

## Howmet Aerospace Inc.

## Flying through turbulence: expect strong growth despite uncertainty at OEMs

Reiterate Rating: BUY | PO: 52.00 USD | Price: 43.81 USD

## Mixed signals: strong 1Q + raised outlook amid OEM risk

Howmet Aerospace (NYSE: HWM) reported a strong quarter on both revenue and EPS, motivating the company to raise its outlook for FY23 (see our pre-call earnings note). Management now expects ~9-12% topline growth (vs. prior ~6-9%). While even a weaker 2H23 could enable HWM to achieve its full year targets, uncertainty around OEM production rates adds a layer of fog that obscures the finish line. Despite signaling from Boeing management and industry data pointing to softer 737 MAX deliveries through the remainder of this year, HWM remains confident that Boeing will reach 38 deliveries/month in 2H23. Additionally, the company is hiring to meet this perceived demand, adding ~500 employees in 1Q with similar expectations for 2Q. We fear that difficulties at the OEM level may be more pronounced than expected, which could pressure HWM's full year outlook.

## Move away from Russian titanium still an opportunity

The movement away from Russian titanium by western OEMs has presented a significant opportunity for Howmet. Share gain from Russian titanium suppliers contributed to ~\$20mn in sales in 4Q22. Through the whole of 2023, management expects that the shift away from Russian suppliers could contribute an additional \$100mn in revenue. The company expects this could grow by ~25-30% in 2024 to \$125-130mn in sales. HWM continues to prepare for these sponge requirements and is prepared for a production ramp at its titanium furnaces through 2023.

## Reiterate Buy, Raise PO to \$52

Despite near term uncertainty on OEM production rate, we believe HWM will continue to benefit from accelerating defense demand and the broader commercial air traffic recovery. We are shifting our valuation to P/FCF from DCF in order to give HWM the benefit of working capital improvements in the immediate term. We raise our PO to \$52 from \$45 based on a 1.3x relative P/FCF multiple on 2024 estimates. We believe a 1.3x relative multiple, above the 1.1x historical average, fairly reflects the upside of the commercial recovery.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	1.01	1.41	1.67	2.15	2.50
GAAP EPS	1.01	1.41	1.67	2.15	2.50
EPS Change (YoY)	24.7%	39.6%	18.4%	28.7%	16.3%
Consensus EPS (Bloomberg)			1.68	2.06	2.43
DPS	0.04	0.10	0.18	0.18	0.18
Valuation (Dec)					
P/E	43.4x	31.1x	26.2x	20.4x	17.5x
GAAP P/E	43.4x	31.1x	26.2x	20.4x	17.5x
Dividend Yield	0.1%	0.2%	0.4%	0.4%	0.4%
EV / EBITDA*	19.5x	17.4x	15.7x	13.9x	12.7x
Free Cash Flow Yield*	1.4%	3.0%	3.6%	4.7%	5.2%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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**Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.**

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Timestamp: 09 May 2023 03:00AM EDT

09 May 2023

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	45.00	52.00
2023E Rev (m)	6,341.0	6,249.5
2024E Rev (m)	7,137.0	7,038.3
2025E Rev (m)	7,537.0	7,432.3
2023E EPS	1.75	1.67
2024E EPS	2.20	2.15
2025E EPS	2.60	2.50
2023E DPS	0.16	0.18

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## Stock Data

Price	43.81 USD
Price Objective	52.00 USD
Date Established	9-May-2023
Investment Opinion	B-1-7
52-Week Range	29.84 USD - 45.70 USD
Mkt Val (mn) / Shares Out (mn)	18,106 USD / 413.3
Average Daily Value (mn)	124.46 USD
BofA Ticker / Exchange	HWM / NYSE
Bloomberg / Reuters	HWM US / HWM.N
ROE (2023E)	18.0%
Net Dbt to Eqty (Dec-2022A)	93.6%

## ESGMeter™

High

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# iQprofile<sup>SM</sup> Howmet Aerospace Inc.

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	6.2%	8.0%	10.4%	11.6%	12.6%
Return on Equity	12.5%	16.7%	18.0%	19.9%	19.8%
Operating Margin	15.0%	16.2%	19.0%	19.2%	20.3%
Free Cash Flow	250	540	653	849	944

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.0x	1.2x	1.3x	1.3x	1.2x
Asset Replacement Ratio	0.7x	0.7x	0.9x	1.0x	1.1x
Tax Rate	20.4%	22.6%	23.0%	23.0%	23.0%
Net Debt-to-Equity Ratio	100.1%	93.6%	75.9%	55.4%	39.5%
Interest Cover	2.9x	4.0x	5.4x	6.7x	8.6x

## Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	4,972	5,663	6,249	7,038	7,432
% Change	-5.5%	13.9%	10.4%	12.6%	5.6%
Gross Profit	4,972	5,663	6,249	7,038	7,432
% Change	-5.5%	13.9%	10.4%	12.6%	5.6%
EBITDA	1,136	1,276	1,412	1,602	1,749
% Change	5.2%	12.3%	10.7%	13.4%	9.2%
Net Interest & Other Income	(424)	(313)	(266)	(257)	(214)
<b>Net Income (Adjusted)</b>	<b>442</b>	<b>593</b>	<b>694</b>	<b>885</b>	<b>1,014</b>
<b>% Change</b>	<b>24.9%</b>	<b>34.2%</b>	<b>17.0%</b>	<b>27.5%</b>	<b>14.6%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	258	469	712	843	994
Depreciation & Amortization	270	265	282	264	264
Change in Working Capital	(441)	(246)	(297)	(186)	(229)
Deferred Taxation Charge	38	79	60	60	60
Other Adjustments, Net	324	166	139	138	138
Capital Expenditure	(199)	(193)	(242)	(270)	(283)
<b>Free Cash Flow</b>	<b>250</b>	<b>540</b>	<b>653</b>	<b>849</b>	<b>944</b>
<b>% Change</b>	<b>NM</b>	<b>116.0%</b>	<b>21.0%</b>	<b>29.9%</b>	<b>11.2%</b>

## Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	720	791	649	724	794
Trade Receivables	367	506	589	675	733
Other Current Assets	1,650	1,846	1,837	2,077	2,168
Property, Plant & Equipment	2,467	2,332	2,287	2,292	2,312
Other Non-Current Assets	5,015	4,780	4,796	4,796	4,796
<b>Total Assets</b>	<b>10,219</b>	<b>10,255</b>	<b>10,158</b>	<b>10,564</b>	<b>10,804</b>
Short-Term Debt	5	0	0	0	0
Other Current Liabilities	1,248	1,482	1,318	1,513	1,483
Long-Term Debt	4,227	4,162	3,763	3,363	2,963
Other Non-Current Liabilities	1,231	1,010	975	920	870
<b>Total Liabilities</b>	<b>6,711</b>	<b>6,654</b>	<b>6,056</b>	<b>5,796</b>	<b>5,316</b>
<b>Total Equity</b>	<b>3,508</b>	<b>3,601</b>	<b>4,102</b>	<b>4,768</b>	<b>5,487</b>
<b>Total Equity &amp; Liabilities</b>	<b>10,219</b>	<b>10,255</b>	<b>10,158</b>	<b>10,564</b>	<b>10,804</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Aerospace

## Company Description

Howmet manufactures components for jet engines, fasteners and titanium structures for aerospace applications and forged aluminum wheels or heavy trucks within its four main business segments - Engine Products, Fastening Systems, Engineered Structures and Forged Wheels. The company separated from Arconic Corp in April 2020 and has since been focused on product quality, long term agreements and improving free cash flow.

## Investment Rationale

We believe HWM has only begun to unlock shareholder value post-separation from Arconic Corp. Through a combination of pricing initiatives, cost cutting and strategic positioning we estimate HWM will grow EPS at a nearly 17% CAGR from 2022-2027. With available forging capacity HWM has the potential to backfill the lost supply from VSMPO for Airbus and/or Boeing which could start to benefit the top line in 2023.

## Stock Data

Average Daily Volume 2,840,899

## Quarterly Earnings Estimates

	2022	2023
Q1	0.31A	0.42A
Q2	0.35A	0.43E
Q3	0.36A	0.40E
Q4	0.38A	0.42E

## Strength in aero recovery, defense holding up well too

### Upside from widebody recovery still on the horizon

HWM continues to see strength from both the commercial aero recovery as well as ramping defense demand. The commercial aerospace end market recorded its eighth consecutive quarter of growth in 1Q23, now accounting for 47% of total revenue. However, this is still short of the pre-pandemic level of 60% of revenue, reflecting significant room for continued growth as air traffic demand continues to rise.

Additionally, we have yet to see the widespread benefit of the widebody recovery, which management projects will come in 2H23 and 2024 on anticipated rate increases on the A350 and 787 programs. The company continues to hire disproportionately at the Fastening Systems business in preparation for this mix shift.

### Defense remains robust on heightened F-35 demand

Despite some softness through the past couple quarters, the Defense end market saw a strong start to 2023 with 11% Y/Y growth. The strength came largely from the F-35 program and legacy spares. We expect HWM to continue benefiting from defense demand as the F-35 wins further orders from NATO allies. Across the other end markets, commercial transportation grew 17% Y/Y on higher volumes. Industrials 16% Y/Y largely on strong oil and gas demand (+53% Y/Y).

## Inventory poses challenge in the event of lower OEM rates

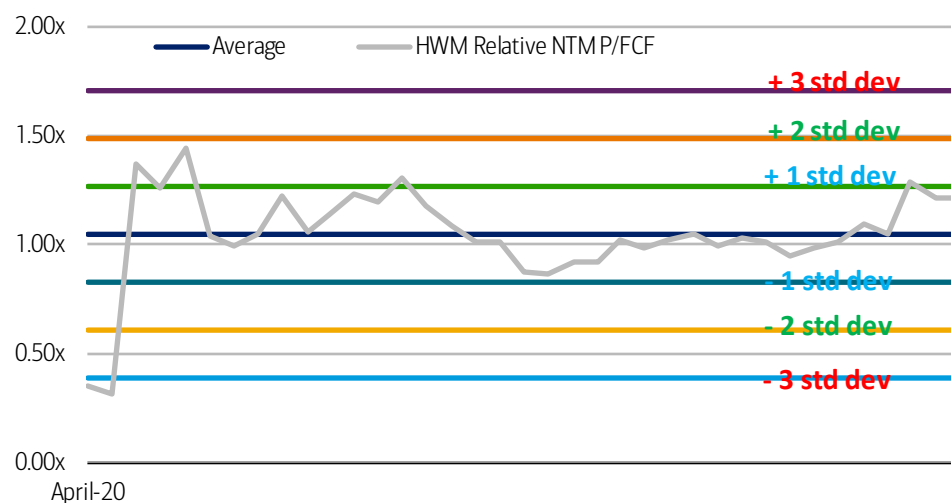
We believe higher inventory levels could pose a risk to free cash flow in the event that the OEMs do not actually reach their production targets for 2023. Inventory has risen ~\$179mn since 1Q22, and management chose not to lower inventories in the first quarter. The company expects to keep inventory levels elevated in preparation for rate increases at the OEMs. However, in the event that these rate increases do not occur, HWM may be unable to execute on its planned FCF improvement through the end of the year.

## EPS estimate changes

We lower our 2023 EPS estimate to \$1.67 (vs. prior \$1.75), in line with management outlook of 2023 EPS of \$1.65-1.70. We lower our 2024 EPS estimate to \$2.15 (vs. prior \$2.20) and our 2025 EPS estimate to \$2.50 (vs. prior \$2.60).

### Exhibit 1: HWM P/FCF multiple relative to S&P 500

On average, HWM has historically traded 1.1x the market multiple on a P/FCF basis



Source: BofA Global Research, FactSet

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## Price objective basis & risk

### Howmet Aerospace Inc. (HWM)

Our PO of \$52 for HWM is based on a relative P/FCF multiple of 1.3x, resulting in a 25.5x P/FCF multiple. We believe a 1.3x relative multiple, above the 1.1x historical average, fairly reflects the upside of the commercial recovery.

Upside risks to our PO are an accelerated commercial aero upcycle, additional wins from commercial OEMs moving away from VSMPO, increased F-35 sales either domestically or internationally, and further pressure on emissions standards, thus benefitting the company's wheels business.

Downside risks are the economic backdrop results in another downturn to the commercial aero cycle that is not offset by the unmet demand of the last few years, F-35 program deliveries decline and the trucking industry sees a significant downturn.

## Analyst Certification

I, Ronald J. Epstein, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	AerCap Holdings N.V.	AER	AER US	Ronald J. Epstein
	Air Lease Corporation	AL	AL US	Ronald J. Epstein
	BWX Technologies, Inc.	BWXT	BWXT US	Ronald J. Epstein
	CACI International	CACI	CACI US	Mariana Perez Mora
	Cadre Holdings Inc	CDRE	CDRE US	Elizabeth Grenfell
	Crane Co.	CR	CR US	Elizabeth Grenfell
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	Howmet Aerospace Inc.	HWM	HWM US	Ronald J. Epstein
	KBR	KBR	KBR US	Mariana Perez Mora
	Leidos Holdings	LDOS	LDOS US	Mariana Perez Mora
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	Rocket Lab	RKLB	RKLB US	Ronald J. Epstein
	Teledyne Technologies Inc	TDY	TDY US	Elizabeth Grenfell
	Terran Orbital Corporation	LLAP	LLAP US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
	Triumph Group	TGI	TGI US	Ronald J. Epstein
<b>NEUTRAL</b>				
	Albany International	AIN	AIN US	Ronald J. Epstein
	Boeing	BA	BA US	Ronald J. Epstein
	Booz Allen Hamilton	BAH	BAH US	Ronald J. Epstein
	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein
	CAE Inc.	CAE	CAE US	Ronald J. Epstein
	Garmin	GRMN	GRMN US	Ronald J. Epstein
	HEICO Corporation	HEI	HEI US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L3Harris	LHX	LHX US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein
<b>UNDERPERFORM</b>				
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	Bombardier	BDRBF	BDRBF US	Ronald J. Epstein
	Bombardier Inc.	YBBD B	BBD/B CN	Ronald J. Epstein
	Huntington Ingalls Industries	HII	HII US	Ronald J. Epstein

**US - Aerospace and Defense Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Parsons Corporation	PSN	PSN US	Ronald J. Epstein
	RBC Bearings Inc	RBC	RBC US	Elizabeth Grenfell
	Spire Global inc	SPIR	SPIR US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein
	Virgin Galactic Holdings	SPCE	SPCE US	Ronald J. Epstein

**IQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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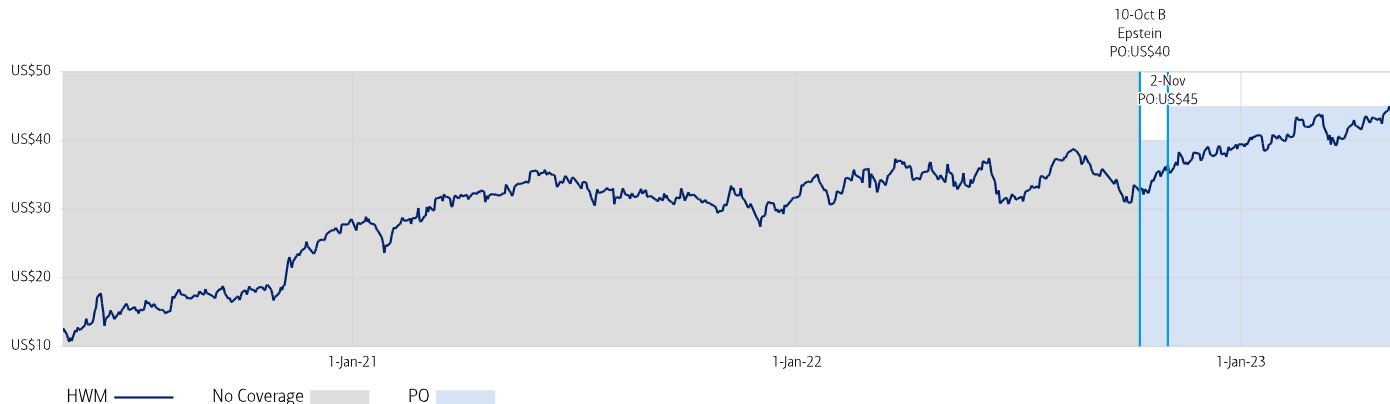
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### Howmet (HWM) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	25	51.02%	Buy	18	72.00%
Hold	14	28.57%	Hold	13	92.86%
Sell	10	20.41%	Sell	4	40.00%

### Equity Investment Rating Distribution: Global Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1869	53.01%	Buy	1030	55.11%
Hold	827	23.45%	Hold	476	57.56%
Sell	830	23.54%	Sell	389	46.87%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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