Howmet Aerospace Inc. (NYSE:HWM) Q3 2021 Earnings Conference Call November 4, 2021 10:00 AM ET

Company Participants

Paul Luther – Vice President of Investor Relations
John Plant – Executive Chairman and Chief Executive Officer
Ken Giacobbe – Executive Vice President and Chief Financial Officer

Conference Call Participants

Seth Seifman – JPMorgan
Robert Stallard – Vertical Research
Myles Walton – UBS
David Strauss – Barclays
Gautam Khanna – Cowen
Matt Akers – Wells Fargo
Paretosh Misra – Berenberg
Noah Poponak – Goldman Sachs
Phil Gibbs – KeyBanc Capital Markets
Josh Sullivan – The Benchmark Company
George Shapiro – Shapiro Research

Operator

Good morning, ladies and gentlemen, and welcome to the Howmet Aerospace Third Quarter 2021 Results. My name is Erica, and I will be your operator for today. As a reminder, today's conference is being recorded for replay purposes.

I would now like to turn the conference over to your host for today, Paul Luther, Vice President of Investor Relations. Please proceed.

Paul Luther

Thank you, Erica. Good morning, and welcome to the Howmet Aerospace Third Quarter 2021 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 addition, we've included some non-GAAP financial measures 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, PT. Good morning, and welcome to the call. We'll move quickly through the slides and then get to your questions. First, let's summarize the headline numbers, starting on Slide number 4. Revenue was $1.28 billion, adjusted EBITDA $292 million and EBITDA margin was 22.8%. Each number was within the guidance range provided. More importantly, year-over-year revenues increased for the first time. The revenue was led by Commercial Aerospace, up 15% year-over-year, and contributing to a total increase of 13%. Of note, the Howmet segment leading the increase was Engine Products as previously forecasted.

The company was also able to overcome the challenges once again of the Boeing 787 build rate declines and the supply chain issues limiting commercial truck production, the 787 affecting Fastening Systems and Engineering Structures in particular. Aluminum prices continued their upward surge with aluminum and regional premiums increasing by over $400 per metric ton sequentially and impacting the margin rate by 20 basis points. Adjusted earnings per share, excluding special items, was $0.27, and cash generated in the quarter was $115 million. AR securitization was unchanged at $250 million. On a sequential basis, Third quarter revenue and adjusted EBITDA were up 7% and adjusted earnings per share up 23%.

Moving to the balance sheet and cash flow. Adjusted free cash flow for the quarter was strong at $115 million, which results in a Q3 year-to-date free cash flow at a record $275 million. Ken will provide further details of our debt actions in the quarter, which included a bond tender refi – finance to fundamentally lower interest costs and thereby improve future free cash flow yields. The combination of debt actions in the third quarter, combined with our first half results and actions, will reduce annual interest expense by approximately $70 million.

In the quarter, we also repurchased approximately 770,000 shares of common stock for $25 million, which increases share repurchases year-to-date to approximately 7 million shares for $225 million. The net result of all these actions plus the reinstatement of the common stock dividend and the $115 million cash inflow resulted in a cash balance of $726 million, similar to that at the end of Q2. Lastly, we continue to focus on legacy liabilities and have reduced pension and OPEB liabilities by approximately $180 million year-to-date. Moreover, year-to-date pension and OPEB expense have reduced by approximately 50% compared to last year.

Please move to Slide number 5. Revenue for the quarter increased 13% year-over-year and 7% sequentially. As expected, Commercial Aerospace was up 15% year-over-year and 16% sequentially, driven by the Engine Products segment and narrow-body aircraft production. Commercial Transportation, namely Wheels, was up 38% year-over-year. Volume was impacted by supply chain constraints, limiting the commercial truck production. The volume reduction in the Wheels business was offset by metal recovery dollars. The industrial gas turbine business continues to grow and was up 26% year-over-year and 6% sequentially, driven by new builds and spares. Defense Aerospace was down 11% year-over-year, driven by reductions in the Joint Strike Fighter builds, but was up 3% sequentially from the second quarter.

At the bottom of the slide, you can see the progress on price, cost reduction and cash management. Price increases are up year-over-year and continue to be in line with expectations. Structural cost reductions have exceeded our annual target of $100 million. Q3 structural cost reductions were $23 million year-over-year and $121 million year-to-date. Every segment achieved a strong year-on-year margin expansion as revenue increased for the first time in the year in aggregate.

In the third quarter, Engine Products had an incremental operating margin of approximately 70%, and Forged Wheels had an incremental operating margin of approximately 45%. Fastening Systems and Engineering Structures both had a higher EBITDA and lower revenue. Fasteners had an operating margin expansion of some 630 basis points, while structures was up 210 basis points. As a result, Howmet's adjusted EBITDA margin expanded a full 800 basis points year-on-year, driven by volume, price and structural cost reductions. Adjusted free cash flow for the quarter was $115 million and year-to-date $275 million. And as I said previously, AR securitization is unchanged from the start of the year. Lastly, we have lowered our annualized interest cost by $70 million through a combination of paying down debt and refinancing into lower cost debt.

Please move to Slide number 6. Adjusted EBITDA margin for the quarter was 22.8%, representing an 800 basis point improvement compared to the third quarter of 2020. The margin for the third quarter was consistent with the last few quarters, despite the cost of adding employees to meet the increasing production demand and the effect on margins of the higher aluminum prices. In the quarter, Engine Products added approximately 500 employees net, which now brings the total to 800 net additional employees hired for that segment during the second and third quarters. We continue to review the headcount required in our other segments to adjust for future demand requirements.

Now let me turn it over to Ken for further details on revenue by market and the detailed financials.

Ken Giacobbe

Thank you, John. Please move to markets on Slide 7. Third quarter total revenue was up 13% year-over-year and 7% sequentially. Commercial Aerospace increased to 42% of total revenue, which is an improvement sequentially, but far short of pre-COVID levels of 60%. The third quarter marked the start of the Commercial Aerospace recovery, with commercial aerospace revenue up 15% year-over-year and 16% sequentially. Defense Aerospace was down 11% year-over-year, driven by the Joint Strike Fighter and up 3% sequentially.

Commercial Transportation, which impacts both the Forged Wheels and Fastening Systems segment was up 38% year-over-year, however, flat sequentially after we adjust for the increase in aluminum prices. Finally, the Industrial and Other Markets, which is composed of IGT, oil and gas and general industrial was up 14% year-over-year and down 2% sequentially. IGT, which makes up approximately 45% of this market continues to be strong and was up a healthy 26% year-over-year and 6% sequentially.

Let's move to Slide 8 for the segment results. As expected, Engine Products year-over-year revenue was 24% higher in the third quarter. Commercial Aerospace was 50% higher, driven by the narrow-body recovery. IGT was 26% higher as demand for cleaner energy continues. Defense Aerospace was down 8% year-over-year, but up 7% sequentially. Incremental margins for Engine Products were approximately 70% for the quarter despite hiring back approximately 500 workers to prepare for future growth. Operating margin improved 1,200 basis points year-over-year. In the appendix of the presentation, we have provided a schedule which shows each segment's incremental margins for the quarter.

Please move to Slide 9. Also as expected, Fastening Systems year-over-year revenue was 6% lower in the third quarter. Commercial Aerospace was 25% lower as we saw continued production declines for the Boeing 787 and customer inventory corrections. The commercial transportation and industrial markets within the Fastening Systems segments were approximately 55% and 19% year-over-year, respectively. Year-over-year Fastening Systems was able to generate $14 million more in operating profit, while revenue declined $17 million. As a result, operating margin improved 630 basis points.

Please move to Slide 10. Engineered Structures year-over-year revenue was 3% lower in the third quarter. Commercial Aerospace was 13% higher as the narrow-body recovery was partially offset by production declines for the Boeing 787. Defense Aerospace was down 21% year-over-year but was flat sequentially. Year-over-year, Engineered

Structures was able to generate $4 million more in operating profit on $7 million of lower revenue. As a result, operating margin improved 210 basis points.

Finally, please move to Slide 11. Forged Wheels year-over-year revenue was 34% higher in the third quarter. On a sequential basis, revenue and operating profit were essentially flat. The segment was able to overcome a 4% decrease in volume due to customer supply chain issues, limiting commercial truck production, and a 13% increase in aluminum prices to maintain a healthy operating margin of approximately 27%. Year-over-year incremental margins for Forged Wheels were approximately 45% for the quarter. Improved margins were driven by continued cost management and maximizing production in low-cost countries.

Now let's move to Slide 12. We continue to focus on improving our capital structure and liquidity. I would highlight three actions. First, in the first half of the year, we paid down approximately $835 million of debt by completing the early redemption of our 2021 and 2022 bonds with cash on hand. The annualized interest expense savings with this action is approximately $47 million. Second, in the third quarter we tendered $600 million of our 6.875% notes due in 2025 and issued $700 million of 3% notes due in 2029. The annualized interest expense savings with this action is approximately $20 million. Third, with cash on hand, we repurchased $100 million of our 2021 notes through an open market repurchase in Q3 and in October, which neutralized the gross debt impact of the tender and refinancing. The annualized interest expense saving with this action is approximately $5 million.

As a result of these actions, we have lowered annualized interest costs by approximately $70 million and smoothed out our future debt maturities. At the end of Q3, gross debt was approximately $4.2 billion, which is similar to Q2. Net debt to EBITDA improved from 3.5x in Q2 to 3.2x despite the deployment of cash for debt refinancing, share buybacks and dividends. All debt is unsecured, and the next maturity is in October of 2024. Finally, our $1 billion revolving credit facility remains undrawn.

Before turning it back to John to discuss guidance, I would like to point out that there's a slide in the appendix that covers special items for the quarter. Special items for the third quarter were a net charge of approximately $93 million, mainly driven by the costs associated with the bond tender and refinancing completed in the quarter.

Now let me turn it back over to John.

John Plant

Thanks, Ken. The leading indicators for air travel continue to show improvement, notably for domestic travel. But also we note the sort of revised requirements or restrictions being lifted for certainly transatlantic travel starting this month. As expected, Howmet transitioned to revenue growth in the third quarter, and we expect year-over-year revenue growth will continue into the fourth quarter and to 2022, with a growth of approximately 12% in commercial aerospace and total revenue growth in the fourth quarter of approximately 6%. Growth is expected to continue in 2022.

As expected, the Engine Products business began to grow notably in the third quarter. We expect modest sequential growth in Q4 for Engineered Structures despite continued delays with the 787. Fastening Systems is expected to show growth in the first half of 2022. In terms of specific numbers, we expect the following: In terms of guidance for Q4, I'll just call out the midpoints, as you can read the slide: Revenue of $1.315 billion; EBITDA, $300 million; EBITDA margin, 22.8%; earnings per share of $0.29. And for the year, we expect revenue to be $5 billion, plus or minus; EBITDA at $1.135 billion; EBITDA margin at 22.7%; earnings per share increased to $1 per share; and cash flow of $450 million.

Moving to the right-hand side of the slide, we expect the following: Second half revenue to be up approximately 8% versus the first half driven by Commercial Aerospace, Commercial Transportation and ITT; Q4 sequential segment incremental operating margins, we expect to be in the order of 28%. Price increases will continue to be greater than 2020, the cost-reduction carryover of $100 million, as already commented, is exceeded. Pension and OPEB contributions of approximately $120 million and CapEx should be in the range of $180 million to $200 million compared to depreciation of approximately $270 million. Adjusted free cash flow compared to net income continues to be approximately 100%.

I'd now like to preview some initial thoughts regarding 2022. An early approximate total revenue guide would be for an increase in annual revenues of 12% to 15%, led by recovery in Commercial Aerospace. In aggregate, our current view is that we see an acceleration during the course of the year, following a fairly flat first quarter compared to the fourth quarter of this year, except for increased revenues due to metal recovery. We'll refine this view and provide guidance at our earnings call in February 2022.

Now let's move to Slide 14 for the summary. We delivered strong performance in the third quarter, which was in line with guidance. Growth was very healthy, year-on-year and sequentially. Incrementals were truly exceptional, and the company's margin is in the top decile in aerospace. Q3 started – or marked the start of the Commercial Aerospace recovery. Moreover, we delivered sequential improvements in both EBITDA and earnings per share. We'll continue to manage costs very carefully during this recovery phase. Liquidity is strong, and we have very healthy cash generation. The fourth quarter for our revenue outlook is $30 million higher than the third quarter, with margins of approximately 23%, which sets a platform for a healthy 2022. Adjusted earnings per share guidance was increased reflecting lower interest costs.

Thank you and we'll now take your questions.

Question-and-Answer Session

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from the line of Seth Seifman with JPMorgan. Your line is open.

Seth Seifman

Thanks very much. Good morning everyone.

John Plant

Hi, Seth.

Seth Seifman

I guess maybe starting off, if you could tell us where you expect to exit the year on – in terms of rate on the two major narrow-body programs, on 737 and on A320?

John Plant

Okay. For A320, the 45 rate that Airbus has called out seems to be the right number. In terms of Boeing, I've seen so many numbers, but it's really hard for us to know exactly what's the correct one. So I'm going to go with the – probably Skyline at 14 aircraft per month, even though I've seen reports of – last July on the 16 number, which I didn't recognize then and the 19 number. So I don't know, Seth. I'm going to stick with my 14 with the expectation uplift in the first quarter next year.

Seth Seifman

Okay, very good. I will obey the moderate stick to one and get back in queue. Thanks.

John Plant

Okay.

Operator

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

Robert Stallard

Thanks so much. Good morning.

John Plant

Hi, Rob.

Robert Stallard

John, I think I'll follow up on Seth's question with regard to the Boeing 787. Where are you at the moment? And what have you baked into that 2022 revenue number with regard to what the 787 deliveries could do? Thank you.

John Plant

Okay. So, first of all, original expectation, if you went back six months, it was the 787 would continue through this year at rate 5 per month, clearly with Boeing wanting to reduce that in the latter part of the year. As far as we can see Boeing went as 0 build condition for 90 days. And while they've adjusted the rate for the fourth quarter to 2, my thought has been it's been a 0 build and then it will be built at may be 4 a month to 2 average that 2. I don't really know, there's some speculation that maybe have built to 2, but it's pretty opaque to us.

The most important factor is when does recertification occur because whether they build or don't build, it's going to come out of inventory. And we've seen inventories drop as well. And so suppliers into the 787 have been low, and we expect them to continue to be low in the fourth quarter. And then the question is what will the rate be in 2022. Our thought at this point is that maybe a 2022 annual build might be 48 aircrafts, I don't know. We've had to make some guesstimates, and that's provided for in that 12% to 15% volume increase that I talked about in revenues as an initial thought for 2022. And that takes account of what we think the balance of probability is across all of the end markets that we serve.

And maybe I'll just continue a bit further to give a better color is when you consider the overall uncertainty in the industry regarding liquidation of inventories and in particular, the – in wide-body, and the fact that it will probably be flat for a further 12 months, the supply chain issues, which are certainly very newsworthy but are real. And indeed caused the truck production to be lower in the third quarter, that's also combined with the annual shutdowns in Europe. And then, of course, this – I'm going to call 0 build condition or is it only 2 on the 787. Then I think the sequential growth is outstanding. And all we're doing is not debating the fact of recovery, but what's the exact angle of the slope of recovery. And that's about it really, Rob.

Robert Stallard

Yes. Just one clarification, John. Are you therefore, assuming that the destock on the 787 is now done and you're basically going to be following the Boeing build rate?

John Plant

You tell me what the build rate is going to be, and I'll tell you the destock is where I find myself. No, I'm not trying to be clever about the response to question, but I find myself in a position where we've been grappling all year with moving end markets. You're grappling with all the different end markets moving at different ways, whether it's industrial or commercial transportation or commercial aero or defense and you've got all of these things moving around. And then you overlaid that with some very specific issues at Boeing, which we know about but none of us knows the recertification date. And in fact, Boeing have not provided that guidance either themselves.

Robert Stallard

That's very helpful. Thanks John.

John Plant

Thank you.

Operator

Our next question comes from the line of Myles Walton with UBS. Your line is open.

Myles Walton

Thanks. Good morning. I was wondering if I could ask one detail and one question about 2022. In the detail one, I think, the Structures business was more anticipated to be a fourth quarter growth. And obviously, you saw some pretty great sequential growth here in Structures and out of commercial aero in particular. Could you maybe talk to why that happened a little bit sooner? And then secondarily, the defense expectation for 2022, can you just benchmark where that is in the 12% to 15% top-line? Thanks.

John Plant

Yes. So let me deal with Structures first. I think that the growth is a little bit higher in our third quarter. I think it would be similar for fourth. And then depending on 787, I could see some inventory correction in the first quarter, don't know enough yet to really know. In terms of defense, of course, we all know that there's a little bit of seasonality to that, where we do get a second half lift generally, which is a little bit of payback in the first quarter on a use it or lose it basis for defense budgets for spares in particular. Defense for next year, I'm guessing at this point that I'm not going to get too far to 2022. But I'll say, fairly flat, if anything, given what Raytheon said about the rate reduction in engine that they see on the – let's say, the original equipment build side. Then that will be fairly muted for us and then maybe there'll be some pickup on the spare side.

So it's difficult to really know there. And then the question is to what degree we'll see level loading from Lockheed on the overall business. So best guess is at the moment, I'd say, we shouldn't be anticipating too much by way of defense growth next year, but we should be expecting good growth in terms of the narrow-body commercial aircraft production and then continuing growth in IGT. And also we do anticipate some of these supply chain constraints will be affecting the commercial truck business to move away certainly by the second half of the year.

Myles Walton

Okay, thank you.

John Plant

It's all contained in that 12 to 15 best guess. And I don't want to call it a best guess rather than a guide at this point.

Myles Walton

Fair enough. Thanks John.

John Plant

You're welcome.

Operator

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

David Strauss

Thanks. Good morning.

John Plant

Hi, David.

David Strauss

So John, obviously, the announcement here recently, you've decided to stay on a bit longer. Maybe a little bit of color on your thinking there and how might longer, how might – longer might that be?

John Plant

Well, sorry, you're disappointed, David, if my being around is going to sort of plague your life a little bit longer. But – no, basically, the color I'd give you is the Board concluded that Tolga wasn't demonstrating the leadership they felt necessary to succeed myself as simple as that. I think it's great credit to the Board that the they stepped up and made a determination and exercise that judgment. I think it's one of the most important things that a Board does. I've said that I'm willing to continue to lead Howmet through the aerospace recovery. As I talked about, all with all the different changes in all these end markets that we've covered already, but certainly discuss again that I think that will hopefully be to the benefit of the company. And with no specific end dates provided, so yes, I'm going to be talking to you for some time.

David Strauss

All right. Perfect, John. Happy to have you here around.

John Plant

Thank you. Thank you David.

Operator

Our next question comes from the line of Gautam Khanna with Cowen.

Gautam Khanna

Hi. Thanks. Good morning guys.

John Plant

Thanks, Gautam.

Gautam Khanna

A couple of questions – maybe a two-part question. I was just curious you gave a ballpark range for sales for next year. Do you want to venture a guess on EBITDA margin, adjusted EPS, just to calibrate people in front of the formal guide that's going to happen next quarter. Just maybe if you can talk through some of the moving pieces.

John Plant

I don't really want to get that far ahead of myself, Gautam. I feel positive about next year. I'm convinced that – I can convince myself anyway that when we do guide, it will be healthy for next year without, again, saying what exactly what I mean by healthy because I don't want to give specific numbers for increased EBITDA and earnings per share.

But right now, despite all the, I'll call it, uncertainties, and of course as you know, many companies are still not providing much by way of guidance or sometimes not at all, is that we feel confident enough to give you what we've already given you. And I feel confident enough to say that 2022 will be a healthy year for us. And that will be a combination of both – for both EBITDA and for cash flow.

Gautam Khanna

Okay. And one other thing, we've heard incrementally some concerns about in the auto industry related to magnesium and what have you. I just – I'm curious, is this – are you seeing incrementally more difficult pinch points emerge? I mean, just – I know since last quarter, it sounds like things have gotten tougher on the supply chain.

John Plant

We're not a massive user. We've already covered through the next few months and so no big deal for Howmet now.

Gautam Khanna

Okay. Thank you very much.

John Plant

Thank you.

Operator

Our next question comes from the line of Matt Akers with Wells Fargo. Your line is open.

Matt Akers

Yes, hi, good morning. Actually kind of to follow up on the last one. I guess some of the concerns I've heard is the magnesium shortage potentially close to kind of less aluminum? And I guess, is that an area where you guys are seeing any risk of lack of material availability or just kind of how long are you covered with sort of the inventory that's available?

John Plant

Yes. I really don't believe that we're going to be calling out lack of magnesium as an issue for us meeting any guide that we give you at all. We looked at it recently. I can't make the exact numbers, but both when you look at the amount we use and – and then the – say, the contract commitments we've got, we are setting it in an okay territory. So it's not top of mind in terms of my worries. In fact, on the aero side, I don't really have much by way of input materials concerns at all. And the only time I have a concern is the way it affects our customers on the Commercial Transportation side.

Matt Akers

Got it. Okay. Thanks.

John Plant

Thank you.

Operator

Our next question comes from the line of Paretosh Misra with Berenberg. Your line is open.

Paretosh Misra

Thank you. Good morning. I had a question on your metal pass-through. So EBITDA margins are somewhat affected in the Wheels business because of the aluminum pass-through. But in the commercial aerospace business, we don't see a similar impact, even though the nickel prices have been very high, and I'm sure the other metal prices also went up. Is it because just that metal price is a much smaller component in aerospace? Or is there some difference in how revenues recorded in the two businesses?

John Plant

No. I mean, the principle is exactly the same, Paretosh. So I rarely call out things. So for example, you don't hear me talking about bad weather in Texas. You don't hear me talking about a particular press going down, why not talk too much about labor and this sort of stuff. It's just we work off, just normal course of business.

And indeed, for the – for margins, if you look at nickel, cobalt, all of these metals into our aerospace segments have also had very significant increases. It has aluminum into some of the bulk end in our structures business, and some elements of titanium, although titanium has been pretty muted in aggregate.

So I just look at all of those things and say, I tend not to call out much. It's just that I think it was on the last call where it was Seth from JPM that was asking specifically about Wheels and the margin, and it's very noticeable for that segment. And so I had to comment about it. And basically, this quarter is exactly the same. So there's a metal impact.

So last quarter, it was like at the company level, so I don't really get into it at the segment level, it was 30 basis points. And this quarter, it's about 20 basis points of impact. And I just called it out for the – for that Wheels segment. And obviously, I wanted to I'd be saying to you things like, well, 22.8 really is 23. And if I added a bit more on for aerospace, it's higher than that. But it's like I don't think it's worthy. And so just don't comment, just move on.

And our job is to manage these things. And one day when metal begins to abate and goes the other way, maybe I won't be calling it out when things are really good either. So that's about it. But if you want to, use 20 or 30 basis points for aluminum impact on the total holdco for Howmet year-to-date.

Paretosh Misra

That’s great to hear. Thanks, John.

John Plant

Thank you.

Operator

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

Noah Poponak

Hi, good morning, everyone.

John Plant

Hi, Noah.

Noah Poponak

John, I just wanted to see if I could make sure I understand where Fastening Systems is and it's kind of sequential process since it started to decline later, and I think it still has some inventory destocking. It sounds like you're expecting that to be kind of flat sequentially in the fourth quarter. And then I think previously, you talked about it growing year-over-year in the first quarter, which would require a decent sequential step up. Is that the right shape? And just maybe you could talk about where that segment is in terms of snapping back to the actual end demand?

John Plant

Yes. If you listened to my words carefully, what I spoke to earlier, I actually used the word first half rather than the first quarter. I don't mean by slide, but at least I'll call it out and be open about it, is that previously, we'd said that the destocking – and in particular, the washout through the wide-body we would like to be complete by the end of the year, and we start to see improvements in the first quarter of next year.

I want to be a little bit more cautious today. And essentially, I'm going to hang it all on 787 because, as I said earlier, I don't know exactly what the build, but then neither does anybody seem to know the exact build. And so my assumption is that it's less likely that it will be back at rate five in January. And so based upon that, I'm going to say it's more like a Q2 effect.

But again, you tell me 787, I'll tell you what fasteners does because it's significant in the life of that business. My assumption is the rest is pretty flat, wide-body, by improving on narrowbody. So it's really difficult to be precise on any of this at this point in time. That's why all I know is that recovery is occurring, revenues are going up. And the only thing we were really debating here is just what exactly is the angle, that requires us to make a judgment around labor inputs. The rest just falls into place when we know the angle will be upswing.

And so I just think that's – let's not get too wrapped around on a minute. The answer is good things are occurring a lot of moving parts, but generally, things are looking positive.

Noah Poponak

It sounds like that's probably hit its low watermark given 87 is already down. And then to your point, it's a debate around timing and pace of recovery. But it probably doesn't need to go lower based on everything you just said.

John Plant

It's difficult to go below zero. Yes.

Noah Poponak

Right. Okay.

John Plant

Yes. I mean anticipating that some are going to be built. But again, it's not that we know precisely exactly what build rate is. But – so at the moment, I'll just say, yes, I completely stand at an average of two for the quarter with that now the exact shape of production, whether it's just one or two, or is it zero and then three or four, I don't know. It doesn't really matter.

Noah Poponak

Yes. I mostly just was in how much inventory stock has left.

John Plant

Yes, the critical thing is when recertification – and at that point, the sky begin to turn blue. And the things just begin to feel a bit better. That's why I give you a broad calibration of where I think we're going to head towards next year.

Noah Poponak

So is there no inventory destock left in that segment?

John Plant

Well, there is while they've just got the bill down to the end of the – let's call it two level. Yes, the corrective inventory again.

Noah Poponak

Okay. All right. Thank you.

John Plant

Thank you.

Operator

Our next question comes from the line of Phil Gibbs with KeyBanc Capital Markets. Your line is open.

Phil Gibbs

Hey, John and team. Good morning.

John Plant

Hey, how are you doing?

Phil Gibbs

Doing well. Can you talk a little bit about what you're seeing in the aftermarket, particularly as it relates to the air foils side? And then also whether or not we should expect you to have some price increase opportunities next year?

John Plant

Okay. So first of all, we did see an uptick in the aftermarket demand in coils in Q3. We're expecting a similar sort of improvement in the fourth quarter. So overall, it's good to see. But of course, as I've explained before, because the level comes off a really low level, then what I talk about as an increase as a percentage, it's notable, it's not exactly great in terms of dollar terms.

Our thought is that, that continues on the talking, generally Commercial Aerospace and the air foils that will continue to show further growth in 2022. Within the overall Commercial Aerospace, clearly, business jet is doing quite well. And we say at that moment, that segment, is healthy. And we expect to see improvements in narrow-body as we move through the next few quarters to quite a healthy level in 2022.

So I think then the dollars do become more significant for us because a similar percentage increase on a larger dollar base begins to become more material. Price increases, my statement is, I think that 2022 will be – will be positive, not as big as 2021. That's not in terms of a difference in percentage but more in terms of just the base for renewal. So that's the what I'd say that subject.

Phil Gibbs

Thank you. And then as a follow-up, Ken, on the interest expense side, what should we be modeling relative to the $63 million level that we saw in the third quarter on a run rate basis looking ahead with all the moves you've made? Congrats. Thanks.

Ken Giacobbe

Yes. Just the way I would look at interest expense for next year, about $235 million, substantial action that we took on the debt profile this year, as we talked about on the call. So around $235 million for next year seems to be in good shape.

Operator

Our next question comes from the line of Josh Sullivan with The Benchmark Company. Your line is open.

Josh Sullivan

Hey, good morning.

John Plant

Hey, Josh.

Josh Sullivan

Just curious on the conversations around the overall cost reductions potentially for the F-35 program. How are – or are those discussions reaching your desk yet, either on price, volumes, redesigns? Just curious how you're navigating that.

John Plant

We had conversations on that more over a year ago, so no update since then. I mean the – I think being public about our – the LTA was renewed and pricing settled on that program. So nothing going on at the moment.

Josh Sullivan

Okay. Thank you.

John Plant

Thank you.

Operator

Our next question comes from the line of George Shapiro with Shapiro Research. Your line is open.

George Shapiro

John, just a quick couple for you. Is the ship set value of a 787 between $6 million to $7 million, in that way we can obviously put in our own expectations for what the build rate is going to be next year?

John Plant

I've never been willing to call out ship set values, George. There's guesstimates out there, but it's not a place that I want to go because cutting out ship set values are people trying to model things up and down when they don't know exactly what they all are, what the inventory takes, put and takes are. I think it just clouds the whole position. I think I'd much rather keep people focused on the big relevant numbers, which essentially is how I guide. And basically, clearly, always people are going to go up or down around that. I always think I'd give you a really ahead of me, I think we get below me, and that's how I think about it. But chipset value is an area I'm not being prepared to go.

George Shapiro

Okay. And then just a follow-up on your comments in the wheel business. You said you expect the supply chain issues to maybe resolve by next year. So can you tell us the ballpark is how much you would expect that wheel business to grow next year, if that's the case?

John Plant

At the moment, I'm convincing myself that we're going to see supply chain issues through the first half of next year. I'm not subscribing to anything that magically changes on the first of January as just another day in our lives. But I do think that things begin to ease as we go through the back end of the year and whether it's the chip shortages begin to ease or whether it's resins or whether it's glass, all of these things. We have been working on that for six, nine months. And so bit by bit, they do get resolved capacities, broad supply chains ironed out, people come back to work and vaccination rates go up, and so labor availability, let's say, in Malaysia gets better, and so on.

So the end market demand for commercial trucks is slightly really high. And so this quarter, what we saw was that some of our major customers have actually – I'm going to say, given up trying to build on three shifts and having it and build aren't off every few days. It's so, I call it our customers completely abandoned its third shift.

I just accepted that for the next for – let's say, the balance of year, they're going to just operate on two shifts, reassess again in 2022. My expectation is that the – well, orders, dealerships have been very high. Those will be further improved when 2022 pricing is announced for your end markets for those trucks.

So that's why I'm giving you my best estimate of what I think is going to happen. But there's no – I mean I don't have a special fact set that's private to me, just like just like looking at all of the factors which have been constraining supply and saying, what do I think and what's a balanced view? And are you going to go with – it begins to materially improve in the second half of next year because the demand is there. And what we don't build, we'll just get to the backlog where the backlog is already enormous, it will get added to 2023 backlog.

Operator

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

Seth Seifman

Thanks for the follow-up. I guess, John, maybe to go about the margin question in a less direct way. You've talked in the past about...

John Plant

Sorry.

Seth Seifman

That’s okay, kind of a target sort of incremental for the business as a whole. Is there any reason to think that 2022 should be significantly above or below that sort of target incremental level you've discussed in the past?

John Plant

No, I don't think so. My – clearly, we start going to be the sort of incrementals you saw in the third quarter, which yearly are fabulous. And the fact that we not only called it but did it is good. I think best guess for next year is that normalized the sort of level that we've talked about in the past. So let's use the word 35% plus or minus, and apply that to the volume side of the – whatever the volume is. And then you only adjust it fractionally for the whole issue of dollar of metal and a dollar of revenue in terms of recovery.

So that's the one where you can get it wrong, I think. Assuming we do our staff operationally and keep it on the full incremental, even though that's going to be really good if we do that.

Seth Seifman

All right. Okay. Very good. And either John or Ken, if you could maybe run through some of the – not operational but sort of big moving pieces we can think about for cash next year, so kind of pension, CapEx, tax working capital?

John Plant

Yes. I'll have a go at the big strokes and then let Ken refine it. So my guess is that CapEx when we guide it, will be a bit higher than this year, but still a source of cash compared to depreciation. I think cash taxes will be higher. That's just a function of profit.

So that's kind of the piece of the equation. Working capital, it depends on the slope of the recovery, but I guess it will be a slight drag. I think pension in aggregate will be lower at cash cost than 2021. Not as much as I've got – we've got to view what each of those numbers is. But at the moment, we're still refining it as we get a better view on the overall demand side. Ken, anything you'd like to supplement a bit more granular than that?

Ken Giacobbe

No. The only thing that I would add to that is just the work that we've done on the pension and OPEB side. So to your point, this year, cash contributions for pension and OPEB, about $120 million. We think it's going to be less next year, Seth.

And you saw in the materials here, what we've been doing on pension and OPEB this year and that always benefits next year. But just a couple of items, if I start first with the balance sheet side of the equation, the liability has gone down around $180 million for pension and OPEB. That's significant. That's a combination of company actions that we've taken, as well as the asset returns that we had last year that flow into 2021 and then our contributions.

But the little known fact as well is we have been spending a lot of time to reduce our gross liability for the pension. Last year, you saw us move around $320 million, either annuitizing or buying out certain programs. We intend to continue that this year, probably another $230 million of gross liability reduction in our gross liability. So that will help us out.

And then we're also assuming everything right now, all these numbers that discount rates stay where they're at. If we looked at where discount rates finished last year, it was about 2.5%. And if you snap the line today, it would be about 2.8%, so a 30 basis point improvement, that's going to help. We've shared our sensitivity in the past, about a 25 basis point improvement, improves our position by about $90 million. So hopefully, that stays where it's at.

But definitely doing a lot of work on the balance sheet side. You see how that flows into the P&L. Our pension and OPEB expenses this year, year-to-date, are about $12 million. It's a 50% reduction to where we were from last year. But not only P&L, but as we talked about, that will all help us out from the cash contribution side next year. So we anticipate, as we mentioned, to be lower than $120 million.

John Plant

I think the gross liability reduction is probably something is fundamentally underappreciated. I mean, well over $0.5 billion of gross liabilities come off the balance sheet, which inherently reduces its volatility to both mortality and the interest rates going forward. So I treat that as a really outstanding outcome with essentially very little cash used to achieve that. And it's hard to draw a line between that exactly in value, but it does matter in terms of what that gross and then also the net liabilities are for the company.

Seth Seifman

Great. Great. And then, since we're in the second round here, if I can overstate my welcome. It sounds like you're done hiring for this year. Is there – where are you set for in terms of people, in terms of how far sort of into next year before the next round of adding folks might come?

John Plant

It's difficult to exactly know at this point. As you say, we've taken on, say, net 800 into the engine business, if you asked me before, I thought we would have been hiring in Q1. I'm not really sure if I call it today. I think we probably will be towards the end of Q1. And we want to take a cautious view on all of that. I mean there's a lot of stuff that's got to play out here, all the uncertain I talked to.

I'll give you piece of information here. You didn't ask for it just because it is interesting. Just by way of information, our vaccination rate is over 70% across the company, between 70% and 75%. So that's been responding fairly well to the encouragement that we've been providing to our workforce to provide that protection for everybody. And we hope it continues to improve.

Seth Seifman

Great. Okay. Thanks. Thanks very much.

John Plant

Thank you.

Operator

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

David Strauss

All right. Thanks. I don't think you mentioned this, John, but 2022 price negotiations, where those stand today, how far are you through that? And what might pricing look like relative to 2021?

John Plant

Exactly in line with what I previously said, is that 2022 will be a lower year than 2021 by a significant demand. It will still be healthy, but just the – I'll call it the natural flow of the

LTA renewals. So I would say, all in order there from the previous, I'll say, dialogue. What was the part question, part from?

David Strauss

I think that was it.

John Plant

Okay.

David Strauss

Yes, I think that was it. Yes, as a follow-up, I think you've gotten some relief to do higher levels of cash return between dividends and share repo. But what about the potential to even get more relief, just given where your balance sheet is and the cash generation looks like that will come through next year?

John Plant

Well, first of all, we've certainly increased both the authorization and the scale of baskets that we have to do that. Critical to that in terms of utilization of those baskets is the view of the industry and the strength of view of that industry, and maybe some of the current uncertainties.

It would be great to see those recede. I mean we've talked very clear about the solid recovery of the narrow-body business. And then recertification, I think it would be great to see, let's say, the 737 certified in China, the 787 recertified, I'd say, globally to build condition. And then I think those give us further confidence in deployment.

If I roll myself forward let's say, a year, I'm not really sure whether – depending upon exactly what I'll guide to by way of cash flow for next year. I don't know whether there will be, much by way of restrictions a year from now, if any. But I'm not sure it actually would change the mindset over what we'll be prepared to do. So I think we'll again take a forward view of what our leverage will be, how much wings deployed, what's the overall confidence level in doing so. And basically to provide a balanced set of returns to our stakeholders or our shareholders, in particular.