BorgWarner Inc. (BWA) CEO Fred Lissalde on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-31-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.96 beats by $0.11 | Revenue of $2.49B (0.54% Y/Y) beats by $103.18M

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BorgWarner Inc. (NYSE:BWA) Q3 2019 Earnings Conference Call October 31, 2019 9:30 AM ET

Company Participants

Patrick Nolan - Vice President of Investor Relations

Fred Lissalde - President & Chief Executive Officer

Kevin Nowlan - Chief Financial Officer

Conference Call Participants

Joseph Spak - RBC Capital Markets

Noah Kaye - Oppenheimer

Ryan Brinkman - JPMorgan

Emmanuel Rosner - Deutsche Bank

Armintas Sinkevicius - Morgan Stanley

John Murphy - Bank of America

David Kelley - Jefferies

Operator

Good morning. My name is Sharon, and I will be your conference facilitator. At this time, I would like to welcome everyone to the BorgWarner 2019 Third Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise. After speakers' remarks, there will be a question-and-answer period. [Operator Instructions]

I would now like to turn the call over to Patrick Nolan, Vice President of Investor Relations. Mr. Nolan, you may begin your conference.

Patrick Nolan

Thank you, Sharon, and good morning, everyone. Thank you for joining us. We issued our earnings release at 6:30 AM Eastern Time posted on our website borgwarner.com on our homepage and on our Investor Relations homepage. A replay of today's call will be available through November 14. The dial-in number for that call is 855-859-2056. The conference ID for that replay is 2638875, or you can listen to the replay on our website.

With regard to our Investor Relations calendar, we will be attending multiple conferences between now and our next earnings release. Please see the Events section of our Investor Relations homepage for a full list.

Before we begin, I need to inform you that during this call, we may make forward-looking statements, which involves risks and uncertainties as detailed in our 10-K. Our actual results may differ significantly from the matters discussed today. During today's presentation, we will highlight certain non-GAAP measures in order to provide a clearer picture of how the core business performed and for comparison purposes with prior periods. When you hear us say, on a comparable basis, that means excluding the impact of FX, net M&A and other non-comparable items. When you hear us say adjusted, that means excluding non-comparable items. When you hear us say, organic, that means excluding the impact of FX and net M&A.

We will also refer to our growth compared to our markets. When you hear us say, market, that means the change in light vehicle production weighted for our geographic exposure. Our outgrowth is defined as our organic revenue change versus the market.

But now back to today's call. First, Fred Lissalde, our President and CEO, will comment on our Q3 results. This will be followed by a discussion of our recent cash flow performance. He will conclude with a discussion of our recent product highlights. Then Kevin Nowlan, our CFO, will discuss the industry outlook as well as the details of results and guidance. Please note, that we have posted an earnings call presentation to the IR page of our website. We encourage you to follow along with these slides during our discussion.

With that, I'll turn it over to Fred.

Fred Lissalde

Thanks, Pat, and good morning, everyone. We're very pleased to share our results from Q3 today and also provide an overall company update. Let me start with the highlights of the quarter on slide 4. I am pleased with our stronger than expected top line and margin performance in the quarter. With approximately $2.5 billion in sales, we were up about 4.5% organically. This compares to a market being down approximately 0.4%. So our outgrowth was about 490 basis points in the quarter, which was well ahead of our expectation, driven by stronger than expected revenue trends in Europe, essentially, and in China.

Regionally, we saw outgrowth in all major regions. On an organic basis, our European light vehicle revenue was up double-digits. Our North American and Chinese light vehicle revenue was up mid-single digits year-over-year. Our adjusted earnings per share came in at $0.96, ahead of our guidance, driven by the revenue upside and better than expected margins.

Our near-term cost actions are beginning to drive our incremental margins, and we are identifying additional cost saving opportunities to sustain our strong margin profile. At the same time, we are also securing key new wins across combustion, hybrid and electric, which is positioning us to deliver continued revenue outgrowth. In fact, in this quarter, we secured awards for two new products for electric vehicles, which I'll speak about in more detail shortly.

Next, I would like to highlight our strong cash generation on slide 5. As you know, cash flow has become an important focus for the company over the last couple of years. Year-to-date we have generated $478 million of free cash flow, up significantly year-over-year despite the volatile industry volume. We're able to drive this level of free cash flow thanks to our strong margin and earnings profile.

Combining this with, our increased focus on capital spending efficiency and working capital management we remain poised to continue to improve our free cash flow generation going forward. A strong cash generation allows us to reinvest in the business to support our continued revenue outgrowth initiatives. It also gives us an ability to provide real cash returns to our shareholders.

We've been relatively balanced in how we've deployed this capital over time. As you can see, over the past five years, we've utilized about half of our free cash flow for strategic growth opportunities while deploying the other half towards returns of capital to shareholders. We expect to maintain a balanced approach to capital deployment as we look ahead.

In a few minutes, Kevin will talk about our strategic deployment of capital that we just executed this week, which allows us to eliminate our exposure to asbestos. Beyond our track record of capital deployment, our prudent leverage profile combined with strong cash generation better positions us to manage the business throughout the demand cycle.

At the same time, as we manage through the challenging global market environment, we continue to focus on pursuing new business and new technologies. This quarter, we achieved continued success on both fronts bookings and new technologies.

For combustion products, on slide 6, I want to highlight two contracts. First, we're supplying our turbocharges to a global OEM for its gasoline engines in multiple markets including North America. This program will start with two vehicles and expand to additional applications over the life of the program.

And second, we're supplying our gasoline EGR technology to Indian OEM for its small gasoline engines. This is an expansion of our existing business with this customer. Both of these wins point to the increased penetration of highly efficient gasoline engines around the world.

There are also great examples of applying already proven solutions towards meeting demands of OEMs. This allows us to reduce time to market, reduce cost to our customers while sustaining our product leadership in combustion propulsion.

Now, let's turn to slide 7 and discuss our first awards for two new electric vehicle products. First, our Torque-Vectoring Dual-Clutch for electric vehicles. This Dual-Clutch design replaces the conventional differential in an electric driveline while improving handling and maneuverability in an all-wheel drive application.

This clutch distributes torque independently to the left and right wheels from its position on the rear axle. The technology features disconnect capabilities to minimize energy loss and increase range.

This is a great example of applying our existing clutch and hydraulic controls expertise to electric vehicle platforms. This first award is supplying a major global OEM with start of production expected in 2022.

Next, I'm glad to announce that we have secured our first contract for our integrated drive module, so-called iDM. This product integrates our highly efficient power electronics with our advanced transmission system and our drive motor technology.

Our iDM creates value to our customers in several fields, including packaging, efficiency, low NVH, and of course, ease of assembly. We're supplying a China EV brand for an electric vehicle which is scheduled to go into mass production in 2021.

Importantly all components used in this iDM are part of BorgWarner's owned technologies. We have ongoing interest from several customers and are currently pursuing multiple program awards for our iDM.

Our differentiation in electric propulsion is our full propulsion system expertise. Many of our competitors purchase some of their components and subsystems. In our case, we design and manufacture the motor, the transmission, and the power electronics, creating system value for our customers. This first iDM award is a significant step for BorgWarner.

So, let me summarize the quarter. We exceeded our expectation for revenue growth. Earnings were better than our guidance, driven by better topline performance and our cost saving measures. We delivered strong free cash flow and the benefits of R&D investments in electric propulsion are continuing to pay off with the award of our first iDM contracts.

Before I turn it over to Kevin, I also want to commend and thank the entire BorgWarner team for how they have reacted to the challenging external environment. It is your actions, smartness, and dedication that allows the company to successfully manage the presence, while continuing to position us for future success.

Now, over to you Kevin.

Kevin Nowlan

Thank you, Fred and good morning everyone. Before I review the financials in detail, I'd like to provide a quick overview of the two key drivers of our third quarter results. First, our revenue outgrowth was ahead of our expectations at 490 basis points in the quarter. This was driven primarily by higher volumes of new programs and strong mix, especially in Europe. This puts us on track to deliver full year revenue outgrowth of 350 to 400 basis points. Second, our margin performance was ahead of guidance driven by better-than-expected sales and our focus on cost management actions.

Let's turn to slide 8, where you can see our perspective on industry production. Overall, while production expectations continue to moderate in the quarter, the volatility of these forecasts has declined over the past few months. This is a welcome change.

Looking specifically at Q3 global production for our market declined by 0.4% year-over-year roughly at the midpoint of our expectations going into the quarter. Within that global result, we saw European production up less than 1% against a relatively easy prior year comparison. North America production was down modestly while China production was down about 5% as that market remains under pressure.

On a full year basis we now expect the market decline to be in the minus 4% to 4.5% range which is roughly in line with our prior outlook. By region, we're now planning for China to be down anywhere from 9% to 11% on a full year basis which is a modest improvement from a few months ago. Europe is likely to be down 3.5% to 4% just as we previously expected. And North America is now likely to be down 2.5% to 3.5% which is a little bit worse than before.

As we look toward the remainder of 2019 and into 2020, we expect that the challenging industry conditions will continue so we are managing our cost structure accordingly.

Let's turn to slide 9. As we look at year-over-year revenue, you can see the impact from the thermostat divestiture we executed earlier this year. In addition, you can see that the stronger U.S. dollar reduced revenue by about 2.7% from a year ago.

Excluding these items, our organic sales were up 4.5% despite the 0.4% decline in industry production. This is the 490 basis points of market outgrowth. And importantly, this outgrowth occurred in all of the major light vehicle markets around the globe.

In Europe our light vehicle organic revenue was up double digits on strong new programs and platform mix. And in China we grew double digits over the market. Partially offsetting the strength in our light vehicle growth our commercial vehicle and off-highway businesses declined relative to last year, resulting in a more than 100 basis point drag on our total organic growth. Overall, we're pleased that we continue to deliver revenue outgrowth even in this challenging end-market environment.

Now, let's look at our adjusted operating income performance, which can be found on slide 10. Q3 adjusted operating income was $294 million, compared to $293 million in the third quarter of 2018. Our adjusted operating margin was 11.8%, which was flat year-over-year. On a comparable basis, adjusted operating income increased $9 million on $109 million of higher sales, which translates to an incremental margin of roughly 8%. Even though this was below our long-term expected incremental conversion of 15%, the result was still ahead of our guidance, due to stronger revenue and our cost management actions, which included a reduction in R&D spending in our engine segment compared to the same quarter in 2018.

Adjusted earnings per share, was $0.96 for the quarter above the top end of our guidance range. The $0.04 decline in earnings per share compared to the third quarter of 2018 was driven by lower equity and affiliates earnings and a slightly higher tax rate.

Moving to cash flow. As Fred discussed earlier, we are proud of the fact, we delivered a strong result for the quarter. In the third quarter, we generated $255 million of free cash flow, significantly stronger than the $126 million we delivered in the same quarter a year ago. This is a great result as we continue to focus on cash generation as a management team.

Now, let's take a closer look at our segment results on slide 11. Engine segment sales were just over $1.5 billion in the quarter. Organic sales for the Engine segment increased 4.6% or $69 million despite lower industry-wide production. Growth in Europe for our Engine business was partially offset by the impact of the weaker China end market.

Adjusted EBIT was $241 million for the Engine segment or 15.9% of sales. On a comparable basis, the Engine segment's adjusted EBIT was up $8 million on $69 million of higher sales. Drivetrain segment sales were $993 million in the quarter. On a comparable basis, sales for the Drivetrain segment increased 4.2% year-over-year, also meaningfully outperforming the market, driven by strong outgrowth in China and European mix.

Adjusted EBIT was $100 million for Drivetrain or 10.1% of sales. On a comparable basis, the Drivetrain segment's adjusted EBIT was down $5 million on $41 million of higher sales. The adjusted EBIT decline was driven by higher R&D spending and launch-related costs, primarily in China.

Now, I'd like to discuss our full year guidance, which is on slide 12. Our guidance is based on the end market assumptions I discussed earlier, with global production down 4% to 4.5%. Despite that, we expect organic revenue to be in the range of down only 1% to roughly flat. That's because we continue to expect to drive significant market outgrowth of 350 to 400 basis points for the full year. This is in line with our year-to-date outgrowth of approximately 400 basis points.

With these organic growth assumptions, we now expect total revenue to be in the range of $9.95 billion to $10.1 billion. The midpoint of this guidance is slightly lower than the midpoint of our prior guidance, as there is an additional $105 million of FX headwinds that are offsetting the benefit of stronger organic growth. Our adjusted operating margin is now expected to be in the range of 11.7% to 12.0%. The 20 to 30 basis point increase in our margin outlook relative to our prior guidance reflects stronger organic growth, which has a higher incremental margin than the margin impact of the additional FX headwinds and cost management actions including lower full year R&D relative to our prior planning assumption.

We continue to proactively manage and aligned our overall cost structure to the revenue we're actually seeing in the marketplace, while ensuring we continue to support the investments that drive our sustained revenue outgrowth. For full year adjusted EPS, we've tightened our guidance by increasing the bottom end of our range by $0.10 as a result of our stronger margin outlook. Therefore our new guidance range is $3.85 to $4 per diluted share.

And finally, we are now targeting free cash flow of $550 million to $600 million which is up $25 million from our prior guidance. In addition to higher earnings at the midpoint of our guide, we expect capital spending to come in lower than our prior guidance. That's our 2019 outlook.

Before we move to Q&A, I'd like to spend a few minutes discussing an important transaction you saw us announce yesterday which is summarized on slide 13. On Wednesday, we signed and closed on a transaction in which we effectively sold the company's asbestos liabilities to a subsidiary of Enstar which is a publicly traded insurance company that specializes in managing runoff liability exposures like asbestos.

The transaction involved BorgWarner investing $172 million in cash into the non-operating legal entity that holds the asbestos liabilities. Then we transferred this entity including the cash and other related insurance assets to the buyer. The result of this transaction is that, we expect to remove the $772 million in asbestos liabilities from our balance sheet.

By eliminating the company's exposure to this liability, we will also avoid future exposure to the annual defense and indemnity cash costs which have been running in the $45 million to $60 million range as you can see on the slide. We think this was an important strategic deployment of capital that will eliminate the overhang of asbestos liabilities on our balance sheet and our cash flow.

Overall, we had a really solid quarter as we delivered 11.8% adjusted operating margin, 490 basis points of market outgrowth, $0.96 of adjusted EPS which was above our guidance range and $255 million of free cash flow. On top of that we executed a very important derisking transaction this week.

As a management team, we are taking the necessary actions to maintain our company's historically strong margin profile and strengthen our free cash flow generation. We'll continue to do this while managing through a very difficult near-term market environment that we expect will continue for the remainder of 2019 and likely into 2020.

With that I'd like to turn the call back over to Pat.

Patrick Nolan

Thank you, Kevin. Sharon we're ready to open up for questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from Joseph Spak with RBC Capital Markets.

Joseph Spak

Thanks all and good morning. I guess I just first wanted to focus on the backlog that you're indicating for this year. It's within your -- the range you talked about at the beginning of the year, but it does look like it was raised 15% at the midpoint versus what you indicated last quarter. So -- and I apologize if I missed this, but did something come back? Or did something pull forward? Or what was the cause of that revision?

Fred Lissalde

Joe, the major driver is actually from the engine group, better-than-expected new program launch and associated volume on small gasoline in Europe. That's the main driver.

Joseph Spak

Okay. So you took that down last quarter and then the volumes were just stronger than you thought as this quarter progressed?

Fred Lissalde

Yes. Yes it was difficult to forecast with the volatility of the market and it turned out to be better than expected.

Joseph Spak

Okay. And then just on the iDM market, it's nice to see a win there. Can you talk a little bit about how -- now that you're sort of bidding on those awards, how you see that market evolving? It’s having all the subcomponents a true differentiating feature in winning that award and as you go after additional business?

Fred Lissalde

Yes, we think it is a true differentiating features because by -- not only developing and buying, but also manufacturing the three key elements of that iDM, we're able to design it smarter and make it smarter and make it lighter. And in those systems this is the interaction of those subsystems that make the product creating value in different shapes or form for our customers. So we think that it is going to be a differentiating factor and it has been for this business win.

Joseph Spak

And in the quoting are you seeing any shift towards more of an integrated product versus more of in a way a sourced-by-component strategy?

Fred Lissalde

This one was a system. We also as you know are in production with what we call eDM which is transmission end motor. We're not forced to sell our system. We're happy to sell systems or subcomponents. What's important in this market is to understand the system in order to partner with our customers and sell them whatever they want. And we are in this position.

Joseph Spak

Okay. Thank you.

Fred Lissalde

Thanks, Joe.

Operator

Next question comes from with Noah Kaye with Oppenheimer.

Noah Kaye

Thanks. Good morning. So high-level question first. We're a few months away from the start of the implementation in Europe the more stringent CO2 standards. I guess, just based on your conversation with the customers what you've got in the pipeline as the process plays out over the next few years how does this impact BorgWarner in terms of content per vehicle growth backlog other dynamics?

Fred Lissalde

So Europe, first of all, the second half of this year is stabilizing and it's a good thing. It's true that it's comparing to a rather weak second half of 2018. And we see no signs of WLTP disruption. Now as far as next year is concerned for RDE, I would say that it's difficult to forecast and we will give you our look in our Q4 call.

The good news for us is that these standards in Europe will drive opportunity for our components and systems. So we see that as a plus. How this -- what will be the disturbance in 2020 due to the RDE validation remains to be seen. And again Noah, we'll give you some more color in our Q4 call.

Noah Kaye

Okay. I appreciate that. I think you commented on the key points of having an integrated solution with the iDM just knowing all the components there. So I want to ask about integration on, sort of, a similar product which would be electric turbochargers. I think one of your competitors recently stated they're introducing an E-turbo where the motor is integrated on the shaft of the turbo unit.

Clearly, you've got in-house competencies around both turbos and electric motors. So engineering and integrated unit would seem feasible, I guess just -- is that in your product road map? Is it something your customers are asking for? And more generally how do you see your competitive positioning with respect to electrically boosted turbos?

Fred Lissalde

Yes. So we are in production with E-boosters since quite some time with Daimler and others. And it is pretty much also motor around the turbo and our own power electronics. It's also a system that requires understanding of turbo motor and power electronics. So we have that in our portfolio. That's the E-booster. We also have E-turbo in our portfolio. And we think that this market will see some daylight in the next years to come. We are -- we believe is that electrification of turbocharges will drive growth for us.

Noah Kaye

Okay. Very helpful. I will jump back in queue. Thanks.

Fred Lissalde

Thanks, Noah.

Operator

Next question comes from Ryan Brinkman with JPMorgan.

Ryan Brinkman

Hi. Great. Thanks for taking my question. You know, maybe just first can you talk about what you think the impact of customer consolidation is on the supply base around BorgWarner? Are there any market share or pricing implications for investors to consider?

Fred Lissalde

Are you -- well, overall we're very global and we serve all markets around the world. There is not one customer's that we don't serve. And to the extent that they use the same propulsion and they want to combine forces I think there are costs and benefits to both us and them. So we focus on what we can control and what we can control is carry on delivering great products that deliver value to any customers around the world.

Ryan Brinkman

Okay, great. Thanks. And can you please remind us of your latest exposure to commercial vehicles and your outlook for this market. Some of the other suppliers reporting this quarter have called out softer production of off-the-road vehicles where I think yours – you're primarily commercial on-highway. That tracked better, but there's a lot of changing estimates for next year. Just curious how you're thinking about that?

Fred Lissalde

Yeah. Commercial vehicle overall is about 13%, 14% of our revenue. And it's very, very I would say fragmented around the three continents about a third in North America, a third in Europe, and the last third between China and Brazil. It's also very fragmented as far as Class 8 is concerned in off-highway and agricultural construction. And its true CV was down this quarter especially the Class 8. And we'll give you our view of 2020 in the Q4 call. But again, when you think about 14% or 13% of revenue for CV for BorgWarner don't associate that to U.S. Class 8. It's much more than that.

Ryan Brinkman

Ryan Brinkman

Very helpful. Thank you.

Fred Lissalde

You’re welcome.

Operator

Your next question comes from Emmanuel Rosner with Deutsche Bank.

Emmanuel Rosner

Good morning. First some clarification on the backlog, if there's anything you can give in terms of incremental color. So, I guess last quarter, you were sort of like taking your expectations down for this year's backlog. In particular, you were making a fairly bold forecast or assumption of essentially no backlog in the third quarter. Obviously, extremely pleased with your performance this quarter $153 million, but it sort of feels like just incrementally higher volumes wouldn't sort of like explain going from like 0 to like $150 million. So anything else you can give us in terms of dynamics of why you maybe felt somewhat less positive? And what actually sort of is playing out in the quarter that turned out to be a really, really strong backlog?

Fed Lissalde

Yeah. So the last quarter guide from a backlog perspective, we actually thought that the China backlog was going to be down. And we saw that Q3 was modestly stronger than expected. But as I mentioned in my prepared remarks, the majority of the backlog is better-than-expected engine products related to small gasoline European platforms. And it was also a little bit of mix in Europe too. And that was not forecasted right? It's a good surprise that we take. We have enjoyed that our growth and also converted very well on it.

Emmanuel Rosner

Understood. And are you able to talk about implications from I guess the backlog now for this year trending towards the high end of the range communicated all the way back in January despite some fairly meaningful weakening in I guess production environment. What are the implications for that in terms of your existing three-year backlog? Are the

What are the implications for that in terms of your existing three-year backlog? Are the puts and takes still the same where the volumes are maybe weaker than its back in January but at the same time potentially faster rollout of some of these launches or better volume on some of these new products? Or is it too early to tell?

Kevin Nowlan

Yeah, I think it's – I mean, I think overall what I would tell you is as we look ahead obviously, the markets are looking a lot different than they were maybe a year ago at this time. And undoubtedly, that will have implications on the business. We'll give more updates on our longer-term outlook when we get into our Analyst Day in the spring upcoming. But at this point, we're not prepared to give guidance on that in terms of a long-range outlook. But I would say obviously market is – has changed from where we were a year ago in terms of our outlook.

Emmanuel Rosner

Understood. Thank you.

Operator

Next question comes from Armintas Sinkevicius with Morgan Stanley.

Armintas Sinkevicius

Great. Thank you for taking the question. I was hoping you could – as we look ahead here and think about some of the puts and takes for margins into 2020 obviously a lot of it's driven by global production the environment in China the backlog in China, the emission standards in Europe. But something within your control is the cost management, which you've done a good job on, but trying to think through how you plan to attack cost of goods sold and manufacturing?

Kevin Nowlan

Yes, I think -- I mean a focus point of ours as I've talked about in my remarks is sustaining our strong margin profile. And obviously we -- as we indicated on the call, we expect that the markets are going to remain under pressure and challenged as we look ahead to 2020. So our continued focus on managing cost performance is going to be a key element

2020. So our continued focus on managing cost performance is going to be a key element of how we think about 2020. So when we give guidance in February, you can expect it to reflect that we expect the market to be under pressure and we're going to look at cost actions that are appropriate to take to make sure we sustain the margin profile we have.

Armintas Sinkevicius

Okay. And then with regards to the asbestos transaction, can you remind me how the accounting works for the cash cost? Does it flow through the income statement? Or is it a cash flow item?

Kevin Nowlan

It's a cash flow -- the entirety of the liability has been accrued on the balance sheet. And so what happens is when we have cash costs, it simply relieves the liability. So it's not P&L. It's purely cash. But it's obviously real cash going out of our pockets $45 million to $60 million every year.

Armintas Sinkevicius

Okay. Much appreciated.

Operator

Next question comes from John Murphy with Bank of America.

John Murphy

Good morning guys. Just sort of in light of the divestiture of the thermostat business and what you're doing with the asbestos liability, it seems like you're a little bit more open to at least small portfolio actions and sort of a little bit of restructuring here. Given the balance sheet is pretty underlevered at 0.7 times at least relative to other folks in the industry, I'm just curious how open you are or how active you are in portfolio -- in your portfolio review and potentially adding maybe some acquisitions? Given the stress that we might see there might be some really good stuff that opens up in the next year or two. I mean, how are you thinking about that? And how far could you go on leverage?

Fred Lissalde

Yes. We're managing our portfolio actively and we will do that going forward. From an M&A perspective, what drives our approach is the drive for technology in two elements: First would be scale and competencies in electronics; and secondly system focus and electric propulsion. So we do that very disciplined and it is a focus of us and we just carry on doing that.

John Murphy

So Fred, it's fair to characterize that as small acquisitions that would be focused on the EV powertrain is really where you're headed. Nothing that would be big bang, nothing that would be in "sort of old school combustion technology." Is that a fair statement?

Fred Lissalde

Again, we'll be opportunistic and -- but also very disciplined on how we see that. The drive will be technology. That's the punch line.

John Murphy

Okay. And then just a clarification on the sale of the asbestos liability, it's being called Morse TEC. Is there anything going on with the chain business that's being sold? Or is that all residing? Is this just a way that this has been structured under the name Morse TEC just a little confusion.

Kevin Nowlan

They unfortunately happen to share the name Morse, but the Morse TEC entity that was transferred to Enstar has -- is a non-operating subsidiary of the company. So there is no portion of the operating business including the chain business that was transferred as part of this. It's still absolutely an important part of BorgWarner going forward.

John Murphy

….the liability and the assets going over?

Kevin Nowlan

That's called Morse Systems. It's the liability that happened to reside in a legal entity that had the name Morse TEC LLC. That's what's been transferred to Enstar. Non-operating, it really has the asbestos liabilities some environmental liabilities and then the cash and the insurance-related assets.

John Murphy

That's very helpful. Thank you very much.

Operator

[Operator Instructions] We have a question from David Kelley with Jefferies.

David Kelley

Good morning guys. Thanks for taking my question. You alluded to the cost initiatives starting to bear fruit. I think you're targeting $40 million to $50 million in savings over some 18 months or so. Can you kind of update us on where we are in that process?

Fred Lissalde

Yes. And I think you're starting seeing evidence on the results in our Q3. And as Kevin alluded to we will give you some more updates in Q4 call. We started by looking at the SG&A and the corporate costs. And now we take a bit of a more aggressive look at our manufacturing costs and other structural costs and that's the picture that we're going to give you hopefully in early next year. So far on track.

David Kelley

Okay. Perfect. Thank you. And maybe I get the same answer for this question. But just thinking back to your last three-year backlog update, I think 80% of it was tied to EVs and hybrids, clearly weighted more to hybrids though. It seems like over the last few months EV adoption has been a bit softer than most expected particularly in China. Are you more or less bullish today on hybrid adoption and potential sales growth? And do you foresee the pace of EV adoption getting pushed out even further?

Fred Lissalde

We are bullish on electrification overall. We think that the world is moving towards electrification. And for us with our portfolio it doesn't really matter if it's hybrid or electric. We are in a position to support the customers with whatever they want to do.

David Kelley

But -- okay. Thank you. But just a quick follow-up. You weren't seeing any, I mean, it's got a lot of -- you're getting a lot of traction in China and the EV market. Are you seeing any pullback in customer interest and the technology or transition to hybrids or anything there?

Fred Lissalde

You'll have a little bit of noise driven by incentives. And yes, we saw the EV pull in China getting a little bit choppy. But the contracts are still coming in and we think that the long-term outlook for electric vehicle as well as hybrids in China is very strong for us.

David Kelley

Perfect. Really appreciate the color. Thank you.

Fred Lissalde

Thank you.

Operator

At this time, I will turn the call over to Mr. Nolan.

Patrick Nolan

I'd like to thank you all for your great questions today. If you have any follow-ups, feel free to reach out to me directly. Sharon, you can close the call.

Operator

That does conclude the BorgWarner 2019 third quarter results conference call. You may now disconnect.