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Westinghouse Air Brake Technologies Corp. (WAB)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Wabtec's Third Quarter 2024 Earnings Conference Call. All participants will be in 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 now would like to turn the conference over to Kyra Yates, Vice President, Investor Relations. Please go ahead.

Kyra Yates

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

Thank you, operator. Good morning, everyone, and welcome to Wabtec's third 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 O. Santana

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

Thanks, Kyra, and good morning, everyone. Let's move to Slide 4. I will 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 solid quarter evidenced by sales growth, margin expansion, increased earnings, and strong cash flow. Sales were $2.7 billion, which was up nearly 4.5% versus the prior year. Revenue growth was driven by both the Freight and Transit segments. Adjusted EPS was up nearly 18% from the year-ago quarter, driven by increased sales and margin expansion.

Total cash flow from operations for the quarter was $542 million. We continue to execute against our capital allocation framework to maximize shareholder value by investing for future growth and returning cash to our shareholders.

The 12-month backlog was $7.6 billion, up 7.5%, signifying continued momentum and visibility across the business. And the total multiyear backlog was $22 billion. Overall, the Wabtec team delivered a solid third quarter behind an intense focus on execution. Looking ahead, I'm encouraged by the underlying strength and momentum across the business and believe Wabtec is positioned for continued profitable growth ahead.

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 underlying momentum of our business, the continued strength of our international markets, and the robust pipeline of opportunities across geographies. North American carloads continued to be up in the quarter. Despite this carload growth, the industry's and Wabtec active locomotive fleet was largely flat when compared to last year's third quarter.

Looking at the North American railcar build, last quarter, the industry outlook for 2024 was 38,000 cars to be delivered, which has now been raised by the industry sources to 41,000 cars, down from last year's build of 45,000 cars. Internationally, we're seeing significant investments to expand and upgrade infrastructure, which are supporting a robust international locomotive orders pipeline. This is the strongest it has been over the last five years. In mining, commodity prices and an aging fleet continue to support activity to refresh and upgrade the truck fleet.

Finally, moving to the Transit sector, we continue to see underlying indicators for growth. Ridership levels are increasing in key geographies, along with the fleet expansion and renewals. There also continues to be a strong push with regulation and customer initiatives on decarbonization and sustainable transportation solutions.

Next, let's turn to Slide 6 to discuss a few business highlights. Last year, in the third quarter, we announced the signing of a strategic MOU with KTZ, the national railway company in Kazakhstan, for over $2 billion. Since that time, we have worked to finalize orders associated with that MOU, a multiyear new locomotive order with KTZ for $405 million. These locomotives will provide the efficiency, reliability and operational savings to effectively support the growing demand on the Trans-Caspian International route that connects China to Europe.

Moving to North America, we secured the long-term parts agreement with a Class 1 railroad for over $300 million. In Transit, we signed a contract for $70 million with Siemens Mobility to supply passenger information systems for 90 Munich S-Bahn trains. And earlier in the quarter, we expanded our service contract with Indian Railways for another $30 million. This agreement expands Wabtec's locomotive service capabilities into the southern part of the country. All of this demonstrates the underlying strength across our businesses, the team's relentless focus on execution, and the strong pipeline of opportunities which we continue to execute on.

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

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

Thanks, Rafael, and hello, everyone. Turning to slide 7, I will review our third quarter results in more detail. Our third quarter results played out largely as we planned with revenue and better than expected with our operating margins. As we discussed in the last quarter call, we expected both revenue and margin growth to be higher in the first half than in the second half, with the second half growth to be at a much more tempered pace than we experienced in the first half.

We also noted during the last call that within the second half of this year, we expected the third quarter's growth to be greater than the fourth quarter's growth. This is still the case. Sequentially, we expect margins in Q4 to come down from Q3, driven by the reverse of what we saw in Q3 regarding business group revenue mix.

In Q3, we saw robust services growth which comes at a higher margin, while the equipment business which comes at a lower margin, was down versus prior year. This was largely a result of the timing of our production between new locomotives, modernizations, and engine overhauls.

In Q4, we expect a significant mix headwind, which will temper Q4 adjusted operating margins to be modestly higher than year-ago levels. We expect double-digit sales growth in our equipment group due to increased locomotive deliveries, while services sales are expected to be down double-digit on a year-over-year basis, basically the reverse of our production timing in Q3.

Sales for the third quarter were $2.66 billion, which reflects a 4.4% increase versus the prior year. Sales growth in the quarter was driven by both the Freight and Transit segments. For the quarter, GAAP operating income was $433 million. The increase was driven by higher sales, improved gross margin, and an unrelenting focus on continuous improvement in productivity.

Adjusted operating margin in Q3 was 19.7%, up 1.8 percentage points versus the prior year. This increase was driven by improved gross margin of 1.8 percentage points. GAAP earnings per diluted share were $1.63, which was up 22.6% versus the year-ago quarter. During the quarter, we had net pre-tax charges of $18 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 $2, up 17.6% versus the prior year. Overall, Wabtec delivered another solid quarter, demonstrating the underlying strength of the business.

Turning to slide 8, let's review our product lines in more detail. Third quarter consolidated sales were up 4.4%. Our quarter results were driven by growth in our services, digital intelligence, and transit businesses, partially offset by our equipment business. Equipment sales were down 17.3% from last year's third quarter. This decline was planned and driven by the timing of new locomotive deliveries. As mentioned earlier, we expect this to reverse in Q4, with equipment sales expected to be up double digit.

Component sales were up 1.0% versus last year due to higher international freight car sales and industrial product growth, which was offset by lower North American freight car build. The industry is forecasting the 2024 freight car build to be down 9% from last year.

Digital intelligence sales were up 12.7% from last year. This was driven by growth in our international sales of PTC, next-generation onboard products, and digital mining products. Our services sales grew 16.5%. Sales growth was driven primarily by higher year-over-year modernizations and overhauls. As mentioned earlier, we expect the timing of our mods and overhaul production and deliveries to reverse in Q4, resulting in our year-over-year service revenue to be down double digits.

In our Transit segment, sales were up 9.6%. During the quarter, we saw our OE revenue grow 13.3%. On a constant currency basis, sales grew 8.4%. The momentum in the Transit segment continues to remain 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 2.0 percentage points from the third quarter last year. Adjusted gross margin was also up 1.8 percentage points during the quarter. In addition to the higher sales, gross margin benefited from favorable mix between business groups. Mix within the Freight segment was better than expected due to growth in our services business behind the timing of mods and overhauls in the quarter, partially offset by a planned decline in locomotive production and deliveries.

Foreign currency exchange was a slight headwind to revenue, as well as gross profit and operating margin in the quarter. During the quarter, we also benefited from increased productivity and the benefits of our Integration 2.0 and Portfolio Optimization efforts, as well as lapping last year's Erie strike that ran through a portion of the third quarter of 2023. Our team continues to execute well by driving operational productivity and lean benefits.

Now, turning to Slide 10, for the third quarter, GAAP operating margin was 16.3%, which was up 1.8 percentage points versus last year. Adjusted operating margin improved 1.8 percentage points to 19.7%. GAAP and adjusted SG&A and engineering expenses were up versus prior year, but largely flat as a percentage of revenues.

Engineering expense was $50 million, slightly lower than Q3 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 the segment results on slide 11, starting with the Freight segment. As I already discussed, Freight segment sales were up 2.6% during the quarter. GAAP segment operating income was $390 million for an operating margin of 20.2%, up 2.9 percentage points versus last year. GAAP operating income included $10 million of restructuring costs, primarily related to Integration 2.0 and portfolio optimization.

Adjusted operating income for the Freight segment was $467 million, up 17.6% versus the prior year. Adjusted operating margin in the Freight segment was 24.1%, up 2.9 percentage points from the prior year. The increase was driven by improved gross margin behind favorable business mix, strong operational execution, Integration 2.0 savings, and as we lapped last year's manufacturing inefficiencies caused by the strike in Erie. At the same time, SG&A and engineering expense were slightly lower as a percentage of revenue.

Finally, segment 12-month backlog was $5.59 billion, up 6.4% from the same period a year ago. The multiyear backlog was $17.76 billion, up 1.1% from prior year.

Turning to slide 12, Transit segment sales were up 9.6% at $733 million. When adjusting for foreign currency, transit sales were up 8.4%. GAAP operating income was $79 million. Restructuring costs related to Integration 2.0 were $8 million in Q3. Adjusted segment operating income was $93 million. Adjusted operating income as a percent of revenue was 12.8%, up 0.3 percentage points.

During the quarter, adjusted gross margin was down modestly behind unfavorable mix, partially offset by Integration 2.0 savings. Margins also benefited from SG&A and engineering expenses being lower as a percent of revenue. Finally, Transit segment 12-month backlog for the quarter was $2.04 billion, up 10.8% versus a year ago.

Now, let's turn to our financial position on slide 13. Third quarter cash flow was another highlight for the quarter, with operating cash coming in at $542 million. During the quarter, cash flow benefited from higher earnings and $95 million of higher 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 $1.9 billion; and our net debt leverage ratio, which ended the third quarter at 1.7 times, which was lower versus the same quarter a year ago at 2.1 times debt leverage.

We continue to allocate capital to maximize returns for our shareholders. During the quarter, we repurchased $599 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 O. Santana

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

Thanks, John. Now, let's turn to slide 14 to discuss our 2024 full year guidance. As you heard today, our team delivered a solid third quarter, which was ahead of our expectations. Consequently, we are increasing our previous adjusted EPS guidance. We now expect adjusted EPS to be in the range of $7.45 to $7.65, at the midpoint, up 27.5%. 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 on our value creation framework, thanks in large part to our resilient installed base, world-class team, innovative technologies, and our continued focus on our customers.

With solid underlying demand for our products and technologies, and rigorous focus on continuous improvement and cost management, consistent with our previous guidance, we continue to expect to drive mid-single-digit organic growth while driving double-digit EPS growth through our planning horizon, thereby maximizing our shareholders' returns.

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

Kyra Yates

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: Yes, thank you. We will now begin the question-and-answer session. [Operator Instructions] And today's first question comes from Angel Castillo with Morgan Stanley.

Angel O. Castillo
Analyst, Morgan Stanley & Co. LLC Q

Good morning. Thanks for taking my question and congrats on a strong quarter.

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

Good morning.

Angel O. Castillo
Analyst, Morgan Stanley & Co. LLC Q

Just wanted to maybe start on maybe preliminary thoughts. I know you won't necessarily provide guidance for 2025, but just curious as you see your backlog continuing to grow and you're getting these contract wins or turning MOUs to orders, what does that tell you in terms of preliminary thoughts on 2025 in terms of price, volume, kind of margins, at least directionally, any sense that you could provide based on your backlog?

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

Well, first, it's certainly early to be providing guidance into 2025, but the fundamentals for the business are strong. We're finishing 2024 with – really every single one of our businesses are growing. Year-to-date orders are up double digit. Profitability is up across the board as well. And I'll finish with consistent with what we've given on previous guidance, we continue to expect to drive mid-single-digit organic growth while delivering double-digit EPS growth through our planning horizon.

Angel O. Castillo
Analyst, Morgan Stanley & Co. LLC Q

Understood. And maybe switching over to Integration 2.0, I just wanted to maybe get a little bit more color on maybe what's the run rate thus far versus that $75 million to $90 million target and just kind of how that's shaping out.

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

Right. As you know, Integration 2.0, as we came out of last year, savings were $22 million and we were looking to get to a midpoint of $82.5 million, so that leaves a ramp of $60 million over 2024 and 2025. And what I'll tell you, Angel, is that we are on track and actually exceeding our expectations a bit. Not only are we getting a little bit more than we anticipated, but it's coming a little bit earlier. And we're really seeing that inflection in the third quarter. And as you see, we're raising our guidance. Part of that is driven by the over-delivery on Integration 2.0 in the third quarter, and we expect that to kind of compound into the fourth quarter.

So, we feel real good about where we're at today. Most of the spending is behind us. We finished the quarter program to date with $140 million of spending, that's on the low end of our range. We will have a little bit more spending to go, but tracking well on the expense side and a little bit ahead on the savings side.

Angel O. Castillo
Analyst, Morgan Stanley & Co. LLC Q

Very helpful. Thank you.

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

Thank you.

Operator: Thank you. And the next question comes from Saree Boroditsky with Jefferies.

Saree Boroditsky
Analyst, Jefferies LLC Q

Good morning. Congratulations on the quarter. Maybe just kind of talking a little bit more about freight margins, obviously very strong again at 24%, better than your expectations. So, maybe just walk through what drove the upside surprise, how much did mix contribute to this. And then maybe a little bit on the sustainability at freight margins at this level and how that sets you up for 2025.

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

Hi, Saree. This is John. When we look at the margins being up 1.8 percentage points, it was higher than our expectations, and it was driven in two areas, Saree. Number one is on mix and the other is on cost. First on mix. While we knew there was going to be favorable mix because of the services production coming in at a higher margin at the expense of some of the locos produced in the equipment group, that we planned on.

What we didn't was there was additional mix favorability in our overhauls, which come at a pretty good margin, as well as in our mining business, we leaned more toward the aftermarket in our sales in the third quarter than OE, and we were expecting a little bit more on the OE side. So, that's on the mix side, and we don't expect that to transcend from the third quarter into the fourth quarter.

The second piece of it is on the cost side, and there's two elements to that. One is productivity. Every day, continuous improvement productivity was very strong during the quarter, and we certainly got a nod to the manufacturing and supply chain folks that are running the system extremely well, and for that, we're getting rewarded on additional productivity.

The second area on the cost side is what I just spoke to Angel about, is the Integration 2.0 is coming in better and faster than expected. Both of those cost items benefited the third quarter and will benefit the fourth quarter. And those two combined – I'm sorry, the mix and the cost combined is what got us the increase in EPS at the midpoint of $0.20.

When we look now to the fourth quarter, we're going to see a reverse of what we saw in the third quarter between the production of mods, locos, and overhauls. And with that, we expect in the fourth quarter that equipment will be up in the double digits and services at a higher margin will be down in the double digits.

So, we are going to have a significant amount of mix pressure, and this is nothing new. This we've talked about. The second half would be unfavorable in mix, and this is – what's going to drive it is the fourth quarter. And with that, we would expect overall margins to be higher on a year-over-year basis, but slightly, but down sequentially by a fair amount as we move into the fourth quarter. Again, this has nothing to do with the underlying demand. It's really all about how we've produced the year so that we could more level-load our factories.

Saree Boroditsky Q
Analyst, Jefferies LLC

Appreciate the color. And then just one more. The transit backlog grew in the quarter despite you focusing on some higher margin projects there. Can you just update us on the margins in Transit that are coming into the backlog versus the current margins that are in the P&L and how that translates to transit margin expansion?

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

I'll take this one, and I'll start with we continue to be pleased with the overall progress in the business. Our teams are continuing to really drive significant simplification on the footprints. They're further improving and sustaining margins. I think you're going to see variation quarter to quarter.

Some will be driven by mix and timing of projects, but I expect transit to continue to deliver on profitable growth. You asked about selectivity on projects. I think the best way for us to look at it it's when we look at the profitability of the backlog, and that's up. So, that business is on track to continue to expand on margins, and their North Star is mid-teens and continue to improve from there. So, I feel strong about the plan they have ahead.

Saree Boroditsky Q
Analyst, Jefferies LLC

Thank you. Congrats again on the quarter.

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

Thank you.

Operator: Thank you. And the next question comes from Ken Hoexter with Bank of America.

Ken Hoexter Q
Analyst, BofA Securities, Inc.

Hey, great. Good morning. And I'll echo that, great job building the backlog back and intra-quarter contract announcements. Can you maybe talk about the – a lot of international announcements on some locomotives recently. Can you talk about how we should think about gross margins on international versus North American margins? I know you don't break it up by contract, but maybe just in general to understand the splits.

And then just to clarify, John, when you mentioned service revenue down double digit, is that balancing out the mods production? Is that why we're seeing that down so much?

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

Yeah. Starting with the first question, Ken, is – we get the question often is international margins, whether – international versus North America, it is really specific to the country and the contracts that we're working off of. And we have some international that are higher than North America, some that are lower, some areas that we're investing in, others that we're not. So, it's not as simple as saying that international is this when we get revenue, it's going to come at that margin. It really is with regards to the various contracts that we have. I think suffice to say that we couldn't be more pleased with the growth that we're having from our international business, from a revenue perspective as well as a margin perspective. And our view across everything is how do we continue to deliver more value to our customers and get that built into our backlog as we go forward.

The second question, Ken, is on the service revenue in the fourth quarter. Let's take the third and the fourth quarter together. We – as you know, and you've been down to the facility down there, we do mods and locos on the same production line. So, we've level-loaded those. But they're still – because these fall into different groups, mods falls into the service group and new locos falls into the equipment group, we're going to have some variation as to how we run the product. We typically like to run a customer order as much as we can together or consistently for the productivity and quality aspect of it. And it just happened in the third quarter that, given the orders that we had, we produced more mods on a year-over-year basis and less new locos, and that's simply going to reverse in the fourth quarter.

But with that, we're going to see that shift from more favorable mix in the third quarter to less favorable in the fourth quarter. But there's nothing more than just how we plan the production. There's nothing different with the demand for the products, just how we're fulfilling that demand.

Ken Hoexter
Analyst, BofA Securities, Inc.

Q

Okay. And just to understand, what's left to shut down on the portfolio optimization?

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

A

So, we talked about this in February that we were going to do $110 million. A good portion of that is – well, it's mostly all executed. We got a little bit more to execute in the fourth quarter, and we'll see the lower revenues both in this year, 2024, and some lower revenues into 2025 as a result of it. But that's all tracking very well.

Ken Hoexter
Analyst, BofA Securities, Inc.

Q

Wonderful. Thank you. Thanks for the time.

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

A

Thank you, Ken.

Operator: Thank you. And the next question comes from Daniel Imbro with Stephens, Inc.

Daniel Imbro
Analyst, Stephens, Inc.

Q

Yeah. Hey, good morning, everybody. Thanks for taking our questions.

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

Hi, Daniel.

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

Morning.

Daniel Imbro
Analyst, Stephens, Inc. Q

Rafael, maybe one to dig into international markets more specifically. It does feel like these contract wins are becoming more and more frequent, and the backlog you mentioned is growing. I'm curious how we should think about why this is accelerating. Is it something you guys are doing differently? Is it just a maturation of those markets? And then understanding your answer to the last question that all countries are different, but is it fair to say that as you add density in these countries, incremental margins should improve as you add more scale and limit your costs there? Or how should we think about that as you keep accelerating this international growth?

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

So when we think about just the dynamics of the business, internationally, growth really continues. I think we're bullish on key international markets. We've got some elements of projects taking place in Africa. I think you're going to continue to see some wins from us there, so that's a positive. We're continuing to expand on the Trans-Caspian routes, and demand continues there in Kazakhstan as well.

And the good news on some of these projects, and I speak here to South America and Australia, I mean, some of the discussions here go well into 2026, 2027. We're discussing locomotive deliveries into 2028, so that's, I think, a positive in that regard, and it comes down to the experience customers are having with our fleets, driving both productivity, availability and reliability. So, we see that really continuing, some of the investments we've done in technology, I think you're going to continue to see a significant opportunity here for us to actually accelerate some of the modernization. We'll talk more about this early next year, but there's certainly an element of the innovation on how we continue to drive that.

We mentioned Kazakhstan. We talked about locomotive order. What we often sometimes don't give the same emphasis is on the opportunities we have with digital here. And we're expanding on not just the Trip Optimizer. Some of our KinetiX products are being brought as well into this mix. We often talk about PTC, and that's an area that we'll continue to expand. So, we see it as positive, and I think we'll continue to see profitable growth there. Some of those markets I mentioned are markets we're more mature, so we've got a lot of products that are really best in class to compete.

Daniel Imbro
Analyst, Stephens, Inc. Q

Helpful. And then maybe as a follow-up, just on the balance sheet side. So, cash conversion this year has driven accelerated buybacks year-to-date in 2024, but as we bounce along the bottom of the freight market, has that brought any more sellers to market? And just curious how you're seeing the M&A markets evolve in terms of the targets that you're looking at and what you'd like to maybe spend some of that cash on on the M&A side. Thanks.

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

I think the best way to answer this is when we look at our capital allocation strategy, that hasn't changed. Right? We continue to focus to be on making sure we're driving profitable organic growth for the business. We're certainly very much focused on M&A as well. When I think about the inorganic, this is the strongest pipeline we've had on M&A, and we'll continue to look at those. We'll be opportunistic here. And this is a question of returns. And if the returns are there, we're going to invest on it. If they're not, we won't be shy about doing share buybacks.

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

And then, Ken, within the quarter, the $600 million that we repurchased is really a function of that cash flow you mentioned. We have had year-to-date cash of $1.1 billion, and that's up over 100% versus a year ago. So in the absence of M&A, which we would prefer, we returned the value to our shareholders in the form of share repurchases, and we couldn't be more pleased to do that.

Daniel Imbro
Analyst, Stephens, Inc.
Q

Thanks so much, guys. Best of luck.

John A. Olin
Executive Vice President & Chief Financial Officer, 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: Thank you. And the next question comes from Bascome Majors with Susquehanna.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP
Q

Good morning. Yesterday, one of your Class 1 modification customers suggested they were interested in either stretching out or reducing some of their locomotive CapEx near term. I wonder if you could comment maybe not specifically on that, but more broadly, are we at the point in the North American locomotive replacement cycle where that's kind of starting to plateau in the short term and international is going to drive the bulk of the growth over the next two years? Just any thoughts on that market? Thank you.

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

North America, we continue to see mixed. I mean, you've got to be looking at specifics on customers here, but we continue to see demand that's for both new locomotives and for mods. I think our customers overall are continuing to invest. If you think about customers investing, it's most of the time for improved costs, it's for reliability, it's for efficiency. It's not for carload growth, it's not for necessarily revenue growth. So that's where I think we're excited about. And coming back to some earlier comments I made is the opportunity we have here to continue to innovate and make sure that they're investing for a return at the end of the day, getting a more efficient product that will help improve their OR and improve the service levels in the railroad. That's how we look at it at the end of the day, but you've got to really look at customer specifics here.

Operator: And the next question comes from Jerry Revich with Goldman Sachs.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC Q

Yes, hi. Good morning, everyone.

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

Hi, Jerry.

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

Good morning.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC Q

Hi. I'm wondering if we could just talk about your receivables for a moment. So, really interesting, your total receivables, including securitizations, are down mid-single digit year-over-year. Your top line on an LTM basis is up nearly 10%. That's a really significant improvement in DSOs. Can you just talk about what's driven that improvement and how much more opportunity do you folks have to continue to drive DSOs lower?

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

Jerry, actually, receivables on a year-to-date basis are up about 6.5%. I don't think you're picking up all the receivables there, but they are up 6.5%. But to your point, we've got overall revenue on a year-to-date basis up 9.1%. And if you adjust for some of that securitization, you would see the receivables more nearly matching the rate of the growth of the company.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC Q

Okay. I guess, John, maybe you securitized more than I thought in the quarter, because a year ago you were at $1.9 billion in receivables, including securitizations, so you're saying you're up over that third quarter number, because obviously there's seasonality 4Q versus 3Q.

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

Yeah. So for the securitization, we ended the quarter at $95 million securitized, and the reason we do that, Jerry, is it's a lower cost of funds for us, and we would prefer to borrow with that. But we ended the quarter at $95 million. We started the quarter at zero, so that was a headwind – I'm sorry, that was a benefit to our cash flow in the quarter of the $542 million.

Now, on a year-over-year basis, the receivables of the securitization borrowings are down quite a bit. They're down $140 million from where we were at the end of the third quarter last year. But within the quarter, it did provide some benefit to that cash flow number, and the cash conversion, ex the securitization, would have been 106%.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Yeah. Let's follow up offline, because I'm looking at it on a year-over-year basis. Separately, as we look back at your long-term plans, Rafael, you folks are well ahead of plan in terms of the margin performance for the organization, and I think you had spoken about a steady 50, 60 basis points per year margin improvement. I'm wondering, since we've already achieved the Analyst Day targets a couple of years early here, how are you thinking about the opportunity to continue to drive margin expansion at that same clip off of these levels as we think about the next 12, 24 months?

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

A

I think we have significant momentum here still. Our teams continue to simplify the business. They're driving continuous improvement actions across the business. And with that, I think we have the opportunity here to continue to drive margin expansion. So, margin rates in our overall business, I think, will continue to benefit from, not just as lean efforts, [ph] with (00:38:56) productivity Integration, 2.0, John mentioned portfolio optimization. So, I think we have significant opportunities here to continue to drive momentum, and we are committed here to drive profitable growth as we go into 2025 and beyond.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

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

A

Thank you.

Operator: Thank you. And the next question comes from Rob Wertheimer with Melius Research.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Howdy. Good morning, guys.

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

A

Hey, Rob.

Rob Wertheimer
Analyst, Melius Research LLC

Q

So, questions on backlog and pipeline. In the backlog, just to clarify, is the Kazakhstan order in the backlog numbers that you reported kind of on the slides for the quarter, and I don't know if you have the ability or willingness to say whether the big order you had in North American rail in July came into backlog at all this quarter much. I think it's for 2025 and 2026 deliveries, so I don't know if it's in the 12-month backlog.

And then, Rafael, not to make you repeat your prepared remarks, but your thoughts on kind of pipeline pre-orders and where you stand after having had a bunch. I mean, is that activity still as good as ever, or how would you characterize it? Thank you.

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

Let me start with the backlog question. So, the $405 million, which is the first order we've received against the 200-plus-billion-dollar MOU, that is in backlog for the third quarter. So, all the backlog numbers that we've read to you is inclusive of that $405 million. We will continue to work on the rest of those orders, and they will come over time.

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

With regards to, I guess, the fundamentals of the business. I mean, we are finishing 2024 with, again, every single one of our businesses are growing. Orders are up double digits. The pipeline is strong. We feel especially strong about the international growth, some of the markets I mentioned here, and that growth translates into momentum, not just – it goes into 2025, 2027, so that's really a positive there for us. So, the pipeline is strong. And even in North America, as I said, demand is there, but customers are investing for a return.

And what makes me really feel positive about the momentum is that innovation, as we – we'll talk to you in more details at the start of the year, is the ability to drive that next level of efficiency into the existing fleets and making sure that customers are accelerating and improving their operating ratios through that process, improving productivity, availability, and reliability of the fleets. So all in all, as I said, we continue to expect to drive mid-single digit organic growth, while delivering double-digit EPS growth through the planning horizon.

Rob Wertheimer Q
Analyst, Melius Research LLC

Thank you, Rafael. Thanks, John.

Operator: Thank you. And the next question comes from Scott Group with Wolfe Research.

Scott H. Group Q
Analyst, Wolfe Research LLC

Hey, thanks. Good morning, guys.

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

Good morning, Scott.

Scott H. Group Q
Analyst, Wolfe Research LLC

So, I totally get there's quarterly volatility in mix and it's helping Q3 and hurting Q4. When we think about – and again, I know it's early, so it may be hard to answer, but like do you think – is there a reason to think 2025 in aggregate has either a mix, tailwind or headwind, or is it more, hey, there's going to be some quarters it helps, some quarters it hurts, but net-net, it's not a big swing next year?

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

Yeah, Scott, it is a little bit early to talk about the components of 2025. We probably had more shifting – not probably, we've had more shifting in 2024. We wouldn't expect as much activity from a production standpoint in 2025. I think the way to think about, though, the overall margins are really where we're expecting or we're guiding to, and that's what we will take into 2025 and work to improve against.

Scott H. Group Q
Analyst, Wolfe Research LLC

And then the $400 million with KTZ, the $300 million parts, any color on duration of those two contracts? And then just separately, I don't know if there's any update or anything you're hearing on CARB EPA worth highlighting. Thank you.

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

Okay. The backlog, the $405 million KTZ order will be largely delivered over 2025 and 2026 timeframe, and the service agreement is a longer term. That'll be over a longer term. I'm not sure exactly how many years, but...

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

On the EPA, Scott, we haven't really had, I'm going to call, substantial change since we last talked, but I guess what we're saying is if you look at the heavy truck fleet, which is now really expected to have to drive 25% reduction of greenhouse gas emissions, the EPA is – also defined that liquid hydrogen for internal combustion engines would be classified as a near-zero or zero emissions.

And we see that as a validation of the strategy we have pursued with really making sure our engines are ultimately agnostic and we're able to run alternative gases like hydrogen with biofuels, renewable fuels, and we see that as a validation for really making sure we're the best-in-class product to help our customers achieve their goals on decarbonization in various parts of the world.

So, the fuels that might be available in Brazil might be different than in California and other parts of North America, so we see that as really a validation and we feel very strong about having the best-in-class products here to play, given any regulation changes and things like that. So, that's positive for us.

Scott H. Group Q
Analyst, Wolfe Research LLC

Helpful, guys. Thank you.

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

Thank you.

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

Thank you.

Operator: Thank you. And the next question comes from Steve Barger with KeyBanc Capital Markets.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.
Q

Hey, good morning. Thanks. John, you said M&A was the preferred use of capital. As you look at the portfolio today, are you primarily focused on freight additions or do you want to build out the transit portfolio, or is the overall strategy more opportunistic and returns-based? Can you just talk about how you're approaching it?

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

I think there's a couple areas, Steve, that we're focused on. One is the digital area and others are near-end adjacencies. Of course, we're always interested in bolt-ons to our existing business, but other than that it would be near-end adjacencies. And when I say near-end adjacencies, think about things such as mining. Right? We've got a good foothold in that market. L&M was a great example of a near-end adjacency that we did a year ago, and we had four key elements or vital organs to a mining truck and now we added a fifth with L&M acquisition. And then again on digital, we've done a couple digital acquisitions over the last couple of years. We'd expect to see more.

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

Our focus here ultimately is maximizing returns and we will be opportunistic, but just to add additional color here, high recurring revenue streams, bolt-ons, digital service-related, those are certainly, I'm going to call, the bulk of the preference that we have. And with that, I think we have a strong pipeline. It's making sure that ultimately the best returns reside on those. And if not, making sure we're not ultimately shy about returning to your share buybacks.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.
Q

Yeah. And I think everyone would like to see more digital in the portfolio. And you had said that that was stronger in international this quarter. Was that a one-off or do you see the beginnings of a more consistent trend in digital internationally?

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

I think there's two elements there. I think we continue to see a softer North America market. Internationally, we continue to see gaining momentum there. PTC is certainly one of those products and the KinetiX also portfolio is very strong there. But there's also an element within digital of making sure we move from, what I'll call, one-time sales to more recurring revenues. So, that's the element of transformation in that business.

I think we're happy to see the business has moved into growth since the second quarter, but it's an element of transforming that business, and we're committed to it. We see it as a big element of driving efficiency, productivity. And we're seeing, to some extent, in the international markets as you think about the opportunity to automate and drive that, potentially gaining momentum ahead of North America given regulation and given some other things. So, it's all in all a positive and we're highly committed to continue to grow that business.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. Thank you.

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

A

Thank you.

Operator: Thank you. And this concludes the question-and-answer session. I would like to turn the floor back to Kyra Yates for any closing comments.

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

Thank you, Keith, and thank you, everyone, for your participation today. We look forward to speaking with you again next quarter. Thank you and goodbye.

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