Howmet Aerospace, Inc. (NYSE:HWM) Q1 2021 Earnings Conference Call May 6, 2021 10:00 AM ET

Company Participants

Paul Luther - VP, IR
John Plant - Executive Chairman & Co-CEO
Tolga Oal - Co-CEO & Director
Kenneth Giacobbe - EVP & CFO

Conference Call Participants

Seth Seifman - JPMorgan Chase & Co.
Robert Spingarn - Crédit Suisse
David Strauss - Barclays Bank
Carter Copeland - Melius Research
Gautam Khanna - Cowen and Company
Robert Stallard - Vertical Research Partners
Noah Poponak - Goldman Sachs Group
Paretosh Misra - Berenberg
Michael Leshock - KeyBanc Capital Markets
George Shapiro - Shapiro Research

Operator

Good morning, ladies and gentlemen, and welcome to the Howmet Aerospace First Quarter 2021 Results. My name is Shelby, and I'll 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, Shelby. Good morning, and welcome to the Howmet Aerospace First Quarter 2021 Results Conference Call. I'm joined by John Plant, Executive Chairman and Co-Chief Executive Officer; Tolga Oal, Co-Chief Executive Officer; and Ken Giacobbe, Executive Vice President and Chief Financial Officer. After comments by John, Tolga 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. Similar to last quarter, I will give an overview of Howmet's first quarter performance, then pass to Tolga, who will talk to our markets, and then Ken will provide further financial detail. I'll return to the call to talk to guidance for the second quarter and the full year 2021.

Please move to Slide 4. Let me start with some commentary on the first quarter. Revenue was $1.2 billion and in line with expectations while EBITDA, EBITDA margin and earnings per share exceeded expectations. Adjusted EBITDA was $275 million, and adjusted EBITDA margin was a healthy 22.7%, similar to the fourth quarter of 2020. Earnings per share, excluding special items, was $0.22, which was ahead of expectations and ahead of Q4 2020.

Historically, Q1 has been a significant cash outflow for the company. However, with improved margins and enhanced working capital control, the outcome has noticeably improved. This will be followed by cash generation in quarters 2, 3 and 4.

Lastly, in the first quarter, we focused on deleveraging, completing the early redemption of the 2021 notes at par for approximately $360 million of cash in -- using cash in hand. The resulting quarter end cash balance was $1.24 billion. Moreover, on May 3, we completed the early redemption of the $476 million of notes due in 2022 for approximately $500 million, inclusive of the accrued interest and fees. Both transactions were completed with cash on hand.

Year-to-date, we have reduced debt by approximately $840 million, which reduces the 2021 interest expense by $38 million and $47 million on a run rate basis. In addition, in 2022, there will be a carryover interest savings of $10 million.

Now let's move to markets and performance on Slide 5. Q1 revenue was the same as the Q2 to Q4 2020 average and in line with our expectations. On a year-over-year basis, commercial aerospace was down 52%, driven by the lingering effects of customer inventory reductions and fundamentally lower builds, starting with the Boeing MAX. Commercial aerospace continues to represent 40% of the total revenue of the company, compared to pre-COVID levels of 60%. The commercial aerospace decline is partially offset by continued strength in our other markets. Defense aerospace was up 12% year-over-year, driven by the Joint Strike Fighter new builds and spares. The industrial gas turbine business continues to grow and was up 35% year-over-year, also driven by new builds and spares.

Lastly, the commercial transportation business was up 15% year-over-year, despite customer supply chain constraints. Although truck demand is very strong, our customers managed through supply chain issues with several commodities, which are in short supply, including semiconductors, tires and glass, to name just a few. We are working closely with our customers to meet demand, which is showing some interruptions.

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 are also in line with expectations, with a $61 million year-over-year benefit. Segment decremental margins continue to be good at 27%, driven by price, variable cost flexing and fixed cost management. CapEx was $55 million in the quarter and continues to be less than depreciation and amortization, resulting in a net source of cash.

Adjusted EBITDA margin for the quarter was 22.7% and consistent with Q4 2020 on approximately $30 million of less revenue. Q1 revenue of $1.2 billion was consistent with the Q4 -- Q2 to Q4 2020 average. You can see the benefit of our actions since the start of the pandemic with a 300 basis point EBITDA margin expansion while revenue was approximately $45 million less than the same period, so good year-on-year performance.

Now let me turn it over to Tolga to give an overview of the markets.

Tolga Oal

Thank you, John. Please move to Slide 7. Now to year-over-year revenue performance. Q1 revenue was down 26%, driven by commercial aerospace, which continues to represent approximately 40% of total revenue in the quarter. Commercial aerospace was down 52% year-over-year, in line with our projections, as we continue to see customer inventory corrections as expected.

Defense aerospace continues to grow and was up 12% in Q1 as we are on a diverse set of programs, with the Joint Strike Fighter being approximately 40% of the total defense business. Commercial transportation, which impacts both the Forged Wheels and Fastening Systems segments, was up 15% year-over-year with a very strong market demand. Finally, the industrial and other markets, which consists of IGT, oil and gas and general industrial, was up 1%. IGT, which makes up approximately 45% of this market, continues to be strong and was up a healthy 35% year-over-year.

I will now turn it over to Ken to give a more detailed view of the financials.

Kenneth Giacobbe

Thank you, Tolga, and good morning, everyone. Now let's move to Slide 8 for the segment results. As expected, Engine Products year-over-year revenue was down 32% in the first quarter. Commercial aerospace was down 55%, driven by customer inventory corrections and reduced demand for spares. Commercial aerospace was partially offset by a year-over-year increase of 18% in defense aerospace and a 35% increase in IGT. IGT continues to be strong, and we will continue to make investments in this business as demand has been increasing for cleaner energy. Decremental margins for engines were 26% for the quarter as segment operating profit margin was approximately 19%. In the appendix of the presentation, we have provided a schedule which shows each segment's decremental margins for Q3 2020 through Q1 2021.

Now let's move to Fastening Systems on Slide 9. Also as expected, Fastening Systems year-over-year revenue was down 29% in the first quarter. Commercial aerospace was down 42%. Like the engine segment, we continue to experience inventory corrections in the commercial aerospace market. The industrial and commercial transportation markets were down 2% year-over-year, but up 19% sequentially. Decremental margins for Fastening Systems were 45% for the first quarter as furloughed workers returned to work.

Please move to Slide 10 to review Engineered Structures. For Engineered Structures, year-over-year revenue was down 36% in the first quarter. Commercial aerospace was down 57%, driven by customer inventory corrections and production declines for the 787 and 737 MAX. Commercial aerospace was partially offset by a 10% year-over-year increase in defense aerospace. Decremental margins for Engineered Structures were 18% for the quarter, compared to 24% in Q4.

Lastly, please move to Slide 11 for Forged Wheels. Forged Wheels revenue increased 19% year-over-year despite customer supply chain constraints. Forged Wheels revenue grew faster than the overall market, in part due to Howmet's new innovative 39-pound wheel. Segment operating profit margin was another record at almost 31% as year-over-year incremental margins were 56%. The improved margin was driven by continued cost management and maximizing production in low-cost countries.

Please move to Slide 12. We continue to focus on improving our capital structure and liquidity. First, we completed 2 early redemptions of our bonds. The first transaction was on January 15. We used cash on hand to complete the early redemption at par of the 2021 bonds due in April 2021. By paying down the bonds 3 months early at no additional cost, we saved $5 million of interest.

The second transaction was earlier this week on May 3. We used cash on hand to complete the early redemption of the bonds that are due in February 2022. The bonds were redeemed at a cost of approximately $500 million. As a result, the interest costs have been reduced by approximately $47 million year-over-year. Moreover, as John has mentioned, in 2022, we'll get an incremental $10 million of carryover interest savings. Gross debt stands at $4.2 billion. All debt is unsecured, and the next maturity is in 2024. Finally, our $1 billion revolver remains undrawn.

Before I turn it back to John to discuss the 2021 guidance, I would point out that there's a slide in the appendix that covers special items in the quarter. Special items for the quarter were a charge for approximately $16 million after tax, and the charge was primarily related to 3 items: first, we had fire costs at 2 of our plants of $7 million; second, we had an impairment of assets associated with an agreement to sell a small manufacturing business in France of $4 million; and third, we had a pension settlement charge in the U.S. of $3 million.

Finally, we continue to work on reducing legacy liabilities and improving asset returns for the pension plan. I would highlight 2 significant items: first, we had announced a planned administration change of certain prescription drug benefits that is expected to reduce cost and reduce our OPEB liability by approximately 20% or $39 million; second, we are benefiting from pension asset investment returns of over 13% that we realized in 2020. The combination of the asset returns and the liability reduction have decreased annual pension and OPEB expense by 37% or $13 million annually.

So now let me turn it back over to John.

John Plant

Thanks, Ken. Let me move to Slide 13 for the Q2 and annual guidance. First, the good news is that we're another quarter along towards the recovery of the commercial aerospace market. This will go a long way in helping profitability and complementing the growth and solidity at the defense aerospace, IGT and commercial transportation markets.

There are a series of leading indicators that are showing very well for us: numbers of flight inquiries, bookings of flights, hotels and car rentals, and we also note the increase in U.S.A. TSA numbers, flight takeoffs, particularly in the U.S. and China. Europe remains somewhat muted given the effects of the pandemic and slower implementation of COVID vaccines. All of this should begin to help airlines with aircraft production, particularly of narrow-body aircraft. We note that the demand for wide-body aircraft probably may not reappear until mid-2022 or even into 2023.

We see at the end of the second quarter as to be an inflection point to the beginnings of production increases for Howmet in the second half of the year, with the exact precise timing yet to be determined. We are planning to bring back from furlough or recruit several hundred workers during the next 2 quarters to train and retrain to be ready for this demand, just in the same effective way that we did in the third quarter of 2020 for the commercial wheels business. My expectation is that these costs plus cost of recommencing mothball plants and equipment will hold EBITDA margins at around the 22% level until further stabilization is reached.

We also know that there is an effect on the commercial transportation market of part shortages, particularly semiconductors, which is reducing shifts and production work in the second quarter. As noted earlier today, the timing for cash generation has been a focus for us. And instead of the normal large Q1 outflow, which then has to be subsequently overcome, the first quarter was essentially breakeven and all subsequent quarters are expected to be cash generative.

Specifically, the guidance for Q2: sales at $1.2 billion, plus or minus $30 million; EBITDA of $265 million, plus or minus $5 million; EBITDA margin of 22.1%, plus or minus 10 basis points; and earnings per share of $0.20, plus or minus $0.01. And for the year, sales of $5.1 billion, plus $100 million, minus $50 million; EBITDA line increases -- the EBITDA baseline increases by $50 million to $1.15 billion, with a range of plus $50 million to minus $25 million; EBITDA margin baseline has now increased to 22.5%, plus 60 basis points and minus 20 basis points in terms of a range. The earnings per share baseline increases to $0.95, a significant increase over prior guidance and with a range of plus $0.07 to minus $0.04. And the cash flow baseline increased to $425 million, plus or minus $30 million.

Moving to the right-hand side of the slide. We noted that second half revenue is expected to be up 12% for the total company, driven by the increases in commercial aerospace, defense and IGT. Price increases to be greater than 2020. Cost reduction carryover of approximately $100 million, and pension and OPEB contributions of $160 million. We continue to evaluate the impacts of the American Rescue Plan Act upon pension contributions and we'll determine those later in the year.

CapEx is expected to be in the range of $200 million to $220 million compared to depreciation and amortization of $270 million. And adjusted free cash flow conversion is about 100% of net income. We plan to reinstate the quarterly dividend of $0.02 per share of common stock in the third quarter of 2021, pending the final Board approval.

Now please move to Slide 14. To summarize, Q1 was a healthy start to the year, and liquidity of the company continues to be strong. The guidance provided is raised from that given in early February and reflects our first quarter profitability strength. The redemption of bonds for cash, the reinstitution of the dividend, all of which provide value to shareholders. More broadly, the focus is now turning to the beginning of the revenue recovery in the second half, commencing with commercial aerospace and the run rate of both revenues and margins as we exit 2021 and move into 2022, where we see the prospect of further leading indicator improvements.

Thank you, and now we'll take your questions.

Question-and-Answer Session

Operator

[Operator Instructions]. Our first question comes from Seth Seifman of JPMorgan.

Seth Seifman

Just looking at the different segments and sort of where aero came down, I guess, if you think about where you are relative to the bottom, it sounds like, obviously, there's increases coming for the second half. But for -- I guess, for fasteners, I guess, do you feel like you have visibility with regard to what the level of destocking is and at the -- what we've seen in Q1 is kind of close to the bottom and then, I guess, similarly for structures as well?

John Plant

Yes. So the way I think about it is in terms of sequence of the transition and with the end of the second quarter being the transition from basically the current holding part and recent results of the reduced demand and then the correction of the inventory to our customers. And already, we know that commercial transportation is going well, subject to those, I'll say, interruptions because of supply shortages. The big third comes in commercial aerospace, we believe, at the end of the second quarter. And I think that's going to be led by the engines business in terms of the first uptick in demand with -- and supported by structures, with fasteners probably still being a little bit behind that by another quarter or so.

So my picture for the year is that commercial aerospace, I think, year-on-year, we're going to see that segment up 15% to 20% in the third quarter compared to second. Second quarter will be a reduced decrement compared to what we see the 52% currently. And then as that increase that we see as the turn occurs will be led by engine, supported by structures, with fasteners following maybe fourth quarter or even at the end of the year just as those inventories are absorbed then with what we think will be a fairly a significant snapback in the first part of 2022. So that gives the sequence that I expect both for the commercial aerospace markets and how it affects each of our segments through the next 3 quarters.

Seth Seifman

Great. That's very helpful. And then just as a quick follow-up, can you talk about your level of visibility on the 737 MAX versus, I guess, when we were on the call 3 months ago?

John Plant

Yes. I mean, we think that it's going to continue in line with Boeing's build rate, which is currently at 7, rising to 14 in the late summer and then into the, I think, 22 per month range as we start 2022 and then up to 30 a month. So it seems set well at the moment. We're still, as I said on the previous call, have been supplying effectively below the 7 rate per month in aggregate. Obviously, different levels go into different product lines. But we are expecting to see being in line with shipset values to equal production and then the lift of production as we go forward.

So that's all built into what we think would be that 20% increase in commercial aero in the -- commencing in the third quarter. And also supported by the increase in production that in narrow-body for the A320 for Airbus as well.

Operator

Your next question is from Robert Spingarn of Crédit Suisse.

Robert Spingarn

John, just following up on Seth's question there on the MAX, maybe just to ask it slightly differently. But with Boeing or other suppliers talking about 160 aircraft being produced in 2021, can you tell us where you are relative to that number given the inventories in this already in the supply chain and so on? In other words, how much production do you need to do to match to their 160?

John Plant

Yes. I think we are closer to the 120 level, so let's say, 25% below that number for the year is how we see it with, say, that inflection point coming -- a significant inflection point coming as we start Q3, for which, if we didn't have confidence, we would not be going through the recruitment and bringing back of people in the second quarter, starting the second quarter, and seeing significant employment increases during the next two quarters.

Robert Spingarn

Okay. And just on that, I guess, on the other question that Seth asked, and you talked about the second half improvement earlier led by engines. When will you actually know how far in advance of the shop visits? Are they scheduled? And are parts ordered? And what are the lead times for structures and fasteners as well? So in other words, when will you know what your second half looks like?

John Plant

Okay. We have already begun to receive order intake now from our customers, particularly on the engine side, with letters of commitments on the, I'll say, schedule releases and EDI transmission. So what we're seeing is all the things which have been stated appear to be materializing as we speak to. Even in the last week, we received letters from, let's say, Safran or CFM and meetings with GE Aviation, et cetera.

So it's gone from what we think may happen to, I can say, a lot more confidence. And the question is one of just the final degree to be determined. So there's other stuff which has to be filled in, but an increasing level of confidence compared to 3 months ago.

Robert Spingarn

And is it different for fasteners? It's much more book and burn, so the lead times are shorter and you won't yet have a firm view on that?

John Plant

Yes. We operate with some of our customers on min-max systems. And so the averages take some time to re-average. So at the moment, as they -- we were re-averaging down on those min-max systems, it takes time for it to feed through. And then it will then snap back. It gained more significant to the upside. But with that to -- I'd say maybe a 2-quarter delay for that segment is what I see as the most likely scenario. So that's why I said I think that fasteners will be a quarter or 2 behind what we're seeing elsewhere.

Operator

Your next question is from David Strauss of Barclays.

David Strauss

John, can you touch on what an inflationary environment might mean for your business, thinking about it from a pricing and raw material standpoint? Is an inflation -- as you net all of it, do you think an inflationary environment potentially going forward will it be a net positive for the business?

John Plant

For the next few years, I don't see it significant either way because material inflation will essentially be passed through to our customers by the escalator agreements that we have. And therefore, we're talking more about what would be the impact of labor inflation. Labor -- for labor inflation, some significant parts of our businesses those are already set for the next, I'll say, 2 to 4 years depending upon the various labor agreements that we have in place. But obviously, some of the workforce, it's an annual event. And then it's up for us to gain the productivity that we seek to gain each year to offset that labor inflation.

So I'm -- in an inflationary environment, I don't expect that to be a problem for us. And indeed, with customer agreements that we have and also some of that we see is, say, being taken care of with the -- within the bandwidth of the LTA negotiations that we've been undergoing.

David Strauss

Okay. As a follow-up on the capital deployment front, I know you've -- you've taken out a fair amount of debt reinstituting the dividend, but it still looks like the way you're tracking your cash balance will be well over $1 billion at year-end without doing anything else. So now that you don't have much, it looks like, to do on the debt side of things, how are you thinking about share repurchase from here?

John Plant

Yes. So we described the potential for capital allocation strategies in some detail on the last call. In fact, I think I called it smorgasbord of opportunity to do various things. What we considered is the first order of battle was to deal with the next couple of maturities of our bonds. We did that easily from cash on hand. And that obviously produces a lower interest burden for the company, lower gross debt. And therefore, it's also seen some improvement from the rating agencies. So that's been, I think, a good step for us.

And now the next thing you have to address at some point, but not, I don't think, just now is the October 2024 at some point. So that's 3.5 years away in terms of bonds. So I'd say that part of the balance sheet is dealt with. We felt confident in the cash flows of the business to reinstate the dividend. That's an expression of our confidence and, again, part of our plan to return money to shareholders.

And then the other 2 aspects that we have to consider is what about share repurchase and also to what degree, if anything, do we participate in any M&A activity, which may materialize over the next, say, year or so as the commercial aerospace market solidifies into, let's say, skylines and the confidence that we all can believe in. Clearly, that's beginning to happen given what I said about the inflection point that we see coming. And I guess, we're in that position, David, that you said, is that if all things work out as planned, is that we'll have a very significant cash balance at the end of the year and have the ability to make other decisions in capital deployment in the future.

So I think it's always well in terms of, let's say, the whole capital allocation strategy that we set out for ourselves in the recent months.

Operator

[Operator Instructions]. Our next question is from Carter Copeland of Melius Research.

Carter Copeland

One question. David is in trouble. I guess I got to stick to one, right, John?

John Plant

Well, you never do anyway, Carter. So I just like -- it's one of these like aspiration things, but yes, you go for the -- you go for the multiple 5-part question.

Carter Copeland

That's fine. I'll do 1-parter. So obviously, the shift in focus is moving to going back up in production and then bringing people back from furlough, training and the like. But one of the things that we used to talk about before this all went down was yield, whether that's first pass yields or rolled throughput yields in some of those key spots in your facilities.

When you look at yields and production facilities today versus where those were when we were talking about shortages and engine OEM factories 2 years ago or so, how does that stand today? And how does that play into your confidence and conviction around going up without hiccups?

John Plant

Okay. When I look at the last couple of years in our aerospace business, I think one of the untold stories is the improvement in delivery performance and our quality levels where it's been reducing arrears, whether it's being parts per mining defects or even internal scrap in our manufacturing plants. And yields have clearly have definitely improved both for defense aerospace and commercial aerospace segments. And so it's all good.

I really want to protect reputation and reliability with our customers and really seek to do that by bringing labor back and training it. So I think the things we did last year in the third quarter for our wheels business have paid off handsomely in terms of our ability to increase production with excellent quality and deliver these very significant incremental margins that we've seen in that wheels business.

And so rather than, I think, stumble through this, we're trying to be ahead of it, being planful on labor and recognizing that there is a training time or retraining for people to be able to deliver the yields that we currently have and hopefully continue to improve them. So that's why I want to plan carefully through the next couple of quarters because we are talking a very significant increase in labor. Obviously, we'll be tailoring it to and then trimming it exactly as we see to go through it. But I really want to be ahead of this thing and not chasing it and having yield issues and arrears build and all the consequences that, that puts upon the business.

So if it cost us, let's say, a couple of -- 200, 300 basis points or whatever margin for a quarter or so, I think that's money really well spent because it's going to be what's the margin as we exit this year and how do we perform into 2022. So really trying to be planful about the next phase of our business and not just react to it after the event and that you seem to be scrambling. So that's all part of the value we bring to, I think, to the industry and to our customers.

Operator

Your next question is from Gautam Khanna of Cowen.

Gautam Khanna

Forgive a two question asked. But first, I was curious about lead time discussions with customers, are you having those? I mean I imagine it's chicken or egg if the lead times are short. They don't have the urgency to place orders. But then we have as the order books pick up, the lead times extend, and there's a queuing effect.

I mean, do you think that plays out over the next 1.5 years where we see kind of a bullwhip effect? I know you just talked about the second half being above the first half. But I mean, could we see kind of outsized growth as we move in? Or do you think it will be just feathered in gradually in terms of the recovery? And then I have a follow-up.

John Plant

Yes. The way I see it at the moment is everybody is aware there's plenty of metal in the system, and that gives people, I'll say, the ability to drop in a little bit later than would have been normal. If you looked at the demand levels of 2019 where lead times were, let's say, to get metal for some of our products was over 12 months. So we need to recognize the situation we're all in with carrying some trapped inventory. And we still have trapped inventory, which we plan to liquidate during the balance of 2021.

And it's really interesting. Because when we look at our inventory levels as we move through the year, one of recent discussions in our quarterly review has been to what degree do we hold on to some of those in the latter part of the year just so again we're in a really strong position as we enter 2022 with what we think will be a fairly strong year for us in terms of demand.

So where we find ourselves at the moment is our customers know that there's metal in the system, we know there's trapped inventory. And so we're more on that 3 to 6 months of lead times. And people have been holding off, and we've been seeing that fill in very significantly in the last few weeks. And then obviously, it's like everything is going to depend. But I do see, if we look at 6 months from now, then those lead times are going to be significantly increased. And therefore, orders are going to have to be placed.

Otherwise, with some of the production increases on narrow-bodies, in particular, that Airbus and Boeing are looking at for 2022 and certainly later in 2022, I mean they won't occur unless orders are placed because the availability of that inventory and the current excess of metals has just been in the system for the last year just won't be there.

Gautam Khanna

That is helpful. And then I just wanted to ask, last quarter, we talked about how the Boeing schedule is a little bit more in flux than the Airbus production schedule. But we heard Spirit yesterday talk about 9 to 10 A350s coming out of the plan this year and next. So I was curious, how stable is it now on the Airbus side? Did you see much in the way of changes over the past 3 months? And is that in...

John Plant

No, we've seen no changes on Airbus. It's been solid. Solid all the way through, meeting what they've said, reinforcing what they've said, issuing both skyline and production schedules. So no changes for Airbus at all. And in fact, in the more recent past, we have not seen changes from Boeing either, which in last years have tend to be towards the downside. Again, none of that's been occurring.

Operator

Your next question is from Robert Stallard of Vertical Research.

Robert Stallard

John, we're seeing some pretty positive things about what we could be seeing in 2022 and beyond. But I was wondering, as we feed this volume through the system, what your thoughts might be on incremental margins as volumes recover? Can we say, for example, take your experience in wheels and apply that to aerospace?

John Plant

I think there -- obviously, we also have a different profile to our engine business, to our structures business. So it's got to be segment by segment. But essentially, I am on record having said that we expect fairly strong incrementals as we go forward. Because in the way that we managed through this crisis, you can see that, compared to our normal decrementals of, let's call it, 40%, we've been getting those into the 20s and have been quite pleased with both the way we've managed our structural cost takeouts and the variable costs. And it's our job not to allow those more fixed cost to creep back into the system. And they also, indeed, try to be sticky on those variable costs as we go back up the production volume curve. So we are expecting healthy incremental margins.

And part of it is also getting that labor in place at the right time and trained and ready, as I tried to describe on a couple of questions ago. So we don't stumble our way through this. It's planfully set out and accepting it as if it cost us 200 or 300 basis points of margin -- not being 200 but 20 or 30 basis points of margin. So I think I just can't get to like just over 22% for the second quarter just to take out of -- I'd rather bring the labor in and then look forward to those healthy incrementals going forward.

Robert Stallard

That's helpful. And just a quick follow-up. That margin impact from extra labor, that's baked into your 2021 guidance?

John Plant

Yes, it is.

Operator

Your next question is from Noah Poponak of Goldman Sachs.

Noah Poponak

John, having 2Q revenue be down year-over-year a little bit, despite that lapping a largely pandemic-impacted quarter, the low end of the 2Q guide being down a little sequentially, that's pretty surprising given your mix. I kind of expect that in aerospace original equipment as that's longer cycle, but aerospace aftermarket, defense, truck, industrial would think would all be up year-over-year and sequentially.

Is there just more destocking in aerospace original equipment or a longer time for you to link up to Boeing and Airbus than maybe I had appreciated? And so if you could help me understand that and maybe just get specific on how much inventory destock left and anywhere where you're not yet linked up to Boeing and Airbus would be really helpful.

John Plant

So Q2 of 2020, our customers were not rapid to change some of the production requirements, and that became more of featured in the third quarter, as you know, from last year. So when we look at Q2 this year, because some of the schedules have not been reduced that significantly, although they were reduced and you say plants were closed down, it's a very, I'll call, turbulent quarter to comp against. And so the way I look at it is more, let's say, on a sequential basis, where I'm thinking that, well, commercial aero was down 52%, it's going to be down a lot less than that in terms of build comparisons.

And then the only other muting effect I'm thinking about at the moment is we are careful in terms of the commercial truck build plans of our customers, just because of those part shortages. So we are seeing shifts go down and customers take weeks out in the second quarter. And that's part of what we are guiding to as well, including that in our numbers as best as we can estimate it at this point in time. So it's a fairly, I must say, careful assumption around the commercial transportation business for the second quarter.

At the same time, I would say to you now the flip side of that is that order intake for us pretty much globally has been very healthy. And you've seen class 8 truck and trailer orders at levels now, which essentially secure the backlog for the balance of 2021 and most of the way through 2022 at the moment. And so -- whereas before, we were thinking we had a fairly good trajectory, but it wasn't filled in totally. Now you see that demand so strong.

So for example, if you wanted to buy a new trailer to go with your truck at the moment, if you ordered it today, you wouldn't be thinking about taking delivery for 12 months. So you're looking out into the second quarter of 2022. Now that's how long lead times are in the commercial transportation industry. So that's really very healthy for us and really puts a very solid platform on 2022 and never mind the balance of this year.

So I just want to give you the full picture around that. And so if we're cautious on, I'll call, supply-based interruptions the truck build in the very short term, given the strength of the economy, what we see by way of transportation and shipping of things, it's producing a very solid picture for backlog for the next, let's say, 18 months.

Noah Poponak

Okay. That's really helpful. Could you just put a little more detail around where, if anywhere, you're not yet linked up to Boeing and Airbus or where in the business there's more inventory destock yet to occur?

John Plant

Basically, we are still having inventory taken out in the second quarter. And then we think, and it's like it's the best judgment that basically that just essentially stops and so at the end of the second quarter. So we begin to see our structures business in the second half where we're planning for increased production. We're seeing it clearly. I've already mentioned the engine-based business and the only business which is going to lag for, again, a couple of quarters behind that is going to be our fastener business where I think we're going to be close on, balanced all inventories up by the -- maybe by the end of the third quarter, could stray into Q4.

But that's how we see it at the moment. So different flavors for those different segments according to basically lead times and trying to get ahead of it. Because I think one thing our customers don't want to have is some of the supply constraints, particularly around engine parts, which are really long lead-time items ultimately. They're on the same constraints as we saw a couple of years ago.

Operator

Your next question is from Paretosh Misra of Berenberg.

Paretosh Misra

I'm guessing structures have the highest wide-body exposure, and probably engines have the highest narrow-body exposure. Is that correct? And if any way you could further quantify it as to what's the wide-body versus narrow-body split in engine versus structures.

John Plant

Certainly, you're right in terms of basic structures on our fastener business because of the composite content of wide-body aircraft. So if you're thinking Airbus A350s as an example or Boeing 787s and with those composite structures more titanium, whole different suite of fasteners, then you can see that impact in the way we've laid out our revenue expectations with then, as we said, I'll say, an improving situation somewhat behind the engine business.

If you look at the traditional split going back to -- you got to have to go back to 2019 because it's been moving around. And I'm just trying to keep all of these numbers in my head, but it's like a 60-40 narrow -- maybe 55-45 narrow to wide-body split. That has shifted the same as Boeing and Airbus has shifted over the last 12 months. So to give you a picture on that, I think, traditionally, Boeing would have been 60, Airbus 40, split the other way, and they could rebalance again in 2021, to some degree, as the MAX gets back up and going.

For engines, I actually don't keep the numbers in my head in terms of what the exact split is. Certainly, in terms of what we see over the next 12, 18 months is that the narrow-body engines, so think LEAP-1A, LEAP-1B and then obviously, some of the aftermarket service business coming back, particularly for the CFM engines. So what we see begin to fill in the back end of the year to 2022. But I think that's best I can do at this point. I can't exactly remember the split between wide and narrow for engine and maybe we haven't given it.

Paretosh Misra

This is great, John. I really appreciate all the details. And maybe as a follow-up, with regard to the industrial and other end market, I'm sorry if I missed this, but have you given out what sort of full year growth rate is baked in your revenue guidance for the year?

John Plant

For the gross industrial markets, we haven't called that out. But just to me just give you a picture on that, the way we see us going through IGT part of that business is strong and getting stronger, in fact. And so at the moment, we could sell everything we could make. And so again, we're working on raising production for that. So that's, I'll say, fairly exciting.

Oil and gas has been really very muted for the last year and the first half of this year. But we -- our thought process is that maybe in the fourth quarter or certainly by the first quarter of next year, we think in the oil and gas begins to show an improvement for us. We see Texas crude now at $66, plus or minus, and natural gas has moved up. And rig count has moved up significantly for the Gulf. And so all that's talking well to us in terms of the demand partners we work through inventories in oil and gas.

And then in general, industrial is also strengthening, as we see through the balance of 2021, again, in the second half. So basically, snapshot is IGT is strong. Oil and gas, another quarter or two of weakness, followed by some strength, and then general industrial progressively getting better as well.

Operator

Your next question is from Phil Gibbs of KeyBanc Capital.

Michael Leshock

It's Mike on for Phil. I wanted to get an update on price increases here. You're getting good traction there and you expect to be greater than what you saw in 2020. But do you have visibility into when you expect the lion's share of those price increases to be seen in the year? Or should we expect fairly steady benefits quarter-over-quarter?

John Plant

I think we're going to see a fairly steady pattern throughout the year. Most of our agreements have now been -- in fact, I think all of our agreements have been renewed in terms of LTA for '21. We don't expect much by way of spot business, unless something occurs in the back end of the year where a demand is mismatched to previous schedule. So I mean that's the picture there. And I guess, we'll be giving enhanced detail in our 10-Q, which we plan to issue later today. But basically, everything is in order in that side compared to previous statements.

Operator

Your next question is from George Shapiro of Shapiro Research.

George Shapiro

Yes, John, it looks like sequentially commercial aero was maybe down about 2%, if you could validate that. And if you could also break out what you think the mix is now between OE and aftermarket. And then the improvement you're looking for in the second half, is that primarily OE or aftermarket?

John Plant

Okay. So benefits in the second half essentially is OE. There will be some modest improvement, I think, in commercial aero, but fairly modest. If you -- to give you a picture, if you go back, 2019 as the reference point, $800 million of spares, which essentially is engine, plus -- on top of that, fasteners and structure business. It was $400 million of defense and industrial that grew, let's say, let's call it, 20% over the last year or so. So healthy growth there.

But for the most part, the spares or parts we sell through to the MRO shops through our customers just dropped off a cliff in the second half of last year. So basically, you see limited demand, but still a demand like commercial business jet and some very modest levels of spares business. And that picture through that is first half of this year is pretty much the same as the back half of last year. So compared to $100 million a quarter, I think, more like $20 million a quarter. It can be below that, could be just above it, just depends on the quarter. It's just bouncing around with small numbers.

In the second half of this year, I think we're expecting a modest lift, but not planning for anything significant in that spares business in the second half at this point, but let's say a little bit higher than that. That's clear compared to the $20 million a quarter, thinking more like that $25 million to $30 million a quarter. It doesn't move the needle for us at this point in time. I think it will in '22. So all the guidance I've given you is essentially balance in the commercial aerospace part of our business is coming off the OE demand.

Operator

Your final question is from Noah Poponak of Goldman Sachs.

John Plant

Noah, you're back.

Noah Poponak

I'm back.

John Plant

That's way to get more than one question in.

Noah Poponak

I totally never violate the stick to one question rule. So I came back. Just kidding. John, the last time commercial aerospace was in a similar point in its cycle sort of looking at the early part of the recovery, the fasteners market was just volatile and it turned out that because of a lot of use of distributors and just kind of maybe a long path from the part OEM to the airplane OEM, it ended up just taking a long time to recover and was just kind of messy.

And hearing you talk about the inventory destock maybe lasting a little longer there, maybe you could just help us get comfortable that the issues that drove that last time around aren't in the system again. And I guess, how worried are you about that in that business?

John Plant

Well, I don't know if I can give you any more comfort. I think I wasn't sticking around when the last cycle really occurred, so I don't know. We've done a lot of efforts in our business to try to grow it, not just in OE demand, but also through distribution. And at the moment, I think it's good and clear that we've called it out, being probably a couple of quarters behind where we think some of the other parts of our commercial aerospace business are beginning to respond.

And so I think that's a fairly thought-through and quality view of the market at this point. I recognize that we do have extended change. So for example, part of our -- if you could just take the North American business, and so I'll just confine my comments to that. Yes, we'll supply directly to Boeing. So that's part of the demand. But we also supply into -- in Spirit. And therefore, it's another step in the supply chain.

And what we're clear at is that we've been supplying at the low rate for some time. We're not trying to be optimistic in saying we're going to see that recover in the Q3 or Q4. We've been saying it's a couple of quarters behind and do think that it will begin to recover or will maybe even -- maybe it's the bullwhip comment that Gautam used or is it snapback. I think we're going to see significant demand increases for our fastener business in 2022. That's the best I can guide you at this point in time without the perfect visibility that, I guess, we'd all like, but we don't have.

Noah Poponak

Yes. Okay. That's helpful. And just one more while I'm on here. The cost you've referred to, to sort of prepared to have growth come back, hiring, et cetera, is there any range of an absolute dollar number you could put on that just so we could then compare that to the cost-out number you've had?

John Plant

Well, it's -- of course, it's -- the cost-out number is essentially more of a structural cost takeout rather than the variable cost side. The cost -- the employment that I'm talking about bringing into the business is essentially in our variable cost structure. So you need to understand it's completely different parts of bucketing in the P&L. And I just consider like direct labor reflect in accordance with the production requirements.

To give you a picture for second quarter, then we're thinking of, let's say, around 400 people, could be 500 people, to bring into the business in -- during April, May and June to prepare ourselves for what we've talked about and recognizing that many of those hours won't be necessarily that productive as we go through.

So you can begin to work out if you just apply an average direct labor cost per employee for that sort of numbers and average them through a quarter. You can see the sort of costs that we're talking about this being there. But I believe that, that's essential for us to be able to then achieve the yields, the incremental margins that we've talked about, which is really what this business is all about and the way we should think about it.

Noah Poponak

So I should just think of it as your structural cost-out number you've spoken to, then obviously variable cost tethered to revenue, but that you're going to have some variable costs lead the revenue recovery as you anticipate it.

John Plant

Exactly. So production works will be taken on. We're preparing, let's say, go to waxing and I say, prep the slurry tanks and then de-mothballing our casting machines and lines so that all of that occurs. So we can take the production on as we go into Q3 and Q4. Okay. Thank you very much. And I think that concludes today. But if I -- leave the operator to conclude it for us.

Operator

We have no further questions in queue. Ladies and gentlemen, thank you all for your participation. This concludes today's conference call. You may now disconnect.