Howmet Aerospace Inc. (NYSE:HWM) Q3 2023 Earnings Conference Call November 2, 2023 9:30 AM ET

Company Participants

Paul Luther - Vice President, Investor Relations
John Plant - Executive Chairman & Chief Executive Officer
Ken Giacobbe - Executive Vice President & Chief Financial Officer

Conference Call Participants

Kristine Liwag - Morgan Stanley
Scott Mikus - Melius Research
David Strauss - Barclays
Scott Deuschle - Deutsche Bank
Myles Walton - Wolfe Research
Ronald Epstein - Bank of America
Seth Seifman - JPMorgan
Noah Poponak - Goldman Sachs
Sheila Kahyaoglu - Jefferies

Operator

Good day and welcome to the Third Quarter 2023 Howmet Aerospace Earnings Conference Call. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Paul Luther, Vice President of Investor Relations. Please go ahead.

Paul Luther

Thank you, Betsy. Good morning and welcome to the Howmet Aerospace third quarter 2023 results conference call. I'm joined by John Plant, Executive Chairman and Chief Executive Officer; and Ken Giacobbe, Executive Vice President and Chief Financial Officer. After comments by John and Ken, we will have a question-and-answer session.

I would like to remind you that today's discussion will contain forward-looking statements relating to future events and expectations. You can find factors that could cause the company's actual results to differ materially from these projections listed in today's presentation and earnings press release and in our most recent SEC filings.

In today's presentation references to EBITDA, operating income, and EPS mean adjusted EBITDA excluding special items, adjusted operating income excluding special items, and adjusted EPS excluding special items. These measures are among the non-

GAAP financial measures that we've included in our discussion. Reconciliations to the most directly comparable GAAP financial measures can be found in today's press release and in the appendix in today's presentation.

With that I'd like to turn the call over to John.

John Plant

Thanks P.T. and welcome everybody to the Q3 earnings call. The results for the third quarter were solid in all respects and exceeded the guidance given in August, which itself was a further increase on that provided in May and February. Sales of $1.658 billion, increase of 16% year-over-year. EBITDA was $382 million, an increase of 18%. EBITDA margin increased to a headline rate of 23%. Margin rate improvements reflect the continuing good work in all segments.

I would like to note fasteners with not a sequential quarterly improvement of 230 basis points and additionally, the structure segment had a 320 basis points recovery from the Q2 rate.

Howmet's year-over-year revenue increase flowed through to incremental EBITDA margin at a rate of 28%, which was in line with the guidance. Operating income increased by 22% year-over-year and operating income margin was 19%. Continued topline growth and healthy margins generated an earnings per share increase of 28%.

Free cash flow was healthy at $132 million and help drive shareholder-friendly actions including gross debt retirement of $200 million share buyback of $25 million. Lastly, we also announced a 25% increase in the dividend on top of last year's 50% increase.

Having provided this top-level summary, I'll pass the call to Ken to provide further details of revenue by end market and the results by business segments.

Ken Giacobbe

Thank you, John. Let's move to Slide 5. All markets continue to be healthy with revenue in the third quarter, up 16% year-over-year and 1% sequentially. As expected sequential revenue growth was impacted by normal third quarter seasonality. Commercial aerospace increased 23% year-over-year, driven by all three aerospace segments. Commercial Aerospace has grown for 10 consecutive quarters and stands at 49% of total revenue. Commercial Aerospace growth continues to be robust supported by demand for new more fuel-efficient aircraft as well as increased spares demand.

Defense Aerospace was up 13% year-over-year driven by the F-35 and Legacy Fighter programs. Commercial Transportation which impacts both forged wheels in the Fastening Systems segment was up 7% year-over-year driven by higher volumes.

Commercial Transportation remains resilient, despite normal seasonality. Finally, the industrial and other markets were up 10% year-over-year driven by oil and gas up 29%, General Industrial up 8% and IGT up 4%, in summary, another very strong quarter across all of our end markets.

Now let's move to Slide 6, for more details on the third quarter results. Starting with the P&L and enhanced profitability revenue, EBITDA, EBITDA margin and earnings per share all exceeded the high-end of guidance.

Revenue was $1.658 billion up 16% year-over-year. EBITDA was $382 million up 18% year-over-year, while absorbing near-term costs associated with net headcount conditions of approximately 645 employees.

The Engine segment drove a majority of the increase by adding approximately 500 employees. Year-to-date net debt count additions are just over 1500 employees. We continue to increase headcount for the expected revenue ramp. EBITDA margin was strong at 23%, despite absorbing the headcount additions.

Adjusting for year-over-year inflationary cost pass-through of approximately $15 million EBITDA margin was 23.3% in the flow-through of segment incremental revenue to EBITDA was at approximately 28% year-over-year which is right in line with our guidance.

Earnings per share, was strong at $0.46 per share, up 28% year-over-year. The third quarter reason represents the ninth consecutive quarter with growth in revenue EBITDA and earnings per share.

Next is the balance sheet. The balance sheet continues to strengthen, while returning cash to key stakeholders. The ending cash balance was $425 million after generating $132 million of free cash flow.

In the quarter, $242 million of cash on hand was allocated to debt reduction, common stock repurchases and dividends. Net debt to EBITDA improved to a record low, of 2.3 times. All bond debt is unsecured and at fixed rates which will provide stability of interest rate expense in the future.

Our next bond maturity of $705 million is due in October of 2024. Howmet's improved financial leverage and strong cash generation were reflected in Fitch's August credit upgrade from BBB- to BBB, two notches into investment grade.

Moreover Moody's upgraded Howmet's outlook from stable to positive in September. The balance sheet continues to strengthen and is recognized with the rating agency upgrades.

Finally, moving to capital allocation, we continue to be balanced in our approach. In the quarter capital expenditures were $59 million which continues to be less than depreciation and amortization. In the third quarter we reduced debt by another $200 million. Year-to-date, we have reduced debt by approximately $376 million, which will lower annualized interest expense by approximately $19 million. We also repurchased $25 million of common stock in the third quarter at an average price of $49.32 per share. This was the 10th consecutive quarter of common stock repurchases.

Share buyback authority from the Board stands at $797 million. Since separation in 2020, we have repurchased more than $1 billion of common stock. We exited the third quarter with a diluted share count of 414 million shares.

Finally, we continue to be confident in free cash flow. In the third quarter, the quarterly stock dividend was $0.04 per share. The quarterly stock dividend will be increased by 25% in the fourth quarter to $0.05 per share.

Now let's move to slide 7 to go through the segment results for the third quarter. The Engine Products segment continued its strong performance. Revenue was $798 million, an increase of 17% year-over-year. Commercial aerospace was up 15% and Defense Aerospace is up 33% with both markets driven by higher build rates and spares growth. Oil and gas was up 33% and IGP was up 4% as demand continues to be strong.

As expected, Q3 sequential revenue was down 3% driven by seasonal vacations. EBITDA increased 18% year-over-year to $219 million. The EBITDA margin increased 20 basis points both year-over-year and sequentially to 27.4%, while absorbing approximately 500 net new employees. We are pleased with the continued strong performance of the engines team.

Now let's move to slide 8. Fastening Systems year-over-year revenue increased 20%. Commercial aerospace was up 34%, including the impact of the emerging wide-body recovery. Commercial Transportation was up 6%. General Industrial was up 7% and Defense Aerospace was down 5%. Year-over-year segment EBITDA increased 19% EBITDA margin was 21.8% and is improved 320 basis points over the last two quarters.

Please move to slide 9. Engineered Structures year-over-year revenue was up 18% with commercial aerospace up 33%, driven by build rates and approximately $30 million of Russian titanium share gain. Defense Aerospace was down 20% year-over-year. Sequentially, Engineered Structures improved production rates and revenue was up 14%, which was in line with our expectation of 10% to 15%.

Segment EBITDA increased 7% year-over-year. Sequentially EBITDA margin improved 320 basis points to 13.2% despite absorbing approximately 145 net new employees in the third quarter. Q3 was good recovery by the structures team and we continue to expect further improvement in margins.

Let's move to slide 10. Forged Wheels year-over-year revenue increased 7%. The $19 million increase in revenue year-over-year was driven by a 13% increase in volume, partially offset by lower aluminum prices. Segment EBITDA increased 20% year-over-year driven by the higher volumes. EBITDA margin increased 290 basis points primarily due to the impact of higher volumes and lower aluminum prices.

Finally, let's move to slide 11. Our balance sheet continues to be a source of strength with healthy cash flow supporting a $200 million debt reduction in Q3. The $1.25 billion October 2024 debt tower was inherited from Alcoa Inc. and has been reduced to $705 million with cash on hand. Since the separation in 2020, we have paid down gross debt by approximately $2.15 billion with cash on hand and have lowered annualized interest costs by more than $120 million. Gross debt now stands at $3.8 billion. All long-term debt continues to be unsecured and at fixed rates. We will continue to focus on improving our capital structure and liquidity.

Lastly, before turning it back to John, let me highlight one item. In the appendix slide 18 covers our operational tax rate which was approximately 22.8% year-to-date. The midpoint of our guidance represents a 500 basis point improvement in the operational tax rate since the separation in 2020. Strong performance by the tax [Indiscernible] and we continue to be focused on further improvements in our operational tax rate.

Now, let me turn it back to John for the outlook and summary.

John Plant

Thanks, Ken. So let's move to slide 12 and talk about the outlook for the next quarter and year-end. So first of all regarding commercial aerospace, airline load factors continued to show improvement in resilience. Factory improvement for international travel notably in Asia also continues to increase. Domestic airline activity continues to be above 2019 levels in the Western countries. Given these load factors and the continued restriction of aircraft builds, the fleet of existing aircraft are having to work much harder. This is leading to robustness in the engine spares market which is further increased by the fact that the deployment in recent years of new engine technologies which are currently operating with increased replacement parts due to lower time on wing.

You look worried about this and you can be assured that Howmet is playing its path and supporting both the technology upgrades and the high-pressure turbine and through providing additional service parts. This will continue over the next two to three years and probably beyond.

Moving on commercial aerospace to the defense market. This market is also showing strength with the start of the gradual buildup of engine spares over the next two to three years to support the F-35 program for which the fleet now stands at 975 aircraft and growing. These increases more than offset the continued lockhead inventory correction in our structures business.

Other markets of IGT and oil and gas continue to be very healthy. In commercial truck and trailer builds and order intake continued to be good despite the lower freight rates and increased price of diesel fuel. We continue to be cautious though as we look forward until we see several months of data for new 2024 orders, which the order books have only been opened for a month. The initial month was good. But we also know that orders can be canceled depending upon how the broader economy moves in recent months.

In aggregate, we see limited risk of aircraft demand from both the commercial aircraft market and defense markets. The two markets aggregate to approximately 65% of our revenue and that moves up to 80% excluding the commercial transportation business. Beyond the fundamental demand from airlines, clearly we rely upon aircraft manufacturers being able to produce and build up the stated and scheduled quality of aircraft, particularly narrow-body aircraft.

Looking forward into 2024, we envisage growth to be in the 7% range plus or minus a percentage point. The headline sales number for 2024 is likely to be approximately $7 billion. This will be further refined when we see the achieved Q4 build rates from Boeing and Airbus with the confirmed plans going into 2024. All of this will be provided in further detail in February, along with the assumed build rates. Our standard is normally one of caution.

Moving specifically to the fourth quarter of 2023. We see revenue about $1.635 billion plus or minus $15 million, EBITDA $375 million plus or minus $5 million, earnings per share at $0.45 plus or minus $0.01. Regarding the full year 2023, revenues increased by about $100 million from $6.44 billion to $6.54 billion plus or minus $15 million. EBITDA has increased by a further $40 million to $1.485 billion plus or minus $5 million. Earnings per share has increased by $0.07 to $1.77 plus or minus $0.01. Free cash flow is at $635 million plus or minus $35 million.

In summary, we see strong performance with healthy liquidity and an increased guide for the remainder of the year. We consider the year-to-date progress to be very good, despite the continued choppy build conditions in commercial aerospace. We are comforted by the fact that any build misses by aircraft manufacturers who have moved into backlog, given the very strong underlying demand for travel and in particular the absolute requirements for fuel efficient engines and fuel efficient aircraft with an overarching mandate of reduced carbon emissions.

Our full year guide of $1.77 earnings per share is an increase of 26% year-over-year. This builds on the 2022 versus 2021 increase of 39%. Currently in 2023, we repurchased $376 million of debt and brought back $150 million of common stock. Our net leverage has further improved in Q3 and is heading towards approximately two times net debt to EBITDA by year-end. All of the debt actions help accomplish our goal of reduced interest rate burden in both 2023 and also going into 2024 with further improved cash flow yield, despite the increase generally of interest rates. Thanks everybody. And now let's move to your questions.

Question-and-Answer Session

Operator

We will now begin the question-and-answer session [Operator Instructions] The first question today comes from Kristine Liwag with Morgan Stanley. Please go ahead.

Q – Kristine Liwag

Hey, good morning, everyone.

John Plant

Hi, Kristine.

Q – Kristine Liwag

John, Ken or PT I guess with the 7% revenue increase for your 2024 initial outlook, what does it imply for aircraft production rates for the Boeing 737, 787 and the Airbus A320 and A350. And also when you talk to your customers, how much visibility are you getting for the ramp?

John Plant

Okay. I guess that's the big one Kristine. So let me just talk generally about the 7%, first of all. Within that, assumption is a mid-teens assumed increase in commercial aero. And more like single-digit increases in industrial, things like AGT oil and gas and general and other, while an assumed high single-digit decrease in commercial transportation. So basically, in our client solid defense solid general industrial markets healthy increase in commercial aerospace that reduced by a high single-digit assumption on commercial or transportation. That's roughly now applying.

I'm going to say, we see assumed build rates in let's say forecasting agencies. For the most part, we can see that they're going to increase both wide-body and body fractional increase in mix next year. At the moment, specifically, for Boeing 737 is what you assumed. You asked a question about our assumption is that it's somewhere between the mid-30s and 40 somewhere in that region. We don't want to pit it specifically at this point, you can assume that's within the range plus or minus I gave.

It's really important that we see Boeing achieved the rate 38, which we know is going to be prior to now it hasn't really happened that doesn't seem to be happening just yet, but we know it's going to be very soon. But we're not yet ready to believe and input into our guidance even though we can supply a rate 42 should Boeing be in a position to build at that rate.

Q – Kristine Liwag

Great. Thanks for the color.

John Plant

Thank you.

Operator

The next question comes from Robert Spingarn with Melius Research. Please go ahead.

Scott Mikus

Hi. Scott Mikus on for Rob Spingarn. John or Ken, I wanted to ask you a little bit about pension contributions for next year. And also, just given the work you've done there, are you considering any sort of risk transfer to get rid of the pension liability and improve free cash conversion?

John Plant

We've been working at pension liabilities for several years now and we've indeed taken over the last five years from where we started several billion out of that net liability of gross liabilities rather and we've always been focused on taking ROS and net debt together. Otherwise, you just leave yourself open to interest rate risk and mortality risk and we've managed it down now to I think about $750 million for pension and healthcare certainly in that region. And so it's now, let's say tiny traction of our market cap and therefore essentially is not relevant.

At the same time, while I've noted one of the company maybe a couple have continued in prioritizing this. I'm not yet at that point willing to consider that. It's not that, it's off the table because I think it would be something which would be useful to do. But at the same time, I think at this current time there's other better uses of our cash and also I'm not willing to leverage to enable that to occur. So essentially, we are aware of it. We continue to work at our plans. I can see us potentially picking off one or two and do partial initiation either within a plant or in a total of a plan but you shouldn't expect to see that liability extend. We wish to not to pay the premiums to insurance companies to enable that at this point in time.

I think that may come over the next say three to five years at some point but not yet. And the assumption we have for next year is that the cash contributions will be a little bit higher than this year but at this point not material.

Scott Mikus

Okay. Thanks. I'll stick with one question.

John Plant

Thank you.

Operator

The next question comes from David Strauss with Barclays.

John Plant

Hey, David.

David Strauss

John, you mentioned your work on upgraded blades. I wanted to see if you could give a little more color there around the timing of when you when you think you'll be producing upgrading -- producing and delivering upgraded blades to both GE and Pratt?

John Plant

So both for the GTF advantage engine upgrade and for the LEAP 1B upgrades. Those have been something that we've been working on for several years now. And the -- and if anything let's say a little bit later into production than originally envisaged although that is pushed back and timing have not been a result of Howmet not being ready. So we're in good shape. I commented in the past that increased performance in the high-pressure turbine leads to increased complexity and with that is value. And we certainly have been intimate with the engine manufacturers to improve the performance as the engine temperatures have seemed to be higher than originally envisaged and therefore to help improve timeline wing.

I feel there's though specific timing for both what was really called -- now that has a different code name for GE. And I think for the advantage for Pratt & Whitney you're best asking them for pipeline disclosure rather than myself because we have an agreed plan but that can and has been varied according to the specific needs of those engine manufacturers at this point in time?

David Strauss

Okay. Fair enough. I'll ask them.

John Plant

Thank you. It's far better David.

David Strauss

And then Ken I guess a two-parter for you. Just quick comments on working capital through the end of this year. It looks like you're kind of a pretty big reversal benefit in Q4 and thoughts on that into 2024? And then pension expense you brought down a little bit for 2023 but what are you looking at for 2024? Thanks.

John Plant

I'm going to comment on the working capital first, and then let Ken amplify and then Ken can totally deal with the pension side. And the reason why, I want to talk about the working capital because it's also tied up with the specific operations and status of they have met different business units are. So first of all, in terms of working capital I mean AR or account receivable and accounts payable they just move on the days assumption. So, if revenue goes up David, as it has then clearly, we have more dollars tied up in receivables than we had but that's a good answer, because it's whatever day it is and I don't know, if we've ever disclosed it we can back engineer it. But our days are pretty constant. And so because revenue went up a few more dollars went on, but the days in receivables exactly the same payment payables.

The big wildcard on what gap is always inventory. And so far inventory is still elevated more elevated than I would like but just because our flight [ph] hasn't been taken up where it should be at this point in time. So it moves with the, I will say status within each business of where we are operationally and in terms of start from let's say, volume recovery.

So if you take our Wheels segment, which was the first division to show volume increase manning and then moving through towards stability and now smoothness of production. Our days of inventory are in really good shape. And indeed, I believe we're at close to low-class level.

If I look at our engine business, which is our second division out of the gate in terms of building of revenue, increasing manning and that's continuing to increase. We have gradually been smoothing out production albeit, we're not in the same level yet, as we are in Wheels. And so what we see is gradual improvements in efficiency of our inventory holding days is on hand. And I think that will continuing to improve again in the fourth quarter and into next year. So I'm pleased, with the trajectory but we're not yet at where we need to be on our engine business.

In terms of fasteners and structures those are very different points. Fasteners has been later in the cycle in terms of volume pickup. As you know, we've been recruiting this year building it up. And you've seen first of all the margin begin to respond to that and also mix and production efficiency. And also you've seen a little bit of a calming of recruitment, in that business in the last few months ultimate still in that we say recruitment mode and replacement mode for employees, but trying to improve efficiency. Where the moment the date on hand is well out of order in terms of, where it needs to be and is not yet improving at all, but we'll begin to improve I believe as we go through 2024.

In the case of Structures, that's probably our worst business in terms of days on hand. And if you remember last quarter, wasn't particularly a great quarter in terms of the throughput of the business. And so, I elaborate -- business not to focus on inventory, but just to use inventory as the buffer to help stabilize the manufacturing operations, and therefore, improve the margin, which is what you saw occur in the 300 basis points improvement in the structures business.

At this point, I don't think it goes anywhere at all in the fourth quarter. And that's a combination of still needs to stabilize its operations. But also at the moment I see customers laying in additional demand particularly laying in additional urgent demand on the titanium side. I'm not yet prepared to add heads, nor working capital in inventory, nor input materials until I'm satisfied with the economics to pay those premium costs.

And so if anything I'm going to hold back on that because I've got better places to deploy capital, which is what I told you last quarter and generally in the business of analysts is that I'm very disciplined on where we allocate capital. And so at the moment, I'm not trying to drive working capital particularly in that business, but that will come next year as that business begins to smooth out and improve its production and gain more responsiveness in terms of I'll say people paying for the premiums or if they want the demand and drop in then they pay for it. Otherwise they don't get it. It's that simple.

So that deals with working capital be it can't preemptively, David and I'll pass to Ken.

Ken Giacobbe

Yeah. Thanks David. So as John articulated their days are really the key on working capital. And then also depending on where we are in the cycle -- business segment. So as we exit this year, I think we've given everybody the walk in the assumptions tab of the deck to kind of walk through it. But that would indicate a working capital burn this year roughly about $190 million plus or minus.

And it's really driven by -- we've increased the revenue guide once again so you have more AR that goes with that plus we're keeping inventory in the business to make sure that we're not the bottleneck for our customers, delivering on time in full at the right spec is really important for us. So we've got a little bit more inventory.

Next year we've got another growth projection here. So I anticipate there'll be working capital burn again next year in 2024, probably be better than this year as we work down inventory in the business but it's again going to be dependent on where we are in the cycle. So I believe it's in really good order here driven by the growth of the business.

On the pension expense side, as John mentioned I'll start at the top of the house. We've taken gross liabilities down by 45% since separation. That's a pretty big decline. Big significant part of that is the actions that we've taken to reduce gross liabilities. So as we get a bit of a help from the increase in discount rates but there's a lot of action around that gross liability.

John mentioned cash, it will be up next year. We remeasure it at the end of the year. So that's pretty much of a volatile line. So we'll give you more guidance on the next call in terms of what the cash contributions would be.

The expense side -- that's a little bit more visible right now. Again we strike it at the end of the year. If you look at our pension and OPEB expense right now it's $35 million on an annual basis. So next year based on asset returns, the market has been a little tougher. I'd say probably another $15 million plus or minus $5 million on either side of that. It's really not material. But I think that's all in good order as well.

David Strauss

Great. Thanks for all the detail.

Operator

The next question comes from Scott Duco with Deutsche Bank. Please go ahead.

Scott Deuschle

Hi. Good morning.

John Plant

Hi, Scott.

Scott Deuschle

Two very quick questions both for John. First did price realizations accelerate again in the third quarter. I think they had accelerated last quarter. And then on Fasteners, can you say whether you're shipping at five a month on 787 at this point? Or are you still tracking a bit below that? Thank you.

John Plant

Okay. I don't think we've given the third quarter detail on the commercial side. I think that would be in our 10-Q later when we file it, whilst I'd say that it's in good order and in line with what we previously said both for the quarter for the year. And I stand behind my comments regarding 2024 we made them on the last call. 787 at the moment we're a little bit below rate and fully expecting that to move up to grade seven next year. And as I've commented before we see very strong underlying demand for that aircraft. And I can see the need to go above rate seven as well. It's only a question of when.

Scott Deuschle

Okay. Great. Thank you.

Scott Deuschle

Thank you.

Operator

The next question comes from Myles Walton with Wolfe Research. Please go ahead.

Myles Walton

Thanks. John I was hoping you could dig a little bit deeper into the fastening margin performance and obviously, sort of, troughed at the beginning of the year and has been showing some signs of resiliency and improvement. I think at the beginning of the year you told me to not expect much for a couple of years. Are we at a point where new management plus the rate increases on the wide-bodies we should start to think about getting back to 2018, 2019 Fastener performance?

John Plant

Well, I think, it's a bit premature to get back there because I mean the conditions there and the wide-body market in particular is quite different to what they are now. So basically in the first quarter, which is probably a low points in base margins reflected essentially a total metallic build of aircraft and you can call it zero in terms of any real volume on the composite side. So that's one factor. Of course that's begun to change.

The business itself has also begun to improve. And I see very much improved signs of operating efficiency improvements, but with a ways to go. I see additional discipline in the business commercially and there's still a ways to go. And going forward into next year what I see is a volume increase for commercial aircraft production also fractional improvement in mix because of the wide-body going to next year in particular in your assumptions on what the final wide-body production will be in composite aircraft essentially on wide-body transitioning from metal to composite aircraft through the course of the year.

Hopefully with some delivery of 777X parts as well which has got a composite wing. And so I'll say general improvement in conditions for the business, but still with a big thrust on improving its productivity and throughput efficiency which needs to occur. So, basically, some ways to go yes optimism will continue good trend over the last couple of quarters but too soon to call out any specifics on it. And I don't think we have a guide by segment anyway. But I haven't guided or have that margin for next year just given you like the revenue increases. So that gives you a picture of our business.

Myles Walton

Thanks John.

John Plant

Thank you.

Operator

Next question comes from Ronald Epstein with Bank of America. Please go ahead.

Ronald Epstein

Hey John, how are you?

John Plant

Hey Ron.

Ronald Epstein

Yes. The topic that doesn't tend to come up much is the forged wheels. And it appears that it's been running ahead of expectations. I mean how should we think about that?

And what are your expectations around it? And when we think about modeling it what would be a prudent way to do so?

John Plant

Well essentially the play on forged wheels for aluminum is that you start off with what's the big picture in terms of truck and trailer production essentially in North America and Europe, albeit we do play in some of the Asian markets so it's a significant share position as well.

And then you factor in basically some -- so whatever percentage change that is in a new factor in as a positive against what I think will be a worse macro position next year. There'll be some penetration achieved against steel wheels particularly as fuel efficiency requirements that step up, a fractional contribution but nothing in a great node in terms of adoption of different I'll say powertrain hinting out there is move towards electrification or whatever but no big moves next year but that's a positive venture as well.

And the manufactural share improvement on top of that. So, basically we see secular growth in the segment offsetting some macro decline in the assumed markets and that's why I guided as commented an idea about high single-digit reduction for the business is our assumption trying to be fairly cautious at this point in time until we've got a better read on what's the general economy going to do although I did see freight rates begin to stabilize and improve recently.

So, there's a lot of factors yet to bring to bear in terms of what the final outlook for next year is I want to take a fairly cautious assumption. This year I don't really commented -- a more difficult second half as it is we've still been able to burn off backlog. And let's say even despite today we have -- is it Mac truck which is subject to the UAW strike.

Our arrears are such that that's not going to affect us in the fourth quarter. And our assumption is that by Q1 next year by another couple of months at UAW dispute the Mac truck will be resolved and therefore they'll be back. So that's about it really. It's been pretty strong this year. I give you the general is into next year.

Ronald Epstein

And then maybe just one follow-on if I may just a little change subject. When we think about the Pratt & Whitney situation with the GTF and all the tests that need to be reworked, is that good bad neutral for you guys? I mean how should we think about the impact on you? I mean the company vis-a-vis the GTF situation?

John Plant

Yes. I'll start off with having to separate two issues I think on the GTF, because I think while it gets all and mashed together, I see them as quite separate and then the catalysts intertwining for convenience. So this contamination issue clearly that requires inspection that might take, I don't know, so many days, let's call it, 20, 30, 40 days or an off wing to achieve that inspection. And then, I guess longer if those risks turn out they required to be replaced or not. And I guess it is a small fraction of those that will require to be replaced. That's one item or separate item.

Over, let's say, previously incentive field but I'll call it, left field there is the discussion about the time on wing issues that have been publicized by everybody regarding the GTF we're particularly in harsh climate countries or pollution countries the time working is a fraction of the predecessor engine and also what we originally thought for the GTF. So, the question then becomes for the problems around the combustor the filling of holes the higher temperature and then those temperatures and pollutants hitting the two blades in the high-pressure turbine those clearly require replacement. And the question is, what is the replacement interval for them? And so that stands alone as an issue. Pratt & Whitney will determine what frequency they want to replace those blades, again, more of a question for perhaps than for myself. We're able to stand behind them and supply what needs to be supplied within degrees. The question is, what's the requirement?

Then, of course, you can intertwine them together. So maybe where those engines are off wing for the powder metal contamination issue maybe the opportunity will be taken to replace some of those high-pressure turbine laser and other components on the engine or maybe it won't. That's a practice issue. And the question I have in my mind is, do they go for full replacements for them as they really look at inspect and take the engines off the wing for the first time or do they stick them back on just because the lines will want the engines back on wing and only seek to replace those in harsh climates at that time. And so maybe that's the more of the while I read from MTU of the 300 days turnaround time.

So I just don't know Ron, but it will finally turn out to be, because it's a choice by ratio [ph] or Pratt & Whitney to determine to what extent do they make improvements for the time on wing issue including the high-pressure turbine parts as they take those into serve. So why it's written about us almost one issue of power of metal, I think there are two distinct issues which may come together but just depending upon the pressure to get those engines back on wing and we are still in discussions with Pratt & Whitney regarding all of that. And they determined how many of our parts go to OE production and how many go to the spares market. And that's up to them and the aircraft manufacturers to decide that.

Ronald Epstein

Got it. Thank you very much.

John Plant

Thank you.

Operator

The next question comes from Noah Poponak with Goldman Sachs. Please go ahead.

Noah Poponak

Hey, good morning everyone. John I was hoping to get a little more color from you on your perspective on the broader aerospace new-build ramp-up. You've had good perspective. And as you mentioned you've been cautious and that it's been correct. It felt like in the middle of the year and kind of around the air show and into the summer you sounded more optimistic and sounded like the supply chain was kind of finally ready to go. And then we've had these incremental engine and aerostructures issues. Did Boeing especially -- and I guess Boeing and Airbus keep the underlying broader supply chain going towards the planned higher rates? And is everything kind of ready to ramp once after fuselage and the like are fixed. And you mentioned them giving you plans for next year. Are they incrementally more firm on that now with the master schedule than they've been recovery to date are things firmer? Or is that wishful thing?

John Plant

I mean, I think Boeing in particular I have had firm plans throughout the year, it's been the realization of those plants, which has been more of the issues. And I guess it's from a combination of reasons, there's always going to be somewhere in the supply chain amongst all the parts of difficulties. There's always going to be the degree of experience in Boeing on plants with all of the change of people in and out or out and in regarding post-COVID.

And then of course, we read in the press about the difficulties of, I'd say was it strike at Spirit Aerospace and then some other production issues of some failed parts and holes and all the rest of it. And yet there seems to have been some management change there, which may proved to be positive because that's a TBD. And hopefully, I guess, you listen carefully to the commentary from Spirit yesterday.

We're optimistic that those fuselage and other component problems to get resolved it's not sitting in our control. But should those begin to improve, I think, that's a major step forward in Boeing realizing its own plans for production rate increases and also getting behind it the retrofit of those sales, which were subject to pass those only or holes billed too big and bigger fasteners.

So I think they're hoping Herculean efforts to try to achieve all of that. But as you know circulate events by themselves don't sort of produce the output, and we've still got to see that improve. So, hopefully, during October, November, December, we'll begin to see rate pick up, it's spirit other suppliers and then obviously, boring itself to get to their required or stated rate four to next year.

In terms of then on the engine side, you've read commentary or I think anyone, I've seen was the GE commentary instead of let's say 1,700 engine 1,600 engines, isn't really impactful for us at this point in time?

Because for us it's just us meeting their rate requirements and then there's a choice as I said rather than the previous question, what goes to OE compared to what goes to search requirements.

We're dealing with very robust demand on both sides. We see that demand increasing again next year plus some blended in changes potentially for the technology change yet to come.

Noah Poponak

Okay. I appreciate it. Thank you.

John Plant

Thank you.

Operator

The next question comes from Sheila Kahyaoglu with Jefferies. Please go ahead.

Sheila Kahyaoglu

Hi John and hi Ken. Thank you, guys.

John Plant

Hi Sheila.

Sheila Kahyaoglu

So hey, I have two questions if that's okay. So John don't [indiscernible].

John Plant

Well, I am completely leaning today announce it is two-parts, three-parts so yeah sure. Go for it.

Sheila Kahyaoglu

You are. You are. But I want some good nuggets here. So the OEs that are calling out castings and forgings in terms of supply chain kind of slowing down the supply chain. I know you've been clear that Howmet isn't a bottleneck and you aren't in the large structural casting business anyway.

So maybe could you characterize your output today? And what you're capable of in terms of demand? And then, this is more of like a larger opportunity in terms of pricing and volume. How do you think about that trade-off going forward?

John Plant

Generally forgings and castings have been a bit of a whipping below for a couple of years. With commentary I think maybe even before, it was any basis for it albeit, subsequently I think there has been a basis for a commentary where to replace the skill levels to produce some of these in particular the casting is really at a very high order.

So the trade the recruitment and then trading lines to produce effective production workers in some of this certainly strain. I think all of the companies in that regard including Howmet. We did choose to start recruitment a bit earlier.

And I know that I've cost the company probably 20 basis points of margin by being slightly ahead of the curve -- recruitment. But at the same time I think has paid dividends for us and the fact that we've been in a vision to produce generally on time, at rate and generally good quality. So I think it's been a good trade-off for us.

I want to correct you on the structural casting side we're probably the number two in the market behind precision cast parts, but they are still, the big dog on the block in terms of production of structural castings. We do produce them and we're at a good rate for let's say, 98% of all of our structural castings.

I mean early on we had a few moments things like fairings and is like shelling pieces and coming off at good rates and no cost [Ph] or whatsoever. And so should there be increased demand for structural castings obviously where we tool and if not the availabilities that to us for the next few years should engine manufacturers want to is that we're in a position to supply because we still have some available capacity and indeed are willing to invest commensurate with it being a good return of capital.

And generally I've been quite positive about investing in our engine business and contrasting that to -- the our structures business is based upon returns. So it's one way of saying we're in a good state, restructure casting we are the significant supply to the industry on turbine blades. And I hope that gives you enough nuggets.

Sheila Kahyaoglu

How's do you think about pricing and your contract structures going forward given the constraints in the supply chain and you're hiring ahead of the curve.

John Plant

Pricing has been positive for us. And I think it reflects the value that we bring. When I look at some of the requirements for the increased temperature performance in the, let's say, narrow-body engines. We are bringing to bear some of the not all, but some of the technologies that we've deployed for the F-35 engine in terms of ability to manage both pressure thermal performance in the high-pressure turbine. And we're able to produce parts.

We obviously work with the customers to engine into specification. But if they're specified at 2,500 degrees and operate higher we can take it higher because as you know for the F-35 we're up at 3,500 degrees and indeed the only company that well that can provide the turbine parts with that performance in that environment. We've already commented previously that we are working on the improvements for the currently 2028 upgrade to that engine to improve its thrust and time and air.

And so again, we are able to take the temperature performance of those parts and elevate it further. And we've talked a little bit, but only a little bit in our Technology Day about some of the technologies that we'd be able to deploy for that. And so we're in a position to bring a degree of performance and capability at scale, which I think needs to reflect in value because in truth the turbine blade is a pretty small part of the value of the engine and to achieve the requirements for let's say lower carbon footprint continually taking up the pressure inside the engine to improve the optimization that you have fuel and therefore its burn characteristics for lower dilution and the whole say fuel efficiencies and carbon footprint presents great value to the industry.

Sheila Kahyaoglu

Great. Thank you.

John Plant

Thank you.

Operator

The last question today comes from Seth Seifman with JPMorgan. Please go ahead.

Seth Seifman

Hey, thanks very much. Good morning everyone. So John I know you said you wouldn't say this or haven't said this and so I'm not necessarily expecting a number in terms of the margin outlook for next year, but if we think about that sort of baseline incremental of 30% plus or minus 5%. How do we think about the puts and takes for where next year can come in relative to that 30%. Does the addition of headcount and the need for the learning to develop among your employees? Does that keep things sort of below that 30% range as it's been in recent years? Or are there other opportunities to be above it? What's the best way to think about that at this point?

John Plant

Yes. I mean, we were able to step up the last quarter to 19% operating profit and 23% EBITDA rate. I don't have any commentary regarding margin rates for next year. What I still see at the moment is potentially, I don't know this, but potentially a few more months of choppy production particularly on the free manufacturing side, it's just an assumption. Maybe we get lucky towards the second half of next year or the back end of next year and we see things get smooth out, we have seen some things begin to move in our favor and smooth that as I commented on the inventory side, we also think about our engine business.

But in terms of -- at what point do we reach what I previously have referred to the state of Grace where things move out margins become stable and better and cash just use that as the industry and hopefully out of Howmet. I've always said that's a year away and I still think you see year away could be the back end of '24, but more likely getting to '25 and that hopefully combines with if the '25 external debuts of what the aircraft production will be including its wide-body mix then that begins to get I'd say into a good state. So, I have generally medium to long-term optimism and feel we are in a really great place with great backlog and good things to come, albeit still having to face up to shorter-term challenges of all the things we've talked about in terms of broad rate changes and the assumptions change in many parts of the market, in particular the commercial aerospace part of the market. I think it's a better best I can give.

Seth Seifman

Excellent. Thanks very much. Helpful.

John Plant

Thank you, very much.

Operator

This concludes our question-and-answer session and concludes the conference call. Thank you for attending today's presentation. You may now disconnect.