year guide.

Sean Meakim
Thanks, Josh. Jim, over to you. Can you help us unpack the drivers of the slower anticipated growth in commercial aftermarket and defense and space? Just trying to unpack how much of this is supply versus demand, what's being driven by the market versus what's specific to Honeywell Aerospace.

Jim Currier
To emphasize the point here, this is clearly a supply issue and not a demand issue. We mentioned earlier our orders are up 8% on a rolling 12-month. All three end markets have contributed to that 8%, order growth that we have seen. Defense and space has led the order growth due to continued geopolitical conflicts, sustainment procurement, budget increases that are occurring, both domestically and internationally.

So, again, it goes back to what we've been saying. Our growth is constrained by our supply base, which is our singular area of focus to unlock and drive value and growth for the business. To identify specifically where we're in, as we've talked about beforehand, it's the mechanical supply base. But to that end, I think it's a little important here to provide a little bit of context around our supply base and to emphasize a few points here.

We have over 3,000 suppliers that support Honeywell Aerospace; 98% of them are performing, exceptionally well. What I will tell you, the significant improvement, that's a significant improvement from where we were three years ago when I came into the role. So, we've seen a lot of progression throughout our supply base, as evidenced by our double-digit output growth that we've seen over the last couple of years. So, a tremendous amount of effort, investments that were made, and we've seen the benefit thereof.

This remaining 2%, I would categorize them as follows, into two very distinct categories. There are those that are constrained. Those that simply are not providing the output that we need, but that represents, literally, a handful of suppliers. The balance, I would call them critical. These are those suppliers that have yet to demonstrate a level of robustness and consistency that is aligned to my expectations.

So, we enhance our surveillance and engagement with them, as well as a result. But I'll tell you, with the strategic actions we have underway, we are creating that foundation of greater visibility and improved performance in 2027 and beyond, Sean.

Sean Meakim
Thanks, Jim. Alicia, let's please open the line for questions.

Operator
Thank you. We will now be conducting a question and answer session. If you would like to ask a question, please press "*", "1" on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press "*", "2" if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset, before pressing the star keys. We ask that you please limit yourself to one question and one follow-up.

Our first question comes from the line of Ken Herbert with RBC Capital Markets. Your line is now open.

Ken Herbert
Yeah. Hey, good afternoon, Jim and Josh and Sean. Maybe just to start to drill down on that comment, the change in the supply chain performance from what you were seeing in early June to today seems, I think, obviously more drastic than I think lack of improvement would imply.

Can you talk, maybe, Jim, just in a little more detail, what gives you confidence now that you will see some improvement into the back half? And within the mechanical components piece, anything in particular that took a step back maybe in the last few months that contributed to the lower than expected improvement that you saw, across the supply chain?

Jim Currier
No, good afternoon, Ken. What I would tell you is, and emphasizing a point that was made earlier, structurally, nothing has changed that is causing the revised guide that we're seeing. Frankly speaking, overestimating the pace of the output improvement and pushing that to the right is what we're seeing, is really what is driving the revised guide that we have.

Again, we were expecting a significant amount of ramp in the third month of the quarter. In this case, it was June when we provided our guide at the investor event in early June. Our typical profile has always been that the third month of the quarter, we see a very high percentage of the total quarterly revenue materialize.

And even though we were seeing improvement in the early parts of Q2, and that expectation of the growth in that third month of June, it was not at the rate that we had expected to see, going forward. We're taking a very prudent baseline view when we decided to reset that. That even if the supply chain output remains the same, that was a contributor to the revised guide. And I know it's a very big disappointment, but I will tell you, we are exceptionally confident that we're going to see significant output that is sustainable for stronger growth in 2027. I'll add another little point here, as well.

When I came into this role in August of 2023, leading Honeywell Aerospace, I spent a significant amount of my time with customers, rebuilding relationships, establishing partnerships, and I believe that has gone very well for us, going forward. This is the second phase of that activity of where we need to pivot and where I have pivoted my personal time in spending time with these suppliers. It's one ecosystem that I talk about when I talk about Honeywell Aerospace. There's the customer segment, the internal piece, and then the suppliers. So, spending time with suppliers, reestablishing those partnerships in like manner to what I did with customers coming into the role is where we're focusing that time and attention.

And I will tell you, from those personal engagements face-to-face at the supplier locations, we've seen the confidence building through the transparency that we have been providing to them and the visibility that we are providing to them. This improved output that we are expecting in the second half of the year, albeit delayed from what we had anticipated when we gave our guide in early June.

Josh Jepsen
Ken, this is Josh. Maybe one thing I'd add is just this is a pivot to from, and we've said this, from pure brute force to strategic actions and really thinking about what are the things we need to do to build this sustainably, going forward. One of the things, and this is the benefit of separation, is capital allocation and being able to put more CapEx into this area. So, we talked about it, four times the amount of investment going to insourcing and multi-sourcing.

We're doubling the amount of supplier tooling that we're buying between 2025 and 2027. Those are things where we're putting capital into those, that some of those aren't quick, some of them are long lead times, but we think will drive sustainable output growth as we go forward, which we think are really critical.

Ken Herbert
Thanks, Josh. Maybe just to follow up on that, can you just be maybe a little bit more explicit on what the guide for the second half of this year implies in terms of sort of sequential supply chain improvement from second to third and third to fourth quarters?

Josh Jepsen
From an output perspective, we're essentially expecting 3Q and 4Q to have the same amount of growth that we saw in 2Q, so call it roughly 4%. That's essentially what we carried forward. If you went back, our previous guide would have seen a step up, one to two and then again two to three and three to four. We think based on what we've seen. We're resetting this to say we think this is flatter in terms of a growth perspective across the year, and that's why we're accelerating some of these investments and other things to try to drive further output.

Sean Meakim
Ken, this is Sean, just one nuance I'd highlight. Given the seasonality in the business throughout the year, output is higher in the guide second half versus first half. But as Josh said, the year-over-year output growth is comparable between the two halves.

Ken Herbert

Perfect. Thanks, Sean. Thanks, gentlemen.

Operator
Thank you. Our next question comes from the line of Sheila Kahyaoglu with Jefferies. Please proceed.

Sheila Kahyaoglu
Good afternoon, guys. Thank you so much. Maybe you guys discussed this a bunch, but how do we, I guess, think about the guidance cut, how much of the top line and EBIT cut is coming from supply chain? And maybe just to put a finer point on it, what are three things that we should look for in the next six months as you look to fix the supply chain and resurrect growth in '27?

Josh Jepsen
Yeah. Thanks, Sheila. I would say the vast majority, if you think back half of the year, it's all predominantly top line is really driven by the supply side. We've seen demand continue to be really robust, so that's not the challenge. If you think top line, it is essentially limited supply, and then importantly, the mix amongst the businesses. So, s supply gets tighter, given the ramp in OE, we're pushing more of our available output to the OE side, which puts downward pressure on aftermarket. And given the dynamics around aftermarket, it has an outsized impact on that business. So, top line, that's really the main driver.

If you think about the EBIT reduction, again, a little bit of that is the $50 million of inventory obsolescence that we took in 2Q, and then the remainder is mix, which I just described, and then volume leverage, just volume coming in. Those are really the two big components that impact the guide in the back half of the year and the change, overall.

Jim Currier
And one thing I would add on top of that, Sheila, if I may. Kind of following up on the commentary around the personal visits that we've been making, I'll kind of conceptualize and put some texture around this a little bit. As one of these key suppliers that is constrained for us, one of those categories that I described a moment ago, the past due of this particular supplier is roughly $15 million-$16 million.

And you would think that's not a significant amount of past due on a business that's $18 billion in revenue, that's the size of Honeywell Aerospace, but the reality is that one component coming from this one supplier at being about $15 million of past due actually unlocks hundreds of millions of dollars of revenue output for Honeywell Aerospace, so it is disproportionate.

So, even though it's a small group of constrained suppliers, they have a very disproportionate impact on our output volume growth going forward, and that's where we're hyper-focused with the team spending personal time.

Sheila Kahyaoglu

Got it. Can I follow up on the supply chain? At the supplier, who makes the decision to allocate that part to you, that $15 million to you rather than someone else because others might not be seeing the same issue? How can we think about that?

Jim Currier
Yeah, I would characterize, I mean, the industry overall is supply constrained and we, within the industry, are all working to increase output across the board. These are some very specific issues with this handful that are truly limiting our output, revenue and profitability, which creates challenges, obviously, but also opportunities to unlock.

And this is where we insert ourselves as well through supplier investments that we make with respect to some of these constrained suppliers. Tooling investments that we make for these special parts that they make for us, doubling that amount of investment that we're doing. It increases yield throughput for some of these suppliers. It reduces the rework cost associated with these suppliers and provides us a very, very high ROI and a fast payback as a result of that. So, that's where we're continuing to invest more, that's going to unlock within that supply base, as well, for these specific ones for Honeywell Aerospace.

Josh Jepsen
One thing I'd add, too, is investment, not only in dollars, but also in partnership, in working together in clarity, visibility and the like is really critical. The team's been leaning in there.

Sheila Kahyaoglu
Thank you.

Operator
Thank you. Our next question comes from the line of Scott Mikus with Melius Research. Please proceed.

Scott Mikus
Good evening. Jim, in the opening remarks, there was a lot of talk about dual sourcing critical components. You currently have more than 3,000 suppliers. If we look at that today, how many are sole source? And if we were to look three to five years from now, how many of those suppliers will still be sole source?

Jim Currier
Yeah, so we focus our dual sourcing, multi-sourcing and in-sourcing strategy on those that are most constrained within the supply base. As I mentioned, 3,000 of our suppliers are performing exceptionally well. It doesn't mean we're not going to continue to dual source and multi-source them because as we see the continued growth within the business, we need to continue to augment the supply that is available to us to capitalize on the demand and the growth that we are seeing.

Year to date, to kind of conceptualize it a little bit, year to date, we have actually second-sourced 50 suppliers, and we plan on doing another 50 suppliers through the second half of this year as well, on top of sourcing, dual sourcing, and insourcing that we had done in the prior years. So, ultimately, it's that progression of what we're doing.

The intent is not to dual source every single part of the tens and hundreds of thousands of SKUs that we buy. Butin those areas where we are constrained, in those areas where there are critical suppliers, and in those areas that we have suppliers that are performing, yet we know there's additional investment that needs to happen for the growth that we are planning for in the business to support the demand, we will continue to dual, multi and insource.

Scott Mikus
Okay, you had the $50 million inventory obsolescence charge. Are your supply chain issues causing your airline customers to turn to DER repairs and PMAs to alleviate some of the supply chain issues?

Jim Currier
Yeah, there's no correlation to the inventory obsolescence issue that we did in the second quarter. What I would tell you is we are still seeing significant demand in the commercial aftermarket, both in terms of repair and overhaul and in spares. So, we're not seeing a demand shortfall versus what we would've expected that is aligned to our entitlement and that is aligned to the flight hours that are occurring within the commercial air transport market. So, we're not seeing a shift away from bringing those products for repair and overhaul and/or spares away from Honeywell Aerospace.

Scott Mikus
All right. Thank you.

Operator
Thank you. Our next question comes from the line of Myles Walton with Wolfe Research. Please proceed.

Myles Walton
Thanks. Good evening. Josh, I think I heard you give the back half of the year guidance by quarter. I just want to make sure I got that correct, that you're looking for a flat sequential in the third, more or less, and then a 10% sequential growth in the fourth quarter. I guess the question is, is the guidance really de-risked if there's that much of a sequential hockey stick into the fourth quarter?

Josh Jepsen
Yeah, so if we compare 3Q to 3Q, yeah, we do think that's relatively flat year-over-year, and that's really driven by, as I mentioned, that's the toughest comp. Just for perspective, commercial aftermarket last year, 3Q was up like 23%. That puts the most pressure on that one

from a comp perspective. 4Q versus 4Q, we would expect to be up kind of in line with our full year guide. Call it in that four to five range.

Sean Meakim
Myles, to your point on sequentials, we do see our strongest sequential move in the fourth quarter every year, so I wouldn't view that seasonality as outsized relative to prior years you can see in the historical financials.

Myles Walton
Have you ever had a double-digit sequential growth in 4Q?

Sean Meakim
I would say that if you go back, look to the historicals, the biggest sequential move has always been 3Q to 4Q, then we see a natural step down 4Q to 1. I don't view this as outsized relative to historical precedent for the business.

Myles Walton
Okay. Then Jim, on the guidance cut, does the difference just drop into delinquency, so you'll end the year at $2.6 billion+ of delinquency? Then, I guess, what's the drawdown of that delinquency from a timeframe?

Josh Jepsen
Hey, Myles, it's Josh. Yeah, I think given the shift in change, our backlog grew, as we pointed out, and probably a little bit of growth in the past due side. Again, that's why so much of the focus, you hear us, and we're putting our dollars to work from a capital perspective, is on driving additional output, additional capacity, through the supply chain, through our manufacturing footprint, to be able to start to work that down and to reduce those past dues over time.

Jim Currier
The only other point that I would add relative to that is, the added comment would be the days that the parts were sitting in the past due, the churn of those parts going into the past due is accelerating coming back out, so we're reducing the overall turn times for the past due that we have on the books right now. But to Josh's point, the strong exceptional demand that we have, the lack of the unlock and the reallocation to OE versus aftermarket that we've had to do, it does create a modest past due backlog increase.

Myles Walton
Okay. Thank you.

Operator
Thank you. Our next question comes from the line of Robert Stallard with Vertical Research Partners. Please proceed.

Robert Stallard
Thanks so much. Good evening.

Jim Currier
Hey, Rob.

Josh Jepsen
Hey, Rob.

Robert Stallard
Jim, this might be a question for you. Given these supply chain issues that you're experiencing, are you in any way jeopardizing the OEM ramp plans? And have any of these delays that you've experienced led to any compensation discussions with your customers? Thank you.

Jim Currier
Yeah, we're delivering for our OE customers and ramping our shipments with the build schedules, Rob. We stay intimately tied out with our OE customers. What I would tell you is our supply plans, our commitments are aligned to their published production rates that they are experiencing and driving. Ultimately, that is the conundrum, though, as the output is the way it is right now, we end up driving more towards the OE to be able to support that.

I think it's important to understand a little bit of the commercial OE makeup of Honeywell Aerospace. It is not just one customer. It is not just one end market. It's the commercial air transport market and the business aviation market, and they do bifurcate one another, whereby 50% of our OE business is commercial air transport, 50% of that OE business is business aviation.

And so, even though in aggregate, you kind of saw what we were demonstrating the first half of being 5%, you could clearly expect that that growth that is occurring in the commercial air transport portion of that is in line with what we're seeing in terms of growth from our commercial air transport customers and supporting them, accordingly.

Robert Stallard
Okay, thanks so much.

Operator
Thank you. Our next question comes from the line of Seth Seifman with J.P. Morgan. Please proceed.

Seth Seifman
Hey. Thanks very much, and good evening. Wanted to ask the emphasis that you put on castings a little bit earlier. Should we infer that that's the place where you have sort of the most pressure in the supply chain? And to the extent that that's true, do we think of that as being in

kind of the bigger casting houses and therefore, it's about maybe their priorities are elsewhere, and there's a need to recalibrate that? Or is it in some of the maybe smaller places that might be struggling?

Josh Jepsen
Hey, Seth, it's Josh. We talked about this, and it is kind of some of the things you'd expect. Castings are definitely one of them, and we pointed out we're putting significant portion of our CapEx that's going to supplier tooling into castings to drive additional capacity, as well as new tools to drive higher yields and less rework and those sorts of things. But we also see forgings, we see it in complex machining, we see it in bearings. So, it's a few of those categories in the mechanical side. This is much more unique to the mechanical side versus the electronic side. But those are the areas that we're really focused on.

Seth Seifman
Okay. I saw you kind of maintain that second half free cash flow outlook, reduced outlook for earnings. I'm not sure if the level of investment that you're making in the supply chain is greater than previously planned, given some of these headwinds that have popped up. Should we think about that cash flow now being more at the lower end?

Josh Jepsen
I think the range we maintained, again, is somewhat wide intentionally, given kind of all the moving pieces coming through separation. We do have a little bit lower EBIT which impacts that but I think at the same time, we're seeing maybe a little bit of improvement on the working capital side. We would've said in the middle of that range, and I think that's still reasonable based on how we're operating. But again, a lot of moving pieces. That's why we kept it intentionally wide here as we work through the back half of the year.

Jim Currier
Just to add a comment on top of that, I think that is actually one of the benefits of being a standalone that we're realizing here as well, is that we're able to think within the business more strategically, particularly around where we want to accelerate capital investments to drive the highest ROI outcome for the business. So, being able to be agile and being able to move quickly, where necessary, to drive those investments and then be able to balance that across the portfolio where we need to as necessary, is actually a strong benefit for us as being a standalone.

Seth Seifman
Thanks very much.

Operator
Thank you. Our next question comes from the line of David Strauss with Wells Fargo. Please proceed.

David Straus
Great, thanks. Good evening.

Jim Currier
Hey, David.

David Strauss
Hey. Jim, high level, the question I get from a lot of investors is why are you, disproportionately, this far into kind of the ramp up, why are you seeing such a disproportionate impact from supply chain issues? I can't really cite anyone else that's putting up mid-single digit growth at this point. Everyone's kind of solidly double-digit growth. I'm just, your perspective on why the supply chain issues are unique to you, and how did we kind of, or how did you guys kind of end up here a couple of years into the ramp?

Jim Currier
What I would say, David, is this is a multi-year journey. We started this journey a couple of years ago, when I came into the role. As I mentioned, over 3,000 suppliers support our business. We're down to those critical ones and the constrained ones that I mentioned, which is about 2%, which means that 98% of that supply base is functioning well.

But what I would say is the journey to get to where we are to the 2% was not 98%, 2%. It was substantially worse over that journey. So, we were focusing a tremendous amount of attention pan-aero supply base within Honeywell Aerospace to be addressing those issues to get to this part of the journey where it's 98% is functioning well, and these critical, very difficult to solve, very time-consuming are causing us the most pain at the moment.

These are the ones that are difficult in the sense that this kind of goes back to our earlier comment, where I overestimated the pace at which we were going to be able to solve some of these issues, and that is the result in down that we did on the revised guide that came forward.

David Straus
Okay. A quick follow-up. In terms of recoupling to kind of industry growth in '27 or maybe even getting to the point where you outgrow, like you outlined at the Investor Day, how much of that getting there do you feel like is just these critical suppliers getting healthy, getting better, versus kind of improvement in your own house and improvement driving the Honeywell Operating System?

Josh Jepsen
David, it's Josh. By and large, it is output driven. The more output that we are able to get through the supply chain and through our facilities, I think that is what unlocks this. Given the backlogs we have, given the order books that we've seen, we've got tremendous runway of demand to fulfill, so I think that's the biggest piece. Again, it's two pieces, getting the material, and I think continuing then to drive efficiency. We talked about our Honeywell Aerospace

Operating System, and I think both in driving productivity and efficiency becomes really, really critical.

Jim Currier
Yeah, I think a couple things I would add on to that as to why I feel confident about our 2027 performance expectations. Being on the road, face-to-face with our suppliers and looking at the plans and looking at the burndown that is occurring and where we are investing, where 70% of our capital investments are external, outside of our four walls, 30% of it is internal, improving our capacity.

We talked about a new line that we put in Arizona for our Assure product line, what we're doing in Minneapolis and investing there in terms of capital to expand capacity for our navigational business. So, that is single-handedly the biggest driver, and we will get improved output from our suppliers. That's one key point.

Second key point around the 2027 performance expectations and why I'm confident is that as more output comes from our supply base, it allows us to be able to fulfill more of the commercial aftermarket and more of the international defense business as well, which is very positive revenue, higher margins for us across the board.

Then, secondarily, pricing. As with every year, we're making progress on our long-term contract renewals that are going to recouple price that is aligned with the cost that we've been incurring across the business and across the portfolio. That will start to materialize in 2027 and beyond, which is why I have a lot of confidence in our 2027 performance expectations.

David Straus
All right. Thanks, Jim. Thanks, Josh.

Operator
Thank you. Our last question comes from the line of Gautam Khanna with TD Cowen. Please proceed.

Gautam Khanna
Thanks for the time on the earnings call here, going a little longer. I was curious, in the arrears, the delinquencies, can you remind us the mix of OE versus aftermarket versus defense and space? And is there any economic consequence, is there any pricing concession or penalty associated with one of those sub-markets for being late versus the others?

Jim Currier
Yeah, I think the general makeup of our past due backlog is roughly in line with what you see the revenue is associated with the business, generally speaking, in terms of commercial and defense. You could believe, and there is the possibility where these delinquencies transcend themselves into penalties.

But fact of the matter is, based upon what we have done over the last couple of years, meaning the time that we've spent with customers, the time we have spent partnering with them, the time we have been transparent with all of the investments that we have been making into the supply base to unlock and provide more product to them, they are most interested in keeping those investments flowing at the levels that we're keeping them to flow because any penalties associated with late deliveries pale in comparison to the benefits that they realize with more output from Honeywell Aerospace.

So, it's that partnering and transparency and being able to continue to invest in the way that we are into the supply base, kind of negates these issues around potential penalties on late delivery.

Gautam Khanna
Just as a follow-up, thank you for that. With respect to the inventory obsolescence, A, is that something that could occur again in Q3? I didn't quite understand why in Q2. Is it done every quarter, and is there some cascading dynamic to it where it could be repeated? Secondly, if you could give us some flavor by segment of where that inventory write-down occurred. It sounds like it was bigger at E&PS, but I would appreciate it if you gave us some flavor, by segment.

Josh Jepsen
First, we would not expect that that's recurring. I mean, you're always looking at that, but we think that was, as we dug in, as we were going through pre-separation, we looked at that and there were a few areas where we saw that. So, yeah, would not expect to see that on a quarter-on-quarter basis. You're right in terms of the mix of that. The vast majority of that was in Engines & Power Systems, maybe a very little bit in Electronic Solutions, but the vast majority was sitting in E&PS.

Gautam Khanna
Thank you.

Operator
Thank you. I would now like to turn the call back over to Jim Currier for closing remarks.

Jim Currier
Thank you. I'd like to express my deepest appreciation to the 36,000 Honeywell Aerospace employees around the world for your dedication, your focus and your perseverance, as we have set off on our own. To our customers, we never take for granted your trust in our ability to deliver to the highest standards. To our suppliers, we are committed to further strengthening our partnerships and growing together.

Finally, to the investors joining us today, we have the utmost confidence in our strategy to create substantial value going forward, and I look forward to sharing our progress with you in the coming quarters. Thank you.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.