

# **Garrett Motion Inc. (GTX) Q2 2024 Earnings Call Transcript**

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**Body**

Garrett Motion Inc. (GTX)

Q2 2024 Earnings Conference Call

July 25, 2024 8:30 a.m. ET

Company Participants

Eric Burge - Head of Investor Relations

Olivier Rabiller - President and Chief Executive Officer

Sean Deason - Senior Vice President and Chief Financial Officer

Conference Call Participants

Hamed Khorsand - BWS Financial

Michael Ward - Freedom Capital

Presentation

Operator

Hello. My name is Anthony, and I will be your operator this morning. I would like to welcome everyone to the Garrett Motion Second Quarter 2024 Financial Results Conference Call. This call is being recorded, and a replay will be available later today. After the company's presentation, there will be a Q&A session.

I would now like to hand over the call to Eric Burge, Garrett's Head of Investor Relations.

Eric Burge

Thank you, Anthony. Good day, and welcome everyone. Thank you for attending the Garrett Motion second quarter 2024 financial results conference call. Before we begin, I would like to mention that today's presentation and earnings press release are available on the IR section of our Garrett Motion Web site at investors.garrettmotion.com. There you will find a link to our SEC filings, along with other important information about our company.

Turning to slide two, we note that this presentation contains forward-looking statements within the meaning of the U.S. Federal Securities Laws. These statements represent management's current expectations, and are subject to various risks and uncertainties that could cause our actual results to differ materially from such expectations. These risks and uncertainties include the factors identified in our filings with the Securities and Exchange Commission. Please review the disclaimer on slide two of our presentation as the content of our call will be governed by this language.

Today's presentation also includes certain non-GAAP measures which we use to help describe how we manage and operate our business. We reconcile each of these measures to the most directly comparable GAAP measure in the appendix of our presentation and related press release. Finally, in today's presentation comments we may refer to light vehicle diesel and light vehicle gasoline products simply as diesel and gasoline only.

With us today are Olivier Rabiller, Garrett's President and Chief Executive Officer; and Sean Deason, Garrett's Senior Vice President and Chief Financial Officer.

I will now hand the call over to Olivier.

Olivier Rabiller

Thanks, Eric, and thanks everyone for joining Garrett's second quarter 2024 earnings conference call. I will begin today's remark on slide three. Despite a volatile volume environment in the second quarter, I am pleased to report Garrett's very solid performance, driving outstanding operating results. We delivered the strong adjusted EBITDA margin of 16.9%, up 40 basis points sequentially, while navigating continued challenging regional dynamics. We do not expect to see this volatility disappear in both light and commercial vehicle volumes through the remainder of the year, but the performance that we achieve in Q2 illustrates the way we have anticipated this, and set up the company for continued performance through the remainder of 2024.

Our Q2 performance allowed us to once again make significant progress on our capital allocation priorities. Taking benefit of the favorable market conditions, we issued $800 million of Senior Unsecured Notes at favorable interest rates, partially repaying our Term Loan B. And we also re-priced our remaining U.S. dollar Term Loan B. These actions will generate annual cash interest saving of approximately $15 million. In addition, we used $186 million to repay our Euro-denominated Term Loan B and upsized our revolver capacity. At the same time, we kept on executing our share repurchase program. This quarter, we repurchased $65 million of common stock, bringing our total repurchases in the first-half of 2024 to $174 million.

I wanted to pause on this, and turning to slide four, I want to take the opportunity to recap the significant value we have returned to shareholders since the beginning of last year through our capital allocation priorities. Since the successful conversion of our preferred stock last year, we have reduced our debt by $394 million. At the same time, we have also repurchased $958 million in stock or 34% of shares outstanding. If you do the math, this translates to the return in excess of $3.00 per share. As of today, we have used more than half of our share repurchase program that we launched at the beginning of the year. And we will continue to use our strong cash generation to acquire more shares in the second-half. All the actions taken are driven towards making Garrett a highly attractive investment with potential for significant additional upside.

Turning now to slide five, during the quarter we continued to build momentum across our entire portfolio, both in our core turbo business and in new zero-emission vehicle technologies. We kept on securing business across our turbo range. In this respect, I would like to highlight the additional turbo program we won for a new large industrial turbo aimed at the fast growing power generation industry and also for marine applications. This additional win confirms the customer appeal for our technology in this new industrial segment for Garrett.

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On the Zero Emission Technology side, we also recorded significant progress in the quarter. On the fuel cell compressor front, we secured our first series production contract for our largest fuel cell application to date, which will be used in the Commercial Vehicle and Industrial segments. In fact, we continue to expand the broadest and most mature portfolio of fuel cell compressors in the industry.

For E-Powertrain, we decided to bring the benefits of our high-speed motor technologies to the commercial vehicle industry in addition to what we have already launched on the vehicle, the light vehicle side. In record time, we have not only developed new designs, suiting the specific requirements of these vehicles, but we've also secured several predevelopment awards over the last quarter. This is very fast progress. And at the same time, a great recognition of the benefits we bring in an industry, where end consumers are savvy and are willing to pay for the value you bring.

Finally, we continue to see momentum for our revolutionary high power equaling centrifugal compressors with two additional predevelopment contracts for commercial vehicles won during the quarter. All of this once again confirms the increasing traction we receive from customers for our differentiated high-speed electrification solutions.

I will now turn the call over to Sean to provide more insights on our financial results and full-year outlook.

Sean Deason

Thanks, Olivier, and welcome, everyone. I will begin my remarks on slide six. Overall, and in light of challenging production environment, we delivered a very solid Q2 result. On the upper left-hand graph, you see that our reported net sales are continuing to trend down due to softer global industry trends across light and commercial vehicles, as well as some regional dynamics with our customers. We also continue to experience commodity deflation, which impacts sales, but is margin accretive.

Although we are operating in a volatile global production environment, as you can see from the graph on the upper right-hand side of the page, by flexing our cost structure and continuing to perform operationally, we neutralized the impact of lower net sales and delivered solid adjusted EBITDA of $150 million in the quarter. This led to a strong adjusted EBITDA margin of 16.9%, a 40 basis point increase sequentially compared to Q1 of this year. In addition, we generated a healthy adjusted free cash flow of $62 million in the quarter, which we expect to continue to increase in the second-half of this year.

Turning now to slide seven, I will walk you through our year-over-year sales bridge. Similar to what I just mentioned sequentially, Q2 net sales are down 12% on a GAAP basis and 10% at constant currency, driven by industry softness across all verticals and regions except for aftermarket, which was up 7%. We also experienced commodity deflation, the impact of which resulted in an additional $30 million reduction in sales compared to Q2 last year, but also increased our adjusted EBITDA margin.

Gasoline and diesel products were down 15% and 14%, respectively for a combined impact to reported net sales of $107 million. And commercial vehicle sales decreased 2% at constant currency, decreasing less than gasoline and diesel products, which resulted in an increase to 18% as a percentage of net sales, driving favorable mix dynamics. Our aftermarket business increased 7% at constant currency or $8 million and comprised 14% of reported net sales, up 11% from last year, which when combined with the mix impact of commercial vehicles as a percentage of our total sales resulted in a slightly favorable mix impact year-over-year. And finally, we saw an unfavorable impact of $18 million due to foreign exchange on a year-over-year basis.

Turning to slide eight, you will see our Q2 adjusted EBITDA bridge compared with the same period last year. Again, we delivered an adjusted EBITDA of $150 million in Q2. Representing a $20 million decrease over the same period last year, with reported net sales decreasing $121 million which decreased adjusted EBITDA by $34 million. This impact was partially offset by favorable mix, operational productivity, and cost actions driven by flexing our cost structure to adjust to lower sales volumes. These unfavorable industry dynamics partially offset by our operational excellence resulted in a 16.5% decremental margin, demonstrating our ability to quickly adapt to industry volatility.

Overall, operating performance contributed $19 million to adjusted EBITDA versus the prior year driven by the operational actions I just mentioned. By leveraging our variable cost structure and delivering fixed cost productivity, we are able to deliver a strong 16.9% adjusted EBITDA margin in this challenging macro environment. This represents a 10 basis point improvement when compared to the same period last year, and once again, a 40 basis point sequential improvement over the last quarter.

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Moving now to slide nine, we show the adjusted EBITDA to adjusted free cash flow bridge for Q2 2024. We delivered a solid adjusted free cash flow of $62 million in line with our full-year outlook. Adjusted free cash flow was impacted by a change in working capital of $52 million, primarily due to declining industry trends driving decreased sequential sales as mentioned previously. We expect that working capital will stabilize and improve in the second-half as industry volumes recover in Q4. Total expenditures, cash taxes, and cash interest were all in line with our expectations.

Turning to slide 10, as Olivier mentioned earlier, we continue to generate cash and execute on our capital allocation priorities. We ended the quarter with a strong liquidity position of $698 million comprised of $600 million of our upsized, undrawn revolving credit facility and $98 million of unrestricted cash.

During the quarter, we successfully issued $800 million in unsecured notes, which we utilized along with cash on hand to early repay $985 million under two of our term loans. In addition, we repriced our remaining term loan. These actions that Olivier mentioned are expected to generate annual interest savings of approximately $15 million. Importantly, these changes contributed to upgrades of our credit ratings of our secured debt from both S&P and Moody's to BB+ and Ba1 respectively.

And as discussed, our cash generation enabled us to return significant value to our shareholders in the quarter as we repurchased an additional $65 million of common stock for a total of a $174 million repurchased in the first-half of the year under our $350 million stock repurchase program. Moving to slide 11, you can see our updated 2024 outlook with the following implied midpoints.

Net sales of $3.57 billion, constant currency net sales decline of 7%, net income of $265 million, adjusted EBITDA of $608 million implying an adjusted EBITA margin of 17%, and net cash provided by operating activities of $405 million and adjusted free cash flow of $350 million. These updates reflect lower production in both light and commercial vehicle industries implying a sales outlook of flat to slightly down in the second-half of the year.

Commodity deflation is expected to continue and results in a 2% organic decline versus prior outlook on net sales with no adjusted EBITDA impact due to pass-through mechanisms. As demonstrated in the first-half of this year, our ability to flex our cost structure and deliver operational productivity enables to keep the same midpoint on adjusted EBITDA after adjusting for the non-operational effects of foreign exchange and the equity income loss from our divesture on April 3rd this quarter. For which, we received $46 million in cash. Our adjusted EBITDA margin also continues to benefit from commodity deflation as we pass-through this effect to our customers.

Although our industry is experiencing challenging macroeconomic effects, we continue to dedicate approximately 60% of our research and development spending in 2024 to zero emissions technologies, while still investing in turbo. Our updated 2024 outlook reflects our strong operational execution as we continue to generate cash flow in a market where we see volatility in both light and commercial vehicle volumes through the remainder of the year.

Turning now to slide 12, we bridge our prior outlook, our prior outlook, midpoint adjusted EBITDA of $620 million for updated outlook, midpoint of $608 million. We have proactively deployed variable and fixed productivity actions that will generate $58 million of incremental margin contribution to offset the impact of software industry demand for both lighting commercial vehicles.

As a result, our revised adjusted EBITDA midpoint has been adjusted only due to the non-operational impacts of foreign exchange and the loss of three quarters of equity income following our divestiture, as previously mentioned.

And with that, I will now turn the call back to Olivier to conclude.

Olivier Rabiller

Thank you, Sean. Turning now to slide 13, I briefly want to remind you of the ways in which we are well positioned for the long-term success of Garrett. We continue to be the number one turbo player in the technology-driven industry.

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Our operational framework is highly cash generative of our cycles, allowing us to invest in new technologies while reducing debt and returning cash to shareholders, our priority remains to identify and focus on customers unmet needs, where we can leverage our innovation capability to develop differentiated and highly efficient solutions at scale. All of this is made possible by what I consider to be one of the best team in the industry, and now concluding with slide 14, I want to thank the entire Garrett team for driving outstanding operating performance in the quarter.

Together, we offset some challenging regional dynamics, delivered strong financial performance and set up the company to keep on performing for the quarters to come. At the same time, we secured several significant commercial wins with our turbo and zero emission technologies.

Over the last 18 months, we have returned more than $3 per share to shareholders, while at the same time repaying debt, investing into new business. And we will continue to take actions focused on making Garrett a highly attractive investment with potential for significant additional upside. And finally, we have updated our full job guidance to reflect software industry demands, and we remain confident in our ability to deliver continued operating strength and cash generation across all economic cycles.

Thank you for your time. And Operator, I think we are ready for the Q&A.

Question-and-Answer Session

Operator

We will now begin the question-and-answer session. [Operator Instructions] Our first question will come from Hamed Khorsand with BWS Financial. You may now go ahead.

Hamed Khorsand

Hi. So, first off, I just want to see, could you provide a little bit more details as to what that demand dynamic is between Europe and China that you're citing? Is it all related to end users -- sorry, the consumer not buying anything, or is it production-related, is it geopolitical-related?

Olivier Rabiller

That's a good question. Let me help you with that. First, what we see is obviously the production of the carmakers. You know that there is a very strong price war in China. There are some losers, there are some winners. And this is influencing, obviously, and I'm talking about the light vehicle gasoline and hybrid segment. This is influencing the volumes, whether we sell to the global brands or whether we sell to the local brands. Some of them are winning, and some of them are losing.

So, we are just getting through all that. It's quite complex, quite volatile. And that's one of the drivers. But at the same time, we know that worldwide all the issues are not coming from China. We know that Korea is still weak, and it's a significant piece of our business. And as well, we know that, globally, commercial vehicle off-highway is not exactly booming to say the least. You've seen the result of some off-highway specialists in North America. And obviously, since we are the biggest suppliers to this industry we are obviously seeing our revenue line with these guys suffering as well. So, these are a mix of things that are happening a little bit across the globe. Not mentioning the fact that, from a production standpoint, Europe is not exactly doing great.

Hamed Khorsand

Okay. And then -- but just given the magnitude of the drop in sales, how fast are you able to participate in hybrid and zero-emissions to offset some of this?

Olivier Rabiller

Hybrid, it's immediate. We are participating to it because a very significant portion of what we sell is ending up on the hybrid platforms. So, we are participating to that, that's clear. For zero-emission vehicle, I think we've shared the cycles already. We are today extremely please and, by the way, just to close on the turbo side and on hybrid, we keep on winning business. And we are seeing those new hybrid programs lining up. But you know that between the time at which carmakers are deciding on hybrid programs and the time at which they put that to production, there is about three years. We heard, in the past, questions about how quick we were seeing customers reacting and developing more hybrids. I should say today that we are starting to see the activities ramping-up that we are not seeing to that kind of pace in the past.

To the part of your question that is on zero-emission vehicle, today, we are in the middle of a lot of predevelopments with our customers. We are already in production on fuel cell compressors. We've said that, this year, we would generate already $20 million on fuel cell compressors, which is very significant when you compare it to the size of the hydrogen industry. And for the rest, for E-Powertrain, we have a very promising predevelopments going on. I cannot say more at this stage. We've just announced today, in this release, that we have decided to also tackle the E-Powertrain, the three-in-one business, and as always with the e-motor investor on the gearbox for commercial vehicle, whether it's medium-duty and heavy-duty. And I've been even surprised at the speed at which customers were biting on that because we've already assigned three predevelopment contracts on this very interesting technology for them.

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So, I'm pleased to see all that. Unfortunately, I would say -- or fortunately, because there is a good side to it, is that we are focusing on the next generation of those electric vehicles. And fortunately, it means that we are not suffering from any kind of weakness that the industry is seeing in the ramp-up of those zero-emission vehicle technology.

Hamed Khorsand

Okay. And last topic is, are you still seeing the same dynamic of weakness now that you saw in Q2?

Olivier Rabiller

I would say yes, and that's why, quite frankly, that we don't see a lot of changes happening in China in the medium-term. We don't see dynamics getting better in the other global markets. And I would say when you look back at the registration numbers and everything for Q2, we take -- pretty much confirms that trend. We may be surprised on the way up, but we'd rather be conservative into the way we plan. The big focus we had since the end of last year, because we saw some of it coming Q1 and Q2, was to make sure that even if the revenue line is down, we are setting up the company to perform. Meaning, it's not one-off actions just to get or go after, it's really fundamental actions we've done in term of improving the efficiency of the company, and at the same time leveraging the valuable cost nature of Garrett.

And if I may, if you look at the results that we've delivered in Q2, which is 16.9% EBITDA margin and despite the revenue line drop, that's a testimony to it. And when you look at the fact that we did not move adjusted for H6 and divestiture, we did not move our guidance full-year on EBITDA. It shows the capability and the confidence we have in the company to perform even when the industry is weak outside. So, I'm very proud of that. I think it's a differentiating point for Garrett in the way we execute. And I'm confident we have the right set up to address what we have anticipated in the lowering of the guidance on the revenue side to keep on performing for what matters for all of us, which is, how much margin do we generate, how much money do we generate. And then, from that money that we generate, what do we do with it, which is the strong capital allocation strategy that we followed since the beginning of the year. And even if we are in the middle of that, it's always impressive to put those numbers together.

Hamed Khorsand

Great. Thank you.

Operator

Our next question will come from Michael Ward with Freedom Capital. You may now go ahead.

Michael Ward

Good morning, everyone. Olivier, is it a customer mix? Is most of your revenue in China coming from the U.S. and European-based manufacturers?

Olivier Rabiller

In fact, we are working both with global players and local players.

Michael Ward

Okay. And the local players, the content tends to be less. Is that it? So it's on a mix standpoint it's negative?

Olivier Rabiller

I would not say that. I would say the content is probably about the same when I'm talking about passenger vehicle China, okay, because in China we are not only doing passenger vehicle, we are also doing light trucks and we have a big business on commercial vehicles. So, specifically to light vehicles, I would not say the content is different. I would just say that you have less global players and you have less global players in term of number of players and you have more local players in term of number of players.

So, not only have we seen a swing between the global and the locals for the last few years, swing that for us is important. But at the end of the day, we are working both sides. But we've seen swings even among the local players, massive swings, offshore demand. So, that's pretty much more that kind of swing that is impacting us and I think we are not the only ones to be impacted.

Michael Ward

No, no, I think that's right. And are you seeing the U.S. based manufacturers especially like General Motors has been moved away from the hybrids over the last several years and dominated by the Japanese based manufacturers and Europeans. Are you starting to see them look for more to expand as they start to ramp up additional hybrid output in North America? You have more content on a hybrid than you would a straight ICE vehicle, correct?

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Olivier Rabiller

Yes, to a certain extent, that's correct, because it's hybrid offering are usually using engines that are a bit more advanced, I would say, it's more of a general statement. We are getting more variable geometry and we are getting a total penetration that is a bit higher. But I would say all the carmakers now are working and reinforcing their programs on hybrid, even the ones that said that they would not touch it, which in all fairness.

Michael Ward

That's a net positive, if you look at it.

Olivier Rabiller

That's a net positive. The point I'd like to explain a little bit is a little bit to a point I was making a few minutes before, which is, if they start to redeploy a new range of vehicles to hybrid to address that trend of more hybrids, it takes three years for any kind of vehicle to be on the market, okay? So, obviously, we are very active in the bidding and working with many of them. For some of them, they are planning to reuse some engines on which we are already. So, there is less work to be done, but still adapting the vehicle. Short-term though, what you could see and you can see that in the registration in Europe to some extent, some companies that have specialized on hybrid like Toyota are winning over the others.

Michael Ward

Yes. Sean, can you walk through the impact, the delay really and when it flows through your revenue line with the lower commodity costs. We've seen commodity costs come down across the board. And I think that's part of what you're seeing. And then, you also have FX and can you talk about which currencies are being are affecting that number?

Sean Deason

Sure. For us, FX is mainly, we're seeing a little bit on the Korean won, the Japanese yen, and the Chinese renminbi, which is in the past, those have been more stable. As we're very sensitive to the euro, but the euro has actually held in there quite well year-over-year, and sequentially, and holding in there about 108, 109. So, it hasn't been as big of an issue, but it's those Asian currencies where we've really seen an impact.

Michael Ward

Okay. And on the commodities, what is the kind of, is there a delay? I mean, because we continue to see those prices come down into the third quarter. Does that affect your outlook for the first-half of '25?

Sean Deason

Yes, we will continue to pass through though. So, what that ends up doing is it will impact sales as I mentioned, but it also results in higher margins. And we are on about a one quarter delay, but that's also it's aligned, it's matched up with our supply base as well. So, we don't have really a mismatch between supply, supplier and customer pass-through.

Michael Ward

Okay. And do you have any exposure, or is it 100% pass-through?

Sean Deason

I think we are able to say, we are 100% pass-through. The vast, vast majority of it is contractual, and then we're able to very effectively negotiate one-offs where we need to. And in fact, as we've talked about before, we've successfully passed through freight increases, even some labor increases in the past.

Michael Ward

I've never seen that before. Thank you.

Olivier Rabiller

We have not seen some of those decreasing, like labor, for example.

Sean Deason

Yes.

Olivier Rabiller

Yes.

Michael Ward

Okay.

Operator

This concludes our question-and-answer session. I would like to turn the comments back over to Olivier for any closing remarks.

Olivier Rabiller

Okay, well, thank you very much to everyone for joining. Once again, important quarter for us in a way to demonstrate our ability to adapt our costs even when the environment is less favorable, and we are set up the right way for the remainder of the year and for any cycle to come.

The second point is the strength that we see in the pull from customers, not only on turbochargers, but also on zero emission vehicle technology. And when I say turbocharger, it's obviously including hybrids. All of that makes us confident for the future. This company is a very nice investment opportunity. Thank you.

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Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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