Howmet Aerospace Inc. (NYSE:HWM) Q3 2024 Earnings Conference Call November 6, 2024 10:00 AM ET

Company Participants

Paul Luther - VP, IR
Ken Giacobbe - EVP and CFO
John Plant - Executive Chairman and CEO

Conference Call Participants

Sheila Kahyaoglu - Jefferies
Robert Stallard - Vertical Research Partners
Doug Harned - Bernstein
Scott Deuschle - Deutsche Bank
David Strauss - Barclays
Myles Walton - Wolfe Research
Seth Seifman - JPMorgan
Ronald Epstein - Bank of America
Gautam Khanna - TD Cowen

Operator

Good day and welcome to the Howmet Aerospace Third Quarter of 2024 Earnings Call. All participants will be in listen-only mode for the duration of the call. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] On today's call, we ask that you please limit yourself to only one question. Also, please be aware that today's call is being recorded.

I would now like to turn the call over to Paul Luther, Vice President of Investor Relations and FP&A. Please go ahead.

Paul Luther

Thank you, Joe. Good morning and welcome to the Howmet Aerospace third quarter 2024 results conference call. I'm joined by John Plant, Executive Chairman and Chief Executive Officer; and Ken Giacobbe, Executive Vice President and Chief Financial Officer. After comments by John and Ken, we will have a question-and-answer session.

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

In today's presentation references to EBITDA, operating income, and EPS mean adjusted EBITDA, excluding special items, adjusted operating income, excluding special items and adjusted EPS, excluding special items. These measures are among the non-GAAP financial measures that we've included in our discussion. Reconciliations to the most directly comparable GAAP financial measures can be found in today's press release and in the appendix in today's presentation.

And with that, I'd like to turn the call over to John.

John Plant

Thank you, PT, and welcome, everyone to the Howmet third quarter earnings call. Q3 was another strong quarter for the company. Year-over-year revenue growth was 11%, building on the 14% growth in the first half. Within this number, commercial aerospace growth was 17% continuing a strong trend, including engine spares growth. Other markets will be covered later in the call.

EBITDA was a record $487 million, along with a margin of 26.5%, while operating income was $419 million with a margin of 22.8%. Operating income was up 33% year-over-year and increased 390 basis points, with engines and fasteners performing at high levels, supported by an increasingly strong results in structures.

Wheels revenue was down, driven by market declines, especially in Europe, which reduced double-digits with extended summer vacations. However, wheels continued to deliver a healthy EBITDA margin of 26%.

Earnings per share was $0.71, an increase of 54% year-over-year. Free cash flow was also strong at $162 million, improving year-to-date free cash flow to approximately $600 million.

The quarter end cash balance of $475 million is after deploying $282 million to debt pay down, $100 million to share buybacks, and $34 million to dividends. Overall, Howmet had a healthy set of results with EBITDA, EBITDA margin, earnings per share, and free cash flow above expectations.

Let me comment on revenue, which is fractionally light of our guide. In September, we restricted our aerospace parts supplied to Boeing, pending further understanding about the duration of the strike. Naturally, we are pleased that the Boeing strike is now over and the business can gradually return to normal.

The other notable shortfall was in our wheels business. Wheels revenue was approximately $30 million below Q2, principally due to notably weaker European market

conditions, resulting in an 18% decrease in revenue. North America revenues were down by 10%.

I'll now pass the call to Ken to provide additional details by end market and business segments before I return to cover the outlook for the company.

Ken Giacobbe

Thank you, John. Good morning everyone. Let's move to Slide 5. So, market growth continued to be healthy in the third quarter with total revenue up 11% year-over-year, building on the first half revenue growth of 14%.

Commercial aerospace growth remained strong despite our decision to restrict supply to Boeing due to the strike. Commercial aerospace revenue was up 17%, which built on the 25% commercial aerospace growth in the first half. Defense Aerospace was also strong, up 15% driven by fighter programs and fighter engine spares demand.

As expected, the commercial transportation market weakened with revenue down 12% led by the slowdown in Europe and to a lesser extent, North America. Finally, the industrial and other markets were up a healthy 17%, driven by oil and gas, up 26%, IGT up 20%, and general industrial up 5%.

In summary, continued strong performance in commercial aerospace, defense aerospace and industrial, partially offset by commercial transportation.

Now, let's move to Slide 6, starting with the P&L. For the third consecutive quarter, EBITDA, EBITDA margin, and earnings per share were all records and exceeded the high end of guidance.

On a year-over-year basis, revenue was up 11% and EBITDA outpaced revenue growth by being up 27% as total headcount remained flat in the quarter despite adding approximately 235 headcount in the Engine segment.

Incremental flow-through of revenue to EBITDA was a healthy 59%. Moreover, the team delivered records for both EBITDA margin at 26.5% and earnings per share of $0.71, which was up a healthy 54% year-over-year.

Now, let's cover the balance sheet and cash flow. The balance sheet continues to strengthen. Cash at the end of the quarter was $475 million, and free cash flow was a record for Q3 at $162 million. Year-to-date free cash flow was approximately $600 million. Net debt to EBITDA continues to improve and was at a record low of 1.6 times.

All long-term debt is unsecured and at fixed rates. Howmet improved financial leverage and strong cash generation were reflected in Moody's 2-notch rating upgrade to Baa1.

Additionally, Fitch upgraded Howmet's outlook to positive.

Liquidity remains strong with a healthy cash balance in a $1 billion undrawn revolver complemented by the flexibility of a $1 billion commercial paper program. Regarding capital deployment, we deployed approximately $416 million of cash in the quarter to debt paydown, common stock repurchases, and quarterly dividends.

For the quarter, we reduced debt by approximately $282 million through the following three actions. First, we redeemed the remaining $205 million balance of the 2024 bonds with cash on hand. Payment was at par.

Second, we issued $500 million of new bonds due in October 2031, the fixed interest rate is 3.72%. Third, we redeemed the remaining $577 million balance on the May 2025 bonds. We used $77 million of cash on hand plus the proceeds from the October 2031 bond issuance, which has a substantially lower fixed interest rate.

All combined debt actions year-to-date through the third quarter 2024 will reduce annualized interest expense by approximately $33 million. The company's next debt maturity is in November of 2026.

Moving to share repurchases. In the third quarter, we repurchased $100 million of common stock at an average price of approximately $94 per share. Year-to-date through September, we repurchased $310 million of common stock at an average price of approximately $77 per share.

Q3 was the 14th consecutive quarter of common stock repurchases. The average diluted share count improved to a record low Q3 exit rate of 409 million shares. Moreover, in October of 2024, the company repurchased an additional $90 million of common stock at an average price of approximately $103 per share.

Year-to-date through October 31st, the company has repurchased $400 million of common stock at an average price of approximately $81 per share, retiring approximately 4.9 million shares. Remaining authorization from the Board of Directors for share repurchases is approximately $2.3 billion as of the end of October.

Finally, we continue to be confident in free cash flow. In the third quarter, we paid $34 million in dividends as we increased the common stock dividend 60% from $0.05 per share to $0.08 per share.

Now, let's move to Slide 7 to cover the segment results for the third quarter. Engine Products delivered another record performance. Revenue increased 18% year-over-year to $945 million. Commercial aerospace was up 20% and defense aerospace was up 15%, driven by engine spares growth. Oil and gas was up 26% and IGT was up 20%.

Demand continues to be strong across all of our engines markets with strong engine spares volumes, which are expected to reach a record with $1.25 billion of revenue in 2024.

EBITDA outpaced revenue growth with an increase of 40% year-over-year to a record $307 million. EBITDA margin increased 510 basis points year-over-year to a record 32.5%, while absorbing approximately 235 net new employees in the quarter to support growth. The Engine's team once again delivered a record quarter for revenue, EBITDA and EBITDA margin.

Now, let's move to Slide 8. Fastening Systems also had another strong quarter. Revenue increased 13% year-over-year to $392 million. Commercial aerospace was 17% higher, including the impact of the wide-body recovery and the Boeing strike.

General industrial was up 26%, defense/aerospace was up 5%, and commercial transportation, which represents 16% of fasteners revenue was down 3%.

Year-over-year revenue outpaced revenue growth -- excuse me, year-over-year EBITDA outpaced revenue growth with an increase of 34% to $102 million. EBITDA margin increased 420 basis points year-over-year to a healthy 26%. The team continues to expand margins through commercial and operational performance.

Now, let's move to Slide 9. Engineered Structures performance continues to improve. Revenue increased 11% year-over-year to $253 million. Commercial aerospace was up 11% and defense aerospace was up 27% year-over-year, driven primarily by the F-35 program. Year-over-year segment EBITDA outpaced revenue growth and was up 27% to $38 million. EBITDA margin increased 180 basis points to 15%.

Sequentially, revenue decreased 8% as we continue to optimize the Structures' manufacturing footprint and rationalize the product mix to maximize profitability. The team continues to make progress and we expect continued improvements heading into 2025.

Finally, let's move to Slide 10. Forged Wheels revenue was down 14% year-over-year as the long expected slowdown takes hold of the commercial transportation market. EBITDA decreased 17% as the team flexed cost to minimize the margin decline. EBITDA margin continues to be healthy at 26.1%.

Lastly, before turning it back over to John, I wanted to highlight a special item on Page 18 in the appendix. In the third quarter, we completed a study that resulted in a favorable R&D tax credit of approximately $44 million, which was approved by the IRS. The credit was for prior period expenses associated with R&D investments.

The favorable credit was excluded from our results and was noted as a special item. The favorable R&D tax credit reflects Howmet's continued investment in innovation and technology.

Now, let me turn it back over to John.

John Plant

Thanks Ken and let's move to Page 11. First, let me start with an overview of the markets for 2025 before moving to the specific guidance for the balance of 2024.

Starting with commercial aerospace. Demand for air travel continues to be robust, this applies to both passengers and freight traffic. Air traffic growth rates have eased compared to the recent past as we moved into the second half of 2024 as we expect with normal seasonality, albeit the growth of Asia-Pacific continues to be strong at, I think, about 7%.

However, given the recent years of underproduction of aircraft, demand for additional spares and the record backlogs of new orders, the order book outlook for aircraft production, and our products continue to look very healthy and should lead to higher growth for several years compared to historic norms. And this is supported by future passenger growth of approximately 4% to 5% a year.

In 2025, we envisioned commercial aerospace growth to be about 12%, plus or minus and leading to the total revenue growth for the company of about 7.5%, plus or minus. It should be noted that at the start of 2024, we envisioned a similar growth to the managed -- but we managed to exceed this. However, we need to see sustained and consistent narrow-body aircraft production to be confident.

For 2025, defense aerospace growth continues to be solid and is forecasted at mid-single-digits with both F-35 spares and legacy aircraft production, all contributing. IGT to grow at mid-single-digits, with oil and gas a little bit higher.

The outlook for commercial truck wheels continues to be muted in the fourth quarter of this year and the first two quarters of 2025, with the prospect of some pickup in the second half of the year.

The second half of 2025 potential is principally due to North America, where it is envisioned that the early stages of truck pre-buying will occur in response to the new environmental regulations, which become effective in 2027.

Let me now turn to the topic of future IGT demand, which I referred to in our August call when I use the words of AI for the first time. Firstly, let me address AI. Of course, we are keeping current with AI developments and using our offices and manufacturing plants.

However, what I would like to address is the effect on future revenues for Howmet as we address the increased demand for electricity over the next few years. AI, data center builds, and cryptocurrency mining all impact positively the future energy demand.

Examples are AI computer capacity, which has grown over 50% per quarter since the start of 2023. Data center per consumption which was 19 gigawatts in 2023 is expected to increase to 50 gigawatts in 2030. Much of the demand is from cloud hyperscalers that is Meta, Microsoft, Amazon, Google, and Oracle, and AI query results in 10x the electricity usage of a Google search.

Data center build-outs are expected to be approximately $600 billion by 2028 and they require uninterruptible electricity supply. This is likely to be fulfilled by a combination of possibly nuclear and certainly IGT power generation in some percentage combination.

While we are unsure about the exact demand, what we see are new plans forecast gas generation. For example, Duke, AEP, and Dominion have announced plans for an additional 18 gigawatts of new gas generation over the next 10 years. We see this as not just a U.S. phenomenon, but a worldwide one and consider Howmet well-positioned in the supply chain given our IGT turbine blades since we support GE Vernova, Siemens, Mitsubishi Heavy, and Salto given our global network where we are the number one supplier of turbine blades for each customer. While this will have limited effects in 2025, growth will begin in earnest in 2026. Beyond that, we have optimism for the addressable market over the next several years.

In summary, 2025 is expected to be strong for Howmet. Let me turn to commercial aerospace since this impact is significant. External forecasting agencies envision aircraft production increases significantly ahead of our view. We have considered the gradual restart of the Boeing 737 assembly lines now that the strike has settled, plus the supply chain impacts on Airbus mentioned by themselves.

We have tempered the builds accordingly and further adjusted for the 2024 under builds by Boeing compared to their planned build rates due to inventory considerations.

In doing so, we envision commercial aerospace growth to be about 12% with total growth to be in the 7.5%, plus or minus 1%, with stronger growth in the second half of the year versus the first half. Naturally, we will adjust the revenue outlook as we move through 2025, especially as we come to understand more about specific Boeing production.

Now, let's move to the near-term and the Q4 and full year guidance. The one additional comment I would like to make for Q4 is that any weakness from Boeing and commercial truck wheels is offset by sales of additional engine spares.

The specific numbers are as follows; revenue of $1.87 billion, plus or minus $20 million; EBITDA of $488 million, plus or minus $10 million; earnings per share of $0.71, plus or minus $0.01.

And for the year, revenue of $7.41 billion, plus or minus $20 million; EBITDA of $1.895 billion, plus or minus $10 million; earnings per share of $2.66, plus or minus $0.01; and free cash flow of $920 million, plus $20 million, minus $30 million.

One final comment is regards to future dividends. The plan is to increase the common stock dividend in 2025 by 25% from $0.08 to $0.10 with the first payment in 2025, subject to final Board approval. And the only other comment I'd make is that in aggregate, our net headcount for the third quarter was a 0 increase.

Thank you very much, and we'll now move to Q&A.

Question-and-Answer Session

Operator

We will now begin the question-and-answer session. [Operator Instructions]

At this time, we will take our first question, which will come from Sheila Kahyaoglu with Jefferies.

Sheila Kahyaoglu

That's close enough, it's not as easy as planned. Thanks John, thanks Ken and PT. Maybe if we could start off, obviously, you've given your 2025 guide, and you've talked about Q4 any weakness from Boeing being offset by spares. But in 2025, you gave -- you've given a guide that's pretty in line with the Street, how are you thinking about commercial build rates, if you could talk about that?

John Plant

It's tough to get to specific build rates at the moment. And if you start with this time Boeing rather than Airbus, I don't think it's clear to anyone yet the rate at which Boeing will build in the balance of November or December or indeed exactly what the rate will be in 2025.

What I've done is to look at the external forecasting agencies for total aircraft production next year by platform and by customer and consider the increase from what I expect the 2024 actual is that, that increase is rather unrealistic given your stance at approximately 30% at this point.

And so I think we need to reevaluate that and consider what is the art of the possible way of builds of aircraft, starting with Boeing and the 737, all the way through their aircraft platforms.

And then, of course, Airbus themselves as well, given their commentary regarding several types of parts and supply chain constraints. So, we've just taken our best guess and I get -- we will give more color on that in our February call, Sheila.

But we've just said let's think of a more realistic number and feel as though a 12% increase year-on-year is quite doable. And certainly, it has to be better than 2024, which has really been a pretty miserable year for aircraft build and indeed, engine build. And so we are looking forward to better things but taking a fairly cautious view at this stage until we know more.

Sheila Kahyaoglu

Okay. Thank you.

John Plant

Thank you.

Operator

And our next question will come from Robert Stallard with Vertical Research Partners. Please go ahead.

Robert Stallard

Thanks so much. Good morning.

John Plant

Good morning Rob.

Robert Stallard

Hey John. Just a follow-up really on Sheila's question in relation to the 2025 revenue forecast. I was wondering if you could give us some idea of what your thoughts might be on aerospace aftermarket revenues in whatever form for next year? And also whether you've included any risk of destocking on the back of this OEM production rate uncertainty? Thank you.

John Plant

Yes. So, when we start talking about spares and future rates of revenue and increases, I'd probably like to deal with the topic in a fairly broad fashion because I think it comes to the heart of several questions, which may be asked during the course of this call.

And I'm going to start off with, first of all, in press release this morning, I think we indicated that we expect our spares revenue this year to be about $1.25 billion now, which is a further increase on the last quoting number, which is about $1.1 billion that we gave, I think on our August call.

And I think the first point, I'd like to make, which I think is the fundamental and most important one for investors is the strategic positioning of the company. And what I mean by that is that in 2019, when our revenues were about $7 billion, our spares or our aftermarket exposure was about 11% of those revenues and obviously, a higher percentage of the Engine Products business.

And 2024, given the outlook for the year and our revenues close to $7.5 billion is that spares or aftermarket exposure has risen to 17% and that is a very significant increase, especially given the growth in the OE builds as well in aggregates.

And going forward, my thought, is over the next two, three, or four years, that that level of aftermarket content of our revenues will go to be in excess of 20%. And so I think that what that means for the company and therefore, the owners of the company is that it implies less volatility and with less volatility given the exposure for the OE production. That's really good for shareholders. So, I think that's the most important point, which I think should resonate.

And then I'd like to deal with spares in the more topical framework of supply chain constraints because you've heard and seen and reported in the press quite a lot of commentary around the availability of engine spares and turbine blades in particular, and its impact on engine production.

So, again, I'm going to repeat one data point that we provided in the last call to say that specifically on LEAP engines and the type of blade, which is currently used is that -- our output is up from 2023 by 40%.

And for top 10 turbine blades for the company across all engine manufacturers, our output is up by over 50%. And of course, when the casting leaves Howmet, we don't designate which part of the end market it goes to whether it goes to a spares, builds and specific OE engine build.

Given the commentary by Airbus about having gliders and lack of engines is that we had -- and asked for a joint meeting of every interested party at Howmet to go through the production data, so we could demonstrate and show specific production.

And what they could see is that plus 40% or 50% overall, and also the production of the new engine blade, we're just awaiting the final approvals by the FAA and EASA. And what is remarkable, I think, is that we've increased production by the specific blades that I've talked about, while also producing many tens of thousands, and in fact, 500 engine sets of blades for the new type pending approval. And those castings have left Howmet and been delivered to the customer.

So, I've covered specifically what's been going on in terms of our production and also much more generally the strategic positioning for the company, which I think is much more fundamental than, I'll say, any specific commentary about production in 2024, which is, let's say, just moves into transitory situation. And of course, given the output of both the current and the future engine sets is that, that puts, I think, everybody in a really good position going forward.

And of course, we're working really well with our customers to try to drive further increases in output, which ideally would be required. And so we expect both the increase in engine production next year to be robust and also the increase in spares requirements, which are also going to be robust. And even more importantly, leading to that longer-term trend of increasing engine, spares and total spares for the company as a percent of our revenues.

And so the other thing which I think is really good for us is that what we want, of course, is more aircraft production and more engine production, both of the more robust LEAP engines, the more robust GTF Advantage Engine.

And of course, then we'll be able to sell all of the other parts that we make for those engines, which are structural castings, low-pressure turbine parts for that part of the turbine and indeed fan blades as well.

So, that's given you a pretty comprehensive answer to your specific question, but broaden it out, and I think in all of that, the most important thing is the strategic positioning with fundamental less volatility for our revenues given very significant increase in the aftermarket as a percentage content of the company.

Robert Stallard

That’s great. Thanks John.

John Plant

Thank you.

Operator

And our next question will come from Doug Harned with Bernstein. Please go ahead.

Doug Harned

Good morning. Thank you. John, I wanted to continue on what you were just describing because you've got rising airfoil production for the current blades on the LEAP-1A, the LEAP-1B over time. And then you're also now in new lines doing the new blades and we're going to see the LEAP-1B presumably the new blades for that next year.

How do you think about your planning for production capacity for both sets of blades over time? And I'm trying to understand kind of where you are today in terms of that that capacity, automation and so forth to understand what the investment profile is likely to be?

John Plant

So, I think that everybody has heard that we are increasing our investment in the engine business. And I'm not quite sure exactly what has been said regarding the exact aims of that investment.

But essentially, given the robust demand overall for engine production increases, aircraft production increases, but also, in particular, the increased requirement for spares, given not only the temporary effect of the time on wing issue, Doug, which you've certainly commented and written about.

But even more significant, I think, is the increase in requirement for spares over time given the fact that the more modern engines with the higher operating temperatures and increased pressures means that the shop visit frequency is increased.

And therefore, we see, and indeed, we've been having very detailed conversations with our customers what that demand looks like over the next, not just one year and two years, but over the next five years, and looking to increase our capacities along with the right agreements to invest for that capacity.

And so I believe we're in the best position that we've been in for many years in terms of understanding what that future demand pattern is and have really, I'll say, signed up to increase our production to meet that demand, which we see is going to increase for both the OE production over the next few years, commensurate with both narrow-body aircraft production and wide-body aircraft production, but also through the increase in spares as well.

And while I think the rate of change of the spares will change over the next -- it will even accelerate further with the time on wing issues to be addressed in the next two or three years. I just think we'll see increased demand overall for those spares with

uninterrupted increases, albeit at different percentages between the years, let's say, certainly for the next five, seven years, I'm not willing to comment much further beyond that. And I think you see that our engine customers also building out additional MRO shops to take care of those that increased frequency of engine visits.

Doug Harned

Very good. Thank you.

Operator

And our next question will come from Scott Deutsche with Deutsche Bank. Please go ahead.

Scott Deuschle

Hey good morning.

John Plant

Good morning Scott.

Scott Deuschle

John, can you talk a bit about what's driving this reacceleration in incremental margins in the fourth quarter? And I was curious if there's anything you'd be willing to offer at this point just to level set us on how to think about what this recent strength in incremental margins means for the trend going into next year? Thank you.

John Plant

I certainly don't want to get into any margin commentary for next year because I think as you appreciate, nothing's ever linear. You can't just extrapolate a line, certainly not for margins because things occur at different times and the rates. I think that when -- one of the determinants of your margin rate is also the rate of change for your top line. And then that rate of change is not just down to the top line, but your ability to convert at a higher level of efficiency.

And so given I think the significant uncertainty and given the expectation that as we build out this capacity, we're going to have to take our increased labor next year. It's one of those things where, while I think we're going to see the benefits of the leverage to volume, we're also going to have the impact of the getting a lot of people trained in the company to meet those future production requirements going forward.

So, we've probably hit a pretty good patch over the last two or three quarters in terms of productivity increases within the company. So, you've seen maybe a net 600 people recruited in the first quarter, maybe 400 in the second quarter.

And while we've increased in our engine business in Q3 and net zero for the company and really trying to hold that for the balance of year, while expecting that we're going to need to reaccelerate our hiring as we go into 2025 such that when we commence production, much of the new equipment we've been talking about is that the workforce will be trained so that we can keep our levels of quality and our levels of delivery performance in the -- I think, in the really good zone that they've been and able to respond to the customers' demand.

So, I think we've seen the benefits of that. But at this point, I don't have any margin comments regarding next year. And indeed, I don't think you can extrapolate anything from this at this point in time, apart from acknowledging that we've got the volume increase of the 7.5% I've talked about plus or minus.

And then the net effect of the additional hiring as we go into next year, which puts us in a position, hopefully, of continued, really excellent supply that I've also talked about picking on that spares question. then going into 2026 where we see the requirements, again, increase for both OE production on the commercial aerospace side and indeed spares again.

Scott Deuschle

All right. Thank you, John.

John Plant

Thank you.

Operator

And our next question will come from David Strauss of Barclays. Please go ahead.

David Strauss

Thanks. good morning everyone.

John Plant

Hi David.

David Strauss

Hey John. So, I know there are a lot of things kind of that go into this potentially. But just at a high level, given the market share gains on the engine side that you've hinted at that will start to come in a bit, I guess, in 2025, but more so in 2026. If aero revenue growth does turn out to be 12% in 2025, would you expect that your aero revenue growth would accelerate off that level in 2026 based on the market share pick up?

John Plant

Yes, I keep thinking about what's the trajectory of aircraft production. And we've heard a lot of commentary about supply chain and supply chain constraints over the last two, three, four years now to a point where almost the first response is always supply chain.

I think those constraints have to begin to ease and time is a great healer. And I think as each one is mentioned, I see the potential for further improvements in the wider supply chain performance.

And so what I still think that 2025 as a year of flux given the targets to increase the Airbus A320, 321 and the introducing of new XLR and obviously, the really first for increasing A350 if those supply chain constraints can be solved.

But similarly, Boeing, I mean, the additional overlay there is that you have to gain confidence in the restart of production while under FAA oversight to be able to increase their production.

But certainly, the demand for new aircraft is there going back to the fundamentals for airlines, which is not just for fuel efficiency, but even more importantly, for emissions, which I think are here and will continue and particularly in other parts of the world as well, where the carbon footprint is really important.

And so those requirements for aircraft are there, and you've seen aircraft held in service, probably longer than the ideally would have been wanted given the lack of production.

So, maybe while 2025 is still another year of flux and sorting out, which I don't think is going to be totally smooth is that surely by 2026, we're going to be in a better position than the aircraft and the backlogs are there. And so I get really optimistic that aircraft production is going to improve.

And that combined with the vectors of demand that I talked about on the call for electricity, and therefore, what I expect to be an increasing demand certainly for our IGT business, and see no diminution of demand by countries around the world for, for example, the F-35 or even legacy fighters like the F-15 and the F-16.

I just think all of that as positive as we go forward. And so that plus the additional spares demand and the capacity we're putting in, I think we can get pretty optimistic that 2026 should be a further step up on 2025.

David Strauss

Perfect. Thanks very much.

John Plant

Thank you.

Operator

And our next question will come from Myles Walton with Wolfe Research. Please go ahead.

Myles Walton

Thanks. Good morning. I think, John, one of the biggest areas of growth from your guidance initially over the last couple of years has been on the defense side. And so I'm just curious, the mid-single-digit placeholder you have, do you think that's as conservative for the last couple of years?

And given the F-35 is kicking back in, in terms of deliveries within structures and obviously, I'm sure the airfoils business is going gangbusters, why is it only mid-single-digit growth? Thanks.

John Plant

At the moment, if you take Lockheed's stated production, let's say, 150 aircraft, I think it was 152, but as we all know, they've struggled to produce that each year, and deliveries have been somewhat less than that given the software issues that are being or have been resolved. And so I think we're going to see higher deliveries than production over the next two or three years.

And production still maybe incrementing up a little bit maybe for the 152 to 156 level. And so I mean, that's only four aircraft, so it's like 2% to 3%. I'm more optimistic that we see spares demand increase because the engine and aircraft fleet is now over 1,000 worldwide.

And indeed, in Europe over the next few years, it's going to increase to 600 by the end of the decade. And so that additional OE demand bodes well for engine spares demand over the next few years. So, I'm optimistic about that.

And also on the bulkhead side, particularly, on the titanium bulkhead side, that should also begin to improve, given that, I think this quarter, I'm hopeful it's this quarter doesn't continue into 2025, then the excess inventory, which was at our customer from, let's say, builds, which have been anticipated, but didn't not occur. Is it that inventories cleared out and the last part of it's cleared out in 2024, but with some possibility, there's still a little bit left over, but hopefully not into 2025.

So, at this point, I think that, I'll say, mid-single digits is the right call. And of course, should, I'll say, Boeing find themselves able to increase their legacy fighter production, which they struggle with because of labor. And I don't know that's going to change this quarter, next quarter or the first half of next year. But should it improve, then I think we could become a little bit more optimistic, but not yet.

Myles Walton

Okay. Thanks. And just a clarification, the $1.25 billion of spares, is that about split even between commercial and defense/IGT at this point?

John Plant

Yes, I mean the rate of growth on the commercial side has been higher in the last, let's say, 12 months. But the absolute level of the, I'll say, defense and IGT, and oil and gas has been higher in absolute terms because that didn't see the very significant interruption that we had with COVID and post-COVID, and then because of the builds and all of that.

And so at this point, the way I'm thinking about it is the -- roughly used to be 50/50. And I'm going to guess at and Ken can correct me because I struggle to keep every single number in the front of the mind, but I'm thinking that we're 55% to 60% currently on the, let's say, non-commercial aero side, but with the commercial aero growing faster.

Ken Giacobbe

And a lot of numbers there, Myles. But I'd look at it as commercial aero probably around $550 million plus or minus this year. And then on the defense and IGT, right around $700 million, plus or minus, right? But the key is, the numbers are up year-over-year, great performance compared to 2019, but accelerating as we exit the year. So it's more all good.

Myles Walton

Thanks for the color.

Operator

And our next question will come from Seth Seifman with JPMorgan. Please go ahead.

Seth Seifman

Thanks very much and good morning.

John Plant

Good morning Seth.

Seth Seifman

Morning. I wanted to ask just in terms of the spares demand you're seeing, and it sounds like the answer is no, but a lot of -- we think about older planes staying in service longer as a driver of aftermarket demand. It sounds like the aftermarket demand here is very much driven by the newer engines.

And so to the extent that we were to see increased retirements at some point that doesn't really interfere at all with your expectations for spares growth over that kind of two to four-year period that you outlined?

John Plant

Several parts to pick apart in that question there, Seth. So the fact that the legacy aircraft and engines, let's think about the V2500 and the CFM56, I don't think their shop visits have peaked yet. And that's probably been pushed out further by the fact of lack of retirement.

So, previously, if you've gone back three or four years, I think everybody expected 2025 to be the peak demand for CFM56 and V2500, I think that was the expectation. But I think that, that peak is now going to be pushed out to 2026, 2027. It's probably more likely possibly even beyond 2027. But I don't think you then expect a significant dip after that peak. It's sustained and a very gradual decline.

Meanwhile, your assumption or statement that there are more spares requirements for the new engines. Well, that's absolutely true given the well-documented time on wing issues driven by, I'll say, the earlier-than-expected shop visits for those engines and that applies to both the GTF and to the LEAP engines, and improvements coming with the increased robustness of the suite of products, which is being introduced of which the early-stage turbine blades is only got one of those improvements.

So, we are part of much bigger packages of improvements reliability, but the way it stacks up is, I've talked about time on wing, which is creating higher and excessive

demand now.

But there has been a long-term trend with growth every year for the next many years because of the cycle of shop visits which we anticipate as those new aircraft are adopted even with the robustness improvements that we've talked about. So, I think I've covered all of it that's in your question. So, the only thing I'm saying is that the legacy engines will also continue to peak yet.

Seth Seifman

Excellent. Thanks very much.

John Plant

Thank you.

Operator

And our next question will come from Ronald Epstein with Bank of America. Please go ahead.

Ronald Epstein

Hey, good morning guys. We've covered a lot of turf, but one area we haven't talked too much about is just kind of your continued capital deployment focus. Is there any M&A to do out there or not? How are you thinking about that? I mean can you expand the business out into maybe some adjacencies in kind of your core skill set?

John Plant

Yes. So, we certainly are in a position of choice, and have the ability to look at potential acquisitions and to study those things which come to the market even though the majority have really been companies coming out of private equity hands in the more recent past.

It's possible given the change of administration, given the election is that deals which we thought may run some hurdles in the past may have less hurdle constraints in the future. I don't know yet. It's too early to -- apart from just speculative commentary there.

So, we are in a position to consider. We do -- but also want to be disciplined enough to say we'll do small ones, if they're a technology play and you possibly saw that we did buy a company in the last quarter, fairly small, but important for us to enable us to take our engine capability to another level and tuck that one in. But we're also willing to, say,

if we're going to do others, then they need to be of some decent size given the market cap of the company. So, we're willing to look.

We also have to compare that to the cash-on-cash returns of buying our own stock back, and again, looking at it on a risk-adjusted basis. And so we want to be very disciplined in terms of the returns for that money for shareholders.

And so we still see that buying our stock back is healthy and positive in terms of well above our cost of capital, but also willing to look at the returns from any M&A move as well, albeit there's nothing that we have currently on the stocks to go out in the next quarter or two that we can see. But we'll continue to look and examine it as appropriate. And, obviously, we'll keep you informed.

Ronald Epstein

Got it. Thank you very much.

John Plant

Thank you.

Operator

And our next question here will come from Gautam Khanna with TD Cowen. Please go ahead.

Gautam Khanna

Hey good morning and great results guys.

John Plant

Thanks Gautam.

Gautam Khanna

Great results, guys. John, I wanted to ask on the high-pressure turbine blade that you guys are working on the 1A. Two things. Does it confer higher pricing to Howmet because it's more or less an aftermarket type product?

And second of all, relatedly, GE mentioned it might be easier to manufacture. And do you view that as true? And therefore, is there a good opportunity to get throughput up quickly on this?

John Plant

I think the comment about it going mainly for aftermarket and is I'll say, I don't understand that comment because every new engine, of the LEAP-1A variant, when that package of change is approved, is going to go to the new configuration and new turbine blade.

So, we'll see that fitted both for OE production and full spares production going forward. And the -- in anything where additional performance is obtained, then it goes to that whole question of content, et cetera. So, I think that deals with that part of the question.

And as to producibility, we have some optimism that it may be. And we have, as I said, provided some several hundred engine sets this year in addition to manufacturing all of the increase in production to the existing type of turbine blade.

So, I'm pleased with that, but I still think it's early days yet in terms of absolutely giving clarity over what the long-term yields will be in production. But I see nothing at this point, which lead us to have concerns, so we're well into it and looking forward to very -- hopefully, a very near-term cutover to the new type of blade.

And then several months or a year or so later then also on the LEAP-1B for Boeing as well. But that's going to be, I'll say, another several quarters from now in terms of timing for that, but again, subject to the FAA and EASA oversight.

Operator

And this concludes our question-and-answer session in addition to today's conference. Thank you for attending today's presentation and you may now disconnect your lines.