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Westinghouse Air Brake Technologies Corp. (WAB)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Wabtec's Second Quarter 2023 Earnings Conference Call. [Operator instructions] After today's presentation, there will an opportunity to ask questions. Please note that this event is being recorded.

I would like to turn the call over to Ms. Kristine Kubacki, Vice President, Investor Relations. Please go ahead, ma'am.

Kristine Kubacki

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

Thank you, operator. Good morning everyone, and welcome to Wabtec's second quarter 2023 earnings call. With us today are President and CEO, Rafael Santana; CFO, John Olin; and Senior Vice President of Finance, John Mastalerz.

Today's slide presentation, along with our earnings release and financial disclosures were posted to our website earlier today and can be accessed on Investor Relations tab on wabteccorp.com.

Some statements we're making are forward-looking and based on our best view of the world and our business today. For more detailed risks, uncertainties and assumptions related to our forward-looking statements, please see 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, Kristine, and good morning everyone. Let's move to slide 4. I'll start with an update on our business, my perspectives on the quarter, and progress against our long-term value creation framework, and then John will cover the financials. We delivered another strong quarter, evidenced by robust sales and earnings per share growth. We achieved these despite continued volatility and economic challenges.

Sales were $2.41 billion, which was up 17.5% versus prior year. Revenue was driven by strong performance from both the Freight and Transit segments. Total cash flow from operations was $115 million. Overall, our financial position remains strong. We continue to execute against our capital allocation framework to maximize shareholder value by investing for the future growth, executing on the strategic M&A like our recent acquisition of L&M, and returning cash to shareholders.

The 12-month backlog was $7.2 billion, up 10%, signifying growing momentum and visibility across the business. The total multi-year backlog was $22.4 billion. Overall, the Wabtec team delivered a strong second quarter, marking a good first half of 2023.

Looking forward, I'm encouraged by the underlying strength and robust momentum across the business. Wabtec is well positioned to continue driving profitable growth even amidst a challenging economy.

Shifting our focus to slide 5, let's talk about our 2023 end market expectations for more details. As we look at key metrics across our Freight business, we remain encouraged by the underlying business momentum and our robust pipeline of opportunities across geographies. North America carloads continue to be down in the quarter and locomotive parkings moved up slightly as we exited the second quarter, but better than we had anticipated as customers prioritize service and fluidity.

We continue to see significant opportunities across the globe in demand for new locomotives, modernizations and digital solutions as our customers invest in solutions that continue to drive reliability, productivity and fuel efficiency. Looking at the North American railcar builds, demand for railcar continues to show growth. The industry outlook for 2023 is for about 45,000 cars to be delivered. Overall, we believe we have an opportunity to continue building significant long-term momentum with growth in modernizations, new locomotive sales, railcar builds, and digital solutions.

Internationally, activity is strong in core markets such as Brazil, Australia, India, and the CIS region, significant investments to expand and upgrade infrastructure are supporting a very strong international order pipeline.

Finally, moving to the Transit sector, the mega trends remain in place, driving the need for clean, safe and efficient transportation solutions around the globe.

Next, let's turn to slide 6 to discuss a few recent business highlights. In North America, we secured several key wins, including orders for 30 new locomotives, an order for 69 locomotives under our certified pre-owned program and an order for 60 modernizations from Canadian National that closed after the end of the quarter. In Australia, we recently won a strategic order for 17 locomotives from CBH, which will support the continued growth of agricultural commodities in the region.

And with regards to our zero emissions portfolio, we also recently signed a strategic order with Vale for three flex drive locomotives. These locomotives will pull the world's largest iron ore train, and is expected to remove 63,000 tons of carbon, the equivalent of 14,000 passenger cars per year.

In Transit, we won a major order to supply passenger information systems and pantographs for up to 504 Stadler cars for Germany and Austria. And finally, during June, we completed the bolt-on acquisition of L&M. This strategic acquisition will enhance Wabtec's existing heat transfer portfolio, and we will extend our installed base in mining, providing a solid platform for domestic and international profitable growth.

All of this demonstrates the growing momentum across the business, the team's relentless focus on delivering for our customers and a strong pipeline of opportunities we continue to execute on, Wabtec is well positioned to continue to capture profitable growth with innovative and scalable technologies that address our customers' most pressing needs.

Turning to slide 7, I'd like to highlight how Wabtec will provide efficient solutions for our customers by driving their productivity, reducing fuel consumption, and improving safety, while leading the decarbonization of rail across the industry.

Wabtec is uniquely positioned to shape a more sustainable future for rail by inventing and developing technologies that provide customers with adaptable and efficient solutions to meet their carbon reduction goals, while providing strong investment returns to our customers given improved reliability, haulage ability and fuel efficiency.

Ultimately, we will help lead the industry towards a zero emissions rail network and we have already started laying that path to get there through new locomotives, modernizations with advancements in utilizing renewable and biofuels, leading in battery electric applications, investing in hydrogen technology, and providing a wide range of digital solutions.

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

John A. Olin

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

Thanks, Rafael, and hello everyone. Turning to slide 8, I will review our second quarter results in more detail. We delivered another strong quarter of operational and financial performance with underlying business momentum strengthening through the first half of the year.

Sales for the second quarter were $2.41 billion, which reflects a 17.5% increase versus the prior year. Sales were driven by strong growth across all major product lines. For the quarter, GAAP operating income was up $48 million, driven by higher sales. Adjusted operating margin in Q2 was 16.4%, down 0.3 percentage points versus the prior year. The benefits of higher sales were offset by a less rich mix of sales between and within segments.

GAAP earnings per diluted share were $1.06, which was up 16.5% versus the second quarter a year ago. During the quarter, we had pre-tax charges of $10 million for restructuring, which was primarily related to our Integration

2.0 initiative to further integrate Wabtec's operations and to drive $75 million to $90 million of run rate savings by 2025.

In the quarter, adjusted earnings per diluted share were $1.41, up 14.6% versus the prior year. Overall, Wabtec executed a good quarter and a strong first half of 2023. We outperformed our expectations, demonstrating the underlying strength and momentum of the business and as a result, we are raising our full year outlook for sales and adjusted earnings.

Now turning to slide 9. Let's review our product lines in more detail. Second quarter consolidated sales were very strong, up 17.5%. Equipment sales were up 8.9% due to higher locomotive sales this quarter versus last year's second quarter.

Components sales were up 23.1% versus last year, largely driven by the higher OE railcar build and an increase in our market share due to product availability, along with increased demand for industrial products. We also closed the strategic acquisition of L&M late in the quarter, which did not have an impact on components sales during the quarter.

Digital intelligence sales were up 18.9%, which was driven by robust demand for onboard locomotive products and international PTC, along with revenue contribution from the acquisitions in Q2 of last year.

Our services sales grew 13.9%. Sales growth was driven by higher sales from increased modernization deliveries and increased parts sales. Our customers continue to recognize a superior performance, reliability, efficiency, and availability across their Wabtec locomotive fleets.

Across our Transit segment, OE and aftermarket sales significantly increased versus last year. Segment sales were up 25.3% to $699 million. The momentum in this segment is strong across our core markets as secular drivers such as urbanization and decarbonization accelerate the need for investments in sustainable infrastructure.

Moving to slide 10. As forecasted, gross profit margin was slightly lower, driven by a less rich mix and higher manufacturing costs. Mix was unfavorable driven by strong sales from the Transit segment and higher sales of new locomotives and modernizations within the Freight segment. Raw material costs, while still elevated, were largely flat on a year-over-year basis.

Foreign currency exchange was unfavorable to sales by $7 million or 0.3 of a percentage point., and it reduced our second quarter gross profits by $2 million. Finally, manufacturing costs were positively impacted by favorable fixed-cost absorption more than offset by manufacturing inefficiencies at our Erie facility in June. Our team continues to execute well to mitigate the impact of continued cost pressures by driving operational productivity and lean initiatives.

Turning to slide 11. For the second quarter, GAAP operating margin was 12.9%, which was flat versus last year, while adjusted operating margin declined 0.3 percentage points to 16.4%. GAAP SG&A was $285 million, and adjusted SG&A was $283 million, both of which were up versus the prior year, but down significantly as a percent of sales.

Engineering expense increased from last year according to plan, yet was down 0.2 percentage points as a percentage of sales at 2.2%. We continue to invest engineering resources and current business opportunities, but more importantly, we are investing in our future as the 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 12, starting with the Freight segment. As I already discussed, Freight segment sales were strong for the quarter, up 14.6%. GAAP segment operating income was $271 million for an operating margin of 15.9%, up 0.2 percentage points versus last year.

Adjusted operating income for the Freight segment was $346 million, up 15% versus the prior year. Adjusted operating margin in the Freight segment was flat with prior year at 20.3%. The benefits of increased sales, including fixed-cost absorption and lower SG&A as a percentage of revenue were offset by unfavorable mix from higher sales of international locos and modernizations as well as non-recurring expenses from our labor negotiations in Erie.

Finally, segment multi-year backlog was $18.3 billion, down 6.8% from the end of Q2 last year, while the 12-month backlog was $5.3 billion, up 10.3% over the same period. The 12-month backlog continues to show momentum beyond 2023. Conversely, the year-over-year reduction in the backlog was driven by lapping last year's significant multi-year order from Union Pacific for over $1 billion of modernizations.

Now turning to slide 13. Transit segment sales were up 25.3%, driven by strong OE and aftermarket sales. GAAP operating income was $66 million, up 32.0%. GAAP operating income increased as a result of higher sales and benefits from our Integration 2.0 activities, partially offset by higher restructuring costs.

Adjusted segment operating income was $76 million, which was up 31.0%. This resulted in adjusted operating margin of 11.1%, up 0.8 of a percentage point from last year. Finally, Transit segment multi-year backlog for the quarter was $4.1 billion, up 15.4% versus a year ago.

Now let's turn to our financial position on slide 14. Q2 cash from operations was $115 million. While cash flow benefited from higher earnings, we are continuing to invest in the business's growth, which is driving working capital higher, in particular, receivables and inventory. Despite that, we continue to drive toward a greater than 90% cash conversion for the full year.

Our debt leverage ratio was 2.4 times at the end of the second quarter, which was flat versus prior year, primarily due to the acquisition of L&M. As we look forward, we have a $250 million senior note at 4.38% coming due in August. We intend to roll that debt into our delayed draw term facility.

I'd like to spend just a moment on providing some additional color on L&M. As Rafael mentioned, during the quarter, we completed the bolt-on acquisition of L&M. This strategic acquisition will extend and complement our portfolio of premium heat transfer solutions in mining. We purchased L&M for $223 million in cash and the business is expected to have calendar year 2023 sales of about $130 million.

And finally, we returned $105 million of capital back to shareholders in the quarter through share repurchases and dividends. As you can see in these results, our financial position is strong and we continue to allocate capital and a balanced strategy to maximize shareholder returns.

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

Rafael O. Santana

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

Thanks, John. Let's move to slide 15 to discuss our updated 2023 financial guidance. We believe that the underlying customer demand for our products and solutions is growing across our business. Our order pipeline and 12-month backlog continue to strengthen, providing solid visibility for profitable growth for the rest of 2023 and beyond.

The team is committed to driving strong top-line growth while managing costs. We are also committed to driving adjusted margin expansion in 2023 despite a still challenging macro environment. With these factors in mind, we are increasing our previous guidance. We now expect 2023 sales of $9.25 billion to $9.5 billion, up 12% from last year at the midpoint and adjusted EPS to be between $5.50 and $5.80 per share, up 16% at the midpoint. We also expect cash flow conversions to be greater than 90%.

Now let's wrap up on slide 16. As you heard today, our team delivered another strong quarter to the year despite an uncertain and volatile environment. Thanks in large part to our resilient installed base, world-class team, innovative solutions and our relentless focus on our customers.

Our results remain on track for us to deliver on our five-year outlook that we provided at our Investor Day last year. With strong momentum across the portfolio, increased visibility through our strengthening order pipeline, and a rigorous focus on execution, Wabtec is well positioned to drive profitable long-term growth and maximize shareholder returns.

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

Kristine Kubacki

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

Thank you, Rafael. We will now move on to questions. Before we do and out of consideration for others on the call, I ask you 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: Thank you. We'll now begin the question-and-answer session. [Operator Instructions] First question will be from Justin Long of Stephens. Please go ahead.

Justin Long
Analyst, Stephens, Inc. Q

Thanks, and good morning.

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

Good morning, Justin.

Justin Long
Analyst, Stephens, Inc. Q

Based on the updated full year guidance, I was wondering if you could share how you're expecting third quarter and fourth quarter to look on a relative basis. Do you think they'll look similar from a revenue and earnings perspective? I just wanted to better understand the cadence that you're anticipating when you think about the timing of deliveries, mix, or anything else we should be mindful of in the back half.

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

Great, Justin. This is John. Justin, when we look at the back half cadence, starting with revenue, we would expect the majority of our revenue growth to come in the third quarter versus the fourth quarter. And again, this is due to the way that the orders have come in and production is scheduled as well as we got a slight little, a little lapping benefit over a slightly easier comp from a revenue standpoint.

When we look at the earnings side or margin side of it, the equation, we would see the opposite or expect the opposite, Justin. We would expect the majority of our earnings growth, our margin growth to come in the fourth quarter versus the third quarter. And that is simply because we're lapping a much easier comp in the fourth quarter of last year than we have in the third quarter.

Justin Long
Analyst, Stephens, Inc. Q

Okay. That's very helpful. Second question I had was on the Freight services segment. We saw some notable strength there in the second quarter. Is there a way you can help us think about the growth in that segment if you exclude mods? And then going forward, I was wondering if you could share what you're assuming for locomotive utilization. It sounds like parkings were maybe a little bit better than you thought, but we're hearing from some of the rails that locomotives are getting put into storage. So I just wanted to kind of marry those two trends.

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

So Justin, you're right. So I think we'll see, especially as we go into the second half of the year, and beyond the second half, I think you'll see acceleration of growth in services. Some of that, I mean, you see it with some recent order that we announced here. So mods is a growth case continuing to us moving forward, so that continues to be a positive.

When it comes down to parkings, we're seeing really active fleet staying steady sides, any elements of really fluctuation within the year, but the focus on services continues, and we feel very good about our fleet stands out there providing really, I'll call significant benefits to the customer when compared to our competitors' fleets. And that's both in terms of reliability, availability, fuel efficiency, which is a significant element here. We stand with really feel better than in average more than 5% on every single one of our platforms. So we don't expect no signs of any significant changes on that active fleet either.

Justin Long
Analyst, Stephens, Inc.

Q

Okay. Thanks for the time and congrats on the quarter.

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

A

Thank you.

Operator: Thank you. Our next question will be from Chris Wetherbee at Citi. Please go ahead.

Q

Hey, good morning, guys. It's [ph] Rob (23:56) on for Chris.

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

A

Good morning.

Q

Could you give us a sense in terms of the backlog, obviously it increased over the 12 months sequentially. How should we think about just that conversion in 2023 versus kind of 2024?

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

A

Yeah. I'll going to start just with, I feel very good about our overall backlog. I feel strong about the pipeline of opportunities that the team is working on. I think the overall underlying growth fundamentals of the business is also strong. As you said, the 12 months is up 10%. It's accelerating. Last quarter was up 4%, 4.4%. The current total backlog is also healthy. So while it's down 3.5%, I look at it in conjunction with the multi-year $1 billion order that we got from Union Pacific and the other multibillion-dollar other opportunities we're being worked right now with the team.

So we see good momentum internationally. We see it in North America. It's positive. We're progressing, and we're continuing to grow and our pipeline supports it. In terms of the convertibility, the 12 months, already provides you a view into 2024, and we continue to see strength in the pipeline.

Q

That's helpful. And just to piggyback on Justin's question. Your response, you'd said, I thought I heard you saying that you're expecting acceleration of services growth. So should I think about that stepping up from the roughly 14% you guys did in 2Q in the back half of the year? And maybe if you could provide a little bit more context.

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

A

That was comments on first half versus second half of the year. That's where I made the comment.

Q

Okay. That's helpful. And how are you thinking about services growth longer term?

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

A

It continues. I mean, as you saw, I think the demand for a lot of the solutions we have there continues to be robust. We have an opportunity to modernize a significant part of the fleet out there. I think customers are really looking into it. You see based on the announcement we just made yesterday.

When you're looking at 18% fuel savings, 40% improvement on reliability, 55% on pulling power, those are significant numbers that are really compelling in terms of driving, not just the quality of the service you're providing to your customers, but reducing your costs. And I think that these are some of the fundamentals we'll continue to build on growth for the modernization of the fleet and demand for new units as well.

Q

Appreciate the time.

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

A

Thanks [ph] Rob (26:38).

Operator: Thank you. Next question will be from Rob Wertheimer of Melius Research. Please go ahead.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thank you. So just to clarify on gross margin, obviously you mentioned that you had mix headwinds between segments and within. Is mix the entire driver of the down gross margin? Or is there any price/cost or anything else to catch up still? And then was there a mix drag within Transit as a segment?

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

A

Okay, Rob, this is John. Looking at the quarter, we came in, margin came in at 16.4%, down 0.3 percentage point. As we talked about in the earlier quarter, we expected the first half to be flat on margin. So, margins were down a little bit more than we expected. The key driver of that, Rob, was the inefficiencies we're experiencing at our facility in Erie behind the strike. So that is the biggest driver. The mix we anticipated, the mix within the groups we anticipated on locomotives and mods in the original guidance. But the difference really is the inefficiencies at our facility at York. I mean at Erie.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Erie. Perfect. Okay. Got it. And then if I can ask a different one, on hybrid electric, the win in mining, the biggest iron ore train in the world. I don't know what the size of that market is and what your expectation for the pace of testing, validation and potential future orders may be. I wonder if you have any comments that you could make.

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

A

I do. We're continuing to first make progress on battery electric. I think that order is a great example of that. We're developing a supply chain around it to make sure that we make really the overall product reliable. First deliveries are happening next year. We're continuing to work actively with customers, both in North America and internationally.

There is demand out there to further expand the use of the technology. We're working with customers to really make sure that we pace as we step into it. Fuel continues to, of course, be a significant element of cost for our customers. I think there is a really significant opportunity for us to continue to grow that, and we're going to pace it as we grow into different geographies.

That's I think the exciting piece. It's not a demand around one specific customer or one specific segment. I think we have an opportunity to apply that battery concept also in conjunction with what I'll call not just a hybrid product, but hybrid systems as well. I recently came back from Europe and there's, I'll call it, significant opportunity for us there as well.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Perfect. Thank you.

Operator: Thank you. Our next question will be from Saree Boroditsky of Jefferies. Please go ahead.

Q

Good morning. This is [ph] James (29:40) on for Saree. Thanks for taking the questions today. So I wanted to touch on Integration 2.0. So can you provide an update on how Integration 2.0 is progressing? And how should we think about cost savings into 2024?

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

A

Great, [ph] James (29:57). So as we've talked about, when we announced Integration 2.0 a little bit over a year ago that we would invest $135 million to $165 million and expect ongoing savings of $75 million to $90 million.

We're off to a great start as we talked about at the end of the 2022, investment was a little bit ahead of schedule, which is a good thing.

And as we ended last year, we were at run rate savings of $5 million. In the six months that we've had this year, we've over doubled that, and the trajectory will continue through the remainder of 2023, and add to a fair amount of our incremental margin in the back half as well as through 2024 as we head up to that $75 million to $90 million run rate in 2025.

Q

Great. That's helpful. And just following up on the Erie plant strike. So can you provide like a little bit more detail on the strike and how that is affecting the production schedule like revenue mix, given that the facility was more focused on like components like customized locomotive for international and electric locomotives?

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

A

I'll start with, over the last two years, we have successfully reached an agreement with all of our union and non-union sites. So we're working on collaboration. We remain committed to the workforce. With that, we remain optimistic that we can reach an agreement here in a timely manner. From a financial perspective, I'd say we've planned through really for a variety of outcomes and contingencies here and we do not anticipate any impact to the full year revenue.

Q

Great. Thank you.

Operator: Thank you. Our next question will be from Allison Poliniak of Wells Fargo. Please go ahead.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Hi, good morning.

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

A

Good morning.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

A quick question on the outlook. Your 5% revenue growth at 5% earnings growth. So it really implies sort of lack of leverage on that revenue. Is that just simply a mix situation that's driving that? Just any, if you could walk us through that. Thanks.

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

A

Allison, you're talking about within the quarter?

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

No, for the full year, the guidance raise. Nice revenue guidance raise, but EPS really just in line with that revenue guide just implies the lower incrementals. Just want to understand if that's just purely mix, if there's something else within that that's driving sort of that lack of incrementals there

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

A

Sure, Allison. So yeah, we're thrilled to be able to raise our revenue guidance. Went from a midpoint of up 6% to up 12%. And driven by the underlying momentum that we've experienced, right. And that's continued from the back half of last year into the, through the first half of this year.

When we look at the earnings guide, it was up from a midpoint of $5.65 or up 10% to up 16%. So what we're seeing is a couple things. You're not seeing the full increase in revenue coming through in earnings. And Allison, that's for three reasons. One is in the first quarter, we had some additional investment in our next-generation technology for our PDS software that's precision dispatch software. And so that's a one-time event that kind of will bring the earnings down on a full year basis.

The second driver of that is the strike in Erie. Right, that does have costs. Rafael had mentioned, we don't expect any impact on revenue for the year, but it does have a cost. And we had cost in that in the first, in the second quarter, but we'll also have some costs in the third quarter. So that's included in that as well, again, more on the one-time side.

And the third area is higher interest costs. As you could see in the quarter, interest was up about 25% to $11 million. We would expect interest to be higher in the back half as well, partly behind the L&M acquisition, but also the refinancing of some debt that we've got coming due. So Allison, when you take those three things, that's the difference between the growth rate of revenue and the growth rate of earnings.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Great. That's very helpful. And then on the digital side, if I recall, it's always been more, I would say, cyclically sensitive and it doesn't seem to be exhibiting that sort of same trend. Is it sort of a change in how your customers are approaching that product? Is it sort of the investment that you've done that they can gain maybe even more efficiencies than they did in prior cycles so they're pushing through that investment? Just trying to understand sort of why it broke that sort of cyclical or trend it used to exhibit.

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

A

So a couple of points here, Allison. First, I mean, as you saw, I mean, we had significant order develops in the last two years has positioned the business really well from a backlog perspective. A good chunk of that was really international orders. Some were multi-year agreements.

As you go more international, it's a bit more lumpy. So we would expect that to play out over the different quarters. But, and the other comment I would make, no different than the previous years. We need to really drive convertibility into the year. So, shorter-term orders that continue to deliver on the year results. But backlog coverage is better than we've had before. So we like the fundamentals of the business, but we would expect to be lumpy.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Perfect. Thank you.

Operator: Thank you. Our next question will be from Scott Group of Wolfe Research. Please go ahead.

Ivan Yi
Analyst, Wolfe Research LLC

Q

Yes. Good morning. This is Ivan Yi on for Scott. First of all, your revenue guidance updated to $9.4 billion at the midpoint implies a 12% increase in total sales this year. How much of that 12% increase is volume versus how much of that is price? Thank you.

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

A

We would look at price on a full year basis to be in the 1% to 2% range.

Ivan Yi
Analyst, Wolfe Research LLC

Q

Perfect. Thank you. And secondly, can you provide some background on the pace of absolute locomotive modernizations, meaning how many mods did you do in 2022? What are you're expecting in 2023 and can you talk about 2024? And then lastly, what is the timing of the 60 mods for CN? Thank you very much.

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

A

So I think without getting into any specifics of 2024. Of course, it's kind of early for that. We expect growing momentum on the modernization portfolio. And you see that. I think the order you just asked about, CN, it's part of that, and we see that growth momentum not just going to 2023. We see that momentum going into really 2024 and beyond. So just good backlog.

Ivan Yi
Analyst, Wolfe Research LLC

Q

Thank you very much.

Operator: Thank you. Our next question will be from Jerry Revich of Goldman Sachs. Please go ahead.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Hi. Good morning, everyone.

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

A

Good morning, Jerry.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Rafael, John, I'm wondering if you could just talk about in Transit, you've had really strong bookings for three quarters now, the top-line inflection this quarter. Are we at a point where this business has earned the right to grow, and we could see more substantial pickup in top line now that the margins are where you need them be? In other words, is there more runway based on the bookings and the performance this quarter for the momentum to continue in Transit?

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

A

Jerry, first, the fundamentals for the business remain strong. I think despite of a more competitive environment, I look at our book-to-bill ratio is over 1. The 12-month backlog is up 9%. The multi-year is up double digits. But I'll tell you, while we are pleased with the progress, there's significant work ahead of us to simplify the footprint to farther improve and sustain margins. We're going to have variation quarter-to-quarter but the mandate's there, and the team is executing on expanding margins. And we feel we're building competitiveness in the business so we ultimately drive profitable growth. So it feels good from that perspective. And we're going to continue to drive that there. We continue to have opportunities.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

So this point where we're putting up north of 20% top-line growth, it sounds like, based on the backlog that should continue into the back half.

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

A

So the backlog's strong, but we're also overlapping what all easy comps from last year if you think about just top line. If you remember, some of the disruptions we had associated with not just supply chain, but we also had at that point a cyber incident.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

And in Freight, really impressive performance in service in an environment where freight volumes have obviously not been very good. Can you just talk about for your service business ex-mods, what are some factors that are contributing to the performance? Because if all of the year-over-year sales growth is driven by mods, that would be a pretty dramatic ramp. So it feels like the core business is doing pretty well ex-mods given the gap versus freight volumes. I'm wondering if you could just comment on that if you don't mind, Rafael.

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

A

Fleet is active. It's running hard, right, where if I look at it in the different markets we serve, so Kazakhstan or Australia, I think there's just strong demand out there when you look at the pipeline of opportunities. So I think those things are ultimately connected. In North America, where you could have expected that change in the active fleet, I think it's holding, holding strong. It's again back to the focus on both services. And I think we stand with a significant advantage in our fleet in terms of fuel savings, in terms of haulage capability and reliability. And that's really critical to our customers right now.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Thanks.

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

A

Thank you.

Operator: Thank you. Our next question will be from Steve Barger, KeyBanc Capital Markets. Please go ahead.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks. Good morning.

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

A

Good morning.

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

A

Good morning.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.

Q

Can you talk about the margin profile for new business you're booking relative to the margin profile in the next 12-month backlog? And then just generally, is new business looking higher margin than old business?

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

A

Yeah. Steve, this is John. Absolutely. We've watched our margins come up over the last couple years, and that is a function of bringing in better orders at higher profit. And so as we look forward to the backlog we've talked about, we feel great about it overall, not only from a standpoint of the revenue it will drive in the future, but also from a profitability standpoint. And it's booked at a higher margin than we've seen in the past.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.

Q

Got it. Thanks. And total backlog has contracted. I know it's not much, but it's been a couple of quarters now. When you think about the size of the new deals you're signing and the pipeline, versus what's scheduled to come out of backlog in the back half, would you expect it to continue contracting this year?

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

A

Steve, what I'll tell you is the following. Yes, the total backlog is down. It's going to be lumpy as we have those I'll call multibillion-dollar deals. We've got more than a couple of those being worked right now, so that could drive some lumpiness.

I think our focus here is making sure that we've got the convertibility moving forward. And of course, as you look into the convertibility, 12 months, 18 months and 24 months. So we track that, and we feel very strong about that. And it's really in the pipeline of the deals that we're working on, and we're continuing to grow that and it's really supported by our pipeline.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.

Q

Got it. Thank you.

Operator: Thank you. Our next question will be from Adam Roszkowski of Bank of America. Please go ahead.

Adam Roszkowski
Analyst, BofA Securities, Inc.

Q

Hey. Thanks for taking my question. Adam Roszkowski on for Ken Hoexter. So we've covered a lot. Maybe just to touch on the M&A pipeline, is there anything you can share broadly about verticals or geographies of interest in this space?

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

A

Of course, I mean, we're not going to go into any of the specifics here. We are continuing to explore bolt-on acquisitions. We're going to be very opportunistic here. They will be strategic. They will drive a higher ROIC, ultimately accelerate profitable growth for Wabtec and increase shareholder value. I think L&M is really a great example of that. So we're active, really trying to make sure that we find those opportunities.

Adam Roszkowski
Analyst, BofA Securities, Inc.

Q

Thank you. And then maybe just going over to Transit, you've mentioned a mid-teens margin target in the past. Just maybe give us a sense of how we are trending there versus initial expectations? Any view over the next coming years? Maybe that could be achieved earlier than initially thought. Thanks.

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

A

I'll maybe start and I'll pass it on to John. And I think we're continuing the mandate. We feel strong about it. Pascal and the team are working on really continuing that trajectory. It's never steady and precise. There's always some bumps along the way, but we feel strong about continuing to drive the simplification on that business, improving the competitiveness and a lot of opportunities here.

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

A

Yeah. And as I mentioned early on the question on Integration 2.0, right, we're going to see that continue to ramp. The majority of the benefit will accrue to our Transit group. So we feel great about the consolidation, the integration that's happening here and the results that it's starting to spin. And part of the benefit we saw in margin growth in Transit in the quarter was due to Integration 2.0.

And the other one is, the other question with regards to the backlog, is we continue to bring in volume in the backlog. We're very focused on making sure that it is coming in at a higher margin. And we are focused on bringing in good, profitable business versus revenue in the Transit group.

Adam Roszkowski
Analyst, BofA Securities, Inc.

Q

Thank you.

Operator: Thank you. Our next question will be from Matt Elkott, TD Cowen. Please go ahead.

Matt Elkott
Analyst, TD Cowen

Q

Good morning. On the 69 certified pre-owned locomotives, do you guys foresee any similar opportunities going forward? And if you can provide some insight maybe on to like the revenue and margin profiles of those locomotives, if not on an absolute basis, at least kind of relative to mods?

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

A

I'm not going to get into the specifics of that program. But what I'll tell you, that program provides a significant opportunity for us to, number one, as we think about our products, it's how we cascade those products down. So they're not just on core mainline. We often focus a lot of the dialogue here around the 16,000 locomotives that we got running out there. There's a number of other locomotives running in short lines in yards, and we see an opportunity to cascade that fleet down and cascade it with a fleet that's more efficient, it causes less emissions, able to pull more.

So a lot of those same fundamentals. And I think that's where we look at building and it provides, again, a significant strength for our services business as there will be a pull there in terms of providing spare parts and things like that. So really excited about gaining momentum on that front too.

Matt Elkott
Analyst, TD Cowen

Q

And, Rafael, so it sounds like this is not something that you guys have done actively to any meaningful extent in the past and it's kind of a fairly new area for you, these certified pre-owned units.

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

A

I'd say we've done some of that for the Class 1s, especially bringing, what I'll call, older [ph] dash 9s (46:41) and modernizing those into AC technology. I think it's the first time we do have size with like short lines. And I think there is a significant opportunity there. So you're right about that.

Matt Elkott
Analyst, TD Cowen

Q

Okay. And then is the guidance raise partly in part because of this order that you got? I think you got it last month.

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

A

I would say that, I would say not. There'll be a little bit in there, but not to the extent to drive the overall guidance, Matt. It's the underlying momentum we've talked about for the last year continues to come at us and the backlog continues to fill. It'll be more of an impact on the future growth as we look to 2024 and beyond.

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

Exactly.

Matt Elkott
Analyst, TD Cowen Q

Got it. And then just one question on the 30 new loco orders in North America. You called them strategic. Can you tell us what that means? And given the fact that it's good to see new orders starting to come back in North America over the past year or so, what does that mean to the new-build versus mod mix for next year?

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

I think it just validates what we've been saying. I mean in some cases, customers will look at modernization as a better solution for some of the fleet dynamics they've got. In some other cases, it's going to come with really new locomotives. And so we see both active, and I think the fact that you continue to see that, I think that's really a positive in terms of the dynamics that we're looking into the North America market. So there is really a commitment to continue to drive service to invest in the fleets that are really at this stage at the oldest levels in at least a couple decades. So a good opportunity here.

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

And, Matt, from a financial standpoint, we're pretty indifferent whether it's a modernization or a new, right. We talked about new comes with a higher revenue and modernizations with a higher margin. And so overall, we're pretty indifferent as long as they're Wabtec locomotives, we're good.

Matt Elkott
Analyst, TD Cowen Q

And if I missed it, could you just say what the purpose of those? It's just, these are just diesel locomotives for replacement? Or is there a technology end goal?

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

I think there's both. I mean, there's certainly a technology element here, and they're going to be used to really pull freight more efficiently about there.

Matt Elkott
Analyst, TD Cowen Q

Great. Thank you so much, Rafael. Thanks, John.

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

Thank you.

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

Thank you, Matt.

Operator: Thank you. Next question will be from Steve Barger, KeyBanc Capital Markets. Please go ahead.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.
Q

Thank you. Just a quick clarification. I think you said the Erie situation could be a swing factor in the back half, but I also thought I heard you say that it would be one-time. So can you clarify if expected costs from that are included or excluded the back half EPS range?

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

They are absolutely included in our revised guidance, Steve.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.
Q

Included. Got it. Okay.

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

Absolutely.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.
Q

Thank you.

Operator: Thank you. That concludes our question-and-answer session. I'd like to turn the call back over to Ms. Kristine Kubacki for closing remarks. Please go ahead.

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

Thank you, operator, and thank you everyone for your time today. We appreciate it, and we look forward to talking with you next quarter. Goodbye.

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