

# **Westinghouse Air Brake Technologies Corporation (WAB) Q2 2024 Earnings Call Transcript**

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**Body**

Westinghouse Air Brake Technologies Corporation (WAB)

Q2 2024 Earnings Call Transcript

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Company Participants

Kyra Yates - VP of IR

Rafael Santana - President and CEO

John Olin - CFO

Conference Call Participants

Daniel Imbro - Stephens

Angel Castillo - Morgan Stanley

Bascome Majors - Susquehanna

Scott Group - Wolfe Research

Jerry Revich - Goldman Sachs

Ken Hoexter - Bank of America

Rob Wertheimer - Melius Research

Steve Barger - KeyBanc Capital Markets

Presentation

Operator

Good morning, everyone, and welcome to the Wabtec Second Quarter 2024 Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please also note that this event is being recorded. At this time, I'd like to turn the floor over to Kyra Yates, Vice President of Investor Relations. Ma'am, please go ahead.

Kyra Yates

Thank you, operator. Good morning, everyone, and welcome to Wabtec second quarter 2024 earnings call. With us today are President and CEO, Rafael Santana; CFO, John Olin; and Senior Vice President of Finance, John Mastalerz. Today's slide presentation, along with our earnings release and financial disclosures were posted to our website earlier today and can be accessed on the Investor Relations tab.

Some statements we are making are forward-looking and based on our best view of the world and our business today. For more detailed risks, uncertainties and assumptions relating to our forward-looking statements, please see the disclosures in our earnings release and presentation. We will also discuss non-GAAP financial metrics, and encourage you to read our disclosures and reconciliation tables carefully as you consider these metrics.

I will now turn the call over to Rafael.

Rafael Santana

Thanks, Kyra. And good morning, everyone. Let's move to Slide 4. I'll start with an update on our business, my perspectives on the quarter and progress against our long-term value-creation framework. And then, John will cover the financials.

We delivered another strong quarter, evidenced by robust sales and earnings per share growth. Sales were $2.6 billion, which was up nearly 10% versus prior year. Revenue growth was driven by strong performance from the Freight segment. And adjusted EPS was up 39% from the year-ago quarter, driven by increased sales and margin expansion. Total cash flow from operations for the quarter was $235 million. The 12-month backlog was $7.3 billion, and the multi-year backlog was $22 billion. Overall, the Wabtec team delivered a strong second quarter. With the first half behind us, we are focused on executing against our second half deliverables. Looking forward, I'm encouraged by the underlying strength and momentum across the business.

Shifting our focus to Slide 5, let's talk about 2024 and market expectations in more details. While key metrics across our Freight business remain mixed, we are encouraged by the strength of our business, the strength of our international markets and our robust pipeline of opportunities across geographies. North American car loads were up 2.1% in the quarter. Despite this car load growth, the industry's active locomotive fleet was down when compared to last year's second quarter, while Wabtec's active fleet was higher. Looking at the North American railcar builds. Last quarter we discussed the industry outlook for 2024 to be about 36,000 cars to be delivered, which has now been raised by industry sources back to the original forecast of 38,000 cars. This is still down, however, from the 45,000 in the previous year. Internationally, we continue to see that significant investments to expand and upgrade infrastructure are supporting a robust international orders pipeline. In mining, commodity prices and an aging fleet are continuing to support activity to refresh and upgrade the truck fleet. Finally, moving to the Transit sector, the megatrends of urbanization and decarbonization remain in place, driving the need for clean, safe and efficient transportation solutions around the globe.

Next, let's turn to Slide 6 to discuss a few business highlights. In North America, we secured a multiyear order for greater than $600 million. This is one of our largest orders for new Tier 4 locomotives ever. It demonstrates customer demand for a best-in-class solution to improve productivity, reduce fuel usage, improve reliability and to significantly reduce emissions.

I would also like to share with you a key international services order, a 10-year agreement in Brazil for which Wabtec will manage the servicing of Vale's locomotives fleet to increase availability, reliability and safety. In Pakistan, we recently won a strategic order for 15 modernizations for Pakistan Railway. This is a great example of the opportunities that we have to modernize locomotives in our international markets.

And finally, our Transit segment announced that our Green Friction braking solution is ready to begin commercial fleet operations in the Greater Paris metropolitan area. This innovative solution will improve air quality in the transit's authority tunnels and underground network by reducing particle emissions from braking by up to 90%.

All of this demonstrates the underlying strength across our business, the team's relentless focus on execution and the strong pipeline of opportunities we continue to deliver on. Wabtec is well-positioned to continue to capture profitable growth with innovative and scalable technologies that address our customers' needs.

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With that, I'll turn the call over to John to review the quarter, segment results and our overall financial performance.

John Olin

Thanks, Rafael. And hello, everyone. Turning to Slide 7, I will review our second quarter results in more detail. Our second quarter results played out largely as we expected. We expected both revenue and earnings growth to be overshared versus our full-year growth expectations, but slightly tempered from our first quarter results. The primary driver of our first half results growing faster than our expected second half results is due to a shift in the combined production of our new locomotives and mods to the first half of this year from the second half, in an effort to more evenly load our manufacturing production across the four quarters. It is also important to note that we expect our second half revenue and margin to grow, but at a more tempered pace than we experienced in the first half. Within the second half, we do expect to grow revenue and earnings year-over-year in each quarter. However, we expect the third quarter's growth to be greater than the fourth quarter's growth.

Sales for the second quarter were $2.64 billion, which reflects a 9.8% increase versus the prior year. Sales growth in the quarter was driven by the Freight segment, especially by equipment and components. For the quarter, GAAP operating income was $430 million, driven by higher sales, improved gross margin and an unrelenting focus on continuous improvement in productivity. Adjusted operating margin in Q2 was 19.3%, up 2.9 percentage points versus the prior year. This increase was driven by improved gross margin of 2.9 percentage points. GAAP earnings per diluted share were $1.64, which was up 54.7% versus the second quarter a year ago.

During the quarter, we had net pre-tax charges of $6 million for restructuring, which were primarily related to our Integration 2.0 and our portfolio optimization initiative to further integrate and streamline Wabtec's operations. As you may recall, Integration 2.0 is expected to drive $75 million to $90 million of run-rate savings by 2025. And our portfolio optimization initiative will eliminate roughly $110 million of low-margin non-strategic revenue while reducing manufacturing complexity. In the quarter, adjusted earnings per diluted share was $1.96, up 39.0% versus prior year. Overall, Wabtec delivered another strong quarter, demonstrating the underlying strength of the business.

Turning to Slide 8, let's review our product lines in more detail. Second quarter consolidated sales were up 9.8% as we expected. Our quarter results were driven by solid growth across all our business groups and further aided by a year-over-year increase in the combined new loco and mods as we have shifted our production and deliveries more to the first half versus the second half in order to more appropriately balance or level load our factories, thereby allowing us to be more consistent with our labor staffing, improve our quality and to gain manufacturing efficiencies.

Equipment sales were up 36.4% from last year's second quarter, driven by robust deliveries of new locomotives and increased sales of mining equipment. Component sales were up 17.5% versus last year, largely driven by increased sales of industrial products, higher international sales and the acquisition of L&M in late Q2 of 2023, partially offset by lower North American railcar build. Digital Intelligence sales were up 2.1% from last year, where we continue to experience growth in international sales aided by higher PTC revenues, partially offset by lower revenues in our North American market. Our Services sales grew 2.3%. Sales growth was driven primarily by higher year-over-year overhauls and parts sales. Our customers continue to recognize the superior performance, reliability and availability of our fleet. In our Transit segment, sales were up 2.0%. During the quarter, we saw our aftermarket revenue grow 10%. On a constant-currency basis, sales grew 3.4%. The momentum in the Transit segment remains positive as secular drivers such as urbanization and decarbonization accelerate the need for investments in sustainable infrastructure.

Moving to Slide 9. GAAP gross margin was 33.0%, which was up 2.9 percentage points from last year. Adjusted gross margin was also up 2.9 percentage points during the quarter. In addition to the higher sales, gross margin benefited from favorable mix between segments. Mix within the Freight segment was also favorable despite higher combined new locomotives and modernizations in the quarter. Foreign currency exchange was a headwind to revenue as well as gross profit and operating margin in the quarter. During the quarter, we also benefited from favorable fixed-cost absorption, increased productivity and benefits from Integration 2.0, as well as lapping last year's start of the Erie Strike in late Q2 of 2023. Our team continues to execute well by driving operational productivity and lean benefits.

Now turning to Slide 10. For the second quarter, GAAP operating margin was 16.3%, which was up 3.4 percentage points versus last year. Adjusted operating margin improved 2.9 percentage points to 19.3%. GAAP and adjusted SG&A expenses were up versus prior year, but largely flat as a percentage of revenues. Engineering expense was $57 million, moderately higher than Q2 last year. We continue to invest engineering resources in current business opportunities, but more importantly, we are investing in our future as an industry leader in decarbonization and digital technologies that improve our customers' productivity, capacity utilization and safety.

Now, let's take a look at segment results on Slide 11, starting with the Freight segment. As I already discussed, Freight segment sales were up 13.1% during the quarter. GAAP segment operating income was $391 million for an operating margin of 20.4%, up 4.5 percentage points versus last year. GAAP operating income included $5 million of restructuring costs, primarily related to Integration 2.0 and portfolio optimization. Adjusted operating income for the Freight segment was $462 million, up 34.3% versus prior year. Adjusted operating margin in the Freight segment was 24.1%, up 3.8 percentage points from the prior year. The increase was driven by improved gross margin behind strong operational execution, favorable mix, Integration 2.0 savings, and as we lap last year's manufacturing inefficiencies caused by the strike in Erie. At the same time, SG&A and engineering expenses were lower as a percentage of revenue. Finally, segment 12-month backlog was $5.50 billion, up 4.0% from the same period a year ago. The multiyear backlog was $17.93 billion, down 2.0% from the prior year.

Turning to Slide 12, Transit segment sales were 2.0% at $724 million. When adjusting for foreign currency, Transit sales were up 3.4%. GAAP operating income was $82 million. Restructuring costs related to Integration 2.0 were $5 million in Q2. Adjusted segment operating income was $91 million. Adjusted operating income as a percent of revenue was 12.7%, up 1.6 percentage points from last year, driven by Integration 2.0 savings and favorable mix. Finally, Transit segment 12-month backlog for the quarter was $1.83 billion, down 5.0% versus a year ago. The decrease on a year-over-year basis was expected due to our focus on being more selective on the orders that we add to backlog, thereby expecting to drive improved long-term profitability.

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Now let's turn to our financial position on Slide 13. Second quarter cash flow was another highlight for the quarter, with operating cash coming in at $235 million. During the quarter, cash flow benefited from higher earnings and improved working capital, partially offset by a reduction of $230 million of securitization borrowings. We continue to expect greater than 90% cash conversion for the full year. Our balance sheet and financial position continue to be very strong as evidenced by, first, our liquidity position, which ended the quarter at $2.09 billion. And our net-debt leverage ratio was 1.6 times at the end of the second quarter, which was lower versus the same quarter a year ago at 2.4 times debt leverage. We continue to allocate capital in a disciplined and balanced way to maximize returns for our shareholders. During the quarter, we purchased $200 million of our shares and paid $35 million in dividends.

With that, I'd like to turn the call back over to Rafael to talk about our 2024 financial guidance.

Rafael Santana

Thanks, John. Now let's turn to Slide 14 to discuss our 2024 full year guidance. As you heard today, our team delivered a very strong second quarter, which was slightly ahead of our expectations. Consequently, we are increasing our previous adjusted EPS guidance. We now expect adjusted EPS to be in the range of $7.20 to $7.50 at the midpoint, up 24.2%. Our revenue and cash flow conversion guidance remain unchanged. Looking ahead, I'm confident that Wabtec is well positioned to drive profitable growth into 2024 and beyond.

Now let's wrap up on Slide 15. As you heard today, our team continues to deliver value for our stakeholders, thanks in large part to our resilient installed base, world-class team, innovative technologies and our continued focus on our customers. Overall, we believe we have an opportunity to continue building significant long-term momentum with growth in equipment, services, components, digital solutions and transit systems. With solid underlying demand for our products and technologies and intense focus on continuous improvement in cost management, consistent with our previous guidance, we continue to expect to drive mid-single-digit organic growth while delivering double-digit earnings per share growth through our planning horizon, thereby maximizing our shareholder returns.

With that, I want to thank you for your time this morning, and I'll now turn the call over to Kyra to begin the Q&A portion of our discussion. Kyra?

Kyra Yates

Thank you, Rafael. We will now move on to questions. But before we do, and out of consideration for others on the call, I ask that you limit yourself to one question and one follow-up question. If you have additional questions, please rejoin the queue. Operator, we are now ready for our first question.

Question-and-Answer Session

Operator

And our first question today comes from Daniel Imbro from Stephens. Please go ahead with your question.

Daniel Imbro

Good morning, everybody. Thanks for taking our questions.

Rafael Santana

Good morning.

Daniel Imbro

Rafael, maybe I'll start on the new locomotive side. I think you mentioned in your remarks that the $600-plus-million order, one of the bigger Tier 4 orders you've had in a while. It's coming over multiple years from the slides. Any color you can provide just on how many years that contract is, when it should start up as we think about modeling it? And then to clarify, was that included in the 2Q backlog or was that assigned July quarter-to-date?

Rafael Santana

No, that was not included in the previous backlog, so it's in the second Q backlog. The second piece is this is an order that will largely be executed between '25 and '26. And the other piece is I think it just speaks to the strength of our pipeline of opportunities. We continue to see good momentum there internationally and that expands really across different geographies. We continue to see it mixed in North America, but with opportunities here. We have a number of sizable opportunities that are being worked in the current pipeline. The current total backlog is healthy and overall it's a positive. We're progressing. We're continuing to grow and our pipeline supports it.

Daniel Imbro

Great. Really encouraging. And for my follow-up, John, maybe just something on the guide, if we can dig into it a little bit. I think you're expecting, you said, revenue and earnings growth in the back half. I think the previous assumptions had been that margins would moderate through the year, but it looks like sequentially revenue is relatively flat. So can you talk about maybe what's changing on the cost side? Are costs increasing to drive that sequential deleverage on the margin piece on the operating margin? Is there some conservatism in that? How are you thinking about the operating margin outlook for the back half of the year after a strong first half?

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John Olin

Thanks, Daniel. And certainly, the last couple of quarters, we've talked about kind of our -- how our halves are going to unfold, and they're certainly unfolding the way we expected. And Daniel, that is with the first half having significantly higher year-over-year growth as well, I'm sorry, for both revenue and margin growth. Revenue was up 11.7% and margin up 2. -- or 3.2 percentage points. With that, we've also talked about the back half being up and growing in both those measures, but at a more significantly level -- tempered level. And the reason for that, Daniel, is what is driving some of the first half growth is not going to be there in the second half. So let's talk about a couple of those things. One is mix, and we talked about this on the last call. Our first half mix is a good tailwind for us and we expect that to turn into a slight headwind in the second half. So that's one of the reasons. The other is really around absorption, right, fixed-cost absorption. With the growth that we have in the first half, again, up being -- being up almost 12%, we are getting much more absorption on a year-over-year basis in the first half versus the second half. So again, that won't be there. Now there's some common things in there, right? Integration 2.0 is benefiting both halves at a similar rate. And we've got some one-time benefit both in the first half and the second half. But the answer is, is really on mix and absorption in the second half.

Daniel Imbro

Great. Appreciate all the color. Best of luck.

Rafael Santana

Thank you, Daniel.

Operator

Our next question comes from Angel Castillo from Morgan Stanley. Please go ahead with your question.

Angel Castillo

Hi, thanks for taking my question. Just a quick one on the kind of revenue. You've kind of touched on it, but you didn't change that guidance and it sounds like there's some kind of mixed factors, some getting better. You talked about car loads and railcar deliveries, but just if you could unpack that a little bit more and maybe the thinking around keeping that unchanged versus the EPS guide?

Rafael Santana

Angel, we are tracking right on our revenue plan. We adjusted that in the first quarter, brought it up a bit largely for some of the things that we're seeing in the parking arena. That's right on track. Everything is tracking well. And I would kind of look at what we did in terms of EPS as fine-tuning the quarter. We brought it up $0.15 at the midpoint. Again, revenue is on track, but we did see a little bit of favorability in mix in the first half and the tax rate came in a little bit favorable. And I would say, Angel, that about, half that $0.15 is in the actuals in the second quarter and a little bit of favorability that we're expecting in the back half, and that is due to the same two reasons. Mix is going to be a little bit more favorable than we expected. However, still a headwind to the half. And then the tax rate is favorable. And we've also re-guided on the tax rate, bringing it down from 25 -- 25% to 24.5%. But, we're seven months into this thing and we feel very good about our overall guidance and how the back half is going to unfold and really in line with what we've talked about the last couple of quarters.

Angel Castillo

That's very helpful. Thank you. And then just given the level of conviction and optimism on how things are unfolding, your first half cash flow has been very robust and you have guided to continued expectation for greater than 90%. And I think second half typically is -- sees better kind of cash generation. So could you talk about just your thought process? You talked about kind of disciplined balanced capital allocation, but it seems like your cash flow generation should be quite robust and allow for perhaps a little bit more aggressive deployment of capital. So, if you could just kind of touch on that and your expectations for cash flow in the second half.

John Olin

Well, Angel, thanks for pointing out the very strong first half, much appreciated. Yeah, the first half was up $469 million on a year-over-year basis. And what we're seeing there and why we're seeing that is if you recall a year ago, our working capital was still rising as most industrial companies were because of the supply disruptions. And we had a little bit of added in there with regards to the inventory we were building on with regard to a potential strike at the time. So in the back half of last year, we brought that inventory down quite a bit. The team did a fantastic job on managing it back down after the supply disruptions. And so what we're seeing in the first half is really lapping that higher working capital, so we're seeing significant strength there. Overall, we are expecting the guidance that we've had of over 90% cash conversion and we're looking to continue to deploy that, Angel, as we've talked about in the past. We're going to favor M&A. And with the excess cash, we'll buy back shares.

Angel Castillo

Could you maybe expand a little bit on the M&A front in the pipeline and what you're seeing?

Rafael Santana

Let me take on that. I mean, we're continuing to be really looking at M&A. The pipeline is as robust as it's ever been. We're going to be opportunistic here. What's going to drive decision-making is really making sure that we drive higher ROIC for the business and faster profitable growth. But we're going to be opportunistic here. And as we continue to see opportunities to return value to shareholders through share buybacks, we'll do so. And we feel we're very well-positioned here to drive long-term profitable growth.

Angel Castillo

Thank you very much.

Operator

Our next question comes from Bascome Majors from Susquehanna. Please go ahead with your question.

Bascome Majors

Thanks for taking my questions. Just wanted to start internationally. Can you expand some on the 15 mod orders you talked about from Pakistan Railway? What's the scale of that business? Where are you doing those modifications? And is there an opportunity to see either the installed base or breadth of geography that you can cover from those facilities to expand to something more like you see in North America over time? Thank you.

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Rafael Santana

Yes. So, we see a strong pipeline of opportunity internationally. When we talked about Pakistan, I think one of the things that we've talked about is the opportunity to continue to modernize the fleets that are out there. We often emphasize the age of the fleet, and we have continued to invest on significant innovation that allows customers here to significantly reduce fuel by upgrading those engines. They can improve both reliability and availability of those units through those. When you think about modernizations, we largely -- we have a kit that's shipped and we ultimately work with the customers on doing some of that internationally. But as you know, we have some of our locations around the world that we're very much equipped to do so, whether if it's in Brazil, whether if it's in Australia, whether if it's in Kazakhstan. And we'll leverage those as we work through. But I think what's exciting about the international opportunities, they're not concentrated in one single location. We're seeing our business be very competitive. If customers are looking for reliable, efficient power, if they're looking for value, we are seeing the business winning. I think we highlighted in the first half of this year, a significant order for us in West Africa. That's the kind of orders that's going to be executed in '26 and '27. So it's good to see the strength of international, especially I'm going to call -- bringing broader and broader visibility into conversion going out into '26 and into '27. So overall, I think good dynamics internationally, and we've seen that business grow between 4% and 5% -- our fleets grow 4% to 5% over the last five years and we continue to see good dynamics there.

Bascome Majors

Thank you for that. And to follow-up domestically, can you talk a little bit about the inquiry levels and discussions with your North American rail customers and specifically, how they're operating within regulatory uncertainty, both with who's going to be in the leadership in Washington and who's going to be in the leadership at the EPA come next year, and if it's just realistic for us to expect to not see extensions of some of the large multiyear orders that you've got in both the mod and new locomotive backlog until after we get into 2025 with a bit more certainty there? Thank you.

Rafael Santana

So I think we continue to see it mixed in North America. It's very customer-specific. So it really varies different levels of, I'm going to call fleet redundancy some customers might have or not. And I think you see that reflected on the significant order here we got in the second quarter. So it's customer specifics. I don't think -- when I think about what will make our customers invest, it's ultimately the value, the returns they obtain on really modernizing their fleets. What I'm happy to see is the innovation we're driving the business. A lot of the growth you saw here over the last few years, which was tied to the modernizations, largely connected to in a lot of ways what I'll call the 7FDL fleet, which is an older engine we have. We're doing the same thing now for the EVO engine. So in fact, we're going at the end of this year into really commercializing the EVO product, which will drive another five-plus-percent fuel efficiency and improvements for that fleet, and we're doing the same thing on Tier 4. So it's that continued innovation that's going to make customers come, modernize their fleets before they get to 25, 30 years of age. And that will drive both an element of a reduction in cost, which will improve OR on how they operate the fleets, but will also improve services with availability and reliability of those fleets. So all in all, I think we see strong coverage here as we progress forward for the business with the backlog we have.

Bascome Majors

Thank you.

Rafael Santana

Thank you.

Operator

Our next question comes from Saree Boroditsky from Jefferies. Please go ahead with your question.

Unidentified Analyst

Good morning. This is James on for Saree. Thanks for taking the questions.

Rafael Santana

Good morning.

Unidentified Analyst

So I just wanted to follow-up on the Tier 4 locomotive orders in North America. What was the driver behind the customer ordering new locos versus modernization? And I believe Class 1s are generally fine with the number of locos they have, so I just wanted to understand like the conversation that you had with the customer and why they decided to go with the new locos. Thanks.

Rafael Santana

I think it's very much tied to, again, value. It's how customers see an opportunity here to improve both cost of operations, how they see the improved reliability and availability. So think about just the speed in their network, just think about the services levels that they're able to sustain. And with this specific fleet of Tier 4s, also the capability of taking what I'll call alternative fuels. That's a fleet that we have very much talked about the opportunity to take on not just biofuels, but also that's fleet ready to take on what I'll call a mix that could come with things like hydrogen and so forth. So those are some of the elements. In addition to that, I got to highlight to you the fact that -- I mean, you've got very much obsolescence taking on on older fleets, especially if you think from an electronics perspective and the challenge on maintaining some of those fleets over time. So I think very much aligned with the dynamics of customers investing to lower their cost, to improve serviceability. And in some cases, you'll also see customers with an opportunity to grow here. So those, I think, are some of the elements that will continue to drive demand from our customers in North America and everywhere else.

Unidentified Analyst

Great. Thanks for the color. And as a follow-up, I want to touch on the digital, like North America kind of remained weak for a while, while international kind of continued to show strength. Can you talk about when you expect North America to recover and the driver behind the weakness here?

Rafael Santana

Yeah. I think some of what you saw in the quarter, which is really, I think, ultimately connected to higher demand for what I'll call onboard locomotive products, we also saw a good demand on the digital mining technologies. I think ultimately those were and continue to be offset by lower sales in the North American market. I think in the second quarter, you saw that tick to a positive, so the business grew 2.1%. But moving forward, I think we're continuing to see here through the second half a pipeline, higher demand from international. That calls for things like PTC, the same onboard products that I discussed in mining technologies as well, but it continues a softer demand in the US driven by fundamentally what I'll call discretionary OpEx in that regard. With that, our businesses are -- or our teams are very much focused on making sure that we continue to drive order convertibility with recurring revenues. And I feel we continue to progress here to ultimately drive a growth here in '24 for this business.

Unidentified Analyst

Great. Thank you.

Operator

Our next question comes from Scott Group from Wolfe Research. Please go ahead with your question.

Scott Group

Hey, thanks. Good morning. One -- just one more on the guidance. So I totally get the first half, second half comps. I just want to sort of look a little bit more on just like on an absolute basis. So op margins were 19.5% in the first half. If we're looking at the model right and guidance right, it sort of suggests that margins go a little bit below 18% in the second half. And I thought the message was more, hey, we're smoothing out mods and deliveries. And so I think we're seeing the revenue smoother. I guess, why aren't the margins smoother? And ultimately, I'm trying to figure out, right, is there sort of upside to the -- to sort of the implied margin in the back half of the year?

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John Olin

Yes, Scott, it's the same -- the same thing we talked about. It's mix, right? Mix is lifting it in the first half and is going to pull it down a little bit in the second half. And also the first half on that 19.3% is aided by a fair amount of absorption that we don't expect in the back half.

Scott Group

And so ultimately, when we start thinking about '25 margins, maybe it's just too early to go there, but like should we -- is there -- is the first half or the second half you think more representative of like what the business should be as on a go-forward?

John Olin

Well, I -- it's too early to get into what 2025 looks like. We'll certainly be looking at it from where we're launching in terms of the margin that we have at the end of the year. And, we have 27,000 people waking up every morning to improve upon that. And so, you know, we'll be in a position in a couple of quarters to provide guidance on that. But we -- you know, are -- believe we are in line with our long-term guidance as we move out of this year and I feel good about what's in front of us.

Rafael Santana

Scott, the only thing I'd add there is I think we have good momentum coming from lean initiatives with productivity, cost actions driven by Integration 2.0. I think you're going to see more on portfolio optimization. And while I think you're going to continue to see variation, whether if it's quarter-to-quarter, half-to-half, we are kind of continue to expand margins ahead.

Scott Group

Yeah, no, that makes sense. And then maybe just one follow-up, like, is price a bigger factor now than maybe it's been in the past, right? Obviously, really good Freight margins. Is price-cost a bigger tailwind than historically, and is that sort of a sustainable driver of further margin improvement?

Rafael Santana

Scott, we look at price very much connected to the level of differentiation and innovation that we bring into the business, which ultimately leads into value for our customers. And by driving value to our customers, we drive value for ourselves. And on those lines, we continue to expect to drive value for our customer share, which means, yes, we should be able to drive profitable growth ahead along those lines.

Scott Group

Okay. Thank you, guys. Appreciate it.

John Olin

Thanks, Scott.

Rafael Santana

Thank you.

Operator

Our next question comes from Jerry Revich from Goldman Sachs. Please go ahead with your question.

Jerry Revich

Yes, hi. Good morning, everyone. I'm wondering…

Rafael Santana

Good morning.

Jerry Revich

Hi. I'm wondering if you could just comment on the conversations that you've had with your customers since the Chevron case and any impact on how they're thinking about potential changes at the EPA and CARB. Can you just talk about what the flows have been since that ruling, if you don't mind?

Rafael Santana

Yeah. So based on that ruling, I mean we can expect here, I think, that federal agencies will receive less deference to their regulations when, of course, our considerate agencies are acting within the authority here granted by Congress, Jerry. But as courts take a more prominent role here, I think they'll certainly have an impact to regulations pertaining to rail. I think the way I would think about it, there's a -- it could go in different ways, but if you think about like the two-person crew mandate, I mean that's certainly one area here. And the other one is really associated with the CARB emissions through that. So I think those are things that are going to play out over time, but I can't say we have seen necessarily a change in customer behavior associated with those. I think those are fairly fluid and still playing out.

Jerry Revich

Got it. And then, you know, really outstanding margin performance, particularly in Freight. I'm wondering, can you just expand on the mix benefits that you alluded to? Because, to see that margin performance with service as a percent of total declining year-over-year really stood out, so I'm wondering what parts of that business drove favorable mix? And then from an efficiency standpoint, are you folks back at pre-COVID levels of labor hours per unit or however you measure it?

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John Olin

With regards to the mix, Jerry, there's really three big drivers. And it's not only the second quarter, it's for the first half. And a lot of the favorability we're going to see in the first half is not going to be there or be a little bit of a headwind in the second half. The first area is in our equipment group, right? While the equipment group is a little bit lower than the average in terms of overall margin, we've had significant favorability. And that -- I'm going to take you back, Jerry, to an order that we had, an international order that wound up in the back half -- I'm sorry, the first half of 2023 that was very low-margin. And so in the first quarter, we're comparing against that and driving significant mix favorability. Again, that won't be there in the second half. The second area is with regards to our mining business. Our mining has been a good strong business for us and expected across the year. However, when we look at the production schedule, we are producing more OE in the first half and more aftermarket in the -- I'm sorry, more aftermarket in the first half and expect to do more OE in the back half. So that's going to turn from a tailwind to a headwind. And then the third area of mix favorability has been in our components group, driven by a couple of things. One is the international growth is greater in the first half. And within this product line, it's a higher margin. And then the second one is the cars that are being built for the railcar build, the orders that we got in the first half for specific cars are higher margin than in the back half. So the same thing there, we've got a benefit and then we're not going to have in the back half.

Jerry Revich

Got it. Thank you, John. And I apologize. The efficiency part of the question, are you folks back at the pre-COVID levels of efficiency at this point?

John Olin

The answer would be overall, yes. And I guess I wouldn't be thinking so much as pre-COVID, but some of the strike ramifications all behind us, all the efficiencies are back where we would expect within our plants. As a matter of fact, John -- Jerry, when we look at the first half of this year, the operation on -- the operations have run extremely well. The operations team has done an admirable job of kind of post-supply disruptions and the strike at Erie of really driving great productivity. And you're seeing that in some of that 3.2 percentage points of lift in the first half due to productivity.

Jerry Revich

Well done. Thank you.

Rafael Santana

Thank you.

Operator

Our next question comes from Ken Hoexter from Bank of America. Please go ahead with your question.

Ken Hoexter

Hey, great. Good morning. Rafael, John, I guess just a real quick one, clarify that North American order, did you mention that was a Class 1 railroad? Just to clarify that. And then looking at the margin expectation slide, you've got North American locomotive still down, railcar deliveries below historical average, Wabtec's share going up. Thoughts on sustainability of that share gain? I know there was lawsuits a while ago to kind of target that. I guess just how that's proceeded as new orders have come in? And then is there anything post the Chevron doctrine in terms of discussions on shifting from new-builds to mods or any discussions on that at this point yet?

Rafael Santana

Let me start, and I'll pass it on to John here. But the only thing we mentioned about that order, that was a North American order. That's the only data we've provided. John?

John Olin

Yeah. And with regards to the -- I think the question, Ken, was the railcar and market share. So going -- taking you back to the first half of last year, the supply disruptions were still in full swing, and we took an inventory position on that and it paid off very well. We gained a fair amount of market share because of availability. And we've seen a lot of that share -- it's tempered a bit, but we've seen a lot of that share stick. And again, I think it goes to the value of our products and the kind of the full service and the way we look at things in supporting and supplying our customers. So again, we're seeing that benefit this year in terms of holding on to a fair amount of that share.

Rafael Santana

You're other question on the Chevron precedent. I think we're very much having robust conversations with customers about their fleet needs for the future. I can't say we have seen any major shift in the conversations either as a result of CARB regulatory process or the two crew -- two-man crew mandate.

Ken Hoexter

All right. And then just a follow-up on the backlog was up 4% in the 12 months, but down 2% long term. Anything -- is the thought here that we're at past peak in terms of building that backlog, or is that -- you're going to tell me it's kind of lumpy and it comes in different things like the $600 million order? Any thoughts on the scale and size of backlog as we look into next year and beyond?

Rafael Santana

So first, I'll start with the way we run the business is really looking at what I call coverage, whether if it's 12 months out, 18 months out. And our coverage at this point, when I think about the next 12 months is -- it's strong and it's really continued work from the business groups to make sure that we drive in that direction. All in all, I think the pipeline of opportunities is strong. We continue to expand visibility into future years, which once again reinforces, I think, our position to drive profitable growth ahead. Yes, there's going to be variation quarter-to-quarter, as you pointed out. We've seen that in previous quarters before. And it really comes down to the coverage we have.

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Ken Hoexter

Great. Thanks, Rafael. Thanks, John.

Operator

[Operator Instructions] Our next question comes from Rob Wertheimer from Melius Research. Please go ahead with your questions.

Rob Wertheimer

Thanks, and good morning, everybody. My question is on -- just a minor one on the front half, back half. John, you mentioned a couple of differences in mix between front and back half, which were helpful. Are you doing -- with the level loading, are you doing fewer mods in the back half than the front half? And is there any room for -- I think you mentioned 3Q a little stronger than 4Q. I don't know if that was absolute or year-over-year, but is there any room for fill-in in revenue still in 4Q?

John Olin

So number one, I think the question on mods, I would broaden that question, Rob, to looking at the combined production of loco and mods. So in the first half, that would be up well into the double-digits. And in the back half, it would be flat to down slightly. So again, that's that shift that's driving the revenue and all the absorption and all those types of things. But right now, more in the back half for both mods and locos combined, we're looking at flat to slightly negative. [indiscernible]

Rob Wertheimer

Well, is that flat to slightly negative one half versus two half or year-over-year? That's what I'm trying to sort of figure out on. I understand the mining thing you said was down, but -- yeah, sorry, go ahead.

John Olin

That's half-to-half, right? We're going to have variations within the half. In the second quarter, we had very strong gain in locos, but modernizations weren't nearly up as much in the second quarter as the first quarter. But I was referring half-to-half. When we look at the back half in terms -- in total, we expect the back half, as we talked about revenue to grow but at a much more moderated rate than the first half, and the same thing with margin percent on a year-over-year basis. And if you look within the quarters within the second half, we would expect the third quarter to be up slightly in terms of growth over the fourth quarter for both revenue and profit growth.

Rob Wertheimer

Okay, perfect. Sorry to be pedantic there. Thank you. And then I guess your Transit guys are getting lonely. You're having great margin progress, a couple of good quarters there as well. Just any commentary on the end markets on, you know, price versus inflation, just margin direction in Transit? And I'll stop there. Thank you.

Rafael Santana

Let me start, and I'll let John complete, but we continue to see the same fundamentals in that business. We expect growth to be on that part of the business, as far as market goes, around 3% to 5%. We expect the teams to continue to apply, I'm going to call strong discipline around order intake, and that should ultimately continue to reflect on improved margins in the backlog, which is what we see today. So good progress, it's never going to be smooth, and you're going to see some variation on the backlog numbers as a result of that.

John Olin

Yeah, commenting on the 12-month backlog. They were down this quarter. They were a little bit tempered in the first quarter. And as you know and we've talked about, it's due on large part of our focus on being more selective on orders that we add to backlog. And Rob, that's in line with our effort to drive improved long-term profitability in the Transit business. We've seen the impact of the selectivity again in the first quarter to some extent, and we would expect to see it over the next few quarters as we build in a higher level of profitability in our backlog over time. But overall, the underlying strength and business of the Transit business is there, but we are going to see some shifts in timing of backlogs as we build in more profitability.

Rob Wertheimer

Thank you.

Operator

And our next question comes from Steve Barger from KeyBanc Capital Markets. Please go ahead with your question.

Steve Barger

Thanks. Good morning.

Rafael Santana

Good morning.

Steve Barger

Going back to digital, can you talk about how you define addressable market size in North America versus international and what the penetration rate is for each? I'm just trying to gauge the relative forward opportunities for those products.

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Rafael Santana

We are, of course, much more highly penetrated in North America. If you think about the bulk of our products with -- if you think -- while if you think about internationally, we still have significant opportunities here. And I think some of that is really connected to some of the products. I mean, you think about Trip Optimizer, we still have ways to go into markets like Kazakhstan, for instance. If you think about PTC 2.0, I think you continue to have demand out there and you're going to see us grow into some of these markets. What I think is interesting also is some of the products like Zero-to-Zero, which we continue to work through regulation in North America, we're moving forward with those into our international markets. So to some extent, you could start seeing some degrees of automation potentially moving faster in the international markets given some of the dynamics in North America. So more and more, I think positive growth coming from international, still some of the dynamics I described earlier in North America.

Steve Barger

So it's listed, for rounding, $800 million business. Is that a multibillion dollar opportunity internationally or I guess, globally, or how do you think about market size?

Rafael Santana

It is a multibillion dollar opportunity, so size is significant here. I think one of the things that I look at internationally is more the timing to get to some of these orders. You're fundamentally describing, in some cases, orders that might take a little bit more time to get those. And those are some really the work started by the group here a couple of years back, but glad to see the progress. I think you've heard from us on some of the orders we've gotten from PTC. You're going to see more of those orders outside of North America as we continue to progress.

Steve Barger

Got it. And John, for you. In the last few years, Transit margins in the fourth quarter have seen a pretty sizable step-up versus the prior three quarters. Do you expect that same dynamic this year?

John Olin

No, Steve, we don't provide individual quarters in margins. I would just say that overall, a lot of businesses over time develop traits and that ends up being in the margin profiles. And I've always felt that it's more important to look year-over-year than sequentially. But we're not going to provide some specific thoughts on the fourth quarter.

Rafael Santana

Just a clarification there, Steve, to see profitable growth ahead. We see that in the fundamentals of the business. And the team has really taken several steps in terms of heading to mid-teen margins and we expect that to continue.

Steve Barger

Got it. And just, John, if I look at the last three years, you know, staying away from this year, what causes that -- has caused that margin step-up? Is that budget flush at customers or what -- why did that happen in the past?

John Olin

In some cases, there's more aftermarket sales in the fourth quarter because customers budgets, a lot of government spending within the Transit business. SG&A typically has patterns of spending in the fourth quarter. But probably the biggest would be is the mix, off the top of my head, for Transit.

Steve Barger

Okay, thanks.

Rafael Santana

Thank you.

Operator

And ladies and gentlemen, that will conclude today's question-and-answer session. At this time, I'd like to turn the floor back over to Kyra Yates for any closing remarks.

Kyra Yates

Thank you, Jamie. And thank you, everyone, for your participation today. We look forward to speaking with you again next quarter. Goodbye.

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Operator

And ladies and gentlemen, with that we'll conclude today's conference call and presentation. We thank you for joining. You may now disconnect your lines.

**Load-Date:** July 24, 2024

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