

# **Woodward, Inc. (WWD) Q3 2024 Earnings Call Transcript**

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**Body**

Woodward, Inc. (WWD)

Q3 2024 Earnings Conference Call

July 29, 2024 4:30 PM ET

Company Participants

Dan Provaznik - Director, Investor Relations

Chip Blankenship - Chairman of the Board and Chief Executive Officer

Bill Lacey - Executive Vice President and Chief Financial Officer

Conference Call Participants

Scott Mikus - Melius Research

Scott Deuschle - Deutsche Bank

Pete Skibitski - Alembic Global

David Strauss - Barclays

Gavin Parsons - UBS

Sheila Kahyaoglu - Jefferies

Louis Raffetto - Wolfe Research

Michael Ciarmoli - Truist Securities

Gautam Khanna - TD Cowen

Noah Poponak - Goldman Sachs

Presentation

Operator

Thank you for standing by. Welcome to the Woodward Inc. Third Quarter Fiscal Year 2024 Earnings Call. At this time, I would like to inform you that this call is being recorded for rebroadcast and that all participants are in a listen-only mode. Following the presentation, you are invited to participate in a question-and-answer session.

Joining us today from the company are Chip Blankenship, Chairman and Chief Executive Officer; Bill Lacey, Chief Financial Officer; and Dan Provaznik, Director of Investor Relations.

I would now like to turn the call over to Dan Provaznik.

Dan Provaznik

Thank you, operator. I would like to welcome all of you to Woodward's third quarter fiscal year 2024 earnings call.

In today's call, Chip will comment on our strategies and related markets. Bill will then discuss our financial results as outlined in our earnings release. At the end of the presentation, we will take questions.

For those who have not seen today's earnings release, you can find it on our website at woodward.com. We have again included some presentation materials to go along with today's call that are also accessible on our website.

An audio replay of this call will be available by phone or our website through August 13th, 2024. All reference to years in tis call are reference to the company's fiscal year unless otherwise noted.

Now, I would like to highlight our cautionary statement as shown on Slide 2. As always, elements of this presentation are forward-looking and based on our current outlook and assumptions for the global economy and our businesses more specifically. Those elements can and do frequently change.

Our forward-looking statements are subject to a number of risks and uncertainties surrounding those elements, including the risks we identify in our filings with the SEC. These statements are made as of today and we do not intend to update them except as required by law.

In addition, Woodward is providing certain non-U.S. GAAP financial measures. We direct your attention to the reconciliations of non-U.S. GAAP financial measures, which are included in today's slide presentation and our earnings release and related schedules. We believe this additional financial information will help in understanding our results.

Now, I will turn the call over to Chip.

Chip Blankenship

Thank you, Dan and good afternoon, everyone. As you may recall, we shared our three interconnected value drivers of growth, operational excellence, and innovation at our Investor Day last December. Before we begin our discussion on financial performance, I would like to share some highlights on the topic of innovation. Designing precise energy and motion control solutions within our customers' complex and challenging product environment is in our DNA, as our current product offerings demonstrate. In fact, it is our purpose to design and deliver energy control solutions our partners count on to power a clean future. We are building on the innovations of our predecessors with a technology roadmap that aligns our purpose and our growth strategy with evolving customer requirements for their next generation platforms.

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This active engagement ensures we can meet the current and future needs of the end markets we serve. Today, I will share some of our R&D and new product development investments that are helping prepare Woodward and our customers for the future. I will start with some recent news. During the Farnborough International Air Show last week, we announced that Boeing selected Woodward to design and manufacture advanced low-profile hydraulic controls for thin-wing applications on its transonic, Truss-braced wing demonstrator, now dubbed the X 66, thankfully.

This project is a collaboration between Boeing and NASA that pioneers a low-drag configuration to reduce fuel burn and emissions. It has the potential to revolutionize single-aisle aircraft design. Woodward has demonstrated concepts that will enable precision motion control and feedback for actuation of control surfaces, yet fit within the envelope of this advanced wing design. Another area where Woodward has invested and achieved leading technical maturity is component design and materials compatibility for control systems delivering alternate fuels known as Power-to- X or P2X.

P2X fuels such as hydrogen, ammonia, and methanol are being evaluated for various applications. These alternative fuels have potential to contribute toward the ambitious carbon reduction targets in aviation, transportation, and power generation driven by changing regulations and the global quest for a cleaner future. Alternative gas and liquid fuels pose new challenges from a materials durability standpoint. Woodward has invested in significant compatibility testing and analysis to develop robust materials selection criteria as each new fuel is identified by customers for specific applications. We have established a state-of-the-art P2X Research Center in Stuttgart, Germany where we're testing hydrogen compatible components for the Airbus Zero-E hydrogen powered aircraft demonstrator. Another one of our newer and very exciting programs is an advanced fuel control system for the next generation of aircraft engines.

To achieve the fuel burn reduction targets for an open fan, or an ultra-high bypass ratio ducted engine, the core will have to be quite small. And the temperature inside the core compartment will be significantly higher than previous engines. To meet the reduced core compartment volume and corresponding fuel system envelope, we've designed and manufactured housings using additive technology to achieve more than 50% reduction in weight and volume compared to current fuel systems in service. In addition, we're developing high temperature, robust electrical and servo hydraulic components designed to deliver motion control and position sensing in this demanding environment. We're currently demonstrating technology that allows 10x better confidence in fuel flow accuracy for combustion management. This will enable our customers to optimize the core size to the mission, delivering substantial improvements in fuel burn. I'm confident that our technology and product roadmaps are on track to maintain Woodward's competitive edge through further innovation and alignment with our customers' evolving requirements.

Moving to our markets, in Aerospace, strong commercial, domestic, and international passenger traffic continues. Though as you heard in recent earnings calls, some airlines discussed over capacity in the US domestic market and lower yields, which they believe to be short term in nature. While the macro environment remains strong, as you heard from other companies, the players in the supply chain from aircraft OEM down to the raw material supplier, and all the tiers in between are not yet performing in synchronization. With that in mind, I'd like to update you on two lines of effort Woodward launched in 2022 to help our supply chain recover. We deployed resources to suppliers that were struggling, and we have invested in rapid complex machining centers to offload suppliers and give them a faster path to recovery.

We continue to run our tiered escalation management system that I described in detail previously. And we currently have engineers and operations experts forward deployed to support suppliers that are impacting or likely to impact our build rates. We have seen numerous suppliers graduate from this list, but we have seen new ones enter the list as well. We will continue to invest resources to collaborate with our suppliers with a goal of taking action sooner and solving problems before they impact build rates. We continue to reap benefits from our investment in rapid complex machining centers as we have temporarily in-sourced thousands of parts to allow suppliers breathing room to recover. We have invested in additional machines this year to provide even more capability and flexibility.

There is a third line of effort, our lean transformation, where we're focused on reducing lead times and improving flow. This most basic body of work is delivering benefits associated with efficiency, but also flexibility and resilience. Back to the bigger picture, the lack of synchronization across the aerospace supply chain is creating part shortages from struggling suppliers and a build-up of inventory from those that can perform. We detect that our inventory is building in the system, and we are monitoring progress and communicating with our customers as we want to manage smooth flow through our operations and offer the same opportunity to our suppliers. We are working together as an industry to better align production and support each other on a path to smoother, connected flow. Aerospace aftermarket activity remains healthy due to continued high utilization, and in particular, high utilization of legacy aircraft and engines that is resulting in additional shop visits and repair activity with a longer horizon than we would have predicted just a few years ago. Overall, we continue to be pleased with the outlook of our Aerospace business.

In Industrial, rising global power demand is driving increased investment in gas-fired power generation. We are also seeing increased demand for more efficient, lower emission, and alternative fuel-ready installations to support grid stability. Data centers and associated demand for backup power are forecast to grow sharply, driven by increasing artificial intelligence and other computing demands.

In Transportation, the marine market remains healthy, with elevated ship-build rates driving OEM engine demand and high utilization rates fueling current and future aftermarket activity. Demand for alternative fuels across the marine industry continues to increase. Demand for heavy-duty trucks in China softened to this quarter. However, industry data indicate that natural gas engines are taking share from diesel engines in heavy-duty truck applications in China. Discussions with our customers revealed elevated inventory levels, and they expect to cycle through their stock in the near term. This resulted in lower China on highway orders for Q4, and we've revised our full year Industrial Sales Guidance accordingly, which Bill will go through in his section.

Regarding oil and gas markets, U.S. natural gas production continues to be pressured by low gas prices, although global demand for natural gas infrastructure remains strong. Positive sentiment in the space is driven by strong performance and outlook in domestic shale oil as well as refining and petrochemical activities in China, the Middle East, and India.

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In summary, I would like to thank our members for their hard work and dedication to serving customers and improving our business results. We are on track for a solid year with sales growth of 12%, 200 basis points of margin expansion, and generating approximately $90 million of incremental free cash flow. Overall, we are well positioned to capitalize on the robust demand across our end markets, and we remain focused on profitable growth, operational excellence, and innovation to maximize shareholder value.

I'll now turn it over to Bill to share our financial results.

Bill Lacey

Thank you, Chip, and good afternoon, everyone. As a reminder, all comparisons are year-over-year unless otherwise stated. Net sales for the third quarter of 2024 were $848 million, an increase of 6%. Earnings per share for the third quarter of 2024 were $1.63 compared to earnings per share of $1.37. Aerospace segment sales for the third quarter of 2024 were $518 million compared to $481 million, an increase of 8%. Commercial OEM sales were up 2%, and commercial aftermarket sales were up 19%. Defense OEM sales were down 4%, while the since aftermarket was up 22%. Overall, aftermarket sales were supported by higher aircraft utilization.

Aerospace segment earnings for the third quarter of 2024 were $102 million, or 19.7% of segment sales compared to $83 million or 17.3% of segment sales. The increase in segment earnings was a result of price utilization in higher aftermarket volumes, which were partially offset by inflation.

Turning to Industrial, Industrial segment sales for the third quarter of 2024 were $330 million compared to $320 million, an increase of 3%. Industrial segment sales growth moderated year-over-year as expected due to relatively flat China on-highway sales.

The increase in industrial sales was primarily driven by an 8% increase in power generation and a 3% increase in transportation, partially offset by a 6% decrease in oil and gas.

China on-highway sales were flat compared to the prior year at approximately $55 million and we are down sequentially. As Chip referenced earlier, we are expecting further declines in the fourth quarter with sales in the range of $10 million to $15 million. At this depressed level of sales, the business delivers negative margins. Industrial segment earnings for the third quarter of 2024 were $60 million or 18.1% of segment sales compared to $58 million or $18.2% of segment sales. Industrial earnings remained relatively flat as a result of price realization, which was largely offset set by inflation and unfavorable mix. Excluding the impact of China on-highway natural gas truck business, Industrial segment margins continue to be strong at approximately 14%. Non-segment expenses were $30 million for the third quarter of 2024 compared to $24 million.

At the Woodward level, R&D for the third quarter of 2024 was $39 million or 4.6% of sales compared to $35 million or 4.4% of sales. SG&A for the third quarter of 2024 was $74 million or 8.7% of sales compared to $65 million or 8.1% of sales. The effective tax rate was 16.4% for the third quarter of 2024 compared to 20%.

Looking at cash flows, net cash provided by operating activities for the first nine months of 2024 was $297 million compared to $156 million. Capital expenditures were $72 million for the first nine months of 2024 compared to $57 million. Free cash flow was $225 million for the first nine months of 2024 compared to $98 million. Adjusted free cash flow for the first nine months of 2024 was $239 million compared to $103 million. The increase in free cash flow and adjusted free cash flow was primarily due to increased earnings and improved working capital partially offset by higher capital expenditures. Leverage was 1.5x EBITDA at the end of the third quarter. During the first nine months of 2024, we returned $348 million to the stockholders in the form of $43 million of dividends and $305 million of share repurchases.

Turning to our 2024 guidance, we are revising certain aspects of our full year 2024 guidance to better align expectations with the current environment. We're lowering the industrial sales growth range based on our visibility into the fourth quarter orders for the China on-highway natural gas truck fuel systems. The reduced China on-highway deliveries coupled with the dynamic supply chain environment that Chip referenced earlier are leading us to return to our original fiscal year 2024 guidance for free cash flow. Supply chain disruptions such as late supplier deliveries and customer pushouts will likely extend the timing to collect cash on planned deliveries outside the fiscal year 2024 year end. We remain confident that we can deliver on the revenue range for Aerospace in spite of these supply chain issues.

Total net sales for 2024 are now expected to be between $3.25 billion and $3.3 billion. For 2024, Aerospace sales growth is still expected to be 12% to 14% and segment earnings are now expected to be approximately 19% of sales, the high end of our previous range. For 2024, we now expect Industrial sales growth to be 11% to 13% and segment earnings are now expected to be approximately 17.5% of segment sales. At the Woodward level, the adjusted effective tax rate is now expected to be approximately 18.5%. We now expect adjusted free cash flow to be between $300 million and $350 million. Capital expenditures are still expected to be approximately $100 million. Adjusting earnings per share is now expected to be between $5.80 and $6 based on approximately 62 million fully downloaded weighted average shares outstanding. To reiterate Chip's earlier comment, we are on track for a solid year with year-over-year sales growth, expanded margins, and strong free cash flow generation. This concludes our comments on the business and results for the third quarter 2024.

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Operator, we are now ready to open the call to questions.

Question-and-Answer Session

Operator

[Operator Instructions]

Our first question comes from Scott Mikus with Melius Research

Scott Mikus

Good evening. Chip, Bill, you flagged airlines talking about having too much capacity in the market, especially in the U.S. domestic market. At the same time, GE Aerospace reported a 1.3 book-to-bill for its commercial aftermarket. I know orders can be lumpy, but can you give us any color on how your commercial aftermarket bookings have been book-to-bill of one either in the quarter or year-to-date?

Bill Lacey

So we don't really advertise our book-to-bill on our aftermarket, but it's strong intake incoming and strong outgoing. As you saw in our results this quarter, it was up 19% on commercial aftermarket. I think the capacity comments are just a little bit of cautionary tale about I think the numbers were, the industry delivered 8% new capacity to the U.S. domestic market and the passenger traffic grew 4%. So it's not a big mismatch. It's small, but it's just a little bit of cautionary that the growth rate might be a little bit slower. I don't think it impacts deliveries or anything of that nature. Utilization is still quite high, just sort of trying to stay consistent with all the news we're hearing in the marketplace.

Scott Mikus

Okay, and then in late May, Boeing received a $7.5 million order for JDAM tail kits and other components. So are you starting to see orders in support of that contract, and could any of that translate to defense revenue this year, or is it more of a fiscal '25 thing?

Chip Blankenship

Well, it's getting late in our fiscal year, as you know, and these requirements take a while to flow down. We are in discussions with Boeing and other parts of the supply chain for potential increased rates, but nothing has been firmed up yet for us.

Operator

Our next question comes from Scott Deuschle with Deutsche Bank.

Scott Deuschle

Good afternoon. Bill, can you clarify how much money the China natural gas truck business is assumed to lose in the fourth quarter?

Bill Lacey

Yes. As we talked about, Scott, we do expect that at the level of 10 to 15 of revenue that it goes from a position where it is a negative impact from a margin standpoint. I won't go into the exact detail of what that is to quantify it, but it is, as you can see, a drag on our business. This is as we have discussed and kind of how we continue to characterize the OH business as being very volatile. And so not surprised that we are here this quarter, given the volatility, but yes, it does drag our margins down on our industrial segment.

Chip Blankenship

I think the good news, though, to be the glass half full, the good news on the industrial side is that we believe our non-China OH business will be in the 14% range, so we are feeling good about our ability to execute in the rest of the business.

Scott Deuschle

I thought the original guidance had assumed that you would have 90 days of visibility so you could guide with a solid forward quarter, but you had always assumed kind of that the fourth quarter wouldn't really have much in there. So I'm a bit surprised by the guidance reduction on this because I had always thought that this is already not assumed. So can you help me just understand that?

Bill Lacey

Yes, we were thinking that we were going to be more in the breakeven zone of maybe 50% more to 2x this amount of business in the fourth quarter. And so like we've said before, we have a one quarter visibility, and so this is our visibility in the fourth quarter. We got a little bit more in third quarter than we were thinking we'd get, and we're getting less in the fourth quarter. Maybe we'll get more in the first quarter of '25, it's just hard to say. We do like this business, it's a strong margin, it's good technology, it's a good application. It's just lumpy and hard to see, so our focus is to be prepared to deliver efficiently and make the money when the opportunity is right and try to get through these tough recorders.

Scott Deuschle

Okay. And then, Bill, your purchased, it looks like $300 million of stock in the quarter, but the share count was actually up sequentially and you didn't change the guide on share count. Can you help me understand that? Thanks.

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Bill Lacey

Yes, we still think that that guide is in the range and we felt that the 62 million shares for now is an appropriate guide for the year.

Scott Deuschle

So the $300 million of buybacks in the quarter, what impact does that have on the share count, if any?

Bill Lacey

Yes, it does help us to, again, stay in that -- stay in the range of our guide of the 62 million. As Chip mentioned last quarter, we were going to look to prioritize the share repurchases in line with the $600 million program that we kicked off at the beginning of the calendar year. And so, and as you know, our plan is to offset dilution, and this will help us to do that.

Scott Deuschle

So are you issuing $300 million of stock? I just, I don't understand how the math works.

Chip Blankenship

There's a dilution associated with compensation programs and exercises of options and things of that nature that we offset with the purchase of these shares.

Operator

Our next question comes from Pete Skibitski with Alembic Global.

Pete Skibitski

Yes, good afternoon, guys. Just wanted to talk more about industrial on the revenue side, I guess. Is net pricing becoming a little more challenging in certain niches in industrial?

Chip Blankenship

Well, I don't know about niches. I think pricing in general is going to be a little bit more challenging across the board as inflation tends to moderate a bit. But we've got, we have opportunities with strategic pricing of our catalogs. We have still a few more longer-term LTAs to come later in this year and into FY25 that will provide us some opportunities for business that has been not adjusted for inflation over the past. So there's still some opportunities to go. And we're focused on also cranking up the cost reduction machine and productivity to make sure that the margin expansion continues throughout the next couple of years.

Pete Skibitski

Okay. And then it looks like oil and gas was down for the second quarter in a row, which I think everyone kind of understands that. On the power gen side, are we kind of, it seems like we're lapping easier comps. Are we getting now to more of a steady state rate where maybe you can grow like, I don't know, two times GDP in power gen? Is that kind of a good kind of estimate for that area, or would you add anything to that?

Chip Blankenship

I think in the short term, medium term, what you just quoted as a logic comparison works for me. I think longer term, I think we still might be facing into a good news story of a natural gas renaissance. Maybe if you listen to some of the other OEM manufacturers for gas turbines, you might get more color there. But if I do the math on the gigawatts per year required, especially in this computing environment and grid stability, we have to add more natural gas to the grid in the U.S. and abroad. So I think that especially gas turbine power generation is looking good for the future.

Operator

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

David Strauss

Thanks. Good evening, everyone. Hey, Chip. Just trying to put a finer point on industrial as we think about modeling this business into '25. It looks like you're applying an exit rate of somewhere around $300 million a quarter in sales and 13% margin. You talked about 14x, the China on-highway. I mean, is $300 million a quarter and 13% margin is the right way to model this next year, or should we be thinking differently about it?

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Chip Blankenship

Well, as you know, we're probably not quite ready to talk about FY25 guidance. We like the industrial businesses that we're in, whether it's standby power and marine and the reciprocating engine business, or it's the right kind of valving and important fuel control systems for gas turbines. We think all of those are growing markets to some extent, though, as you may have noted and others, that the comps are getting a little harder to show large growth. But we think that small to medium growth is still available. And so as we get closer to FY25, we'll try and quantify that for you.

David Strauss

Okay. Bill, would you mind breaking out the volume and price or at least price that you year-over-years in aero and industrial?

Bill Lacey

Yes, we don't typically get into that level at the segment level, but at the Woodward level we saw about 7% of price come through in Q3.

Operator

Our next question comes from the line of Gavin Parsons with UBS.

Gavin Parsons

Thanks guys. Good afternoon. Did you guys actually raise EBIT guidance this quarter of segments.

Bill Lacey

We, basically, at the segment level for our margin guide at an industrial, we went from a range to 17.5% approximately, and we took our aero guidance from a range of 18% to 19% to approximately 19% which is at the top end of the guide, of the previous guide.

Gavin Parsons

The net of those two is higher, is that offset by higher corporate or does that drop through the EPS?

Bill Lacey

On the EPS guide, we took the bottom end from $5.70 up to $5.80 to $6, so it does move the midpoint.

Chip Blankenship

If you're just playing the midpoint, math, then the short answer is yes, but to Bill's point, we're just trying to put a finer point on what we see for the rest of the year since we're that close to the final answer. Did that get it, Kevin?

Chip Blankenship

Did that get for you?

Gavin Parsons

I appreciate it. And then just on aerospace OE, you guys kind of talked about channel inventory building. You grew sequentially still there. I know you don't want to talk about '25 yet, but have you actually seen any change in demand signals from your customers, and then how are you thinking about managing your '25 to ensure there isn't too much inventory in the channel? Thank you.

Chip Blankenship

Right. So we do have signals from different players in the tiers of the supply chain. So we're trying not to read too much into the different signals. We've had some pushouts as people try to rebalance their inventories as well in the supply chain. So we've seen a little bit of that, but we've seen no official overarching change to rates. And we're just trying to manage it well and stay in communication and not build too much of our own finished goods, but make sure we can respond if the pull increases.

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Operator

Our next question comes from the line of Sheila Kahyaoglu with Jefferies.

Sheila Kahyaoglu

Hi, Chip and Bill. Thank you so much. So first on industrial. Just trying to understand the profitability of that business. If we look at the CNG business, I think in prior quarters, you had said it operated pretty inventory-like, suggesting it was book and ship and low cost space on the fixed costs and so how do we think about it going from 40% up margins at $50 million of revenue to breakeven at $25 million and loss making it at $10 million to $15 million of revenue? It seems like it's a 40% operating loss, given the rest of the segment is operating at 14%. So why does the business swing so much? Is it customer or what is it?

Chip Blankenship

Well, it's volume and fixed cost and that's what the math says, Sheila, that we're sensitive to the amount of volume and it, it can swing pretty dramatically.

Sheila Kahyaoglu

Okay, so it's not based on a certain customer and pricing down for that customer just the volume goes and it's very volatile. And then maybe if I could ask about aero again in terms of inventory, I feel like this is what we've been waiting for with others in the supply chain, but nobody's really felt the impact of it. So I guess, do you think this is more to come in terms of inventory? Where are you seeing it most in the supply chain? And then is it fair to say that the aftermarket offset lower OE, hence the margin raises in aerospace?

Chip Blankenship

I didn't get that last part of the question, Sheila.

Sheila Kahyaoglu

Is it fair to say that stronger aftermarket was better and that's what led to higher margins in aero versus the lower OE?

Chip Blankenship

Yes, certainly, Sheila. We had a mixed effect of aftermarket versus OE that helped the aerospace margins. So as far as inventory impact, just to answer your question on inventory build, so it's value stream specific and it's customer specific to that we're seeing some of the builds in the inventory. So, like I said, we're not overreacting in any way. We just want everyone to know that we're paying really close attention to it. We're communicating with our customers and something we're going to pay a lot of attention to as we figure out what FY25 looks like.

Operator

Our next question comes from the line of Louis Raffetto with Wolfe Research.

Louis Raffetto

Good evening. Thanks, guys. So I guess I want to go back to the industrial guide because I'm still a little confused. So you originally guided third quarter CNG to be $35 million to $40 million, and I guess you kind of had this implied $20 million to $30 million in your model for the full year. So back half of the year, you're talking $55 million to $70 million. You did, I think you said $55 million in the third quarter, and now you're looking for $10 million to $15 million. So that's still the same amount of channel natural gas in the second half of the year. So I'm just trying to understand the lower industrial guide. Is it China natural gas or is it something else?

Bill Lacey

Louis, the way I see it is that for the second half, we are actually lower than what we expected. Again, we planned that fourth quarter roughly at, we plan the quarters roughly at sort of that 30, at that level where we don't distort industrial margin rates. So that's what we had for a third quarter, did come in a little bit stronger, but in the fourth quarter, it's actually lower than what we expected. So those two things together, our second half, is less on a China OH standpoint.

Louis Raffetto

Okay. Maybe just on the nonoperating expense, it looks like you're tracking towards maybe 3.5% or even above that. I think you'd previously maybe last year sort of marked that as 3% and 3.5%. I mean, should you think of that as being on a sort of go-forward basis at the high end of that from now on?

Bill Lacey

Yes, it came in around 3.4%. And it's there to support our infrastructure investment, infrastructure to support growth. And we expect it to be around that 3% -3.5%. And we'll update that as we get into our '24 guide.

Louis Raffetto

All right. And then just one last one, just to be clear, I guess one of the reasons the commercial OE growth was relatively speaking, low was since you had a really tough comp. And so, I mean, is it fair to expect we should see acceleration growth into the fourth quarter?

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Bill Lacey

Yes, you're right. 3Q last year, we saw the certification of the RBV, which did, we had inventory, so that did give us a strong quarter last year in commercial OE. And so that is something that we're combating. And we'll continue to see how that work.

Chip Blankenship

Yes, I'd also add that there's a chance for that acceleration, but there's as many things, as many headwinds to that on the supply chain and the customer inventory that we just need to be moderate in our view about what is likely to happen so it could be more but it but we feel confident about the range we've said about the aerospace revenue levels and growth levels for the year based on that.

Operator

Our next question comes from the line of Michael Ciarmoli with Truist Securities.

Michael Ciarmoli

Hey, good evening, guys. Thanks for taking the questions. Just on the aerospace segment and the margins I guess you're going to get some nice lift again in the fourth quarter but the implied margins are going to be down sequentially. And I guess just even bigger picture pre-COVID at this revenue run rate you guys were north at 20% on a less favorable aftermarket OE mix. I mean, you were probably just a shade over a third of the revenues at aftermarket for defense and commercial. And now you're probably running at 45%. I mean, what's holding you back from getting these margins higher, just, I mean, we probably can sit here and say this aftermarket's not going to be sustainable. So just, I know you're not going to give guidance, but that longer term forecast you have is 20% to 22% margins. So is there anything holding back the aero margins right now from getting back to those pre-COVID peaks?

Chip Blankenship

Let me just clarify something that you said about guiding the margins down next quarter. When we give our range of approximate 19% range, that does not indicate that we're going to be sequentially down next quarter based on our year-to-date margin achieved. So just to clarify that, we're not going down in aerospace margin. Next part of the question is really like, what's holding us back? We are starting to enter the realm of the ability to generate productivity based on all the new members we've hired and brought up to speed. And our lean transformation is taken hold and we're getting better on those value stream lines that are under transformation. We incurred a lot of inflation into our supply chain costs that are working their way through. And we have worked hard to get some price to offset that.

So the factors that we've been working with in this sort of 17% to 19% profitability range over the last two years. And while we talked about our Investor Day guidance of 20% to 22 plus percent in the 2026 timeframe, we certainly feel confident that all of the productivity, automation, lean transformation, supply chain work, insourcing work to improve those margins from now to then those are activated programs and it's going to take time to get them all the way through to completion, certification and approval.

Michael Ciarmoli

Got it. And then just back to maybe Sheila's question on inventory. I mean, LEAP, I think GE was originally forecasting 20% to 25% growth for the year now, zero to five. I mean, that's if you have any line of sight into our actual units you've shipped? Were you originally building to that schedule? And can you give us any color maybe where your actual build rates are?

Chip Blankenship

Well, we work very closely with all of our customers, including the GE portion of CFM for LEAP. And we work together to provide all the hardware that they need to build engines and what inventory they want to be comfortable with to ensure that they can start engines on time. So we've been working with them on this program for a long time, and we've got a really good synchronization of what the long-term demand is, and working out what to do each month and each quarter, that's the ongoing real-time discussion.

Operator

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

Gautam Khanna

Hey, good afternoon, guys. To follow up on that last question, maybe asked a different way, are you guys actually a bottleneck or have you been, has your supply chain been relatively resilient in keeping up with the rates that were expected of the entire supply chain? And therefore we should be a little more cautious of how we calibrate 2025 OE rates or OE revenues.

Chip Blankenship

So in aerospace for just broadly speaking, in 2022, we were a problem in terms of trying to be on time and were we impacting customers? Yes, in 2022, we were impacting customers. But in the fiscal year 2024, we're not impacting customers with their build rates. We are not a bottleneck. We are not 90% on time in full like we'd like to be to their MRP systems, but certainly there are inventory -- there's inventory in front of build stations at our customers and we're largely on time is what I would say in the aerospace segment.

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Gautam Khanna

And have the OEMs or the subcontract manufacturers that you ship to communicated a revised purchase schedule from you guys or are you just kind of anticipating that might happen?

Chip Blankenship

Yes, so nothing official has been communicated from the very top though different parts of the sub tiers ask us to push out deliveries and slowdown and things of that nature to adjust to their inventory levels and that causes us to build up more finished goods. And that's what we're just saying here is that we're seeing some of that activity pick up as we start to not only be on time to their need, but be on time to their MRP system and maybe the MRP system's running a little hot.

Gautam Khanna

Got you. And then just to follow up on the guidance then, the guidance revision, so industrial was taken down the top line by whatever, 2% so $22 million - $ 23 million. Was that entirely due to the CNG on-highway stuff, which is a $7 million?

Chip Blankenship

That's correct.

Gautam Khanna

Okay, so that was a $7 million delta, it sounds like, in terms of operating profit?

Chip Blankenship

What some of, I think, what some of the confusion is that when we talk ranges and guidance and then we experience actuals we were setting those ranges based on our forecast for the best number we thought would be achieved. And so when we get the actuals for third quarter and we have the actual orders for fourth quarter we re-snap that line and we say we're down compared to what we expected in the last quarter's guidance. So we're going to adjust the midpoint to that and it's entirely due to China on-highway in this case.

Gautam Khanna

And given it's still a range on aero sales growth, I mean, do you have a, I mean, what's the variance in the range? Is it just level of destocking or do you have, I mean, you're one month into the quarter or so? I'm just curious, like, where would the variance be, if anywhere?

Chip Blankenship

The variance is a combination of customers that could, can push deliveries out and not accept things that are finished as well as suppliers that could cause one of our value streams to not produce as many units as the customer has ordered and we would like to deliver. So it's both sides of that equation can create the low end of that range and then on the high end of that range is that we don't have any supply chain issues standing in the way of deliveries and the customers will accept everything we can provide.

Gautam Khanna

Stepping back guys, I'm curious on how should we think about I mean how do you guys think about 2025 on-highway. Should we assume it's just breakeven through the year like what's your best guess given there's some destocking going on and Q4 levels may not be representative of the following quarters? What would you do?

Chip Blankenship

Well, I'll give you the standard answer that I give on China on-highway is that we can't predict more than a quarter because it's volatile. There are not natural market signals to help us triangulate a forecast. So it's so difficult to do that we've chosen not to do it and we've tried to help you with what our non-China on-highway industrial business capability is with that margin level of around 14% right now is where we're driving that business. And that's probably the best I can do for you right now.

Operator

Our next question comes from Noah Poponak with Goldman Sachs.

Noah Poponak

Hey, good evening, everyone. Chip, maybe there was some confusion around discussing industrial at 14% x China on-highway because if it's truly completely excluding x or China on-highway, that's then the loss making. So then it's some 14%. Is that correct? Or I guess to the last question, if we just took it out of the model next year, what do you think the industrial margins would look like?

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Chip Blankenship

Yes, I apologize for maybe some imprecise language I've used in the past, but if you think about China on-highway doing no harm to the industrial business, it's right now we're operating at 14% margin, which that means that there are enough China on-highway orders and deliveries to cover the fixed cost of that operation. So if it goes negative, then it's going to impact 14%, right.

Noah Poponak

Do you have a sense for where the breakeven is?

Chip Blankenship

Yes, we said in the past that the 35 to, well, we said in the past that $35 million to $40 million is no damage to the, no distortion to the industrial business. And I think we'll just stick with that for now.

Noah Poponak

Okay. Do you have a sense for how long it will take to clear out the inventory that's in the channel on China on-highway?

Chip Blankenship

We don't know for sure on that, Noah. Our customers are telling us that it's going to be a short-lived destocking, but we don't have a great view into that ourselves.

Noah Poponak

Okay.

Chip Blankenship

Just to clarify, Noah, on your question, maybe just to put a fine point on it, in the mid to low 20s, mid $20 million is the breakeven point for the China on-highway.

Noah Poponak

Right. the $35 million would be where it's making something close to the segment margin.

Chip Blankenship

Yes.

Noah Poponak

And then above that, I guess. Okay. Have you started to see LEAP shop visit aftermarket revenue come through? I mean, just the consolidated growth rate seems like no, but those seem to be starting to move along.

Chip Blankenship

Yes, I'm actually glad you asked that question, Noah. We've seen quite a nice increase in repair and overall from geared turbofan and LEAP with the geared turbofan fuel nozzles and maybe some other components, but mostly fuel nozzles. And then on LEAP FM, the fuel metering units, as well as pumps and some other valves and actuators coming through, but mostly pumps and fuel metering units. And that bodes well for the future because it has picked up, I'd say doubling year-over-year in that 1x to 2x, up a small number, but it's picking up.

Noah Poponak

Okay, good. And then just defense, the guided weapons was under pressure for a while, and then it kind of stabilized. And now I think there's been some order flow, but the revenue, I guess quarter-to-quarter hasn't quite sustainably picked up. Maybe, do you have a visibility to speak to just directionally what kind of OE and aftermarket growth rate you could see next year in defense?

Chip Blankenship

Well, we're not really ready to talk about FY25 in yet, Noah, but if you look at the trends, it looks like the defense market itself is growing. And we've stated our strategy is to try and grow our repair and overhaul participation in that market. That's one of our growth strategies for the aerospace business. There's a lot of opportunity there so, and we're excited about it. But we're not ready to quantify that.

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Operator

Our next question comes from Louis Raffetto wit Wolfe Research.

Louis Raffetto

Yes, thank you for the follow-up. Just wanted to be clear on this. So I guess we need to think about $100 million in China natural gas sales next year just to have 14% margins. Is that sort of what I just heard? If they're lower than that, you're going to have lower than 14% margins, if the higher, you're going to have higher than 14% margins.

Chip Blankenship

One thing to clarify, we didn't say what our industrial margins were going to be next year, so we don't intend to stand still on for one point. I don't know, Bill, if you want to talk about the China revenue.

Bill Lacey

Yes, I mean, I think as Chip mentioned, and as we talked about, the breakeven point is kind of what we just stated in terms of for '25 and what the China revenue is. Again, I don't think we're ready to get into that, but Chip's statement that our breakeven is in mid-20s, that just, again, to repeat it, that is the statement.

Louis Raffetto

And fair enough, I didn't mean to imply that you were guiding it for, I'm just taking the current sort of run rate that you've talked about for the last three quarters, but no, I appreciate it, thank you.

Operator

Mr. Blankenship, there are no further questions at this time. I will now turn the conference back to you.

Chip Blankenship

All right, thank you very much. I'd like to thank everybody for joining our earnings call today. Wish you well the rest of the week.

Operator

Ladies and gentlemen, that concludes our conference call today. If you would like to listen to a replay of this conference call, it will be available today at 7.30 p.m. Eastern Time by dialing 1-800-715-9871 for a U.S. call, or 1-646-307-1963 for a non-U.S. call, and by entering the access code Q-819144. A rebroadcast will also be available at the company's website, www.woodward.com for 14 days. We thank you for your participation on today's conference call. And ask that you please disconnect your line.

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