Howmet Aerospace Inc. (NYSE:HWM) Q2 2023 Earnings Conference Call August 1, 2023 10:00 AM ET

Company Participants

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

Conference Call Participants

Sheila Kahyaoglu - Jefferies
Robert Stallard - Vertical Research
David Strauss - Barclays
Peter Arment - Baird
Robert Spingarn - Melius Research
Myles Walton - Wolfe Research
Kristine Liwag – Morgan Stanley
Gautam Khanna - Cowen
Ronald Epstein - Bank of America

Operator

Good morning, and welcome to the Howmet Aerospace Second Quarter 2023 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

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

Paul Luther

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

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

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

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

John Plant

Thanks, PT, and good morning, everyone. Q2 was another strong quarter for Howmet. Revenues were up 18% year-over-year and 3% sequentially, albeit, Q2 is traditionally a stronger quarter seasonally than Q1 due to more effective production and sales days.

Commercial aerospace increased by 23% year-over-year and continues to be the highlight of the quarter and reflects some of the scheduled increases for the anticipated Boeing 737 build rates, which are slated to increase very soon.

Defense sales were also strong at plus 17%. EBITDA was up 16% year-over-year and up sequentially. Earnings per share increased to $0.44 per share and exceeded the high end of guidance. This was an increase of 26% year-over-year. The cash balance was a healthy $536 million, and free cash flow was strong at $188 million, which started at consecutive quarters of cash generation. $100 million of cash flow was used to buy back shares at an average price of $45 per share.

Net debt to EBITDA further improved to 2.5 times leverage and all bond debt is at a fixed rate, which provide predictable interest rate expenses into the future. Howmet has negligible exposure to floating interest rates. Regarding our revolver, we amended and extended our $1 billion undrawn credit facility to 2028, while realizing lower fees and a more favorable net debt to EBITDA covenant.

Lastly, another notable item was the commercial settlement of Lehman claim, $40 million, which is $25 million less than previously reserved, with a cash settlement we paid in July 2023 and a further settlement in July 2024. This litigation was the most significant of all residual claims for Howmet, namely RemainCo, and dates back to 2008.

Before turning it over to Ken, I want to cover three additional items. Firstly, in Q2, Howmet was impacted by approximately 5 days of production stoppage at our Wheels [ph] plant in Hungary due to a 9-day strike at Arconic Corporation, which is now resolved. The interruption of suppliers of aluminum billet had an unfavorable effect of about $5 million to profitability for which a claim has been lodged with Arconic under the terms of the supply agreement, and we expect to gain resolution shortly.

Additionally, Howmet is assessing its significant reliance upon this source of supply. Secondly, while segment commentaries including the finance portion of our call, let me address structures. The margin rate fell back for the first time in several quarters. The profit miss was essentially the result of adding costs or production rate increases, which we did not achieve. The cost of additional people, furnace preparation and other rolling mill facilities preparation were unrecovered due to the production rate increases not being achieved. The main issue was bottlenecks in production at one plant. The backlog did increase since it was not a demand issue.

Naturally, our plan is to achieve production rate increases and burn down the increased backlog as we move into the second half. This reduced production combined with F-35 bulk and inventory burn down was also not helpful. But it was, in aggregate, not material in the context of the Howmet overall results, which were again up, as I commented earlier.

Finally, the Paris Airshow was held in June with the largest significant orders ever at an airshow for commercial aircraft, which adds to the backlog of orders fulfilled -- to be fulfilled once production rates are able to be further increased. The show was very successful for Howmet with a combination of production meetings with both customers and investors all reflecting the huge optimism for both the industry generally and for Howmet, in particular.

I'll now turn the call over to Ken, who will provide further market and segment commentary.

Ken Giacobbe

Thank you, John. Let's move to Slide 5. All markets continue to be healthy with revenue in the quarter up 18% year-over-year and 3% sequentially. Commercial aerospace continued to lead the growth with an increase of 23% year-over-year, driven by all 3 aerospace segments.

Commercial aerospace has grown for 9 consecutive quarters and stands at 47% of total revenue. Commercial aerospace portion of total revenue is expected to increase due to the developing widebody recovery, strong backlog of commercial aircraft orders and spares growth. Spares for commercial aerospace continued to increase sequentially and are now trending to be approximately 95% of 2019 levels at year-end. Defense aerospace was up 17% year-over-year, driven by the F-35 in legacy fighter programs.

Sequentially, defense aerospace was up 4% year-over-year, driven by engine products. Commercial transportation, which impacts both the Forged Wheels and Fastening Systems segments, was up 8% year-over-year and up 2% sequentially driven by higher volumes. Finally, the industrial and other markets were up 20% year-over-year, driven by oil and gas, up 36%; IGT, up 20%; and general industrial, up 11%. Sequentially, these markets were up 4% with general industrial up 9%; oil and gas up 4%; and IGT flat. In summary, another very strong quarter across all of our end markets.

Now let's move to Slide 6. Starting with the P&L and enhanced profitability, revenue, EBITDA and earnings per share, all exceeded the high end of the guidance in the second quarter. Revenue was $1.65 billion, up 18% year-over-year. EBITDA was $368 million, up 16% year-over-year, including net head count additions in Q2 of approximately 380 employees, which builds on additions made in Q1.

Year-to-date, net head count additions are approximately 865, which are in line with our targets. EBITDA margin was 22.3%. Adjusting for the year-over-year inflationary cost pass-through of approximately $25 million. EBITDA margin was 22.7% and the flow-through of incremental revenue to EBITDA was approximately 22%, while absorbing near-term recruiting, training and production costs. Earnings per share was $0.44 which was up 26% year-over-year. The second quarter represented the eighth consecutive quarter of growth in revenue, EBITDA and earnings per share.

Moving to the balance sheet. The ending cash balance was healthy at $536 million after generating $188 million of free cash flow which was our best Q2 of free cash flow generation. We continue to expect strong positive free cash flow in the second half of 2023. $118 million of free cash flow generation was allocated to common stock repurchases and dividends.

Net debt to EBITDA improved to a record low of 2.5 times, while bond debt is unsecured and at fixed rates, which will provide stability of interest rate expense into the future. Our next bond maturity is in October of 2024.

Finally, we amended our $1 billion revolver through 2028, while realizing lower fees and a more favorable financial covenant. The revolver remains undrawn.

Moving to capital allocation. We continue to be balanced in our approach. In the quarter, capital expenditures were $41 million with a focus on automation. Capital installed prior to COVID-19 puts us in a good position to support continued commercial aerospace recovery.

In the second quarter, we repurchased $100 million of common stock at an average price of $44.52 per share, retiring approximately 2.2 million shares. This was the ninth consecutive quarter of common stock repurchases. Share buyback authority from the Board of Directors stands at approximately $822 million. Since separation in 2020, we have repurchased more than $1 billion of common stock.

We continue to be confident in free cash flow. In the second quarter, the quarterly stock dividend was $0.04 per share after it was doubled in the fourth quarter of last year. Finally, we issued a note to redeem $200 million of our 2024 debt tower with cash on hand. The redemption is expected to be complete at the end of September and will lower our annualized interest cost by approximately $10 million.

As you will recall, we repurchased approximately $176 million of bonds last quarter, which will lower annualized interest costs by an additional $9 million. Therefore, year-to-date, bond repurchases are expected to decrease annualized interest costs by approximately $19 million.

Now let's move to Slide 7 to cover the segment results for the second quarter. Engine Products continued its strong performance since the second quarter represented the eighth consecutive quarter of year-over-year growth in revenue and EBITDA. Revenue was $821 million, an increase of 26% year-over-year. Commercial aerospace was up 23%, Defense/aerospace was up 41%, and both markets were driven by higher build rates and spares growth. IGT was up 20%, and oil and gas was up 36%, as demand continues to be strong.

EBITDA increased 25% year-over-year to a record for the segment of $223 million. EBITDA margin was 27.2%, despite the addition of approximately 350 net new employees year-to-date and approximately 90 net additions in Q2. Across all of the aerospace segments, net headcount additions are needed for the continued revenue ramp, but do carry near-term recruiting, training and production costs. Finally, in the second quarter, the Engine's team finalized a new five-year collective bargaining agreement in our Whitehall, Michigan facility.

Let's move to Slide 8. Fastening Systems year-over-year revenue increased 19%. Commercial aerospace was 19% higher as the widebody recovery starts to take effect. Defense aerospace was up 24%, commercial aerospace was up 17% and general industrial was up 16%. Year-over-year segment EBITDA increased 14% as volume increases were partially offset by the addition of 430 net new employees year-to-date and approximately 215 net additions in Q2.

Now let's move to Slide 9. Engineered Structures year-over-year revenue was up 8% with commercial aerospace up 31%, driven by higher build rates in approximately $25 million of Russian titanium share gain. Defense aerospace was down 33% year-over-year, driven by customer inventory corrections. Segment EBITDA decreased 23% year-over-year, while margins declined 410 basis points. The lower EBITDA was driven by higher costs associated with additional headcount as well as operational costs for planned production rate increases, which were unrecovered due to production bottlenecks in one plant. Net head count additions in the quarter were approximately 50 employees. Finally, in the third quarter, the Structures' team finalized a new four-year collective bargaining agreement at our Niles, Ohio facility, which was ahead of schedule.

Now let's move to Slide 10. Forged Wheels revenue year-over-year increased 7%. The $19 million increase in revenue year-over-year was driven by a 6% increase in volume. Segment EBITDA increased 8% year-over-year, despite the interruption of raw material for our Wheels plant in Hungary due to a nine-day strike at our Arconic Corporation supplier, which has now been resolved. Margin increased 30 basis points due to the impact of lower aluminum prices and inflationary cost pass-through.

Finally, let's move to Slide 11. We continue to be focused on improving our capital structure and liquidity. In July, we issued a notice to redeem $200 million of our 2024 debt tower with cash on hand, which is expected to be completed by the end of September. The October 2024 debt tower would be approximately $705 million after the redemption. Since the separation in 2020, including the redemption just announced in July, we will have paid down approximately $2.15 billion of debt with cash on hand and lowered our annualized interest costs by more than $120 million. Gross debt is expected to be less than $3.8 billion after the redemption in September, while long-term debt continues to be unsecured in it fixed rates.

Finally, we amended our $1 billion five-year unsecured revolving credit facility through 2028. The amendment provides lower fees and more favorable covenants. Details can be found in the 10-Q, which is expected to be filed later today. The revolver remains undrawn.

Lastly, before turning it back to John, let me highlight one item in the appendix on slide 18. It covers our operational tax rate, which was approximately 22.6% for the quarter. The second quarter rate represents approximately a 500 basis point improvement in the operational tax rate since the separation in 2020.

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

John Plant

Thanks Ken and let's move to slide number 12. The outlook for Howmet continues to be very strong and supported, in particular, by the extraordinary backlog of commercial aircraft orders at both Boeing and Airbus.

Demand increases have moved further to the right, constrained by current aircraft production, would all go well for revenue increases to come in 2024, 2025, and beyond. This growth in absolute aircraft quantity is further enhanced by the increased sophistication of engine technology upgrades being brought to market by both GE and Pratt & Whitney to the narrow-body markets.

These turbine improvements address fuel efficiency and time on wing issues, which enhance the value of Howmet's differentiated products. This combines well with the upcoming improvement in widebody production, which increasingly features composite technology, which again increases the value of how much differentiated products of titanium structures and fasteners.

Wide-body aircraft also feature improved aerospace engine content for the company. Defense markets continue to be robust, and we envisage increased revenue going into 2024 as the destocking for bulkheads is completed and engine spares continue to increase significantly as shop visits increase.

The F-35 backlog continues to increase to approximately 420 aircraft with recent orders of 126 aircraft for the US government joint Kroger office, plus 25% for Israel, and a further 25 aircraft for the Czech Republic.

Industrial revenue continues to grow for both IGT and oil and gas, in particular. The outlook for Wheels is also healthy for the current quarter. And in Q3, underlying demand continues to be strong, albeit Q3 is notably the weakest quarter for revenue due to European vacations, which are also a feature of our aerospace plants in Europe in both France, Germany, and Hungary, in particular. This seasonal effect -- the seasonal offset it seemed to be approximately $50 million of revenue between Q2 and Q3.

My final markets comment is regarding spares, where we see spares of commercial aircraft closing in on 95% of the 2019 levels by year-end and approximately 130% of the defense and IGT market at 2019 levels. This puts aggregate spares for this year in excess of 2019 levels with higher rates to come as we see the rates increasing as we close out the year.

The cautious stance has been taken relative to Q4 until the demand is more clear for commercial trucks in the quarter and aircraft parts for the first half of 2024. While the backlog is there, we find difficulty in planning for rate increases and the inventory impact, if that's not achieved. Specifically, we are raising guidance once again for the year by another significant step.

To give you an example of guidance assumptions, we have lifted our 737 MAX assumption from 30 per month and nudged it into the 30s, but not anywhere near the rate 38 for the second half. This number is intentionally given the -- all the moving parts of the business and also the lack of clarity over very soon.

And when we plan for the second half, we are increasing people recruitment further, but at a reduced rate in the first half as we hope to use the productivity improvements to come.

Regarding Q3, revenue is expected to be $1.9 billion, plus or minus $10 million; EBITDA, $360 million, plus or minus $5 million; earnings per share of $0.42 plus or minus $0.01.

Regarding the year, revenues increased from $6.25 billion to $6.44 billion, a significant increase. And let's say, plus or minus $30 million, $40 million around that range. And then EBITDA has increased to $1.45 billion, plus or minus $10 million. Earnings per share is increased to $1.70, plus or minus $0.01, and free cash flow is held at $635 million, having absorbed the settlement for the Lehman Brothers claim.

In conclusion to my outlook commentary, we're pleased to demonstrate both excellent Q2 achievements, supplemented by further optimistic outlooks with very solid increases to come in the future.

Let's move to the summary on slide 13. Q2 was another strong quarter for Howmet. Revenue was up 18%, EBITDA 16% and earnings per share 26%. And EBITDA margin for material pass-through was strong at 22.7% and servicing continues to be heading in a healthy direction.

Liquidity is healthy with very positive free cash flow with more to come in the second half, and we've continued to deploy that cash both to share repurchase in the second quarter. And as you can see, we've turned to debt repayment in the third quarter.

Guidance has been increased and we expect year-over-year improvement in annual revenue, EBITDA and earnings per share as stated. Also, we expect very positive free cash flow generation in the third and fourth quarters.

Regarding debt, what we mentioned the $200 million. And as we complete that with the EBITDA improvements, then we'll be improving our net debt-to-EBITDA leverage from the two and half times record that we talked about in Q2, and we'll see improvements in Q3 and Q4 and heading towards two times levered by the end of the year.

And then finally, we expect to increase the quarterly common dividend by 25% from $0.04 a share to $0.05 a share in the fourth quarter of 2023.

Thank you all very much. Let's move across to question-and-answer.

Question-and-Answer Session

Operator

We will now begin the question-and-answer session. [Operator Instructions] The first question is from Sheila Kahyaoglu of Jefferies. Please go ahead.

Sheila Kahyaoglu

Good morning guys, and thank you. John, maybe first one for you here. Just on the incrementals as we go forward, obviously, 22% in the quarter, given structures after 25% in Q1. And you commented last quarter about how difficult it is to convert at a 30%-plus rate, just given where aerospace build rates are and you'll be climbing through at least the middle of the decade here. How do you think about when you put cost into the system, when it converts into higher profitability? Do you have to wait to build rates peak for that to convert to a higher operating profit than revenue?

John Plant

Okay. Thank you, Sheila. First of all, we don't have to wait, but the extraordinary levels of recruitment during the last couple of years have certainly weighed upon us. And probably of all the things that we've been doing, driving labor productivity has been amongst the most difficult. And it's certainly been more difficult than what we believe we've overcome by way of scrap and yield and also driving through on the volume.

If you look at our midpoint of guidance, we believe we're going to raise the incremental to about 28% in Q3. And we are hopeful at about 34% in Q4. And that takes account of what we believe to be hopefully, a slowing of recruitment and an improved retention ratios and as the denominators got bigger of the employees we've taken on. And so, we're optimistic that the incremental drop-through begins to improve and then hopefully improve again in '24 with the combined volume, the pull-through from the automation programs, the -- I'd say, the bigger denominator of recently recruited employees and the mix effective widebody. So, it's a future statement. We're hopeful we're optimistic. We're planning for it, but I'll be very disappointed if we had to wait until we had stability for improvements in that drop-through.

Sheila Kahyaoglu

Thank you for the color. Just a follow-up. In terms of the structures margins in the quarter, how do we think about that bumping up in the second half? How quickly does it improve?

John Plant

So, I mean -- -- when I think about Howmet is more like a relentless machine. I was trying to bring color to my commentary. So the last time I tried to wet paper tissue and that didn’t work so well, as you know. But at this time, I think itself fairly relentless machine rolling forward and delivering results. We're not that flash bang and full of jumping noise like Chinese firecrackers. But within Q2, there is one thing we overcame, which I'm proud in the way we overcame it, which is the consequences of the strike in one of our suppliers of aluminum billet, that nine-day stoppage costs us heavy and yet we marked straight through and delivered really solid margins in our wheels business. So, I think that has really great performance by Howmet in that regard.

Conversely, when I think of structures, we took a much bigger hit than the strike in the margin rate and the lack of achievement of the volume. And so I put that more in the, let's say, almost like a $10 million complete face plans by the business. And I just think myself, if you want to use the play on the taglines, I think, Howmet planted in our structures business. And I'm not proud of what we really didn't achieve there. We thought we'd prepped well. We thought we'd begun to put labor in place. We thought we'd got the, I'll say, improvements made to improve throughput in our furnaces and then rolling mills and basically completely bottlenecked in one area, and it didn't work well.

So -- but despite all of that, so let's call it, if you want to -- and I never like, like the, excuse me, but a combination of structure space planting and a supplier strike, we out-delivered the guide on EBITDA. And when all said and done any one of those is multiples. So like when we talk about margin rate of 20 basis points difference, that's worth $3 million. We felt like it's hardly worth commenting on. And so it's a bit like me saying, yeah, we did really good apart from that. So I generally choose not to. But I'm trying to be responsive to your question. And I'll say, wheels did great and structures was a big face plant.

Sheila Kahyaoglu

It's like you read my mind. I'm going to go with a relentless march rather than base plan. So thanks for that.

John Plant

Thank you.

Operator

The next question is from Robert Stallard of Vertical Research. Please go ahead.

Robert Stallard

Thanks so much. Good morning.

John Plant

Hey, Rob.

Robert Stallard

John, it sound like I cut you off there. Is there something else you wanted to add?

John Plant

Obviously, probably on a role and I was getting carried away. So no, I'm done.

Robert Stallard

You can carry out how many firecrackers if you want.

John Plant

Yes, I don’t like asking questions so, no, please start over and dish down this.

Robert Stallard

Okay. Thanks for the update you noted on the 737 MAX rate assumptions. But I was wondering if you made any further changes on either Boeing or Airbus build rates within your guidance? And whether this -- in relation to that, what Airbus said about direct and indirect risk from this latest GTF issue could have any flow through to Howmet? Thank you.

John Plant

Yeah. First of all, no rate assumption changes for elsewhere. I mean, Airbus has been, I'll say, plowing ahead, but struggling to get to their production numbers. But getting close, certainly, the Q2 delivery was much healthier. And so I think things are getting better generally, and I think everybody is believing that we're going to see higher rate increases. And really, it's a question of when trying to get ready for it. We think we've prepped or it. We have built capability and capacity and labor terms. We had, say, machine capacity. But as you know, on 737, originally, it's going to be Jan 1st, then May 1st and July 1st. And we just want to be cautious. That's why I say all we've done is just nudging into the early 30s and see where it goes and be ready, capable of supplying, but not willing to be clear we're not going to put rate 38 until it's achieved.

Robert Stallard

And just to follow-up, anything to say on the GTF issues?

John Plant

Well, certainly, this powder metal issue that we read about it seems to be historical. I'm sure that we have got a good plan about taking those engines down out of from aircraft wing and looking at them in detail because I think don't work for that sort of level of crack. I think the bigger impact for high Howmet is, I might say, impact, I mean, positive, not because the impact -- the word impact has negative is the time on wing issue, which is present for both current narrowbodies engines of the ETF and the LEAP where -- while each of them, I think, are doing better for that relative point in their life cycle compared to the predecessor engines, I'll say, V2500 and the CFM56 is that they're still well below the exit point of the previous engine.

And so that in itself is leading to what we believe will become increased demand for replacement parts. And also, it's combining with what I referred to maybe not in sufficient detail, which was the improvements that we have worked on to help resolve the issues. So the high-pressure turbine blades have been seeing elevated temperatures from, let's say, combustors that don't have sufficient holes left after to block them up and then causing degradation issues.

And I'd say another issue particularly in, I'll say, Far East and Middle East climates for LEAP is that we are -- I describe intimate with those improvements. We have worked on them. We are prepping for their introduction and commensurate with our customers' needs. And then we are now assessing how that demand combined with the increased demand for wide-body is moving to the 2024, the increased wide-body is moving to 2024. And so it's all setting up well.

In terms of what I think is good demand is clearly where aircraft production increases, less good demand. You could put a if you want to, is where it's a replacement part for a period of time.

And then we are rather more cautious on that. And where we need to increase capacity rapidly to achieve that in the, say, coming months into 2024 and maybe into 2025 is that we certainly don't want to take capacity up and then take it back down. And therefore, we're in -- I'll say deep into commercial discussions with our customers to ensure that doesn't happen.

So a long way of saying GTF powder metal, no issue for us. Nothing to do with us. And powder metal wing, it's leading to the sort of content improvement growth that we talk about as we make improvements to the -- to those turbine blades and introduce some sophisticated technology as certainly indicated looking at things we've done elsewhere on those engines or the more advanced engines and seeking to deploy that, which is great for the future robustness of the engine. It's fuel efficiency and also good for Howmet.

Robert Stallard

That's great. Thanks a lot John.

John Plant

Thank you.

Operator

The next question is from David Strauss from Barclays. Please go ahead.

David Strauss

Thanks. Good morning.

John Plant

Hey, David.

David Strauss

Hey, John. So I just wanted to clarify on the MAX. So while you've upped the guidance from 30 into the 30s, are you actually at 38 a month in terms of what you're shipping the Boeing today?

John Plant

It depends upon the parts. We supply some different parts. But while I recognize that we received schedule rate – schedules for parts increasing to rate 38 is that my -- I'd say my scenario, which I don't like is where should they not achieve that rate, then that the parts we've supplied, I think because that will be bloated inventories, they will then take them out just in the same way as they would -- parts were taken out September, October, November, December of 2022 is that I'm blending it all together and saying, my average assumption is -- I mean the 30 is, but being deliberately loose about it, but I'm very clear that our guidance is not based upon full rate increase of 38 from the 1st of July. That's not the case.

I mean to say that I don't believe that Boeing can do it. I'd love them to do it, but do it and then I'll feel more comfortable about our guidance to -- because I mean our guidance, I tried to describe in the past, tends to be something that you can rely upon. And I want to see aircraft reduced. And then at that point, I feel confident that we're not going to be on the wrong side of inventory takeout during the remaining few months of the year.

David Strauss

Okay. I got it. It sounds like after what you went through in Q4 of last year, you're just erring on the cautious side, I got it.

John Plant

Yes. I mean, Q4 last year was pretty good. The year was really good. And so it's not worrying. It's just -- I'm not putting it all out there. Why would I?

David Strauss

Okay. As a follow-up, can you dig in a little on what's going on at Fasteners? I mean we've seen a pretty good revenue pickup here on the -- within the business on the aero side. I know 787 rates are still low, but kind of the drop through that we've seen there or the lack thereof in terms of the margin drop through in Fasteners?

John Plant

Yes. Well, don't really like using the so-called Chinese partners, but I don't really know where it's Chinese about. But the -- it begins with small steps. Our margin rate did increase in Q2, despite the large ingestation of labor for the balance of the year.

It's always a bit of a hostage to fortune, but I'm feeling confident that we're going to see both revenue and margin accretion in the second half beyond Q2. So in that sense, I'm really pleased with the rate and direction of the business, I wouldn't have been able to say that six months ago. And so I'm feeling increasingly confident that, I mean, there's be saying to you publicly, our margin rate is going to increase. So that's pretty good.

David Strauss

I got it. I'll take the hand. Thanks.

Operator

The next question is from Peter Arment of Baird. Please go ahead.

Peter Arment

Yes, thanks. Good morning, John, Ken.

A – John Plant

Hi, Pete.

Q – Peter Arment

Hi, John. Just within Engineered Structures, the $45 million year-to-date gain on the Russian titanium share, it seems like it's tracking right towards your expectations. So just maybe any of your updated thoughts on that? And how should we think about that as we go into next year? Thanks.

A – John Plant

In terms of demand, the previous metric I've given was $20 million for Q4 last year, multiply it by four for 2023 and then add on, I think, 25%. So that took you to around about $100 million mark. And therefore, implicit, if you did $45 million in H1, it's $55 million in H2. Right now, I'm actually feeling a little bit more confident than that. And so instead of about a 25% lift, I can see us potentially getting to a 40% lift. Certainly, I think the demand is there. So it's going to be above $100 million, well above $100 million. And the thing that I've got to see is the structure standing up and making the stuff. And then I think we're going to realize the market share we've -- and the business we've obtained and won commercially. So at the moment, demand and, I'll say, our commercial win position is healthy with that -- trying to repeat myself, we had say, a hiccup in Q2, of which neither the structures team or myself are proud of what we did or what they didn't do.

Q – Peter Arment

Appreciate the color. Thank you.

A – John Plant

Thank you.

Operator

The next question is from Robert Spingarn of Melius Research. Please go ahead.

Q – Robert Spingarn

Hey, good morning.

A – John Plant

Hi, Rob.

Q – Robert Spingarn

Two follow-up things on what you just discussed. First, on the question of the improvements to GTF and LEAP, how are these affecting or impacting your Shipset content and how do those changes factor into your LTAs? That's the first question. And then just on the titanium. As we move further ahead, you talked about 40% uplift, But as the wide-body rates rise, let's talk about maybe 2025 when Boeing and Airbus are targeting these higher rates, I would imagine even greater uplift. Can you talk about that?

A – John Plant

Yeah, I'll do it in reverse order. So you're absolutely correct, as wide-body moves up, then that is highly beneficial for us, both for our Structures business and for our Fastener business, both in terms of the value delivered. And I'm going to say in the case of Fasteners, the value proposition of what's delivered where the -- I'll say the value set is substantially higher just from the additional sophistication of the personal sets that go with combining composite skins and titanium structures.

So assuming that Boeing had a from rate 3% to 4% to 4% to 5% and then I think, higher than that in 2024 and assuming they get close to the 10 or maybe by then, we'll be feeling a lot more optimistic because I think fundamental demand is above rate 10. And similarly for the A350, that's going to go up to at least 9 a month, I think, to meet market demand. All that is really healthy for our titanium business. And I'm expecting not just the more, I'll say, straightforward sheet and plate, but also some of the forgings, which we are able to bring to bear for that. And so it's an optimism for that.

And again, if everything that we see as potentially could happen by way of volume, wide-body mix, then our structures margins, and I have commented that I do see moving towards the high teens the -- as you move to the middle or second part of the decade, everything is there for us to do. And now just got to make it, the demand is not the issue, neither for what we've won from the titanium opportunity because of the VSMPO and tariff and restriction issues, but also the increasing demand from wide-body.

In terms of the increased, I'll say, sophistication that I referred to, yeah, that goes to shipset value. So as we move forward, the engine value for Howmet will increase as we move to supply the products for the changes required for the -- I'll say, the solution for the GTF issues for which we are -- the part we are playing in it, which is on the advantage engine and we'll see shipset value increase there. And similarly, for the improvements we're making on the LEAP.

As you know, normally in engines, while very long run items, we normally do upgrade about every five to six years. And so we had an upgrade plans with our customer, but the upgrades are, I'll say, a little bit more given the issues in terms of durability that have been found on, let's call it, the generation one parts of the turbine, not necessarily issues with our part per se, but because of basically as you drive the temperatures up because of -- and then shop last with particulates that got through. And those are problems which require even enhanced solutions to be able to improve time on wing.

Robert Spingarn

Thanks, John.

John Plant

Thank you.

Operator

The next question is from Myles Walton of Wolfe Research. Please go ahead.

Myles Walton

Thanks. Good morning. Hey, John.

John Plant

Hi, Myles.

Myles Walton

I know the guidance raise on sales, you gave some color, but I was hoping you'd put a finer point on it. The $190 million did you imply as maybe $40 million or $50 million add back on wheels, a little bit on industrial and the bulk from aero, is that the way to think about the $190 million?

John Plant

I didn't really break it down. I think my aggregate feeling is we see commercial and the move the 737 rates, that's a positive assumption. Defense is proving quite robust and strong. I mean, that 17% on top of what we printed in Q1 is really strong. And we are beginning to see the early stages of the defense spares increases, in particular, I think as we go through into 2024 and 2025, we'll begin to see spares increases for F-35 as an example.

So defense has been really good for us. And I think we continue to see that. Wheels, we think, again, stronger than prior assumptions in Q3. Order books for 2023 are now closed. And so we're getting a much clearer picture for the final outcomes for the 2023 order book close out. And the truck manufacturers have not even opened the order book yet for 2024. So we haven't got a read on that. We're hoping that they're robust. But my guesstimated picture is there'll be in the coming, let's say, 12 months, there'll be some weakness in the trailer market, some distribution and relative strength in the

European truck market and possibly some weakness in the North American truck market. But in aggregate, slightly better than I previously anticipated.

Myles Walton

And just a quick one on the structures bottleneck. It's good to have the assumptions that are conservative and not counting on the OEMs coming through the purchase orders. But was the bottleneck in any way a result of some hesitation to go up in rates and having to quickly than.

A – John Plant

No.

Myles Walton

Okay.

A – John Plant

No, we added people. We're adding more people. So we're optimistic that the -- everything we got a wish for by way of, I'll say, volume requirements for our customers are there. We added the people. We spent money to increase furnace capacity as an example, moving to triple sticks and double stick furnaces. We added some additional automation in what we thought we're improving our, I'll say, rolling mill capacity and throughputs. And as I said, it didn't work out.

And so I just accept that sometimes in life, things don't go exactly as planned. I said, yes, we face planted. But at least we know it and don't pretend we didn't do it, and now it's for us to stand up and do it. It's not a volume issue. It's not a demand issue. It's just -- we've got to make the stuff. And we're expecting to do so in Q3. But I guess every management says that we think we're going to do better. I mean it's always better in the future than the past. But Q2 for that business, we cannot be proud. That's for sure.

Myles Walton

Thanks for the color.

A – John Plant

Thank you.

Operator: Thank you. The next question is from Kristine Liwag of Morgan Stanley. Please go ahead.

Kristine Liwag

Hey. Good morning, guys.

A – John Plant

Hey, Kristine.

Kristine Liwag

John, on the issue that you called out on Engineered Structures, can you just provide more specific details on what caused the plant bottleneck? And then how do we think about recovery? And the other part to that would be depending on what the problem actually is, is there a risk that we could see this spread to the other segments? Like how do we think about all that?

A – John Plant

Well, first of all, absolutely no risk spreading to other segments. It was totally inside 1 segment, inside 1 plant. It's not like a disease, it's not contagious. It's just ease for that thing at a plant. I've sort of done my best to dance around every question on this topic. And as I think it's probably getting excessive airtime for what is like irrelevant in the total results of Howmet and what we achieved, which we already exceeded everything that we said we're going to achieve. But it does come down to -- there's a huge sequencing process within -- to make titanium and in one of the early stages of that, of that process, our work in progress, buffers broke down and we ended up with the labor. We recruited I'll say standing idle. The equipment wasn't working. And then subsequently we starved every subsequent process during the course of the three months. And so we believe we've got things back on track. I just detailed, there's like an analysis going into recently, again, we rereviewing it once again last week, which is my scrutiny of every work in progress, a buffer of every important production stage for that particular product.

And so in terms of daylight being the bestest infectant and a high degree of engagement by the plant management, the head of operations, the business unit leadership -- and then for me to be scrutinizing, I'll say, work-in-progress buffers for each of their production stages, that's a pretty high level of scrutiny for something, which, again, while it's worthy of comment if that were to get too carried away about.

So, I'm hopeful it's going to respond. If it's brute force alone, it will respond. and hopefully, with a bit of sophistication as well, we might make some improvements this quarter.

Kristine Liwag

Thanks John. That's really helpful color. I mean it sounds like a very isolated issue for that specific segment. In terms of the recovery pace, like how long does this issue like this usually get resolved, like by 4Q? Is this largely resolved in your back to where you were for margins like last quarter, it was 400 to 500 basis points higher. How should we think about that pace of recovery?

John Plant

Yes, I don't want to give segment commentary. But I'd be upset if we're not doing at least 10% to 15% improved volume in Q3 in that business. And assuming we do that, then we'll see a large restoration of margin because we'd work long and hard to establish that 14% as the -- let's call it, the line for that business and held it no matter what was thrown at us by way of F-35 bulkheads, 787 drop into nothing and through thick and thin, we've done it.

And then as soon as we got the volume to do what we did was not good. But at least I just think it's best to be straightforward about it and say, we didn't do good. We know what we've got to do. Everybody knows what they're going to do. And we've tracked long and hard to make sure that we succeed and make substantial improvement in Q3 and then we play it again and more in Q4.

Kristine Liwag

I really appreciate the detail you provided John. Thanks.

John Plant

Thank you.

Operator

The next question is from Gautam Khanna of Cowen. Please go ahead.

Gautam Khanna

Hey good morning. Thanks guys.

John Plant

Hey Gautam.

Gautam Khanna

I wanted to follow-up, I think it was Sheila's question. Just directionally, looking at next year, in the past, you've opined on incremental margin potential, given you've already done a lot of hiring and incrementally, that's not as big of a headwind as those people get more productive and the like.

And then the crosscurrents of Forged Wheels and what have you, do you have the same confidence in the 30% to 40% incrementals next year that you did kind of heading into this year? One that you opined on that?

John Plant

It's pretty, I'll say, soon to be imagining 2024 and so we don't make comment much on 2024. I suspect that I'll give you some sort of demand outlook when we get to November time and give Q3 results. We've done that the last couple of years. And I think the most interesting question for, I'll say, when we deliver our Q3 results and decide about giving some color for 2024 is like do we achieve of 2019 levels of revenue? That's the most interesting question.

And bear in mind, as we all know, is that there's a significant mix drag because it's not all things being equal, it's going to be all things being unequal where wide-body will be, let's say, I don't know, a couple of hundred planes down and narrow-body might be a couple of hundred planes up, and that's probably getting towards $0.5 billion revenue drag.

But can we overcome all of that with all the stuff we've been talking about in terms of, I'll say, content, price, just driving through and improving our shares and all the rest of it? And so that, for me, is the most interesting question about 2024 is that do we get there. And therefore, it will be like a whole year early, I'll say, fascinating.

Of course, I'm asking the question. I'm not giving you the answer because it's too early. In terms of margins, 35% plus or minus 5% was appropriate for when we were talking that clearly in -- I think it was in 2021 to 2022. And I'll say heading that way, maybe it's more like a 30% plus or minus for 2023.

Again, too early to say and it's going to depend upon hopefully seeing positive volume, combine that with productivity coming through from a more stable workforce and having really I'll say bore down on that problem, which for me turning like 25% of the problem belongs in the whole recruitment retention and the rest is just in fundamental productivity of the workforce as some of our parts are so sophisticated that the trading times are elevated, and therefore, we should start to see some of the benefits come through on that add together with the wide-body demand. So, a lot of moving parts, Gautam.

But at the moment, I think it's more like a 30% plus or minus range around it, but I don't know that yet. I mean that's no more than me thinking directionally where are we, without any benefit of any detailed financial analysis, and therefore, it's just talking with you.

Gautam Khanna

I appreciate that. And just as part of that, how do you think pricing changes year-to-year, just

John Plant

We haven't told you Q2 yet. Nobody's asked the question, but Q2, everything was in line with what we've said before and the year is in line with what we said before in our Q will be published this afternoon, and you'll be able to see it.

And so everything is in order on that front. 2023 now is essentially completed for negotiations. So, again, all in order, and 2024 is coming rapidly into focus and commensurate with what I said on the last call is that 2024 is going to be similar and good, it's similar and good.

Gautam Khanna

Thank you, John. Appreciate it.

John Plant

Thank you.

Operator

The next question is from Ronald Epstein of Bank of America. Please go ahead.

Ronald Epstein

Hey, good morning guys. So, I think pretty much everything has been asked. So maybe just a quick follow-on here. When rates actually get to 38 or maybe way down the road, they get to 50 or higher on 737s, how should we think about the evolution of incrementals then? Because I think that's on the top of a lot of investors' minds because it can help draw out the trajectory of where earnings and cash flow for the company could ultimately go as the ramp goes?

John Plant

Yes. I think the most difficult thing that we've -- ultimately, if you look through all the issues we faced of stop start, stop start, supply chain, labor, COVID -- all post-COVID and all those things that have -- if they tested us over the last, let's say, two or three years, then I think when I bring it right down to how do we now see it as we've grappled each one of them that fundamental labor productivity has probably been the most difficult for us in what's -- parts of our business have extremely high learning curves and to stabilize that, deliver good quality to our customers, which is paramount we're trying very hard on that front.

And to meet schedule. And I think that we've heard very little from the industry about any inability to Howmet not to meet customers' needs. So thing that labor productivity into place, seeing everything smooth out. And I'm hopeful that as Boeing moves towards achieving the 737 at rate 50, as Airbus move from the, let's call it, early 50s through to something towards rate 75 is that that's going to help smooth out things and will be in a much improved condition to deliver at a higher productive level.

Similarly with the wide-body increases. So I've used a phrase which I'm not sure how apt it really is, but call it state of Grace. I do see that maybe as we move into the second half of 2024. We get close to that state of grace where productivity is smoothed out, production volumes increasing, content increasing, pricing in the right shape.

And so then we begin to print optimal margins and cash flow and hopefully just continue to then improve as a further rate increase in 2025 and 2026. So everything tells me we should be fundamentally optimistic. At the same time, we've currently got issues to overcome, of which I think that labor is used -- is the most -- been the most protracted.