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Westinghouse Air Brake Technologies Corp. (WAB)
Q2 2019 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Wabtec Second Quarter 2019 Earnings Release 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 would now like to turn the conference call over to Ms. Kristine Kubacki, Vice President of Investor Relations. The floor is yours, ma’am.

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

Thank you, Mike. Good morning, everyone, and welcome to Wabtec's second quarter earnings call. With us today are Executive Chairman, Al Neupaver; President and CEO, Rafael Santana; CFO, Pat Dugan; and Corporate Controller, John Mastalerz. Before we start, I would like to remind you that our earnings release and financial disclosures were posted on our website earlier today and can be accessed on the Investor Relations tab on wabteccorp.com.

Some statements we will be making today are forward-looking and based on our best view of the world today. We will also disclose non-GAAP financial metrics and encourage you to read our disclosures and reconciliation tables carefully as you consider these metrics.
And now, I will turn the call over to Al.

Albert J. Neupaver  
*Executive Chairman, Westinghouse Air Brake Technologies Corp.*

Thanks, Kristine, and good morning to everyone. First, I'd like to start by welcoming Kristine to the team. I've known Kristine for quite some time and she's already had a very positive impact at Wabtec. I'm confident she will do the same for you, our investors, going forward.

Today, we are looking forward to sharing with you the progress that we're making across the portfolio as the new Wabtec. This is a strong company that is globally positioned with a significant backlog, a diverse portfolio of businesses and an unmatched market position. It's a company with transformational technologies and solutions and established position in digital and electronics. These are disruptive technologies that are important for the future of Wabtec as well as the industry, and will give us momentum as we help customers redefine how they run their assets and operations. And finally, it's a company with a proven leadership team that has managed successfully through the cycles, with the right levers in place to deliver continuous Lean improvements and drive improved productivity.

We are very pleased with the progress that we have made since the Wabtec and GE Transportation merger. We have made great strides in integrating our cultures and integrating our organizational structure. We have a strong leadership team in place with alignment and we have validated our synergy run rate targets of $250 million by year four.

Before I turn it over to Rafael, I also wanted to share some insights on him as a leader. I've had the opportunity to work closely with him since we announced the deal some 14 months ago. Rafael has a deep understanding of the portfolio and a unique perspective on the world, given his global background. He is a proven growth leader, a strong operator and has a deep appreciation for prudent capital allocation. He is also a champion of Lean enterprise and continuous improvement, and keenly focused on delivering for both the short- and long-term. These traits are great foundational qualities to have as a CEO and I'm looking forward to all that he can deliver.

With that, I'll hand the call over to Rafael.

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

Hey, thanks, Al. It's good to be back with all of you today and officially in the role. As Al noted, Wabtec is a strong company with 150 years of history, serving really as a leader in the transportation industry. We're driving productivity, moving people and product around the globe. We're paving the way for safety, efficiency, reliability and sustainability for our customers. With this context in mind, I really wanted to share with you some initial thoughts on how we'll continue to create shareholder value.

First and foremost, and as I had highlighted to you in our last call, we are focused on executing our plan and delivering on our financial commitments. We have plans laid out (5:38) for better positioning our legacy businesses and we're laser-focused on making sure that we execute on our financial commitments for the year. Stronger cash generation will allow us to create further shareholder value, while prioritizing debt reduction and creating flexibility to fund organic growth, acquisitions, stock buyback and dividends.

Second, we're really committed to continuous margin improvement. We're establishing the right structure to position the company for profitable growth through the cycles. This includes a more focused prioritization of
resources and prudent capital allocation. Our cost reductions and synergy initiatives stemming from the Wabtec and GE Transportation merger, they have already begun to deliver benefits and we have the opportunity to further accelerate synergies. We're confident that our integration efforts will lead to a more competitive cost structure for our business and we will build upon the foundation to improve cash flows and margins.

Third, we'll leverage our scale, deep technology domain, diverse business portfolio to drive profitable growth. We'll continue to invest on organic growth opportunities, expanding our competitive advantage, while combining innovation and technology with process rigor and global reach to drive increased value for both our customers and shareholders.

Finally, we have an exceptional team committed to outperform. Together, we're building a culture focused on execution and accountability, with a shared sense of purpose to move things in a better way. And you're seeing that commitment in our second quarter results. Even despite of a challenging environment in North America that includes carloads down for the year, PSR implementation and one of the highest levels of parked locomotives in over a decade, we're focused on controlling what we can. This means accelerating cost out and restructuring efforts for the business along with synergies.

At a high level, we had a good quarter with strong operating performance, margin expansion, solid cash flows from operations. And based on our second Q performance, current backlog and our assessment of key markets, we're raising our cash flow guidance for the full year to approximately $900 million and our EPS guidance is now $4.10 to $4.20.

I'll talk more about our market expectations for both Freight and Transit, but first, Pat will provide you a deeper dive into the financials. Pat?

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

Thank you, Rafael. As you can see from our press release this morning, we are going to discuss both GAAP and adjusted numbers. So we encourage you to review the reconciliations we've provided.

We continued the momentum started in the first quarter and delivered solid operating performance in the second quarter, which was the first full quarter of results since completing the merger between Wabtec and GE Transportation. Today, we updated our guidance for sales, for adjusted income from operations, for adjusted EBITDA, for adjusted EPS and cash flow from operations, which shows that our business is performing up to expectations.

So, looking at sales, the sales for the second quarter were $2.24 billion. Adjusted sales were $2.25 billion. That adjustment is excluding the effects of accounting policy harmonization. Our Freight segment sales increased 262% to $1.5 billion. That increase is obviously due to the GET merger, which contributed $1.1 billion. Our organic sales decreased $34 million primarily due to lower electronic sales. The quarterly run rate for the rest of the year will fluctuate based on delivery schedules, projects on some seasonality and among other factors.

The Transit segment sales increased 6% to $742 million and that was driven by strong growth in OEM sales. The organic increase was about $81 million and acquisitions contributed $3 million, which was offset by negative impact of foreign exchange of about $41 million. This is the sixth quarter in a row we've now seen organic sales growth, which shows that our near-record backlog has kicked in for Transit.
Looking at consolidated operating income for the quarter, it was $201 million and adjusted operating income was $320 million, or 14.2% of adjusted sales. Adjusted operating income excluded pre-tax expenses of $119 million related to the GE Transportation merger. And to break that out, it consists of $89 million for one-time non-cash purchase price accounting charges, $31 million for transaction and other restructuring costs. Again, I'll point and ask you to see our reconciliation table for these details.

In addition to these expenses, the company also had pre-tax expense of $56 million or about $0.22 earnings per share for non-cash recurring purchase price accounting charges. We have not added that back to our adjusted income from operations.

So, looking at some of the detailed line items in our income statement, SG&A was $291 million, including $40 million of the $119 million in expenses I just discussed. We expect the adjusted number for SG&A to be about $250 million per quarter going forward. Engineering expenses increased to $57 million due mainly to the addition of the GE Transportation business and our amortization expense was $66 million, including $56 million of additional recurring PPA for the GE Transportation merger. Going forward, we expect the amortization expense to be about $65 million for each quarter.

Looking at segment operating income, for Freight, operating income was $152 million and adjusted operating income was $251 million for an adjusted margin of 16.6%. Transit operating income was $71 million for an operating margin of 9.6%, higher due to operating leverage from higher sales.

For the full year of 2019, we expect our consolidated adjusted operating income to be about 14% and we expect adjusted operating segment margins to improve through the year. These improvements will come through our continued improvements in project performance, a better mix of sales, and the benefits of restructuring and cost reduction programs. We have also included net synergy benefits of about $20 million in our adjusted guidance for the year.

I also want to emphasize that we expect to see the normal seasonality in our Transit business in the third quarter. Additionally, product mix can fluctuate quarter-to-quarter. Project deliveries and other factors will impact our results, which is why we do not guide to segment sales and margins.

Interest expense, net interest expense was $59 million due to our higher debt balance related to the acquisition. Adjusted net interest expense was $55 million. Going forward, we expect interest expense to be about $55 million per quarter. Remember that we are focused and have as a priority generating cash to reduce our debt and therefore our interest expense.

Income tax expense was $41 million. Excluding the net tax benefit from transaction costs for the GE Transportation merger, adjusted income tax expense was $65 million or an adjusted effective tax rate of about 24.5%.

Second quarter EPS had a GAAP EPS earnings per diluted share of $0.54 and an adjusted EPS of about $1.06. To help you reconcile that second quarter EPS, you can find the following details in our press release. We start with GAAP EPS of $0.54; we add back one-time non-cash PPA of about $0.35; we add back our transaction and restructuring costs, which is about $0.14; and add back tax expense for non-deductible transaction cost of about $0.03; resulting in an adjusted EPS of $1.06. I'll just highlight again that in addition to the expenses above, the company also had after-tax expense of $0.22 per diluted share for non-cash recurring purchase price accounting charges.
EBITDA, which Wabtec defines as income from operations plus depreciation and amortization, was $308 million and adjusted EBITDA was $428 million. Adjusted EBITDA excluded the pre-tax expenses of $119 million discussed earlier.

Now shifting to our balance sheet and to our cash flow. We believe that our balance sheet provides the financial capacity and flexibility to invest in our growth opportunities. We have an investment-grade credit rating and our goal is to maintain it.

In Q2, we generated cash from operations of about $413 million and that's due mainly to improved working capital and from customer deposits received on certain contracts, certain projects. When you look at our working capital at June 30, our receivables were $1.7 billion, our inventories were $1.9 billion and payables were $1.2 billion, with all showing improvement compared to the first quarter. Our receivable balance included unbilled receivables of about $460 million, which were more than offset by customer deposits of $649 million.

Our cash and debt at June 30, we had $461 million in cash, mostly held outside the United States, and our total debt was about $4.63 billion, resulting in a net debt to adjusted EBITDA of about 3 times compared to about 3.4 times at the end of Q1. By year-end, we are targeting net debt to adjusted EBITDA to be about 2.5 times.

So, a couple miscellaneous items that we always review with you in these calls are depreciation for the quarter was $42 million versus $16 million in the year-ago quarter. The increase is due to the merger with GE Transportation. And for the full year of 2019, we expect our depreciation to be about $155 million. Amortization expense was $66 million, compared to $10 million in last year's quarter. The increase, also due to the merger. For the full year of 2019, we expect it to be about $225 million. Our CapEx expenditures were $32 million in the quarter versus $22 million a year ago. The increase, again, due to the merger. And we expect to spend about $200 million in 2019.

Our backlog at June 30, our multi-year backlog was $22.6 billion and our rolling 12-month backlog, which is a subset of that multi-year backlog, was $5.9 billion.

So, let's talk about our updated guidance for 2019 for a minute. Based on our second quarter performance, based on our current backlog and based on our assessment of conditions in our key markets, our guidance is for sales to be about $8.3 billion, our adjusted EBITDA to be about $1.6 billion, our adjusted income from operations of about $1.2 billion, and adjusted earnings per diluted share between $4.10 and $4.20. And we have raised our GAAP cash from operation guidance to be about $900 million for the year.

Even in light of the aforementioned market challenges, we believe this guidance is achievable as we focus on controlling what we can, which means focusing and accelerating our cost actions and synergies into the year-end.

The adjusted guidance excludes estimated expenses for the GE Transportation merger, for transaction and restructuring costs, for the one-time purchase price accounting charges and for non-cash accounting policy harmonization. Excluding these expenses, our adjusted operating margin target for the full year is about 14% and our effective tax rate for the full year is expected to be about 24%.

I'd also like to point out that our adjusted guidance includes after-tax expense of about $0.80 per diluted share for the non-cash recurring purchase price accounting charges. In other words, we are not adding that back to our adjusted EPS guidance right now.

So, with that, I'd like to turn it back over to Rafael.
Okay. Thanks, Pat. First, let me talk to you about the overall freight market conditions. I'll start with North America. Freight rail traffic is down about 2% year-to-date, driven largely by inclement weather conditions, drop in intermodal traffic, declines in critical commodities like coal and agriculture. Precision Schedule Railroading is certainly having some effect on new local orders, but it's offset by our modernization program and aftermarket services book.

We continue to work closely with all Class 1s to understand their current fleet strategies and we remain confident that our business model, as a technology leader and critical provider of services, is much more aligned with what the railroads are trying to accomplish with PSR, namely improved efficiency and productivity.

Across our international markets, we remain well-positioned for growth and we're pursuing fleet expansions opportunities across several critical growth markets. This includes Southeast Asia, includes Brazil, opportunities in West Coast of Africa. Additionally, we continue to see the strength in our industrial end markets. Particularly in mining, we expect double-digit growth for the total year. So, while we saw a weaker North American market, our Freight business performed as expected.

Looking at the rest of the year, we have adjusted our view on carload volume, which we now expect to be lower versus a year ago. The freight car market has weakened versus last quarter and is tracking, now, to deliveries in the low- to mid-50s for the year, and these assumptions are included in our guidance for the year.

With that in mind, let me move into Transit. The Transit sector, we're seeing steady growth in ridership and urbanization. Aging fleets across Europe and the U.S., they need to be upgraded, presenting really unique opportunities for growth. We see public operators are being pushed for increased productivity and the industry is demanding technical, really, advancements including safety, reliability and condition monitoring, which are areas we place a strong role and will continue to grow.

Across our segment portfolio, we have a firm multi-year backlog that will result in growth. We are continuing to make progress on our Transit business. Lilian Leroux and the Transit team are driving a clear focus on prudent project selection that will lead to increased profitability as well as long-term aftermarket revenues. At the same time, we are continuing to drive actions to improve execution on our existing projects. With these efforts underway, we remain confident that our Transit segment margins will improve over the company's strategic planning period.

With that, I hope you have a better sense for what we're seeing across the company, our strengths, our challenges and our strategy for moving forward. We reported good performance this quarter. We've raised our cash flow guidance for the full year to approximately $900 million with our adjusted EPS guidance [ph] now (23:02) at $4.10 to $4.20. Additionally, we're off to a strong start with the integration of Wabtec and GE Transportation, and remain on plan to deliver $250 million of operating synergies by the end of year four of the merger, with a higher-than-expected run rate of growth synergies by the end of this year. Our teams are focused on delivering for the year, while creating long-term value for our customers and shareholders.

Now, we're happy to answer any of your questions. So, Mike, please proceed.
QUESTION AND ANSWER SECTION

Operator: Yes, sir. [Operator Instructions] The first question we have will come from Allison Poliniak of Wells Fargo. Please go ahead.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Hi, guys. Good morning.

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

Thanks. Good morning.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

So, Rafael, I know you only have a quarter under your belt in terms of managing Wabtec — or less than that, I guess. As you look to it, anything surprising or negative? The one thing that caught my attention was in your opening remarks about trying to find a way to better position the legacy products that Wabtec has. So, any commentary that you have around that?

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

Well, sure. Couple things, I think. Number one, we’ve started to work on this a while back. I’ve had opportunity to start interacting with Al and the team here going back 14 months ago. So we’ve had the opportunity to really go through and map a lot of the opportunities. As I look at these opportunities and we continue to have the opportunity here to grow share in terms of the content of Wabtec products into the locomotives that we provide to the market out there, I think there’s some of the key markets, globally speaking, that we’re well-positioned. We can take advantage of longer-term agreements and bring a lot of those products in to be part of our services franchise. So it’s one area of opportunity here and we feel strong about being able to drive share of wallet up with our customers.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Great. And then, obviously, Transit margins showed nice improvement. Seems like the OEM mix was still there. Can you maybe — are sort of some of the past issues now firmly behind and you’re making some move on the productivity efforts there? Maybe talk to that, just given some of the OEM mix headwinds that seem implied in the quarter.

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

Yeah. So I think we’ve seen some progress there; early days. What I’d say is Lilian Leroux and the team, they’re really committed to make sure that we have a strong rigor to the bidding process. So, that speaks to the quality of the order intake, making sure that we sign up for projects that we clearly understand risks and that we’re able to deliver on it. So, that’s where it starts first, quality of the order intake.
The team has been taking really a strong view on projects we’re executing through, making sure the accountability is there, and that we’re taking cost-out measures as a result of that. So, through that process, we do expect and we’re committed to drive improvement of margins over time.

With regards to the UK projects, those projects – some of these projects actually extends into 2020 and 2021. I think some of these elements of delays is really associated with the receipt of cars to be repaired and overhauled, and they’ve got to be sent by the customer to us. But you’re going to see the majority of that being run out by the end of this year. So it’s continued work, early days, some improvement in the quarter, a lot of work ahead of us.

Allison Poliniak-Cusic  
**Analyst, Wells Fargo Securities LLC**

And you just mentioned early days. I mean, there’s nothing structural with the European business that you guys could not get back to sort of that low-double-digit mid-teens margin, is there?

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

We’ve been there in the past. There is clearly the opportunity. The question is how fast we get there. So we’re certainly committed to improving the margins.

Allison Poliniak-Cusic  
**Analyst, Wells Fargo Securities LLC**

Perfect. Thank you.

**Operator:** Next, we have Justin Long of Stephens.

Justin Long  
**Analyst, Stephens, Inc.**

Thanks. And congrats on the quarter.

Patrick David Dugan  
**Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.**

Thank you.

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

Thank you.

Justin Long  
**Analyst, Stephens, Inc.**

I wanted to start with a question on operating cash flow and the guidance there. So, using the midpoint of the prior guidance, it looks like the expectation for 2019 went up by $350 million on a GAAP basis and it went up about $150 million on an adjusted basis. Pat, can you just help us understand what drove these increases in operating cash flow and the outlook?
Patrick David Dugan  
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

Sure. So I think when you look at it, and we talked about it an awful lot in previous calls, that there was just some concern at the day of close. Remember that in the first quarter we were only five weeks into the combination and we definitely had some what I keep referencing to as supply chain tools that were provided by GE Capital and help the business manage their working capital, factoring programs on receivables, extended supplier payment programs on the payables side.

And so, the impact of those getting out of those tools was a headwind, something that we were concerned about. And I think we kind of referred – gave everybody references that that was about $150 million worth of working capital concern. And frankly, the team has done an excellent job on mitigating that impact, working to do a good job in collecting receivables and working with our suppliers.

And then, on top of that, there's just been an overall better performance in terms of – and focus on working capital management. So, old Wabtec contributed to better receivables, better payable management, better inventory management. And then we've also had, and I talked about this in the script, a little bit of the impact of some customer deposits that we received on some discrete projects. So, all in all, it was a good working capital performance and mitigation of that headwind ended up in a really good cash performance in the second quarter.

On a go-forward basis, in terms of our guidance, we think that we're giving a good view of a typical cash conversion cycle. We don't see any kind of, like, a one-time benefit in working capital, rather a continuous improvement in working capital, and really allows us to come forward with a good guidance number that's materially improved.

Justin Long  
Analyst, Stephens, Inc.

Okay. And just to clarify on that, so previously you were assuming $150 million of a working capital headwind and it sounds like now you're assuming working capital as a neutral for 2019?

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

Yeah. I think that's right and we also had some concerns to the working capital, you had restructuring and other costs. And so, that was really kind of added up to our total impact of cash that was the $300 million.

Justin Long  
Analyst, Stephens, Inc.

Okay. Great. And then, for my second question, Rafael, I wanted to go back to something that you put in the release and said on in your prepared remarks. You talked about an acceleration in cost reductions and synergy initiatives. But can you help us size up the benefit from those actions? And in terms of the timing of these actions, is this more of a benefit to 2020, because I noticed the synergy guidance for this year didn't change?

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

So, from a synergies perspective, yes, I think we've guided for the net synergies of $20 million for this year. We're certainly tracking to north of that, but the bulk of the synergies for the $250 million will hit 2020 and beyond. I think we're really making sure we continue to evaluate and watch closely our end markets, the various end markets that
we serve. And we’ve been ready to take actions as needed as those markets fluctuate and we get a positive or not so positive news on that regard. And you’re seeing the reflection of some of those actions already in our second quarter results.

Justin Long  
Analyst, Stephens, Inc.

And do you have any initial thoughts on the synergy benefit you could see next year?

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

No, we’re not at this point providing. What I’ll tell you is we have validated the $250 million of targets to be achieved by the end of 2022 and we’re certainly mapping incremental opportunities that we could act on as the environment demands.

Justin Long  
Analyst, Stephens, Inc.

Okay. Great. I’ll leave it at that. Thanks for the time.

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

Thank you.

Operator: Next, we have Scott Group of Wolfe Research.

Scott H. Group  
Analyst, Wolfe Research LLC

Hey. Thanks. Morning, guys.

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

Morning.

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

Good morning.

Scott H. Group  
Analyst, Wolfe Research LLC

Pat, wanted to follow-up on some of the cash flow things. Can you just quantify how big is the customer deposit benefit in that change in cash flow? And then, when we talk about we thought we were going to have a $150 million headwind from factoring and now not, is that meaning that we’re doing factoring now and so this is an ongoing benefit? Or is this sort of we found some offsets for this year but we stop that factoring headwind to think about in the future years. And then...
So, just let me answer those two questions first, okay? In terms of factoring, the factoring, we have not replaced the factoring program. We had to exit the GE factoring program. So, in other words, the factoring provided a quick return on cash receipts on receivables. We have been able to – that's been paid off. There's no more factoring out there and we have not put in a new program in place for those receivables we have. So, that's behind us. And if we were to actually find and get into a factoring program that we thought was a good answer and attractive, that would be a benefit going forward. But we have nothing that we're working on right now or plans for that right now.

In terms of the customer deposits, I think in total the receipts of customer deposits that I was referring to are about $60 million. And one of those deposits occurred in – a portion of those deposits occurred in the first quarter, second in the second quarter. But, of course, you're constantly kind of receiving and consuming deposits, so to speak, in terms of project performance. But the gross number received was about $60 million.

Okay. Helpful. And then, just as we think about the free cash flow here, the tax benefit that I guess gets shared to GE or in the beginning, did that show up in the $900 million of cash from ops or is that in investing?
Good morning. President, Chief Executive Officer &
Rafael O. Santana

Hi. Good morning, everyone. This is Ben Burud on for Jerry.
Analyst, Goldman Sachs & Co. LLC

Operator

Thank you.

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

Thanks a lot, guys. Appreciate it.

Scott H. Group
Analyst, Wolfe Research LLC

Okay. Makes sense. And then, just lastly, you mentioned the Freight sales were down, I think just lower electronic sales. I presume that’s some of the PTC stuff starting to roll up. Are we seeing a full run rate of that reduced PTC spend or do you think we need to think about potential another sort of step down in that into next year?

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

No. I think, a year ago, electronic sales and PTC sales were running with the idea that that deadline in 2018 had an impact. And I think that when you look at the current quarter, I think we’re at the kind of the more typical run rate without the PTC deadline out there. So, the decline in electronic sales, you would definitely correlate to the change in PTC demand.

What we are focused on now is, again, the development of the next-generation opportunities on maintenance contracts and upgrade capabilities in PTC. And so, we really see that as our growth opportunity, especially as we integrate it with the digital business that came with GET.

Scott H. Group
Analyst, Wolfe Research LLC

Thanks a lot, guys. Appreciate it.

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

Thank you.

Operator: The next question we have will come from Jerry Revich of Goldman Sachs.

Ben Burud
Analyst, Goldman Sachs & Co. LLC

Hi. Good morning, everyone. This is Ben Burud on for Jerry.

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

Good morning.
Patrick David Dugan  
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

Good morning.

Ben Burud  
Analyst, Goldman Sachs & Co. LLC

Morning. Can you help us think about organic growth in the quarter at the legacy Wabtec Freight business as well as the acquired GE Transportation business? And can you also give us an idea how you're thinking about those distinct organic growth trajectories going forward as well?

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

So, maybe a good way to answer your question is just kind of I'll walk you a little bit on some of the dynamics we're seeing around the world. I'll probably start with Asia where traffic growth continues to be strong, driving demand for a lot of our rolling stock and locomotive replacement. So, we've been working on a number of opportunities there.

You take the aspects of Australia and New Zealand, we also see fleet renewal opportunities in works, a driving demand and here's a combination of not just locomotives but freight cars and a lot of components that we sell. There's continuing to be pockets of opportunities in Africa. Of course, we recently completed contract for 233 locomotives, but we're expecting to grow in West Africa and there's some of the opportunities we work here through the second quarter.

Russia and CIS, despite [ph] what I'll call (39:45) traffic being flattish, there's certainly opportunities for fleet renewal and we're really working strongly with both Russia, Ukraine as opportunities ahead. Last one is probably Latin America, I would say right now demand seems to be moderate, but we've found pockets of opportunities to grow our fleet there and we're continuing to pursue that.

Ben Burud  
Analyst, Goldman Sachs & Co. LLC

Understood. And turning to Freight, the backlog, had some burn in the quarter. Can you comment on the 2Q order activity for, again, both the legacy Wabtec Freight business and the acquired GE Transportation business? And then, going forward, what are you seeing as the cadence for new locomotive opportunities? How is the – stepped through it a little bit, but can you elaborate on the prospect list and when can we expect a return to backlog growth in the Freight segment?

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

Okay. So we've seen the backlog with what I'd call a slight decrease, about $600 million, from the first quarter. I'd say some of that is really associated with the lumpiness of some of the orders. Keep in mind, we've received a number of multi-year orders in the course of last couple years, and I think that's number one, something to keep in mind.

The second piece to that is, as you start looking to the elements of our Freight market in specific, I think there's surely headwinds when I think about, I'll call, our OE business and especially in the light of North America. I think it's important to keep in mind that some of these dynamics have been playing out for some time. I mean, and I
have been – having a number of locomotives were parked starting the first half – in the first part of the second half of last year and it has gone through the first half of this year.

Right now, we're sitting on one of the highest number of locomotives parked for the past 10 years and that has played out over the last 12 months. When you think of the aspects of carloads being down, that's certainly been a dynamic since the beginning of this year. I think what we like in our portfolio is, when I think about the services portfolio of recurring revenues, we certainly have a more global installed base that we're certainly taking advantage of. I think we have a portfolio that allows customers for the fleets that they are maintaining running that we have the opportunities to provide enhancements to that fleet. You're seeing that coming through the modernization program. But you're certainly seeing the fleets that are remaining active, there's more demand for parts, services got a bit intensified on those in order to improve reliability and availability of those units. So, when you blend that up, I mean we're looking at services business that is growing for the year. I think that's one element to keep in mind.

When it comes down to, specifically, you asked on new locomotives, I think as we discuss strategies for our customers, I think there has been a number of discussions where the preference might have gone towards modernizations versus new locomotives, and that's offsetting some of that pressure. And we like the portfolio we have in terms of the opportunities and there's the other pieces of the portfolio, which, Transit, we certainly have an opportunity here to continue to drive growth; mining, we're having double-digit growth for the year and good prospects here moving forward.

Ben Burud  
Analyst, Goldman Sachs & Co. LLC

Q Got it. And, finally, can you give us an update on the share picture in the locomotive business? Are you seeing any shift in competitive intensity or maybe do you anticipate any change down the road when we head up into a new up-cycle?

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

A So, I think we are well-positioned from a technology perspective to have really one of the most competitive products out there as far as you look not just into North America, but internationally. It's an element not just of new locomotives. It's also an element of the services portfolio; so, keeping those fleets up-to-date, efficient, productive. So, when I look at the share of the installed base, I think we've been able to grow that share on installed base, just based on having a more reliable and a more efficient fleet. And we're certainly continuing to make investments to allow customers more opportunities to invest on getting more value out of the existing fleet, which also drives value for us.

Ben Burud  
Analyst, Goldman Sachs & Co. LLC

Q Great. Thank you very much.

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

A Thank you.

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

A
Operator: And the next question we have will come from Chris Wetherbee of Citigroup.

Chris Wetherbee  
*Analyst, Citigroup Global Markets, Inc.*

Yeah. Hey, thanks. Good morning.

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

Morning.

Chris Wetherbee  
*Analyst, Citigroup Global Markets, Inc.*

Yeah. I wanted to stick, I guess, on the Freight business for a moment. And it sounds like you've calibrated the outlook for the full year from a revenue perspective towards some of the deceleration that we've seen, at least here in North America. Can you give us a sense of the – what you think the sort of back half may look like or what's at least embedded in the guidance in terms of maybe a return to some degree of growth here or some stabilization? Certainly, the current environment seems particularly soft. So, kind of just want to get a sense of how the guidance is calibrated to the current environment relative to a potential improvement as we move forward through the rest of the year.

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

Okay. When it comes to the rest of the year, of course, we assess here our backlog and the current projects we're working on, and we felt strong to the point that we've raised the guidance on cash flows and we really moved our range from $4.10 to $4.20. So I'll just start there.

With regards to being able to comment on 2020, it's kind of too early. We're certainly watching carefully our various end markets and we're really ready to take the necessary cost actions to make sure that we offset any elements of challenges on any markets that we ultimately serve. I think one of the things to keep in mind is what I just described for our services business, which I think it really has the opportunity to drive value, providing customers solutions for the existing fleet. So you're going to need to ultimately extract more value of those fleets. They need to be running better conditions, and I think we're seeing the opportunity to grow our services business as a result of that.

But we'll keep really watching carefully some of the same data that you look at it and we will continue to monitor our end markets.

Chris Wetherbee  
*Analyst, Citigroup Global Markets, Inc.*

Okay. Yeah. That's helpful. And I just want to come back to the working capital point for a moment and make sure I understood what you guys are describing here. When you think about sort of working capital go-forward for the mix of the business as it stands today, should we assume that should be sort of more neutral or was that more of a 2019 comp? I just want to make sure I understand sort of what the outlook there is.
Patrick David Dugan  
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

So I think what we're talking about in our guidance is that our working capital at the end of the second quarter will remain about the same levels as it is now. Obviously, we're constantly looking to perform better, to do better with working capital, inventory turns, receivable days outstanding. But in terms of our guidance, we're feeling like that's fairly neutral through the rest of the year.

The overhang that we keep talking about in the initial guidance that we gave earlier in the year is really – we feel is behind us. The factoring, the extended payment terms programs, those have unwound themselves and, of course, the restructuring cash costs were also part of that adjustment. So it's just – we're looking at kind of a neutral view on working capital change for the rest of the year.

Chris Wetherbee  
Analyst, Citigroup Global Markets, Inc.

Okay. Okay. No, that's helpful. If I could sneak one last one here. I know it's early to talk about synergies beyond the rest of 2019, but contextually when you think about the opportunity sets, I think the general view is it will be back-end weighted. What are the sort of factors that you guys are looking at that could potentially influence or impact the timing of being able to sort of leverage those synergies?

I don't know if global macro dynamics, kind of how much that sort of plays into it or maybe that allows you to accelerate things. It sounds like there's an effort to accelerate cost takeout and be more focused. So, just wanted to get a rough sense of, bigger picture when you think about the longer-term integration of the business, how do you think about the potential for realizing those synergies?

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

Yeah. I think we're on track to achieve the synergies. I think what you're kind of driving at is what levers do we have in order to pull those in or what kind of risks are there for them to be pushed off. And I definitely think that there's a lot of factors, there's a lot of opportunity there.

We're going to – when we've talked about our synergies and the kind of the buckets of where these are being achieved, both near-term and long-term, it's definitely coming from sourcing, from buying as a bigger organization, leveraging each other's supply chain, reducing the number of rooftops, having consolidated facilities and capacity. And you can kind of look at those near-term synergies that we've talked about as there could be impact to how fast we move based on our market conditions.

Our goal is to move as fast as possible to get these opportunities kind of benefiting the company in 2019 so that they're up and running and ready for future periods.

Chris Wetherbee  
Analyst, Citigroup Global Markets, Inc.

Perfect. Thanks very much for the color. I appreciate it.

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

Yes.
Operator: The next question we have will come from Matt Elkott of Cowen. Please go ahead.

Matt Elkott
Analyst, Cowen and Company, LLC

Q Can I ask about the Freight backlog? The 12-month portion of that backlog went down slightly from March from I think 20.9% to 20.2%. So it's a slight decline. But I was just wondering if it may be partly a function of customers wanting to push out deliveries or if there are any discussions of that sort going on?

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

A So, a couple of points. I mean, with regards to our backlog, I think we were clear on the first quarter, our backlog for new locomotives was close to 2,000 units, and the modernizations, they were close to 900 units. I'd say, at the end of the second quarter, those numbers are about 1,900 for new locomotives and about 800 for mods on that regard.

We have not had any, I'll call, project cancellations. Again, of course, as part of business, we might have discussions with customers in terms of timing of deliveries and things like that, but we don't disclose those and they're really on a case-by-case basis.

Matt Elkott
Analyst, Cowen and Company, LLC

Q Got it. That's helpful. And Rafael, the initial guidance for locomotives when the deal was first announced was double-digit CAGR growth through 2021. How much lower is that outlook now that rail traffic is down and PSR is widely implemented?

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

A So, a couple of points I think. Number one, this is a cyclical market, but over time we do expect that those numbers can be, I'll call, more than two times higher versus the trough numbers that we had in 2018. With that in mind, I mean there is certainly I mean a variety of elements playing out there. Some of it, as you discussed, fleet strategy with customers, we are seeing a stronger interest in some of the modernization programs. And in terms of numbers, those are more than offsetting, I'll call, some of the numbers on what I'll call new locomotives.

But, over time, I think a good way to think about it is think about as you look into the fleets that we have out there, they're running hard in some key markets. You'll see those locomotives in average being replaced every 20 to 30 years. So, as you think about that just from – I'll just speak on a U.S. market perspective with close to 50,000 units, you apply that logic, I mean you'll see we should expect those numbers to be north of 500 locomotives in average per year. And of course, we've got all the international markets which will be very project based. So we think it's consistent. The timing on those will vary based on where we are in the cycle.

Matt Elkott
Analyst, Cowen and Company, LLC

Q Okay. And the modernization is going to be aftermarket portion of the revenue, right, not the new build?
Rafael O. Santana  
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

That’s correct.

Matt Elkott  
Analyst, Cowen and Company, LLC

Okay. And I know that there are railroads that are contemplating whether they do in-house modernizations or they let you guys do it. Can you maybe talk about that a bit and whether you guys are thinking of any incentives to increase the portion that you would do?

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

So we do both today. In some cases, we do the full, I'll call it, modernization ourselves. In some cases, we ship a lot of the [ph] kits (54:22) and what the railroads will do, they'll utilize the fact that they might have capacity available in their shops to do a lot of what I'll call assembly and apply the labor hours to get more, I'll call, efficiency and [ph] level loads (54:37) in their plants. So this is really a case-by-cases basis. What I'll tell you, I think we've been able to really deliver on strong reliability and availability numbers for the units that we do.

Matt Elkott  
Analyst, Cowen and Company, LLC

Got it. And just one last question, should we expect you guys anytime in the next few quarters to give us updated long-term goals and maybe give us some more color around some sort of quantification of the digital opportunities, because I know that's a pretty big part of your thesis going forward?

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

Yeah. So, up to this point, I'd say we had really been very focused on the integration and synergies and making sure that we’re working on delivering our commitments. We are starting the process of really doing this long-term planning through the second half of the year. We do intend to have an Investor Day at this point likely to happen in the earlier part of next year.

Matt Elkott  
Analyst, Cowen and Company, LLC

Perfect. Thank you very much.

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

Thank you.

Operator: And the next question we have will come from Matt Brooklier of Buckingham Research.

Matthew Brooklier  
Analyst, The Buckingham Research Group, Inc.

Hey. Thanks. Good morning. I was wondering if you could talk to the cadence of EPS in the second half of the year. I think Pat reminded us that you do have some seasonality in your Transit business from 2Q into 3Q, but
this is kind of a different ballgame given the fact that we have GE and there's obviously more kind of project timing that influences numbers. But just curious if you could give us maybe a little directional guidance in terms of how we expect 3Q and 4Q EPS to play out.

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

Yeah, Matt. We've never given any kind of quarter guidance before, it gets kind of difficult. We definitely will have an impact on the Transit business, which is largely European. Not only – our customers will get into shutdowns and other kind of slowdown in their own production. So it kind of has a trickle effect into our Transit business.

The other thing is we have with GET, there is an impact on timing of service and the underlying contracts and projects that we have. And so, so right now, it's probably not as dramatic an impact as it has been in the past, but kind of little bit it's still a factor, it still matters. So, and that's why we pointed it out.

Matthew Brooklier  
Analyst, The Buckingham Research Group, Inc.

Okay. That is helpful. And then, Rafael, you talked about – it's pretty clear there is weakness in the North American locomotive market. You do have some offset from your modernization program. Could you talk about where you are from a utilization perspective on modernizations? Is there the opportunity to potentially grow that program as we move into 2020 to offset maybe continued headwinds in terms of North American new locomotive orders?

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

Yeah. What I'll tell you is we are growing that specific product line by double digits into this year. So there's certainly an element of opportunity here to continue to drive growth there and being a significant part of what we do. We also continue to evaluate opportunities for new locomotives as we continue to advance some of the product offering to improve fuel efficiency and to improve automation as part of that.

I think we had a strong first half for the year. I think we feel we're on track to increase, well, again the low end of the guidance. We're continuing to watch and monitoring our end markets. I think one of the elements to offset some of that softness is the services franchise, the global footprint that we have and the offering that we have to get more out of the installed base.

The assets that are remaining in operations, they are demanding more services, they are demanding more parts. You want to ultimately guarantee that your have a more reliable asset running. And we're seeing services business that it's growing this year. And just to point out again, I mean a lot of these dynamics have been in place for some time. I mean, we've been seeing locomotives being parked as of early part of second half last year. And a year later, we're sitting here on one of the highest levels of locomotives parked. And carloads have been coming down since January here for the business. So I think we like some of the opportunities we have here with the services franchise.

Matthew Brooklier  
Analyst, The Buckingham Research Group, Inc.

Okay. That's helpful. Those were my two. Thank you.

Operator: [Operator Instructions] Next, we have Steve Barger of KeyBanc Capital Markets. Please go ahead.
Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Hey. Good morning. Thanks.

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

Morning.

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

Good morning.

Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Morning. With North America traffic levels down, can you talk about the aftermarket friction product inventory in the channel? I'm just trying to get a sense for if you need to adjust production levels in the plants to balance supply and demand and where you are with that?

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

So, Steve, you're asking about specifically the friction business?

Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Yeah, the legacy Wabtec Freight.

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

Yeah. So the impact of volumes has really been an ongoing factor in how we operate those businesses, especially our plant down in North Carolina. And so they've adjusted their working capital model for that demand. Really in the end, that North America friction business is only a small component of our overall friction business because we have multiple plants in Europe which are serving the Transit side too, as well as Australia, India and South America. So, all-in-all, I would say the impact of any kind of slowdown on friction is definitely behind us and reflected in the results.

Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Got it. And just thinking about Freight segment margins, you talked about sequential improvement in the back half. But do you expect the Freight margin in 1Q was kind of a high watermark for the year? Just trying to think about how we should calibrate two-half in that segment?
Yeah. The first quarter Freight margin was definitely impacted by the five-week GET results, a little about sales mix and the timing of how they were delivered and recognized as part of Wabtec versus part of GET – or GE, excuse me. But also you have to factor in the recurring PPA.

You only had about a month of recurring PPA in the first quarter with that real favorable mix where most of your revenue was kind of delivered for the quarter in the five weeks with Wabtec. When you take the full impact of a quarter, a more balanced sales mix of OE and aftermarket and that recurring PPA, you get that variation on the Freight margins.

The way I've been looking at it is you look at our Q2, we're at about 16.6% Freight margin, okay, once you add back our one-time adjustments. And then if you add back all that recurring PPA, you actually have a margin for the Freight segment that's in excess of 20% and pretty consistent with what kind of the legacy Wabtec Freight business has been.

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Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Right. But you'll report the back half the same way you did this quarter, right?

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

Yeah. Correct.

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Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Okay. And then just one more, Rafael, going back to the locomotive commentary. You've seen the mods really stepped up based on customer thoughts around traffic levels and PSR, but do you still expect positive year-over-year growth in domestic locomotive orders in two-half 2019, or is that less likely due to just the idle equipment that's out there?

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

I'd say, well, we're seeing surely growth in terms of deliveries for this year. I think with regards to next year, I mean this is still early. I mean we're working on a number of opportunities. The bulk of the pipeline is really a lot of international markets for new locomotives and those tend to be a little more volatile in terms of the timing. But we're working to make sure that we improve that pipeline.

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Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Understood. Thank you.

Operator: Well, at this time, we're showing no further questions. We'll go ahead and conclude our question-and-answer session. I will now like to turn the conference call back over to Ms. Kristine Kubacki for any closing remarks. Ma'am?

Kristine Kubacki  
Vice President-Investor Relations, Westinghouse Air Brake Technologies Corp.
Thank you everyone for participating in today’s call. We look forward to talking with you soon. Bye-bye.

Operator: And we thank you, ma’am, and also to the rest of management team for your time also today. Again, the conference call is now concluded. At this time, you may disconnect your lines. Thank you, take care and have a great day, everybody.