25-Oct-2023

Westinghouse Air Brake Technologies Corp. (WAB)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

Kristine Kubacki
Vice President-Investor Relations, Westinghouse Air Brake Technologies Corp.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

OTHER PARTICIPANTS

Justin Long
Analyst, Stephens, Inc.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Nathan Ho
Analyst, BofA Securities, Inc.

Ivan Yi
Analyst, Wolfe Research LLC

Matthew Elkott
Analyst, TD Cowen

Saree Boroditsky
Analyst, Jefferies LLC

Rob Wertheimer
Analyst, Melius Research LLC

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Wabtec Corporation Third Quarter 2023 Earnings Conference Call. All participants will be on listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded. I would now like to turn the conference over to Kristine Kubacki, Vice President of Investor Relations. Please go ahead.

Kristine Kubacki
Vice President-Investor Relations, Westinghouse Air Brake Technologies Corp.

Thank you, operator. Good morning, everyone, and welcome to Wabtec's Third Quarter 2023 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 our Investor Relations tab on wabteccorp.com.

Some statements we're making are forward-looking and based on our best view of the world and our business today. For more detailed risks, uncertainties and assumptions related to our forward-looking statements, please see our 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 O. Santana

President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

Thanks, Kristine, and good morning, everyone. Let's move to slide 4. I'll start with an update on our business, my perspectives on the quarter, the progress against our long-term value creation framework, and then John will cover the financials. We delivered another strong quarter, evidenced by robust sales growth, margin expansion and increased earnings and cash flow. We achieved these, despite increased volatility and uncertainty in the economy. Sales were $2.5 billion, which was up 22.5% versus prior year.

Revenue was driven by strong performance from both the Freight and Transit segments. Total cash flow from operations was $425 million. Cash generation was driven by higher earnings and improved inventory management. Overall, our financial position remained strong. We continue to execute against our capital allocation framework to maximize shareholder value by investing for future growth and returning cash to shareholders.

The 12-month backlog was over $7 billion, up 13%, signifying continued momentum and visibility across the business into 2024. Total multiyear backlog was $21.5 billion. Overall, the Wabtec team delivered a strong quarter behind solid execution. Looking ahead, I'm encouraged by both the underlying momentum across the business and the team's unrelenting focus on delivering for our customers. And even against a more uncertain and volatile macro environment, we believe Wabtec is well positioned to drive profitable growth ahead.

Shifting our focus to slide 5, let's talk about our 2023 and market expectations in more detail. While key metrics across our Freight business remain mixed, we continue to be encouraged by our business momentum, activity in international markets and our robust pipeline of opportunities across geographies. North America carloads continued to be down in the quarter, which resulted in locomotive parkings up slightly from last quarter's levels. Yet, we continue to see significant opportunities across the globe in demand for new locomotives, modernizations and digital solutions as our customers invest in solutions that continue to drive reliability, productivity, safety and fuel efficiency.

Looking at the North American railcar builds, demand for railcars continued to show growth. The industry outlook for 2023 is for about 45,000 cars to be delivered. Internationally, activity is strong across core markets such as Latin America, Australia, South Africa and Kazakhstan. Significant investments to expand and upgrade infrastructure are supporting a substantial international orders pipeline. In mining, commodity prices are supporting 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 recent business highlights. During the quarter, we signed a strategic MOU with KTZ, the national railway company in Kazakhstan, for over $2 billion. This agreement will support significant freight growth through the state-of-the-art equipment and technologies, driving productivity and lowering operating costs. This framework includes locomotives to be delivered in 2024, a long-term supply agreement and a collaboration on a number of digital technologies, all of which we expect to drive strong orders and sales growth in 2024.

Speaking of our business in Kazakhstan, the team just achieved a significant milestone by delivering its 500th locomotive.

Looking at our mining business, the team signed orders totaling over $150 million, which is up double digits versus last year. And early in the fourth quarter, our team in Latin America won an order for 22 additional locomotives to be delivered in 2024. In North America, we won an order in New York City Transit to supply components for an additional 640 subway cars.

Also, late last quarter, we closed the L&M acquisition that expanded our heat transfer portfolio in mining. This is off to a great start. The integration is on track. Third quarter revenue is ahead of plan, taking advantage of a strong mining market globally.

I'd also highlight Nordco which we acquired back in 2021. Our maintenance of way business continues to be ahead of plan and is experiencing double-digit growth in 2023. All of this demonstrates the continued momentum across the business, the team's relentless focus on driving for our customers and the strong pipeline of opportunities we're executing on. Wabtec's well positioned to capture profitable growth with innovative and scalable technologies that addresses our customers' most pressing needs.

Turning to slide 7, I'd like to discuss in more detail our international markets. While North America provides us a solid foundation to refresh and renew the installed base, we also have a significant opportunity for growth across international fleets by leveraging our broad portfolio and superior technologies. We have been successful in expanding our international installed base over time, which has grown at roughly 4.5% annually for the last six years.

Looking ahead, the pipeline of opportunities in our international markets continue to strengthen, and as a result, we expect continued expansion in our installed base. Increasing freight volumes from mining, agriculture and intermodal continue to drive the need for increased investment in clean, efficient and safe modes of transportation. We expect growth in 2024 from key regions like Latin America, CIS, Australia and South Africa, driven by our regional footprint and local partnerships. Our technologies are delivering more fuel-efficient, reliable solutions, which will reduce operational costs for our customers around the world.

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

John A. Olin

Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

Thanks, Rafael, and hello, everyone. Turning to slide 8, I will review our third quarter results in more detail. We delivered another good quarter of operational and financial performance from strong underlying momentum across the business, coupled with great execution from the team. Sales for the third quarter were $2.55 billion, which reflects a 22.5% increase from the prior year. Sales were driven by strong growth across both the Freight and Transit segments.

For the quarter, GAAP operating income was $370 million, driven by higher sales and focused cost management. Adjusted operating margin in Q3 was 17.9%, up 1.5 percentage points versus the prior year. The increase during the quarter was driven by significantly higher sales, improved productivity and cost management, partially offset by manufacturing inefficiencies, driven by the strike at our Erie facility. GAAP earnings per diluted share were $1.33, which was up 51.1% versus the third quarter a year ago.

During the quarter, we had pre-tax charges of $13 million for restructuring, which was primarily related to our Integration 2.0 initiative to further integrate Wabtec's operations and to drive $75 million to $90 million of run rate savings by 2025. In the quarter, adjusted earnings per diluted share were $1.70, up 39.3% versus prior year.

Overall, Wabtec delivered another strong quarter. We outperformed our expectations, demonstrating the underlying strength and momentum of the business. And as a result, we are fine-tuning our full year outlook by increasing our sales and adjusted earnings guidance.

Now turning to slide 9. Let's review our product line in more detail. Third quarter consolidated sales were very strong, up 22.5%. Equipment sales were up 38.8% from last year due to higher locomotive sales which, as planned, were significantly skewed to Q3 versus Q4, along with increased demand for mining products this quarter.

Components sales were up 32.3% versus last year, largely driven by higher North American OE railcar build and market share gains in freight car product sales, along with increased demand for industrial products. Sales also benefited from the strategic acquisition of L&M late in the second quarter by $42 million.

Digital Intelligence sales were down 3.2% from last year, which was driven by a softness in our North American signaling business, partially offset by higher demand for international PTC, next-gen onboard locomotive products and digital mining.

Our Services sales grew 17.6%. Sales growth was driven by higher modernization deliveries and increased part sales. Our customers continue to recognize the superior performance, reliability, efficiency and availability across our Wabtec locomotive fleets.

Across our Transit segment, OE and aftermarket sales significantly increased versus last year. Segment sales were up 20.0% to $660 million, behind the execution of our growing backlog, easing of supply chain disruptions and comparing against the cyber impact in Q3 2022. The momentum in this segment is strong across our core markets, as secular drivers such as urbanization and decarbonization accelerate the need for investments in sustainable infrastructure.

Moving to slide 10. GAAP gross margin was 31.0%, which was down 0.1 percentage points from Q3 last year, while adjusted gross profit margin was up 0.1 percentage points, driven by higher sales and improved productivity, partially offset by inefficiencies related to the strike in Erie.

Mix was favorable, driven by a richer mix between and within segments. Raw material costs, while still elevated, were largely flat on a year-over-year basis. Foreign currency exchange was favorable to sales by $32 million or 1.5 percentage points, and it improved our third quarter gross profits by $7 million.

Finally, manufacturing costs were positively impacted by favorable fixed cost absorption and benefits of Integration 2.0, more than offset by manufacturing inefficiencies, primarily at our Erie facility. Our team continues to execute well to mitigate the impact of continued cost pressures by driving operational productivity and lean initiatives.

Turning to slide 11. For the third quarter, GAAP operating margin was 14.5%, which was up 2.0 percentage points versus last year, while adjusted operating margin improved 1.5 percentage points to 17.9%. GAAP and adjusted SG&A were $295 million. Adjusted SG&A as a percentage of sales was 11.6%, down 0.7 percentage points versus the prior year as we leverage higher sales and strong focus on managing costs.

Engineering expense was $53 million, about flat with Q3 last year. We continued to invest engineering resources and 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 12, starting with the Freight segment. As I already discussed, Freight segment sales were very strong for the quarter, up 23.4%. GAAP segment operating income was $327 million for an operating margin of 17.3%, up 2.1 percentage points versus last year.

Adjusted operating income for the Freight segment was $399 million, up 30.0% versus prior year. Adjusted operating margin in the Freight segment was up 1.3 percentage points from prior year at 21.2%. The increase was driven by significantly higher sales, including fixed cost absorption and lower SG&A as a percentage of revenue and improved mix, somewhat offset by manufacturing inefficiencies driven by the strike at Erie.

Finally, segment multiyear backlog was $17.61 billion, down 8.1% from the end of Q3 last year. We continue to compare against the multiyear modernization and locomotive orders, totaling over $1.5 billion that we received in 2022. The 12-month backlog was $5.28 billion, up 15.7% for the same period and shows good momentum well into 2024.

Turning to slide 13. Transit segment sales were up 20.0% to $660 million. When adjusting for foreign currency, Transit sales were up 14.5%. GAAP operating income was $68 million, up 28.3%. Restructuring costs related to Integration 2.0 activities were $10 million in Q3.

Adjusted segment operating income was $83 million, which was up 38.3%. Adjusted operating income increased as a result of higher sales, favorable mix, benefits from our Integration 2.0 activities and the cyber impact in Q3 2022. This resulted in adjusted operating margin of 12.5%, up 1.5 percentage points from last year. Finally, Transit segment multiyear backlog for the quarter was $3.87 billion, up 12.6% versus a year ago.

Now let's turn to our financial position on slide 14. Q3 cash from operations was $425 million versus $204 million in the prior year. Cash flow benefited from higher earnings and improved inventory management. Our debt leverage ratio was 2.1 times at the end of the third quarter, which was favorable versus prior year.

And finally, we've returned $344 million of capital back to shareholders year-to-date through share repurchase and dividends. During the third quarter, we utilized free cash flow to pay down debt and reduce leverage after the $229 million acquisition of L&M in the second quarter of 2023. As you can see in these results, our financial position is strong, and we continue to allocate capital in a balanced strategy to maximize shareholder returns.

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

Rafael O. Santana

President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

Thanks, John. Let's flip to slide 15 to discuss our updated 2023 financial guidance. We believe that the underlying customer demand for our products and solutions continues. Our orders pipeline and 12-month backlog continue to be strong, providing solid visibility for profitable growth ahead. The team is committed to driving top line growth and adjusted margin expansion in 2023, despite a challenging macro environment.

With these factors in mind, we are increasing our previous guidance. We now expect 2023 sales of $9.5 billion to $9.7 billion, up nearly 15% from last year at the midpoint, and adjusted EPS to be between $5.80 and $6 per share, up about 21.5% at the midpoint. We continue to expect cash flow conversion to be greater than 90%.

Looking ahead, while the macro environment has become more uncertain over the last quarter, I'm confident that Wabtec's well positioned to drive profitable growth in 2024, which is aligned to our long-term financial framework.

Now, let's wrap up on slide 16. As you heard today, our team delivered on another strong quarter. Even in a dynamic environment, we are committed to delivering on our value creation framework. Through the strength of our portfolio, resilient installed base, innovative solutions, and a rigorous focus on execution. Wabtec is well positioned to drive profitable long-term growth and maximize shareholder returns.

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

Kristine Kubacki
Vice President-Investor Relations, Westinghouse Air Brake Technologies Corp.

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 SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question is from Justin Long of Stephens. Please go ahead.

Justin Long Q
Analyst, Stephens, Inc.

Thanks. Good morning and congrats on the quarter.

John A. Olin A
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

Good morning, Justin.

Justin Long Q
Analyst, Stephens, Inc.

So maybe to start, I was wondering if you could quantify the strike impact at Erie in the quarter. And thinking about the guidance, the full year outlook was raised, but it implies a sequential step-down in earnings as we move into the fourth quarter. So, John, can you give a little bit more color on some of the key drivers to that sequential pressure.

John A. Olin A
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

Sure. So number one, on the Erie, we couldn't be more pleased that we came to a successful agreement with the union during the quarter. Well, Justin, we don't provide line item details of our cost of goods sold. It is important to understand that our cost of the strike – to understand the cost of the strike, it's important to know that the plant never closed during the strike, and hence, some of our strong volume performance in the quarter. But it did operate at less than normal efficiency, given the reduced workforce that it was operating under. So overall, it was a little bit of a drag on the quarter in terms of earnings. But certainly, we took it in stride and delivered a great quarter despite that.

The second question you have, Justin, with regards to the implied fourth quarter growth, I guess, is first I'd start by saying that we're very pleased with how the back half is unfolding, certainly favorable to our expectations that we had shared with the group and on the Q2 earnings call. And overall, we've increased the revenue guidance by 2.5% at the midpoint and 4.5% for EPS.

And with that, it kind of pushes out an implied fourth quarter guidance, and that is that we expect revenue to grow roughly at 6% midpoint. And again, this is despite last year's tough comps of over 11% growth, and likewise, expect very strong margin increase in Q4, driven by EPS up roughly 17% at the midpoint.

So when we look at the second half and how it's unfolding, it's just as we discussed last quarter, Justin, with the third quarter revenue growing considerably faster than the fourth quarter, and that's driven by the fact that the production plan for the second half is significantly skewed to the third quarter.

In fact, Justin, when you look at it, roughly 70% of our second half locomotive deliveries will be delivered in the third quarter, and that's strictly to meet the customer expectations, as those schedules were built over a year ago. So consequently, our Q4 underlying growth remains very strong and is evidenced by our strengthening – which is evidenced by the strengthening 12-month backlog, which was up 13% versus prior year. And like Rafael said in the prepared comments, we expect to see profitable growth as we transition into 2024.

Justin Long
Analyst, Stephens, Inc.
Q

Okay. That's helpful. And secondly, I wanted to ask about the backlog. So we did see a sequential moderation. I know timing particularly with some of the multiyear orders can move things around. So I'm curious if you've seen any slowdown in inquiry levels or the pipeline or if you would just chalk this up to timing. And on the Kazakhstan $2 billion MOU, could you just confirm that's not included in the backlog.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.
A

I'll take that one, Justin. So first, no, it's not in the backlog of orders. But talking about backlog, the backlog is healthy. It will be down year-over-year, but you got to look at it in conjunction with the multibillion orders that we signed last year, which don't repeat every year. The other side of it, we have a number of multibillion-dollar opportunities that are being worked, and we just signed a large one which is in the pipeline and will convert into orders. So we see good momentum here. We don't see slowdown. We are progressing. We're continuing to grow, and our pipeline supports it.

Last quarter, as John said, 12 months, last quarter was up 10%. This quarter, third quarter was up 13%. So we're continuing to drive momentum here with key deals being signed. And if you think especially about the long-lead items in our portfolio like mods and new locomotives, you need that backlog to be there as we look into 2024 and beyond.

Justin Long
Analyst, Stephens, Inc.
Q

Okay. Thanks for the time.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp. A

Thank you.

Operator: The next question is from Jerry Revich of Goldman Sachs. Please go ahead.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC Q

Yes. Hi. Good morning, everyone.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp. A

Hey, Jerry. Good morning.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC Q

Rafael – hi. Rafael, John, I'm wondering if we could just piece together a few of the comments that you made, it sounds like a pretty healthy order opportunity backdrop. US railcar orders are constructive as well. So as we think about your five-year outlook, it sounds like 2024 might be a better organic growth revenue opportunity than the five-year outlook that you provided, just putting the pieces together. And I'm wondering if you can confirm that that's how it's tracking. And if you could touch on the level of margin improvement you can deliver, if it does indeed play out that way relative to the margin improvement CAGR that you've laid out on a five-year basis. Thank you.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp. A

So, Jerry, I mean, as you see, finished the strong quarter, strong pipeline of opportunities which, I would say, have just strengthened really the visibility that we have to continue to drive revenue and margin expansion. It's for sure a bit early to get into the specifics of 2024 guidance. But the momentum we'll continue to see, in my mind, with results being driven by, first, I'd start with the strength of the short and midterm backlog. So it's the 12-month backlog that we spoke about at $7.1 billion, up double digits.

Second piece, we continue to see momentum on both new locomotives and mods. Our customers, they are continuing to invest for improved costs. So this is bringing a modernization in so they can park to other units. They're investing for reliability. We're still coming out of the trough there. If you think about the lead times, as I mentioned here before, we need a strong backlog here. Some of the lead times here with mods and new units is longer, and you need the backlog, and we have it for the next 12 and 24 months.

The other piece for me is international. We're very bullish on key international markets. We have the momentum there. You saw in Kazakhstan, but what if I think about Brazil, South Africa and Australia, they're all driving significant momentum going to 2024.

On the margin side, the business will benefit and further benefit from Integration 2.0. So we'll continue to drive expansion here as well. So all in all, the pipeline of opportunities, we continue to get better visibility. In fact, this is the best call we've had stepping into a year, which strengthens our position here to deliver on profitable growth.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Super. Really appreciate the comprehensive discussion. And can I ask on Transit. We've got a couple of orders. We have a really good margin performance there. Has that business, in your mind, earned the right to grow off of these levels? I know you're waiting until you felt really good about the sustainable margin performance. Are we at a point where we can think about that part of the platform, top line accelerating given the improved execution over the past year-plus?

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

Jerry, we're pleased with the progress that we're seeing there. We're continuing significant work to simplify the footprint and further improve the business competitiveness. I think you're going to continue to see some variation quarter-to-quarter, but that team is committed to continue to expand margins and take action here for profitable growth. Despite of the more, I'll call, competitive environment, the fundamentals are good in the business. If you think about our book-to-bill ratio, we'll close above 1 for the year. 12-month backlog is up. Multiyear backlog is up [ph] 16% (00:29:37) the other one, I think, over 12%. And the team is continuing to progress to really drive mid-teen margins. So yes, we expect the business to be more competitive in the marketplace there, and we're seeing no slowdown. In fact, we see the opportunity here to continue to grow with the business. If you think about the record backlog some of our customers had, we're continuing to see momentum there.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Appreciate the discussion. Thanks.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

Thank you.

Operator: The next question is from Ken Hoexter of Bank of America. Please go ahead. Hello, Ken, your line is open.

Nathan Ho
Analyst, BofA Securities, Inc.

Q

Hi. Sorry. This is Nathan Ho dialing in for Ken Hoexter. Congratulations to the team on the solid results. John, I think you commented earlier that mix was favorable to Freight gross margins. And I'm just looking through some of the segments. Looks like Equipment is up 40%, Components up 30%, yet Services and Digital are a little bit – I mean, Services up 18% and Digital's down 3%. I understand the team doesn't usually comment on segment level margins, but could you maybe just talk a little bit more about the comment there and maybe some of the pricing and mix dynamics at play.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

Yeah, Nathan. So number one, what you pointed out, what we said may be a little bit counterintuitive, right? But if you take it back to the discussion that we've been having for the last four quarters, when we really started to step up a lot of the locomotive deliveries internationally, that put a fair amount of overall mix pressure on us, again, starting in the third quarter of 2022 and really going through the last four quarters.

So as we move out of the fourth quarter of 2023, we are stepping in from a Freight perspective into higher-margin deliveries and that's shining through. Even though given the fact that overall Equipment's at a lower margin than Digital, we are still seeing, in aggregate, a fair amount of mix favorability.

The other piece of it is not only mix within the various groups, but also the mix between groups, right? When you look at the Freight growing at 23.4% and currency adjusted Transit at 14.5%, that provides a fair amount of mixed tailwinds as well.

Nathan Ho
Analyst, BofA Securities, Inc. Q

Perfect. Thank you. And as my follow-up, I just wanted to maybe continue on the prior train of thought on the backlog. I noticed just on the Freight side, it seems like this is the fifth quarter of sequential declines. I think just comping the multiyear backlog, this quarter versus 2Q were down $722 million. How should we read this? Is this a – is this – any commentary on unit volumes or maybe something regarding pricing or mix? Any thoughts there would be helpful.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp. A

I think you've got to keep in mind, first, the lumpiness of the multiyear orders that we get. And you're going to see that lumpiness not just playing out through the quarters, that lumpiness will play out on the years as well. As we mentioned, we expect the backlog to be down this year, year-over-year. But the other side of it is the multibillion-dollar orders that we're working on, which are not in our backlog, and we expect that to convert. So I really look at that in terms of the lumpiness of the orders.

The other piece you've got to be very focused on is when you think about the lead times on certain of your products, making sure that you have the coverage to work through it, and that's why I highlighted both modernizations and new locomotives. So if you think about the lead times on those, you need a strong coverage, and we have it. We have it – if we think about 2024, we have it beyond 2024.

Nathan Ho
Analyst, BofA Securities, Inc. Q

Perfect. Appreciate your thoughts. Thank you.

Operator: The next question is from Scott Group of Wolfe Research. Please go ahead.

Ivan Yi
Analyst, Wolfe Research LLC Q

Good morning. This is Ivan Yi on for Scott Group. My first question, you're showing very strong EPS growth this year, but what are the puts and takes to another year of double-digit EPS growth next year? Can you kind of walk through the moving parts there. Thank you.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp. A

I think, Ivan, it's very much similar to what we experienced this year, is, one, volume growth does wonders for expanding margins, right, and driving incremental growth. We've talked about our incremental growth is about

25% to 30%. So with that incremental volume, which we would expect revenue growth in 2024, we will build EPS growth in addition to that.

The other is, as Rafael had mentioned, Integration 2.0. So that was a three-year investment, and we're just starting to get to the kind of the ramp on the savings plan. And we're seeing that ramp up in the first three quarters of this year, but expect the largest growth in terms of savings due to that program in 2024. So that again will drive margins a little bit faster than revenue. But overall, as we sit today and look forward to 2024, we expect that profitable growth that Rafael spoke to. And with that, we expect to be overall in line with our long-term objectives and our long-term guidance.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp. A

I'll reinforce two other points which is just a element of international markets. I spoke here specifically about Brazil, South Africa, Kazakhstan and Australia, which are very significant, and we have significant momentum walking into 2024 with this market. So we do expect significant growth there from a sales perspective. And the other piece is, again, the coverage as we look into stepping into 2024, which is certainly one of the strongest coverages we've had stepping into any given year.

Ivan Yi
Analyst, Wolfe Research LLC Q

Thank you. And then just a follow-on, again, on the backlog. The one-year backlog is up nicely year-over-year, but the multiyear backlog, of course, is down. Can you just kind of go through that divergence, why is that happening? And which one of those metrics is the better one to focus on, the one year or the multiyear? Thank you.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp. A

First, go back to the things I've highlighted here. You've got to make sure you have the coverage, especially on the long-lead items. Otherwise, we're getting an order here for a new locomotive at this point and you don't have the coverage for 2024. There's not much you can do there. So having the coverage for that long-lead items is important, and we have it.

The second piece I talk about is the fact our fleets internationally continue to grow. So we're seeing good momentum there, not just from a CapEx but from also an OpEx perspective. So that's very positive. And in North America, discussions continues, despite of, I'd say, continue to grow parking levels. Customers are investing for really lower costs for improved efficiency, for improved reliability. So all in all, when we think about the momentum here, looking at North America and internationally, CapEx and OpEx, it continues to look into profitable growth going to 2024, very much aligned to the long-term guidance we've provided.

Ivan Yi
Analyst, Wolfe Research LLC Q

Thank you.

Operator: The next question is from Matt Elkott of TD Cowen. Please go ahead.

Matthew Elkott
Analyst, TD Cowen

Q

Good morning. Thank you. If we take the guidance raise and the sequential moderation in the 12-month backlog together, is it because you have some deliveries that were scheduled for next year and were pulled forward to this year?

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

No, no. Not at all, Matt. When we look at it, we've been talking about the year a lot in first half, second half. And at the beginning of the year, we said that first half would grow a little bit faster than the second half. And I think the way to look at between our third and fourth quarter is to look at them together, and we're seeing what you would see on the implied growth is 14% growth in the back half versus 16% growth in the first half. And again, that's what we've expected. But it's really a function of the way the production plan was set up over a year ago in terms of the deliveries that we expected to make in the third quarter versus the fourth quarter on some of our larger equipment, in particular, on locomotives.

And as I had mentioned that about 70% of the second half's production plan for locomotives is delivered in the third quarter versus the fourth quarter. So overall, when you even those out, we've had a year very much in terms of overall cadence expectations, of course, at a higher level of revenue growth, which explains the raise in the second and the third quarter. But the fourth quarter underlying momentum is just as strong as the third quarter, and we feel good as – going into the 2024 with the backlog growing, as Rafael had mentioned. It's actually sequentially grown for the last couple of quarters. And as we exit the third quarter, it's up 13%.

Matthew Elkott
Analyst, TD Cowen

Q

No, that's very helpful to know. And just one – my follow-up question, John. Can you talk a bit about the – a bit more about that $2 billion Kazakhstan MOU. How much of it do you think could materialize into orders in 2024 and how much could materialize in deliveries in 2024?

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

We're not going to break out the timing of it, but we would expect all $2 billion of it to turn into orders. We've got a great customer in Kazakhstan and they've got a tremendous growth opportunity, given some of the dynamics of the flow of products from China to Europe. And we're certainly working with them to upgrade their fleet and expand their fleet so that they can manage their future.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

I would add the following. We expect a large part of that to convert. And as I said, about some international markets, we're increasing deliveries in Kazakhstan, and it's a strong growth going to 2024.

Matthew Elkott
Analyst, TD Cowen

Q

Perfect. Thanks, Rafael. Thanks, John. Appreciate it.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

Thank you.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

Thank you, Matt.

Operator: The next question is from Saree Boroditsky of Jefferies. Please go ahead.

Saree Boroditsky
Analyst, Jefferies LLC

Q

Thanks. Good morning. So kind of building on your comments, I think you mentioned the largest savings from Integration 2.0 into next year. Could you just provide an update on the progress you're seeing there, how is it going versus expectations? And any way to quantify the margin benefit into 2024? Thanks.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

Yeah, Saree. So if you recall that Integration 2.0 was a three-year program that started at the beginning of 2022. And on any of these type of restructuring programs or opportunities to integrate, we'll see a higher investment profile in the beginning and a higher savings profile in the back as we get the projects off and executed. So to date, we've invested about $100 million out of an expected $135 million to $165 million over the next three – or over that three-year period of time.

And, Saree, what we're seeing now is just as those projects start and either the facilities are being consolidated or products being moved or however we're looking at optimization, those savings are starting to build. And at the end of 2022, we had about – ongoing savings of about $5 million and that continues to escalate, and we look for that to build up to $75 million to $95 million. So we won't quantify it, but you can start to see the momentum that we need to have to be at a run rate of $75 million to $95 million in 2025.

Saree Boroditsky
Analyst, Jefferies LLC

Q

Great. And then maybe this is kind of partially related, but Transit margins came in pretty strong, despite what typically would be a weaker seasonal quarter. So what kind of drove that margin improvement there and how does this set you up as we look into 2024?

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

Yeah, we're very pleased with the Transit margin. It was up 1.5 percentage points, driven by a couple of things, Saree. Number one, and certainly, fixed cost absorption was favorable, given the volume growth ex currency of 14.5%. The other area is product mix. Product mix was favorable in Transit. And if you look at the aftermarket grew a fair amount faster than OE. And also, when we talk about Integration 2.0, a fair amount of that hits our Transit business, right? So that's helping driving it. And also, we're lapping some of the inefficiencies that we had in cyber in the year-ago quarter. So, feel very good about the Transit business, as Rafael had mentioned, and certainly a bright future as we continue to move that business forward.

Saree Boroditsky
Analyst, Jefferies LLC

Q

Great. Thanks for taking the questions.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

Thank you.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

Thank you.

Operator: The next question is from Chris Wetherbee of Citigroup. Please go ahead.

Q

Hey. Good morning, guys. It's [ph] Rob (00:42:55) on for Chris this morning. Could you give us an update in terms of your delivery timing expectations for next year. Like, as of right now, the orders more kind of first half or second half loaded? Or do you not yet have line of sight on that one?

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

Yeah. [ph] Rob (00:43:12), it's a little bit early for us to start talking about gating. It's early for us to talk about guidance as well. So a typical cadence would be to provide guidance in the call in February after the year is done. And again, just broadly, we're looking at certainly profitable growth in 2024, but in another quarter's time, we'll have certainly more detail with regards to what that is and what's driving it.

Q

That's helpful. And this might be a little bit too early as well. If we're looking at the 12-month backlog, how does that mix compare to the mix today? Do you have a sense of is it better, is it worse? Just kind of thinking about some of the puts and takes for next year.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

I think more in terms of the coverage looking ahead, right? And my comments on the strong coverage that it provides a piece of it has really to be connected with the long-lead parts of our portfolio. And that's where I think about new locomotives and I think about mods and I think it in conjunction of both international markets and North America. And that's probably the strongest – it's certainly the strongest we've had to walk into any year.

Q

Appreciate the color.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

Thanks, [ph] Rob (00:44:31).

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

Thank you.

Operator: The next question is from Rob Wertheimer of Melius Research. Please go ahead.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thank you. I just had two quick follow-ups. John, I think you've been pretty clear on the gross margin and some of the puts and takes. I wondered, though, I mean, can you give any comment on just what normal gross margin leverage should be, absent the strike or whatever, and whether next year has any incremental labor pressure that would keep gross margin from rising? I mean, a great fixed cost leverage across the enterprise, don't get me wrong, but more on the SG&A line. So just any comment on that would be helpful. Thank you.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

Yeah. I think from a gross margin standpoint, what you're seeing on a year-to-date basis is certainly a drag from the strike in Erie but also that mix that we talked about, right? We had mix headwinds in the first half, and that had an impact on gross margin. So this quarter, gross margin was flat, again, affected by the strike at Erie, but a lot of benefits as we move forward. And when we look at Integration 2.0, that directly fits into the gross margin, and we would expect a tailwind on margins because of that.

And then also, the biggest driver of margin is volume, right, and leveraging the fixed cost structure of the business. And that's not only fixed manufacturing costs, but also the fixed portion of SG&A. So as we grow, we expect to continue to aggressively manage our cost structure and making sure that we do deliver those incremental volumes, which, again, we would expect to be in the 25% to 30% range.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Perfect. Thank you. And then one last one to close out. Mining is really strong, I think, particularly for some of your customers. Any sign that, that has peaked out? Are we still early in that cycle? Just any commentary there and then I will stop.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

A

So we didn't – I don't think we caught the first part of the question.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

A

Exactly.

Rob Wertheimer
Analyst, Melius Research LLC
Q

Beg your pardon. Mining is quite strong, especially, I think, for some of your customers, and I'm just curious if that strength continue or whether you're seeing any signs that could plateau. Thank you.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.
A

It continues. Mining is very strong right now and the indications we've got is of that momentum continuing into next year as well. So that's certainly another one of the positive momentums that we see on the business.

Rob Wertheimer
Analyst, Melius Research LLC
Q

Thank you.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.
A

Thank you.

Operator: The next question is from Steve Barger of KeyBanc Capital Markets. Please go ahead.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.
Q

Hey. Thanks. Good morning.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.
A

Good morning.

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.
A

Good morning, Steve.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.
Q

Rafael – yes. Backlog has been stable at around $22 billion for the five years post the GE deal. Do you think of that as the natural run rate, meaning if things go to plan, it'll be around the same five years from now? Or the way it's structured, does monetization speed up at some point, meaning revenue accelerates but backlog contracts? How do you think about that long term?

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.
A

Rob (sic) [Steve] (00:47:38) I – I'm not going to give you, like, specific numbers, you're thinking five years from now. I just think – I'll tell you how we're running the business, right? There is really a strong focus on making sure that we've got the coverage as we look ahead, and that coverage supports what I'll call profitable growth for the business. That's where a big piece of the focus has been.

In the past, if you go back, there's maybe a lot of focus, especially on multiservice agreements that covered fleets for a long period of time. We've managed that in mix with long-term parts agreements. In some cases, we might take a different approach depending on what the fleets are with the customers. So all in all, I think those are levers that we got to be managing and really thinking more about the value that we're delivering, especially as we introduce more opportunities to improve fleets. A lot of the upgrades that we talk about in terms of fuel efficiency and things like that, we want to make sure we're driving value for both our customers and ourselves through that process. But all in all, I mean, we expect to continue to drive that momentum forward with profitable growth. Does that help?

Steve Barger
Analyst, KeyBanc Capital Markets, Inc. Q

Yeah, I think so. If I can just boil that down, it sounds like you do expect when you look at your pipeline and how you try to manage the business that you'll have 2x the forward years revenue in backlog for the foreseeable future. Is that fair?

John A. Olin
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp. A

I don't think we can – we would put an index on it. Just looking at the backlog over the last five years, we've seen it oscillate between $21.5 billion and $22.5 billion. I think parts of it are the economy that goes into that. And when we have periods of big orders, we see it rise and then that kind of burns off. And that's exactly what we're seeing in 2022 to 2023, right? We saw it rise about $1 billion in 2022. And as we work that off, we're lapping those numbers and backlog's down 4% or 5%.

So I think over a long period of time, we would expect it to rise, but I don't think there's a formula you can put on it. We keep coming back to this word lumpy, is that – it's very lumpy depending on what multiyears. I think the best way to remove the lumpiness is to look at the 12 month, right? So we don't – we kind of neutralize for that, and the 12 month has been very steady and growing up on the three quarters this year and has been gaining momentum.

Rafael O. Santana
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp. A

This is a business that go before the transactional was done. There's a lot of, I'll call, ups and downs through the cycle. I think one of the things that the team has been very purposeful on is making sure we are working with customers to drive what I'll call sustainable investments moving forward, which plays well for the entire ecosystem. It's an element of making sure that we're ultimately getting to the right quality, the right value for the products and ultimately to better costs as we run some of these programs. And that's been a huge part of the focus. If you think about the focus on 12-month backlog, 18, 24, that's a significant part of it. And the longer-term agreements, we'll play them to make sure that we've got the continuation of a lot of the infrastructure that we've got out there that supports the delivery of some of these assets for customers around the world.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc. Q

Yes, that's good color. And the only comment I'll make is mid-single-digit percentage variance around a $21 billion five-year average is not that lumpy. I think a lot of companies would love to have that. As my follow-up, John, I know you don't want to get into specific line items around the strike, but this was a record quarter for Freight revenue and the best segment margin since 2019. Can you tell us what revenue and margin could have been. And is it fair to say this quarter will not be a high-water mark as we think about Freight in 2024?

John A. Olin A

Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

Well, we expect to continue to grow this company in 2024, 2025 and 2026, Steve, and well beyond that. No, I can't pull out what it would look like [indiscernible] (00:51:58). All I can say is it was a tremendous effort on the part of the overall company to be able to deliver that revenue growth. And again, I talked about the locomotive piece, right, and that shift. We delivered all the locomotives in the second quarter that we were intending to deliver with the 10-week strike at our largest plant that makes locomotives. So it's a tremendous tribute to the team and how the whole company pulled together to continue to work through the strike.

Steve Barger Q

Analyst, KeyBanc Capital Markets, Inc.

Got it. Thank you.

Rafael O. Santana A

President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

Thank you.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Kristine Kubacki for closing remarks.

Kristine Kubacki

Vice President-Investor Relations, Westinghouse Air Brake Technologies Corp.

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

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