Howmet Aerospace Inc. (NYSE:HWM) Q4 2021 Earnings Conference Call February 2, 2022 9:30 AM ET

Company Participants

Paul Luther - Vice President, Investor Relations
John Plant - Executive Chairman and CEO
Ken Giacobbe - Executive Vice President and CFO

Conference Call Participants

Robert Spingarn - Melius Research
Gautam Khanna - Cowen
David Strauss - Barclays
Robert Stallard - Vertical Research
Myles Walton - UBS
Seth Seifman - JPMorgan
Noah Poponak - Goldman Sachs
Kristine Liwag - Morgan Stanley
Matt Akers - Wells Fargo
Timna Tanners - Wolfe Research
Phil Gibbs - KeyBanc Capital Markets
Paretosh Misra - Berenberg
George Shapiro - Shapiro Research

Operator

Good morning, ladies and gentlemen. And welcome to the Howmet Aerospace Fourth Quarter and Full Year 2021 Results Conference Call. My name is Natalia, and I will be your operator for today. As a reminder, today's conference is being recorded for replay purposes.

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

Paul Luther

Thank you, Natalia. Good morning. And welcome to the Howmet Aerospace fourth quarter and full year 2021 results conference call. I am joined by John Plant, Executive Chairman and Chief Executive Officer; and Ken Giacobbe, Executive Vice President and Chief Financial Officer. After comments by John and Ken, we will have a question-and-answer session.

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

In addition, we have included some non-GAAP financial measures in our discussion. Reconciliation 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, and good morning, everyone. Let's move to slide four. First, let me frame the quarter for you. The environment was challenging with the new variant of Omicron emerging the day after Thanksgiving.

Fortunately, once we take time to understanding the changing nature of the pandemic, we find that the virus appears to be weakening albeit it's quite transmissible. Boeing also continues to test us with reduced build or zero build of the 787 wide-body aircraft as recertification is once again delayed and unclear.

Despite these impacts, Howmet performed well, with revenues of $1.285 billion, improving well above last year and in line with Q3. Adjusted EBITDA improved both over last year and sequentially and was $296 million, with an EBITDA margin at 23%. We were pleased with the margin exit rate for both the Q4 and the second half of 2021.

The sales picture is one of strengthening Commercial Aerospace narrow-body production, healthy Defense and IGT sales combined with constrained sales of our high performance Wheels segment due to the supply chain constraints at our customers in the Commercial Truck Manufacturing business. Clearly, both Delta and Omicron variant of the virus impacted production operations. But nevertheless, we were able to bring through a good level of efficiency.

Turning to the balance sheet now and the cash flow of the company, adjusted free cash flow was a record at $517 million for the year and well ahead of both last year and guidance, with a conversion rate of 117% of net income.

We also made incremental voluntary pension contributions in the quarter, and if we exclude these contributions, adjusted free cash flow would have been 123% conversion of net income. For your information, the free cash flow conversion has continued in the last three years at a level well in excess of our long-term guide of 90%.

The year-end cash balance was $722 million and reflects both the good cash flow conversion and the fact that in the fourth quarter, Howmet repurchased $205 million of shares at an average price of $30.32.

For the fourth quarter average diluted share count reduced to 431 million and the year-end diluted share stood at 428 million. The repurchase of shares continued in early 2022 with a further 3 million shares purchased for $100 million during the month of January.

As of the end of January, the diluted share count has been reduced to approximately 425 million shares. And finally, the 2021 tax rate was reduced by the work we have done and the effect was $0.01 on earnings in the fourth quarter.

We look forward to 2022, and I will provide commentary when we get to the outlook section of our presentation. Meanwhile, I will hand the call over to Ken Giacobbe.

Ken Giacobbe

Thank you, John. Let’s -- please move to slide five. Fourth quarter total revenue was up 4% year-over-year and flat sequentially. Commercial Aerospace increased to 44% of total revenue, which is an improvement sequentially, but far short of the pre-COVID levels of 60%.

Commercial Aerospace recovery continued in the fourth quarter, with Commercial Aerospace revenue up 13% year-over-year and 4%, sequentially, driven by the Engine Products segment and the narrow-body recovery.

Defense Aerospace was down 22% year-over-year and 4% sequentially, driven by customer inventory corrections and production declines for the Joint Strike Fighter.

Commercial Transportation, which impacts both the Forged Wheels and the Fastening Systems segment, was up 20% year-over-year, driven by higher aluminum prices. However, the market was down 1% sequentially as the market continues to be impacted by supply chain constraints at our customers, which is limiting commercial truck production.

Finally, the industrial and other markets, which is composed of IGT, oil and gas and general industrial was down 2% year-over-year and 3% sequentially.

Now, let’s move to slide six, which sums up the year nicely. Let’s start with the P&L. For the full year, price increases were up year-over-year and in line with expectations, as they are primarily tied to long-term agreements.

Structural cost reductions were approximately $130 million, which exceeded our target of $100 million. Adjusted EBITDA margin for the year was 22.8%, which was an increase of 220 basis points year-over-year, despite $285 million of lower revenue. The fourth quarter exit rate was 23%. Adjusted earnings per share was $1.01 or 31% higher than 2020.

Moving to the balance sheet, our cash balance was healthy at $722 million. Adjusted free cash flow was a record $517 million, which was well above the guidance. Free cash flow conversion was 117% of net income and if we exclude voluntary pension contributions of $28 million, adjusted free cash flow conversion was 123% of net income.

Net pension and OPEB liabilities were reduced by approximately $275 million, while pension and OPEB expense, as well as the associated cash contributions were each reduced by approximately 54%. Net debt-to-EBITDA improved to 3.1 times.

Regarding capital allocation, we have taken a balanced approach. Capital investment projects for Forged Wheels at Hungary and Mexico are now essentially complete. Concurrently, we have been investing in automation projects in the Engines and Fasteners segments.

During the year, we paid down gross debt of approximately $845 million, with cash on hand and reduced annualized interest costs by approximately $70 million. We also reinstated the quarterly dividend of $0.02 per share of common stock in Q3 of 2021.

Lastly, we repurchased approximately 13.4 million shares of common stock for $430 million, with an average acquisition price of $32.07 per share.

To sum it up, during the year, we enhanced our profitability, strengthened the balance sheet and we are balanced in our capital allocation.

Let’s move to slide seven to briefly cover the segment results. Engine Products year-over-year revenue was 9% higher in the fourth quarter. Commercial Aerospace was 39% higher driven by the narrow-body recovery. Defense Aerospace was down 26% year-over-year, driven by customer inventory corrections and production declines for the Joint Strike Fighter.

Operating profit increased 10% year-over-year and operating margin improved 20 basis points, despite adding approximately 150 employees in the fourth quarter, which now brings our total employees added since Q1 to approximately 950 employees.

Now let’s move to slide eight. As expected, Fastening Systems year-over-year revenue was 3% lower in the fourth quarter. Commercial Aerospace was 15% lower, as we continued to experience production declines for the Boeing 787. Commercial Transportation was up approximately 46%. Year-over-year, Fastening Systems was able to maintain segment operating profit on $7 million of lower revenue. As a result, operating margin improved 50 basis points.

Now let's move to slide nine. Engineered Structures year-over-year revenue was 12% lower in the fourth quarter. Commercial Aerospace was flat, as the narrow-body recovery was offset by production declines for the Boeing 787. The Defense Aerospace market was down 26% year-over-year and flat sequentially. Year-over-year, Engine Structures was able to generate $3 million more in segment operating profit on $27 million of lower revenue, primarily due to permanent cost reductions and a favorable $2.5 million non-recurring adjustment related to a customer contract negotiation. As a result, operating margin improved 260 basis points.

Finally, let's move to slide 10. Forged Wheels year-over-year revenue was 15% higher in the fourth quarter. Approximately $28 million of the $31 million revenue increase was due to higher aluminum price pass-through.

Pass-through of higher aluminum prices did not impact operating profit dollars, but unfavorably impacted operating profit margin by approximately 350 basis points. On a sequential basis, revenue and operating profit were essentially flat.

Commercial Transportation demand remained strong, but volumes continued to be impacted by customer supply chain issues. Aluminum prices were flat sequentially, resulting in minimal impact to sequential operating profit margin.

One final comment on the segments, the incremental profit flow-through for the segments in Q4 was 30% year-over-year and can be found in the appendix. The 30% includes a 55% increase in aluminum prices year-over-year, which adversely impacted the incremental profit flow-through. If we adjust for aluminum prices, incrementals were above 70%.

Now let's move to slide 11. We continue to focus on improving our capital structure and liquidity. In 2021, we took actions to lower our annualized interest costs by approximately $70 million through a combination of paying down gross debt by approximately $845 million with cash on hand and also refinancing higher cost debt with lower cost debt. Gross debt remains at $4.2 billion.

Net debt-to-EBITDA improved to 3.1 times, despite cash used for debt refinancing, share buybacks and dividends. All debt is unsecured and the next maturity is in October of 2024. Finally, our $1 billion revolving credit facility remains undrawn.

Before turning it back to John to discuss the guidance, I'd like to point out a few items that you can find in the appendix. First, there's a slide in the appendix that covers special items in the quarter. Special items for the fourth quarter were a net charge of approximately $53 million, mainly driven by costs associated with non-cash pension plan settlement charges.

Second, there's a slide in the appendix that summarizes the share repurchases that occurred in 2021, as well as the share repurchases in January of 2022. Remaining common stock share repurchase authority sits at $1.25 billion as of February 1, 2022.

Finally, in the reconciliation of adjusted free cash flow, you will notice the cash receipt from sold receivables is zero dollars in the fourth quarter. As a result of restructuring our accounts receivable securitization program in Q3 2021, cash receipts from sold receivables will be zero going forward and the entire impact from the sale of accounts receivables will be in cash from operations. Therefore, starting with Q4 of 2021 and beyond, the definition of free cash flow will be simplified and be cash from operations less CapEx.

Please note that the net cash funding from the sale of accounts receivable has been $250 million since Q4 of 2020, which means that the sale of accounts receivables has neither been a source of cash or a use of cash in 2021.

So, with that, let me now turn it back over to John.

John Plant

Thanks, Ken. Let's move to slide 12 for guidance for 2022. The leading indicators for air travel continue to show improvement, notably for domestic travel. We continue to hold the view that we will see an acceleration in revenue growth during the course of the year, following a fairly flat Q1 compared to Q4.

The Engine Products business has led the recovery to-date and we now expect the Engineered Structures business will see lower revenue in the first half of 2022, due to the continued delays with the 787. Fastening Systems is expected to show growth in the first half of 2022, starting in the first quarter.

In terms of specific numbers, we expect the following, the guidance for Q1 revenue at $1.3 billion, plus or minus $20 million, EBITDA of $295 million, plus or minus $9 million, EBITDA margin of 22.7%, plus or minus 30 basis points, and EPS of $0.29, plus or minus $0.01.

And for the year, we expect revenue to be $5.64 billion, plus or minus $80 million, EBITDA at $1.3 billion, plus or minus $35 million, EBITDA margin of 23%, plus 30 basis points and minus 20 basis points, EPS to increase to $1.37, plus or minus $0.06, and cash flow to be $625 million, plus or minus $50 million.

Moving to the right-hand side of the slide we expect the following. Revenue to the up approximately 13% versus 2021, driven by Commercial Aerospace, Commercial Transportation and the IGT market,

The 2022 revenue guidance includes more than $125 million of material pass-through impacted margins by at least 50 basis points. And for clarity, the price increases are excluded from the $125 million of pass-through

Adjusting for that $125-plus million of material pass-through, then the incremental EBITDA margins fall nicely in the 30% to 35% range. Adjusted EBITDA is expected to be up 15% versus last year, adjusted earnings per share to be up approximately 36% versus 2021, pension and OPEB contributions of approximately $60 million in the year.

CapEx should be in the range of $220 million to $250 million and that continues to be less than depreciation and amortization, resulting in a net source of cash. Adjusted free cash flow compared to net income is approximately 110%. Incrementals adjusting for the metal between 30% and 35%, as previously stated.

So let’s move to slide 13 for the summary of 2021. In conclusion, Howmet delivered really well in 2021, and I note the challenges that we overcame. EBITDA and EBITDA margin increased with the Q4 exit rate of 23%. Operational productivity was healthy and structural costs reduced by $130 million. Prices, sorry, pricing was improved during the course of the year and well above inflation recovery.

Free cash flow was excellent and allowed for further share buybacks of $430 million or $13 million -- 13 million shares, while also improving the net leverage of the company and reducing gross debt by $845 million, and furthermore, reducing interest carrying costs of $70 million, thereby improving future free cash flow yield of the company.

Furthermore, pension and OPEB growth liabilities were reduced by $440 million, which is another huge step in the improvement in the balance sheet of the company and net liabilities by $275 million. Lastly, work performed and the tax rate showed improvement with the rate reduced by 250 basis points to 25%.

Thank you. And now let’s take your questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Your first question is from the line of Robert Spingarn with Melius Research.

Robert Spingarn

Hi. Good morning.

John Plant

Hey, Rob.

Robert Spingarn

John, I wanted to ask you about what we have been hearing on castings and forgings potentially being a bottleneck with capacity ramp from some of the OEMs and other folks in the industry. Could you talk about that?

John Plant

Yeah. I mean, I will probably just give you what I seem to be, what I think are three levels of response to your question. I'd probably just cover the first two. At its most simplest, no CEOs that have commented publicly have contacted me to register any concerns whatsoever. I could leave it at that.

But I think I'd like to go a little bit further, and say, I am really glad it's recognized just how hard and how exacting the production of such products are. And it's a good job that there is inventory in the pipeline at many levels, starting with completed engines at Boeing and Airbus, and also in the pipeline between us and the engine manufacturers. I think it will be also great to recognize the lead times with scheduled commitments to back up the skylines and aircraft production in full, assuming that these volumes are required.

And then the third level of commentary would be, I will say, commenting on the whole supply chain, labor availability, skills, response times, et cetera. But for right now, I have no recognition of this as a significant issue in any dimension.

Robert Spingarn

I think that's a fair point that there's so much uncertainty in the production rates. The other thing I'd ask, John, is just, if the competition might not be able to keep up, does this present an opportunity for you?

John Plant

Obviously, it always depends upon the parts that are in question. My expectation is that the spot business will pick up in 2022 and that will be to our benefit. And hopefully, we can respond in the same way that we were able to respond in 2019 and pick up the additional business should it occur and I think that's probably as far as I can go at this point, Rob.

Robert Spingarn

Fair enough. Thank you, John.

John Plant

Thank you.

Operator

Your next question is from the line of Gautam Khanna with Cowen.

Gautam Khanna

Hey. Thanks, guys.

John Plant

Hi.

Gautam Khanna

I was wondering if you could just spell out -- quantify the change in guidance from the Q3 earnings call, obviously, the sales taken down. But what are you now embedding in terms of 787 rate, 777 rate, just some of the moving parts relative to...

John Plant

Yeah.

Gautam Khanna

... what you previously had provided?

John Plant

Yeah. So if I exclude metals from that revenue line, then the volume increase is around 11%. So, close to that 12% to 15% that I previously called, and the reason for it being at the lower-end of that is the 787 and the lack of visibility that we have to be going that aircraft. And we note that our customer hasn't provided any solid view skyline, and therefore, we have to make our own assumption of volume of production.

And in addition, I'd say, there's a bit of an inventory overhang on F-35, given that while we supplied to schedule during 2021, I note that Lockheed did not build the full quantity of aircraft. So while the aircraft production is going to increase in 2022 and increase in 2023 then that's great, but we have got to burn off a bit of an overhang in the early part of 2022 and then we will see further volume improvements as we go into 2023 when that overhang, hopefully, will no longer be there and it will be bit rise in the first part of this year. So those would be the, let's say, a couple of comments regarding the revenues for 2022 and the early part of the year. Does that cover it or do you need a bit more?

Gautam Khanna

Thank you. No. That's very helpful. And just to follow-up on Rob's earlier question on pinch points. Have you seen any pinch points upstream with respect to nickel billet or what have you given the PCP strike and Carpenter having the outage, the unexpected outage at Reading, I don't know. How do you feel about...

John Plant

Yeah. So far nothing on nickel. I recognize the Carpenter matter and I think that's going to be a little bit of a pinch point in the first half of this year. Nothing dramatic that we see at this point, but definitely having some impact.

Gautam Khanna

Thank you.

Operator

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

David Strauss

Thanks. Good morning.

John Plant

Hi, David.

David Strauss

Hi, John. So, I guess, within that 11% revenue growth, John, that you are talking about, can you just give us an idea by end market, what you are assuming, I guess, Aero Defense, Commercial Transportation being the big ones, maybe Industrial, if you want to throw it in there? And then on MAX, can you give us an idea of what you have produced in 2021 and what you are assuming for production in 2022? Thanks.

John Plant

Yeah. So by end markets, Commercial Aero is going to be up in 2022, led by narrow-body, but not a lot happening on wide-body with the 787 being the complete wild card in all of this. IGT should be -- continue to be healthy and I believe to be up in the year. And Commercial Transportation for our Wheels business will be up and I think the supply chain constraints ease that we are going to see a fairly healthy second half of the year in that business and a really great 2023.

The weak point at the moment would be Defense for us. I think it's going to be flat to slightly down for the year and with most of that playing out in the first half of 2022. And oil and gas, too difficult to call at this point, we are hopeful for an improvement, but haven't planned on it. So that covers out the end markets.

737, I haven't got the exact numbers, but maybe while I am chatting here, Ken, get them. But essentially, while we note the production for last year and it's increased in the second half of the year to -- I don't know what the number was, let's say, 14, I am going to recognize rather than the numbers I have seen thrown around.

We have seen that improvement. But again we have been supplying it below that level as the remains of the inventory is being burned off on particularly the LEAP 1B for us in the Engine segment and that's hopefully going to just show healthy growth for us this year, again, strengthening as we go through the year when we see the further rate increase and there's no inventory left in the pipeline to get burned off. And then should Boeing feel more confident and do consider raising the rate that will be great for us and above what we have guided.

Spares, just to comment on that, that's going to be healthy for us this year, but rate of percentage increase, I am thinking on the Commercial Aero side, maybe something like a 30% increase in our aftermarket revenues, 30% plus. But as you know, it's coming at a fairly low base. So the dollars are beginning to be interesting but still well below our previous levels in 2019.

Ken Giacobbe

Yeah. And in terms of, David, the exit rate on the 737 in Q4, we were at about 17 aircraft. And as we look into 2022 consistent with what we said last quarter, probably, low 20s in the first half and low 30s in the second half.

David Strauss

Great. Thanks for all the detail guys.

John Plant

Thank you.

Operator

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

Robert Stallard

Thanks so much. Good morning. John, to follow up on this 787 issue, have you taken the 787 out completely from your 2022 revenue guidance? And then, secondly, assuming that's an accurate forecast, can you use this capacity for other stuff?

John Plant

We have assumed, I mean, it's just a ballpark number, about 35 aircrafts are production for the year. It's just a guess, with very limited production there or maybe zero production in the first quarter. And then assuming there's something, but not quite sure what, so we ballparked it around that 35 level.

In terms of those production facilities, if you take the air force that go into the Engines, clearly, I mean, while that will release casting capacity, it's -- if the device is dedicated to that aircraft. So nothing will be changed over there.

And for the most part, that type of Fastening System and Titanium Structures are dedicated to the aircraft albeit there's enough capacity to produce for other customers for any of those flight types or any bulk fasteners.

So, yes, there's use for them elsewhere, but we have already made provision to be at production rates for everything elsewhere. So, there's no upside in 787 being down. We just like the aircraft to get back certified and production to start and lift and that would be very helpful to us.

Robert Stallard

Yeah. That's great. Thanks, John.

John Plant

Thank you.

Operator

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

Myles Walton

Thanks. Good morning. I was wondering -- I don't know if it's Ken or John. But on the cash flow, obviously, better performance in 2021 and then 2022, still at pretty elevated levels of conversion. I guess the question is, why aren't you building more working capital as you are ramping up into the double-digit growth likely this year and next year? Are the customers payables coming in or excuse me, receivables coming in at pace and POs coming in better than you would historically wanted or are we just setting a new bar for cash conversion versus the 90% long-term target?

John Plant

No change to long-term guidance, just that when you have got, let's say, CapEx below D&A for a period of time, that's healthy, we expect, as I guided, the pension contributions to be lower in 2022 than previous year.

So we are expecting some working capital build and should we hit our marks in terms of, I will say, receivables and payables, then I'd be quite excited to use increased working capital in the back-end of the year, because that would mean a very healthy exit rate and great momentum going into 2022. Working capital drag for us is not the biggest deal, given the strength of margin and we much prefer to see the improved revenues.

Having said all of that, we do hope to further improve our inventory efficiency during the course of the year. It's part of, I'd say, what we do. And that's helping us reduce the -- what is pro rata or pro rata working capital drag from the increased revenue.

So, in summary, there is a working capital drag on cash flow. We try to improve efficiency, but would love that drag to be even higher, because that shows strength particularly in the second half of the year.

Myles Walton

Yeah. And did...

Ken Giacobbe

And Myles, what I would add to that -- this is Ken. As John said, it's a modest cash burn in working capital. But as we exited 2021, we built some inventory, specifically in the Engines business on some of these key platforms in order to get ahead of the ramp. So we think we are in good shape.

Myles Walton

Okay. And did you acquire any inventory from the supplier who maybe been liquidating in the fourth quarter?

John Plant

Small amount, yeah.

Myles Walton

Great. Thanks.

John Plant

Thank you.

Operator

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

Seth Seifman

Hey. Hi. Thanks very much and good morning.

John Plant

Hey, Seth.

Seth Seifman

I wonder if you could comment on maybe not the exact number, but in a relative sense, the LTAs are coming up this year relative to, I don't know, maybe if they are three years to five years on average, then you think of 25% coming up each year. Is this a heavier year, a lighter year and kind of what -- is there much expectation for what that might be able to deliver this year?

John Plant

Yeah. So consistent with what I have said previously, the 2021 was a bigger year for us and you saw that. And I think the number through the third quarter was a cumulative $60-plus million of price, excluding inflationary pass-through. The Q4 number will be issued as we issue today in a week or so time.

And the -- for 2022, the book of LTA will not be as big as 2021, again, consistent with what I previously said. Nothing's changed, we are well through our negotiations, but not completed for 2022, but well through and our expectation for the price improvement is exactly in line with previous statements.

Seth Seifman

Great. Thanks very much.

John Plant

Thank you.

Operator

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

Noah Poponak

Hi. Good morning, everybody.

John Plant

Hey, Noah.

Noah Poponak

John, I heard your comments on the math of the pass-through versus the pricing in terms of what that does to margins. But just the midpoint of the EBITDA margin guidance is a little constrained year-over-year. It seems like sort of the high-end of the EBITDA versus the low-end of the revenue gets you to 35% incremental, but a lot of different places in the ranges don't get that incremental you have been speaking to. So maybe you are just trying to tell us there's risk to revenue, but you feel good about your operating performance. But just wanted to get your latest thinking on your incremental margin potential versus what you were saying last quarter?

John Plant

Yeah. Well, the last quarter, I gave you 35%, plus or minus 5% approx and we are well within that. So I think it's exactly in line. I don't think anybody is going to argue for a couple of percent with all of the variables around us. So those variables will be Omicron, production disruption, I could talk about inflation, I could talk about recovery inflation, I could talk about 787, the F-35, the management of LEAP 1B inventory and also things like container availability, never mind the cost of containers. So there's a lot of stuff going on and within that overall context of uncertainty, then I think the guide is just exactly in line and we will see how things pan out during the course of the year.

Noah Poponak

Okay.

John Plant

I am not accustomed to disappointing and the most important one, not to disappoint myself. And so at the moment, I think, we are in line. I think the most important thing is, we are passing through, we can pass through these significant material changes and others. So that's the important thing. It's not an excuse me for reduce margins.

Noah Poponak

Excellent. And is this...

John Plant

And it's non -- once we get to it, it's a non-conversation. We have given you a range where we will take this and deliver, and hopefully, deliver improved margins in 2023, just in the same way as we deliver the improved margins in 2022 -- in 2021. And 2021, as you know, was a 200-plus-basis-point improvement over 2020 and we have guided you to, I think, 23% midpoint, which would be an increase over 2021.

Noah Poponak

And Fastening didn't see that as much in 2021 and is the furthest below pre-pandemic. Now that the revenue has stabilized there, is that where there's the most upside left moving forward?

John Plant

Well, I am certainly optimistic for our Fastener business, because that's a good margin business. I'd be a lot more bullish about it, if I knew more about the 787.

Noah Poponak

Yeah.

John Plant

But while I don't, I am going to be fairly cautious. I still think that given, I mean, when you go into like sort through this, given, I think, in the Q4 revenue slightly down, but margin up, and if you think margin up when the wide-body is down and 787 down, and given the differential mix of Fastener on aircraft, it was a real credible and creditable performance for the Fastener business.

Noah Poponak

Okay. Thanks very much.

John Plant

Thank you.

Operator

Your next question is from the line of Kristine Liwag with Morgan Stanley.

Kristine Liwag

Hey. Good morning, guys. John, on Russia, there are discussions again on sanctions. How do you think this will pan out for the titanium industry? And is that a risk point or potential pain point for you? How are you thinking about all of this?

John Plant

If anything, I did note comments in the press for -- from Boeing regarding concerns about geopolitical stability and the impact of titanium. And should that -- those concerns prove material or real, then that would be great for us, because we have got titanium capacity. We would be happy to commit to a long-term agreement with that customer or indeed any others. So if there is geopolitical uncertainty, whether it's for the defense contractors or for civil aerospace production, then I think that's -- we would be happy to take your calls.

Kristine Liwag

So, John, I mean, following up on that, I mean, how much capacity do you have for titanium, how much of the aerospace industry's demand can you meet, should this come about?

John Plant

Well, it's clearly not the whole of the VSMPO [ph] demand, that's for sure. But it's like those who come first will get the contracts locked and the capacity we are able to offer. Our reuse of reverse and also titanium sponge, which for the most part for us comes from Japan, is not affected by the geopolitical uncertainties. And I would certainly want to guarantee for myself that I have got access to titanium.

Kristine Liwag

Thanks, John. Very helpful.

John Plant

Thank you.

Operator

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

Matt Akers

Hey. Good morning, guys. Thanks for the question. Could you kind of share your thoughts on headcount additions at this point? You added a lot of people in 2021, are you sort of covered for this year or are there a lot more that you need to add to support some of the ramp-up later this year?

John Plant

So we have tried to put headcount in sequence to those businesses that, I will say, the early movers in the aerospace recovery map. And so you have seen just under, I think, the number of 950 net adds in our Engine business. We think we are going to start adding in our Fastener business shortly, already are adding our Fastener business and so trying to get ahead of that volume recovery that we see.

In terms of access and the availability of labor, so far, it's been okay. I am saying about 70% of its come from people that we have recalled, and let's say, therefore, 30% from fresh labor for us. My expectation is that, if things work out as we expect then we will probably be recruiting an additional similar number, probably, somewhere between 800 and 1,000 people during the course of 2022, and if things work out well, we will be on the upside of that, and if not, we will be on the downside, but we will keep adjusting it as we see fit during the year.

But, again, if you think about what we have said to you today is that, we have tried to be thoughtful about the addition of labor to be ahead of the curve and training and taking those costs up so that we are not only able to meet our customer's demand in these, especially in those very difficult parts to manufacture I already talked about.

But also we took the time and effort and cash cost of building some additional inventory such that we could protect some of the volume ramp that we expect coming. And we think that the demand actually could be quite healthy and rather than get stressed about our production, we want to be ahead of the game and that's where we think we are currently.

Matt Akers

Great. Thanks and that's helpful.

John Plant

Thank you.

Operator

Your next question is from the line of Timna Tanners with Wolfe Research.

Timna Tanners

Yeah. Hey. Good morning. I just had a follow-up...

John Plant

Hi.

Timna Tanners

... on asking about capital allocation, I know you mentioned that 2021 was a balanced approach. You did mention you don't see a lot of CapEx needs. So I guess really just remaining trying to get an understanding of how you are looking at dividends versus buybacks versus refinancing and other opportunities? Thanks.

John Plant

Yeah. My guess at this point is that, given our healthy cash flow, we will still be returning money of note to shareholders during 2022. In fact, if you think about it, we have already done $100 million in the first few weeks of January. So that gives you an idea of our confidence and strength in the cash flows of the company.

We will feel our way through the year and see how we go. But, clearly, if all things go as we expect, then we will be buying additional shares back during the course of the year, with the cadence yet to be determined, but we have plenty of authorization to do so. Clearly, we are also going to make sure we fund the business appropriately and that's taken care of in a slightly higher CapEx number than before.

And I guess that when we get through our first quarter, which we will be reporting to you in early May, we will obviously just take a view of the dividend and whether we feel as though that would benefit from being lifted or not or just do a sense check as we go through. So I expect a balanced approach, but with probably more share buyback as a dividend in terms of any cash flow implication for the company, but I am willing to consider all things.

My guess is that when we exit 2022, we are going to also have improved leverage once again of a similar order of magnitude of turns compared to 2021. So I think we are going to have another conversation where we are going to buy back shares, consider dividend and improve our debt structure, and improve our leverage as we exit 2022, and that will set 2023 up in a really good way.

Timna Tanners

Okay. Great. Thanks for the detail.

John Plant

I can't believe I just talked about 2023. It's only the start of 2022. I must be getting carried away.

Operator

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

Phil Gibbs

Hey. Good morning.

John Plant

Hey, Phil.

Phil Gibbs

A question was on the pricing evolution. Safe to say that last year pricing gains were about $80 million and I think you already said this year is probably going to be something a bit less than that, is that fair?

John Plant

Yeah. Well, the second part is I haven't commented on the first part, because that will be okay in a week or so it's time.

Phil Gibbs

Okay. Then you talked about the pass-through, I think, largely -- I would think, largely in the Forged Wheels business for 2022. But aside from the labor bill that you expect over the course of the year, any other incremental inflationary factors that you guys have maybe at a bit higher level than you were expecting three months ago or something that you don't have hedged out?

John Plant

Energy costs are high, that's for sure, particularly in Europe. So if you would to go to almost any country in Europe, all of them having differential percentage than the cost of energy, because of their, I will say, policy towards renewables, et cetera.

And I will say security of energy is causing that to be an elevated level. It's also higher in the U.S., but nothing like the increases that are there in Europe. So I -- for your attention to energy as one thing, and of course, we are all familiar with why the general inflation increase, that's there, and I guess, that's very early.

Phil Gibbs

And then just a second part to that, energy comment that you just made, are you all hedged in terms of your energy exposure there or are you feeling the brunt of the spot market gyration?

John Plant

You can assume that it's pretty costly to hedge energy, and therefore, we will be incurring additional energy costs during the course of the year. And those which are, let's say, not covered by our customers are all contained within the guidance we have given. And as I said, our guidance is within the incremental range you already provided but just for that metal pass-through.

Phil Gibbs

Thanks, John. Appreciate it.

John Plant

Thank you.

Operator

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

Paretosh Misra

Thanks. Thanks. Good morning. On your CapEx guidance...

John Plant

Hi.

Paretosh Misra

... and recognizing it's below depreciation in 2022, but is there any larger project that you are undertaking that's worth flagging?

John Plant

No. I mean, there's no significant projects at all. So there's no capacity expansion, for example, in our Engine business, as we have had previously. As Ken has already commented that, we finished the capacity expansion in our Wheels business in Hungary and Monterrey, Mexico. So that's also behind us and expect to see the benefits of that capacity available for our customers as we go through the year, and in particular, into next year. So that's all good.

If there's one thing, I think, where we are going to have an elevated spend compared to previous years. It's the -- it will be the combination of many of the automation products that we have started throughout the company.

And I'd be willing to commit to those additional toric, in fact, stimulated in many cases, those projects, because I really do feel that's going to pay dividends for us in terms of meeting our ingestation of labor and also taking those inflationary costs for the future in terms of just managing our productivity.

And also, I think, going along with that productivity, we will also gain further improvement in our quality indices and as you probably recall from previous earnings calls, I have noted that the improved quality and delivery from Howmet over the last two years or three years. And we would like to continue that path and I think automation is going to be key to do so, while we are going through the volume ramps that we are for the next two years or three years.

Paretosh Misra

Interesting. Thanks. And then just a quick follow-up on your comments regarding the aftermarket, sorry, if I missed that, but did you say how big your aftermarket business was last year in 2021?

John Plant

I did not. But clarity for everybody now on the call, in Defense and Aerospace, we -- I think the mark we called out in 2019 was about $400 million and that's close to $500 million these days. And the $400 million, which was in Commercial and Industrial, that dropped the depth of, let's say, the pandemic to about $100 million more or less.

And compared to, say, 2021, so a fractional improvement in the back-end of the year and it's on that Commercial Aerospace business, where, obviously, I believe we are going to have a 30%-plus improvement in 2022 for spares, both the narrow-body and wide-body.

Paretosh Misra

Got it. Thanks, John.

John Plant

And business jet -- and business jet as well, because business jet is really going very well.

Paretosh Misra

Got it. Very clear.

John Plant

Thank you.

Operator

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

George Shapiro

Yeah. Good morning, John.

John Plant

Good morning, George.

George Shapiro

For the last couple of quarters, you have been a little bit less in revenues than you thought, but the margin has either been as good or better than what you have been guiding to. So how long can you continue to do that, if we see the recovery somewhat slower, so the revenues continue to be a little bit less than expected out there?

John Plant

Okay. But certainly, if you say compared to what I'd like to have seen in the back-end of 2021, then revenue would have been a disappointment. But as you know, we can only supply that with what our customers want.

And I think all of us recognize that, I mean, if you call out one instance rather than go through everything, then 787 overshadows everything in the back-end of the year, and in particular, effectively production going to zero in the fourth quarter.

So, yeah, revenue line is a disappointment. The most important thing is that despite all and within that output, containing that through our cost reduction programs and our efficiency, despite all of the impact of Omicron and that production disruption that it did provide.

Plus if you also want to pile on, you can add all of the additional protection that we try to provide our employees so we can maintain production, and there's like testing regimes and we have been whipsawed as you know, by mandates and government core changes, so again a lot going on.

And if you look at the guide for the first quarter, it's not really -- if you then go through it closely, and you will say, well, part of our revenue, let's say, maybe half is material pass-through, so there's not much volume. And -- but when you adjust for that material, you will see that margin is right on top of where we exited the second half of 2021.

So, at the moment, we are -- what we are telling you is we think we can continue to convert effectively, while, I will say, waiting for the volume. And then for me, the really interesting bit is what happens in our second quarter and second half, and we will know a lot more as we go through when we see firmness of production schedules. But we are getting a little bit more optimistic for the second quarter, and certainly, we feel more optimistic in the second half.

Even though when you think about it in the round, it's never good to have a year where you are back-end loaded, but that's always going to be the nature of it when you are in a recovery situation that the -- certainly, Commercial Aerospace market is and recovery is going to be that way through, 2022 is going to be that way through 2023 as well.

So, I'd say, all good, George, with the moment trying to hold things together. We have held things together, while say the market hasn't been kind to us by way of volumes. And then should we get a little bit of a whiff of increase, like, sales we had in Q3, then I am hopeful we are going to convert and maybe enter those sunny uplands as I think.

George Shapiro

Okay. No. It's been impressive performance. I am just wondering how long you can keep it going if you don't get the revenue.

John Plant

Yeah. Well, I guess, I mean, I keep -- if you want, light that candle that might make proud that I want the volume, because operating with the lack, I mean, the headwinds we have had over the last few quarters and years or two years, it's been tough.

But the answer is we have converted, we have done what we should do and delivered, and are looking forward to the volume improvement, which will happen, it's a strong thing that will happen during 2022 at some point.

George Shapiro

Thanks very much.

John Plant

I think it's also important to keep the big picture in mind despite, I will call, all the little bits of stuff that you deal with, the big picture is, let's just consider, revenues are going up in recovery, the Commercial Aerospace business is going to improve, narrow-body is leading the way, volume will increase, whether it's from Airbus and Boeing, and hopefully, stronger from Boeing, and hopefully, aircraft will start being delivered in China shortly for the narrow-body. I mean, it's all good. So let's keep focused on the big picture here.

George Shapiro

Yeah. Very helpful. Thanks very much.

John Plant

Thank you.

Operator

Your final question is from the line of Noah Poponak with Goldman Sachs.

Noah Poponak

Hey, John. I just wanted to try to better understand what's going on with the 787. I am a little surprised by your comments that you are sort of not hearing much from them. I mean is that surprising to you, I know they have a lot of inventory, but they are talking about restarting the underlying production rate, presumably, they need to give the supply chain that info. So what's going on there and then putting their comments aside, what's your assessment of what's happening there, why it's taking so long and when it starts back up?

John Plant

I don't know if my assessment count so much at all.

Noah Poponak

It does.

John Plant

But, I think, it's -- Boeing's assessment makes a lot of difference. My take is, Boeing rightly don't want to get ahead of the FAA in providing commentary. I don't think that's been helpful in the past, and therefore, I think, a cautious line is being taken.

And my thought is that, is it the Omicron, the MPS, the Italian Leonardo problem is behind them. Solutions are done. The gaps which were there and the shims are being worked through. The issue around the doors has been solved and is being worked through.

And I think the audit of the supply base in terms of supplier performance has been completed. And so there's a lot of milestones, which I think are being done and everybody is a bit snake bit on making prediction -- are predictions for the aircraft. And my hope is that during this quarter is that or latest early second quarter is that the FAA give recertification.

And then I think that those aircraft will be flowing because clearly as the fundamental demand for this composite wide-body aircraft and its efficiency and it's a great aircraft. So if you just look at some of the summer cancellation of schedules by the airlines, they need those aircraft.

And so, as it gets recertified production, we will get a lift from the let's assume that those penny numbers are being done currently and we are going to see rates of five in the second half of this year, five per month that is. So I think that's the way it plays out, but I am not in control of those events at all and I am just trying to give you a view...

Noah Poponak

Yeah.

John Plant

... albeit it's a view that, as I said, doesn't count that much really.

Noah Poponak

No. It does. And that's helpful. And I guess given the inventory they have and then that the production rate would start pretty low and maybe be there for a bit, while it may sound surprising to me that they are not giving you a schedule, they don't necessarily need to, because they are going to restart at such a low rate, combine that with the sensitivity of being ahead of the regulator and that would explain that, that, what the communication is right now, even if things are going to restart...

John Plant

Yeah.

Noah Poponak

... relatively soon.

John Plant

Yeah. And I do believe they need to get back to five a month, and overall, if we are not careful, there's going to be, if we end up in zero for an extended period of time, then it's going to be really difficult to get production rates up for that aircraft. I mean that's...

Noah Poponak

Right.

John Plant

...it's a difficult aircraft to build, as we all know, that was an aircraft where not only was the fundamental technology change, but that's combined with a supply chain, change of great notes back in, say, the 2000, let's call it, 2008, 2009 timeframe.

And when you think about all the different subs around the world, let's say, probably, as far away as Japan and lots of other countries as well, then there's inventory in the system all the way through and that will take a bit of burning off.