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Westinghouse Air Brake Technologies Corp. (WAB)
Q2 2018 Earnings Call
MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Wabtec Second Quarter 2018 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 over to Tim Wesley, Vice President of Investor Relations. Mr. Wesley, please go ahead.

Timothy R. Wesley  
VP-Investor Relations, Westinghouse Air Brake Technologies Corp.

Thank you, Anita. Good morning, everybody. Welcome to our 2018 second quarter earnings call. Let me introduce everybody else here who is on the call with me: Ray Betler, our President and CEO; our CFO, Pat Dugan; Stéphane Rambaud-Measson, our COO; John Mastalerz, our Corporate Controller; and Al Neupaver, our Executive Chairman.

As Anita mentioned, we'll make our prepared remarks, and then we will take your questions. During the call, we'll make forward-looking statements, so please review today’s press release for the appropriate disclaimers.

Ray, I'll turn it over to you.

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

Thank you, Tim. Good morning, everyone. It's good to talk with you today. I'm happy to report that we exceeded slightly our financial targets in second quarter and are now comfortable increasing our guidance for the year to revenues of about $4.2 billion and adjusted earnings per diluted share of about $3.85.

In the second quarter, we saw year-on-year revenue growth in both our segments for the third quarter in a row. Even with strong revenue growth this year, adjusting for changes in FX, our backlog is at a record high as we have won new business in most of our major product lines around the world.

As we focus on our short-term performance, we’re also pleased to be able to continue to invest in our long-term growth opportunities, including, of course, our planned merger with GE Transportation, which we’ll talk more about during today’s call. So first, I'd like to turn it over to Pat to review the second quarter numbers.

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

Okay. Thanks, Ray. Sales for the second quarter were about $1.1 billion. And when you break it down and look at our segment, our Transit segment sales increased 19% to $699 million. That increase was due to stronger organic growth adding about $51 million of sales, favorable FX which increased $33 million, and acquisitions which contributed about $28 million. This is the third quarter in a row we've seen organic sales growth, demonstrating that our backlog is starting to kick in.
Freight sales increased 20% to $412 million, the third year-on-year increase in a row. The increase was due to strong organic growth adding about $54 million of sales, slightly favorable FX of about $3 million, and acquisitions which contributed about $11 million. Sales were the highest level for Freight in two years, and the backlog increased 3% and is also at the highest level in two years. Freight aftermarket sales showed year-on-year growth for the fourth quarter in a row. All of these are positive indicators.

When you look at our consolidated operating income for the quarter, it was $124 million or about 11.1% of sales. As mentioned in our press release this morning, this included transaction costs related to the GE Transportation merger of about $9 million, some restructuring costs of about $4 million, and expenses of about $4 million for a Goods and Service Tax Law change in India, all which is reported in SG&A. Excluding those items, our operating margin was 12.6%. Going forward, our full year 2018 adjusted operating margin target is about 13.5%, with improvement expected in the second half as we work through some of our lower margin contracts in the UK that we talked about last year, and as we realize some of the benefits of our restructuring actions.

SG&A was about $171 million. The increase was mainly due to the expense items I mentioned, as well as changes in foreign currency exchange rate, acquisitions, and increased incentive comp accruals. We expect it to be about $145 million to $150 million per quarter in the second half, excluding expenses related to the GE Transportation merger and any additional restructuring. Engineering expenses decreased to $19 million due to the timing of our spending because some of those expenses can be captured in the cost of sales. Amortization expense remained about the same as the year ago quarter.

When you look at our segment operating income for Transit, it decreased 2% to $58 million for an operating margin of about 8.3%. This includes the $4 million for the Indian tax law change and $2 million of restructuring expenses. And if you exclude those items, the margin was about 9.1%. We expect the margin to improve in the second half as we work through some of those lower margin projects I mentioned, and to continue with our restructuring and cost reduction initiatives.

Freight operating income was $84 million, up 34%, for an operating margin of 20.5%. The improvement compared to last year was due to higher sales and a more favorable product mix. For the full-year of 2018, we expect operating margin improvements for both segments during the year and compared to last year. These improvements will come through better project performance, better mix of sales, and the benefits of restructuring and cost reduction.

Just a quick update on our Faiveley integration and synergy plan. In 2017, we generated about $30 million of synergies compared to our target of about $15 million to $20 million. And in 2018, we expect to achieve an additional $15 million. Our total target for the first three years is at least $50 million, so we’re ahead of pace and expect that to continue.

Okay. Looking closer on the income statement for interest expense, our interest expense was $32 million in the second quarter, and that included $12 million of financing costs specific to the bridge loan that I’ll talk about later and related to the GE Transportation merger. For comparison, the interest expense in the prior quarter was lower than normal by about $2 million benefit related to a prepayment of debt assumed in the Faiveley transportation acquisition.

Going forward, we expect our interest expense to be about $20 million per quarter in the second half of the year. And if you exclude any – that would be excluding any effects from the GE Transportation merger. Remember that we are focused on generating cash to reduce debt and reduce our interest expense.
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The other income and expense line, the income was $2.2 million compared to about $1 million in the prior year quarter. The increase was mainly due to higher income from minority investments.

Looking at our income tax expense, our effective tax rate for the quarter was about 11.2%, lower than expected due to a benefit of about $13 million from the reduction of the estimated transition tax charge initially recorded in the fourth quarter of 2017. That charge was related to the 2017 U.S. Tax Reform Act. Excluding this benefit, our effective tax rate was 25.1% for the quarter and our 2018 full-year assumption is about 24%. Remember, that's an annual estimate. The individual quarters can and usually vary due to the timing of any of these discrete items.

So to help with our earnings per share, our second quarter EPS on a GAAP basis on a per diluted share were $0.87. Expenses for the GE Transportation merger, our restructuring actions, and the beneficial effect of that discrete tax item reduced our EPS by a net of $0.09. So to help you reconcile and you also find these details in our press release, you start with net income per diluted share in accordance with GAAP of $0.87, you add back restructuring expenses that are reported in both cost of sales and SG&A of about $0.03. You add back our cost related to the GE transaction, which is recorded in both SG&A and interest, of about $0.16, adding back the impact of the India tax item which is in SG&A that's about $0.03. And you deduct the benefit of the change in our transition tax charge of about $0.13, we end up with a net income per diluted share, excluding these items, of about $0.96 for the quarter.

Okay, shifting to our balance sheet. The balance sheet remains strong. It provides the financial capacity and the flexibility to invest in our growth opportunities. We have an investment grade credit rating and our goal is to maintain it. In terms of cash from operations, we generated about $44 million compared to $12 million in the year ago quarter. Our performance was even better when you consider that we spent about $90 million on transaction expenses related to the GE Transportation merger and other restructuring costs. We expect our cash generation to continue improve in the second half, and to finish 2018 with more cash from operations than net income.

Looking at working capital at June 30, our receivables were $837 million, inventories were $864 million, and payables were $616 million. In addition, we had unbilled receivables of about $378 million, which were more than offset by customer deposits of about $390 million. Our cash and debt at June 30 consisted of the following: We had $246 million of cash, mostly held outside of the U.S.; and total debt of about $1.9 billion, and net debt – so, debt left the cash of about $1.64 billion. Our net debt-to-EBITDA ended up being about 2.6 times.

Just to remind you and to talk about our new financing arrangements. In anticipation of the GE Transportation merger, we did complete some new financing arrangements. It included a syndication of a $2.5 billion senior unsecured bridge commitment and $400 million senior unsecured delayed draw term loan to fund the cash portion of the merger. The bridge commitment will be reduced by any alternative financing that we arrange before closing.

In addition, we refinanced our existing revolving credit facility with a $1.2 billion senior unsecured revolver with a five-year term, and refinanced an existing $350 million senior unsecured term loan with a three-year term loan. Just a couple of miscellaneous items for the models. Our depreciation was $16 million, consistent with the last year's quarter. And for the full year 2018, we expect depreciation expense to be about $70 million.

Our amortization expense was $9.9 million, about $10 million, compared to $9.4 million in the last year's quarter. For the full year of 2018, we expect it to be about $41 million. Our CapEx for the quarter was $22 million versus $19 million a year ago. And we expect to spend about $100 million in capital expenditures in 2018.

Looking at our backlog, we had another good quarter for generating new orders, as you can see from the numbers we're reporting in the press release. At June 30, our multi-year backlog was a near record $4.7 billion.
This was slightly higher than at March 31, if you exclude the impact of changes in foreign exchange rates. Our rolling 12-month backlog, which is a subset of the multi-year backlog, was a record $2.5 billion.

So with that, I'll turn it back over to Ray.

Raymond T. Betler  
*President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.*

Thanks, Pat. That's a lot of numbers to go through and a lot of work you've accomplished since last quarter. So, thank you and [ph] John Munder, Mary Ellen, your entire team for the work that you've done.

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

Thank you.

Raymond T. Betler  
*President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.*

As I mentioned previously, we increased our guidance for the year based on our first half performance and our outlook for the rest of the year. We now expect full year revenues of about $4.2 billion with adjusted earnings per diluted share of about $3.85, excluding costs related to the GE merger, restructuring charges and the effects of tax law changes. Compared to 2017, this would represent revenue growth of about 8% and adjusted EPS growth of about 12%. We expect to generate cash from operations in excess of net income for the year.

Our key assumptions include the following: Revenue growth in both segments, our adjusted operating margin target for the year is about 13.5%. As mentioned by Pat, we should see improvement throughout the rest of the year. Our adjusted tax rate is expected to be about 24% for the year and we're assuming diluted shares outstanding of about 96 million for EPS calculation purposes.

Before I turn it over to Stéphane to discuss the Transit and Freight operating segments, I'd like to give you just an update on the merger with GE Transportation. I've been calling this opportunity a once-in-a-lifetime opportunity, and I truly believe that it is. We're excited by both the short-term and long-term opportunities that it presents. The combination will make Wabtec a Fortune 500 company. We will be a global transportation leader in rail equipment, in software and services, with operations in more than 50 countries around the world.

Financially, GE Transportation has continued to perform as expected this year and is confident about its outlook for 2019. In its second quarter, the company had revenues of $942 million. That's an 8% improvement versus first quarter. And a segment profit of $155 million, which is up 20% versus first quarter.

The company has booked orders of $4.7 billion in the last three quarters, including $1.1 billion in the second quarter. Year-to-date, its orders are up 44% compared to prior year. Across the industry, product locomotives continued to improve, ending the quarter down about 31% since last year. We still expect the GE Transportation transaction to be completed in early 2019, subject to customary closing conditions, approval by Wabtec shareholders, and regulatory approvals.

As expected, both Wabtec and GE have received a request for additional information from the U.S. Department of Justice as part of the regulatory review process, and we are cooperating fully with the DoJ as it reviews the proposed transaction.
So, let's talk about the compelling strategic rationale for the merger. After closing, we will be a diversified global leader in transportation and logistics. We're combining Wabtec's Freight and Transit components with General Electric Transportation's locomotive manufacturing and service capabilities.

From our discussions so far, we see a strong cultural fit that should enable a seamless integration. Our combined electronics and digital businesses and technologies can lead to autonomous operations. Wabtec will be positioned to meet the growing demand for train intelligence and network optimization. We will benefit from recurring revenue in the high margin aftermarket and service sectors. Complementary global customer relationships will drive substantial cross-selling opportunities and help dampen cyclicity.

Our pro forma financials are compelling especially at this attractive stage in the cycle. Our combination will afford us significant skill, rapid growth trajectory, superior margins, and strong free cash flow. General Electric Transportation is well-positioned as the industry recovers with a backlog of $18 billion and robust orders. The significant operating synergy potential and tax benefit drive value creation, approximately $250 million of anticipated run rate synergies driven mainly by cost reduction opportunities and a net tax benefit of about $1.1 billion. We will have a strong cash flow profile that will enable us to rapidly de-lever. We remain committed to retaining our investment grade rating and our dividend.

And with that, I'll turn it over to Stéphane.

Stéphane Rambaud-Measson
Chief Operating Officer & Director, Westinghouse Air Brake Technologies Corp.

Thank you, Ray. I will start with our Transit business. In the quarter, we had 9% organic revenue growth as our backlog is starting to kick in. Our profitability has been affected by the lower margin contract in the UK that we had discussed last year. We expect margins to improve from restructuring actions and as some of these lower margin revenues begin to roll off. Our goal is to improve Transit margin by 1% annuity during a tough period, and we expect to achieve this goal by first applying a more rigorous bidding process, meaning being more selective, better project management, and improved cost structure from our restructuring actions and the transfer of work to lower cost countries, and a disciplined deployment of our lean and sourcing initiatives. Worldwide, the state of the transit market remains strong, and we continue to win and bid on significant orders in all of our major markets.

In the quarter, we booked a long-term aftermarket services agreement with SNCF in France, orders for brake equipment and new cars for India and France, and orders for brake equipment and HVSC on new cars for Israel.

Remember, too, that our OEM orders typically lead to long-term aftermarket contracts, which then provide revenues and good profitability for over 30 years. As we look at our business over the next several years, India remains one of our most dynamic markets, driven by record orders of Kochis, an electric locomotive for Indian railways, along with new metro projects.

The European market continues to expand, driven by replacement of metro fleet in London, in Paris, in Berlin, and new infrastructure projects such as Grand Paris. The regional market in Germany continues to grow, and a new bill just passed in France that could trigger more volume in the medium to long-term by opening up the regional market to private operators.

As a true global player, over time, our Transit business should have better visibility and stability, more growth opportunities, both organic and through acquisitions, and improved margins as we benefit from increased scale and market share, and as aftermarket revenues increase.
Let’s now move to our Freight trade business, which has continued to pick up due to strong market activity. Our Freight backlog is now at its highest level in two years, and our second quarter Freight revenues were the highest in more than two years. In NAFTA, freight rail traffic is up more than 5% year-to-date and rolling stock and storage continues to come down.

As a result, we are seeing growth in our Freight aftermarket revenues, along with more inquiries for component servicing and repair, and locomotive overall projects. Demand for new locomotive and freight cars is also improving, and we’ve seen good volume in our maintenance software business with orders above sales in the first half of the year. Meanwhile, our non-rail business is benefiting from the growth of the oil and gas market. As an example, our heat exchanger business saw orders outpace sales in the second quarter.

As a reminder, our 2018 Freight assumptions include the following: Railroad CapEx which declined about 10% in 2017 is expected to be flat or slightly up in 2018. For new locomotives, we see a slight increase worldwide, down in NAFTA, but it’s looking like 2018 will be the floor. For new freight cars, NAFTA is expected to be slightly up. In Freight, our long term investment include a facility in Turkey for freight cars, products, and new products in electronics and in train control.

I like also to mention that one of our longtime customers, Rio Tinto in Australia, just completed its first delivery of iron ore by an autonomous driver-less train, which included equipment supplied by Wabtec. It is just another sign that railroads continue to be very interested in technology solutions. Ray?

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

Thank you, Stéphane. I’ll conclude our prepared remarks by talking about our long-term outlook. At our Investor Day in early May, we talked about our five-year plan which meets our long-term financial goals to average double-digit growth in revenues and earnings through the business cycle, with improving margins. To achieve these goals, we have growth initiatives in each of our major product lines, which are consistent with our four growth strategies. After we complete our merger with General Electric Transportation, we will, of course, update our strategic plan. From our initial analysis and due diligence, we are confident the merger improves our ability to deliver on our long-term growth targets.

So, just to reiterate some of my comments at the beginning of the call. We’ve had a good first half in 2018. We exceeded slightly our plan for the second quarter and increased our guidance for the year. We saw year-on-year revenue growth in both our segments for the third quarter in a row. Even with strong revenue growth, our backlog remains near record high. And the freight market continues to improve.

So we expect to build on these accomplishments throughout 2018 based on the improvements we’re seeing in our Freight business and on our Wabtec Excellence Program, which gives us the ability to generate cash and to increase margins over time.

And with that, we’ll be happy to answer your questions. Thank you.
QUESTION AND ANSWER SECTION

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

Justin Long  
Analyst, Stephens, Inc.

Thanks, and good morning.

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

Good morning, Justin.

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

Good morning.

Justin Long  
Analyst, Stephens, Inc.

So maybe to start with the question on the Transit side of the business, I was wondering if you could help us think through where Transit margins should exit this year based on your current guidance. Just curious how we should be thinking about the improvement once we start to lap these or get rid of these UK contracts and some of the restructuring that you've talked about is complete.

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

So, Justin, I guess I don't think we've ever really given individual Transit or Freight segment guidance or margins, but I think it's just safe to say that when you look at the first half of the year for 2018 for the whole Wabtec, we have some pretty significant revenue that's flowing through the results with kind of less than normal margins, and that's really having a dampening effect on the overall margin and, in particular, it's really impacting Transit. So, I think that you could kind of, when you look at your results, that you would see us start these things to -- these contracts, these projects to run off, and then we would get back to a more typical margin profile that you've seen in the past for Wabtec on the Transit segment.

Justin Long  
Analyst, Stephens, Inc.

Okay. And, Pat, I think you made the comment that both segments should post year-over-year margin improvement. I'm assuming that's on an adjusted basis.

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

That's right.
And if so, would you mind giving the comparison that you're using for 2017? There've just been so many charges and adjustments, I want to make sure we have the right numbers to be using for last year.

It was about 10%.

Yes, about 10%, Justin.

And what was that number for Freight?

Freight was about 20%. Yeah.

Okay. That's helpful. And then, I guess, second question, I wanted to ask about your locomotive overhaul business. Is there any way you could speak to the amount of overhaul work that was delayed during the past down cycle and how much of that has come back at this point? I just want to understand where we are in terms of that recovery.

Yeah. So, Justin, we took, as you know, an adjustment last year of about $250 million, I think it was second quarter, in revenue. A lot of that was associated with the overhauls, locomotive overhauls. And the locomotive overhaul business is coming back slow. We're in the process of bidding some smaller projects, but there's been nothing significant in terms of new opportunities in the market today.

Okay. I'll leave it at that and pass it along. Thanks, as always, for the time.

Sure.

Operator: The next question comes from Scott Group with Wolfe Research. Please go ahead.
Scott H. Group  
Analyst, Wolfe Research LLC

Hey. Thanks. Morning, guys.

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

Good morning.

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

Hey, Scott.

Scott H. Group  
Analyst, Wolfe Research LLC

I want to start with the revenue guidance. So, you guys have done, give or take, $2.2 billion of revenue first half of the year. Pretty much we always see better revenue in the second half than the first half when you've got a backlog like this, so you should be doing north of, call it, $4.4 billion or higher, and guidance is $4.2 billion. Help me bridge the gap there and what might be getting worse in the back half of the year?

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

I think the guidance is contemplating the seasonality that we see with Q3, especially I guess, it's more impactful than it has been in the past because so much of our business is in Europe now. But we definitely have customers that go through shutdowns and summer slowdowns, and Q3 can really show a revenue that is less than kind of normal. And so, we have that contemplated in our results. But the other thing is, is there is a certain amount of conservatism, especially in the areas where the increases have been kind of strong in Freight.

Scott H. Group  
Analyst, Wolfe Research LLC

Okay. And then, I want to go back to the margins because I think it's the important question, right. So if you did 12.5%, give or take, in the first half and 13.5% for the year, so we got to get to 14.5% margins in the back half of the year. Or maybe can you help us, kind of put some parameters on how you're thinking about the third and fourth quarters? And so, I guess, the implication is that we're going to be north of 14.5% in the fourth quarter on the operating margin. Is there anything about that that feels unusual or unsustainable as we think about operating margins for 2019?

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

Yeah. Well, I think that we don't typically give any kind of guidance on margins, especially going into 2019. But I think you're right, your feeling is, is that you're going to have an improving margin percentage that goes into the second half of the year. That's going to be driven by a couple of things. We definitely expect to see some of these projects to wind down and come out of our mix of revenue. And then, you also have a – and we've seen this especially in the past couple of years, where our fourth quarter mix of sales can be better – better mix, more profitable, and that really contributes to an overall margin for the year that's in our guidance.
Okay. And then, just last one on the margin side. So, we just did a 21% margin adjusted in Freight. We've gotten as high as – I don't know – 23.5%, 24%, but that was with a lot of PTC. How good do you think Freight margins can get to as long as the Freight cycle remains strong?

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

I mean, our goal is to continue to improve the margins every quarter, every year. Clearly, mix has an impact, like you pointed out, PTC and the strength of the freight market, so our goal, though, is to continue to improve.

Okay. All right, guys. Thank you.

Operator: The next question comes from Allison Poliniak with Wells Fargo. Please go ahead.

Allison A. Poliniak-Cusic  
Analyst, Wells Fargo Securities

Hi, guys. Good morning.

Just want to touch on a little bit what Scott and Justin had just asked. On the Transit, you talked about the lower margin contracts rolling off. Could you remind us again, I mean, are those primarily behind us? You have a little bit flow through in Q3 and then in Q4. I mean, how should we think of a cadence of that roll-off for 2018?

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

So, if you go back to third, fourth quarter of 2017, there were contract adjustments. And really, just if you think about project accounting and project results, you reduce your margins on – for cumulative catch-ups, but you're now at a point where the revenue comes through at a zero margin as those projects are completed. What we've described in the past is that these projects are – they're in the UK and will – probably, the largest one essentially winds up in the late third quarter, maybe stretching a little bit into the fourth quarter of 2018. And then, we have a couple that will also stretch into the first half of 2019.

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

So, Allison, maybe since Justin and Scott and you all have asked about margins, let me just take a minute to talk about the margins in Transit again. To remind you, we went through this vetting process to re-baseline our total project portfolio when Faiveley and Wabtec businesses were put together. We explained it. We did identify some
significant project issues and adjustments that we had to make in that project portfolio, and we also
communicated later in the year that a lot of our focus was on projects in the UK, which were vehicle overhaul
projects that were three, four, five years in nature and are coming to a close.

So some of those, the biggest one, will come to a close at the end of this year, and then the beginning of next
year through midyear, the second largest. So, those projects are starting to be completed. They're starting to be
replaced with backlog revenue with higher margins, although the Transit project margins historically are lower
than other projects, other projects like in freight or electronics. So, what we've done is to focus on those projects,
focus on opportunities, project by project, to do monthly reviews and incrementally improve the projects.

Secondly, on a portfolio basis, we've tried to focus on other margin improvement opportunities, and Stéphane has
put together a corporate-wide margin improvement program at the request of the board. And that was reviewed at
the board meeting this last week. We had our July board meeting, and so there's other initiatives that are being
taken across our total business. Some are related to customer projects. Some are related to pure operating
production activities. Some are relating to elimination of one-time issues. And others are relating to what we
would traditionally call continuous improvement or lean. So, there's a lot of sensitivity and focus internally on
margin improvement. I want you folks to understand that it's not an issue that we're taking lightly or cavalier about
the position we're in, relative to the deterioration of Transit mar-
gins. So, it's a very serious thing for us. We're
addressing it, and we're addressing it both at the Transit level as well as the overall corporate level.

Allison A. Poliniak-Cusic
Analyst, Wells Fargo Securities

Great. Thanks. That's helpful. And then just on Faiveley, you talked about success in the cost synergies, but you
also talked about a number of projects that you're winning. Could you talk to your sense of, is the combination of
Faiveley and Wabtec giving you a greater share of the wins than maybe either of you could have gotten on your
own? Any sense of what you're seeing there.

Stéphane Rambaud-Measson
Chief Operating Officer & Director, Westinghouse Air Brake Technologies Corp.

Well, actually, maybe I'm going to take this one. Stéphane speaking. Yes, the combination of the two companies
is very helpful to win more projects. We have the widest portfolio of product in the industry now. In a certain
segment, we are enjoying the number one or number two position. We have very complementary products. I can
just give you an example of the largest commuter project in Europe, which was awarded last year, has been won
with the combination of Wabtec legacy and Faiveley legacy product. Okay. Most of the control electronics were
European-based, were coming from the Faiveley part. And the automatic equipment were originally coming from
Faiveley, while the disc where – the Poli disc, the famous segmented disc of Poli coming from Wabtec legacy
side.

And without this combination, I think we would not have been in a position to be as successful on this major
project. So, yes, I mean, the combination has helped us tremendously to improve our capacity to bundle products
and to have a more competitive technology.

Allison A. Poliniak-Cusic
Analyst, Wells Fargo Securities

Great. Thanks so much.
Operator: The next question comes from Matt Elkott with Cowen. Please go ahead.

Matt Elkott
Analyst, Cowen & Co. LLC

Good morning. Thank you for taking my question.

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

Good morning.

Matt Elkott
Analyst, Cowen & Co. LLC

So, Ray, we're seeing this tightness in the locomotive market, and I was wondering if it's translating into anything, any maybe increased level of conversation with your customers or inquiries? And if so, for those that are not GE of your customers, how much is the GE deal coming up in the conversation? And I'm just trying to gauge if there's a level of concern by your non-GE customers about future supply agreements.

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

Yes, so it's come up, Matt, obviously, in our discussions. We've talked with all the customers, we've also talked to the progress, CAT folks, about the supply agreements and long-term relationships. So, the customers are certainly sensitive about the competitive environment. And I think we've tried to reassure them that our plan is to support both current customers long-term into the future, GE, as well as CAT, EMD. And we're willing to commit to long-term supply agreements to demonstrate that.

Matt Elkott
Analyst, Cowen & Co. LLC

That's fair. So, Ray, you still think that the revenue optimization potential from merging with GE will well offset any type of potential revenue losses to their competitors?

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

Yeah. We do. It's not – we'll be fine there. I don't think that's something that we could really talk – this is Al Neupaver speaking, I think that we're getting a little ahead of ourselves. We feel that we'll be able to supply the market extremely well, and we think we'll have a great product and a great team that's going to be able to deliver whatever is needed in the marketplace.

Matt Elkott
Analyst, Cowen & Co. LLC

Got it. And, Ray, last quarter, I think when you guys gave guidance, I think you suggested that there was a bit of a conservatism built into the guidance. Now, you've raised the EPS guidance very slightly, partly attributable to the...
beat in the quarter. So, you still feel like the same level of conservatism is built into the second half guidance if the environment does not change materially from the current trends?

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

Yeah, I feel pretty good about our opportunities going forward, Matt. You know, we’re — we try to be conservative and, at the same time, responsible about our projections, but I think the trends in the market are very positive right now. And if they continue, there’s certainly a lot of things that can impact them, crazy politics and the other things that are going on all around the world. It’s hard to analyze what the impact of tariffs and all the other things may have on our economy, but the economy is right now strong, and we’re anticipating it’s going to continue to be that way, and we think there’s upside opportunity there.

Matt Elkott  
Analyst, Cowen & Co. LLC

Great. Thank you very much.

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

Thank you.

Operator: The next question comes from the Saree Boroditsky with Deutsche Bank. Please go ahead.

Saree Boroditsky  
Analyst, Deutsche Bank Securities, Inc.

Good morning.

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

Hi, Saree.

Saree Boroditsky  
Analyst, Deutsche Bank Securities, Inc.

So obviously, really strong results in Freight. Could you provide some color on what you saw in the quarter from aftermarket verse OE demand? And then just given your commentary on the conservatism embedded in the outlook, how are you thinking about the growth drivers in Freight for the remainder of the year?

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

One second, Saree. As far as the growth drivers go, certainly, the new car builds and the cars being depleted in storage, both on the Freight side, the locomotive side, the aftermarket sales being up in our repair centers, those are some of the drivers. Commodities, gas prices, again, are all trending the right way. The coal situation in the eastern railroads all were in our favor. So, those are some of the drivers. You have the numbers? Okay.

Patrick David Dugan  
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.
Yeah. So in terms of Freight aftermarket sales, first quarter to second quarter increased about 5% in the second quarter, and about the same over year-over-year quarter.

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

Though another thing, Saree, we should keep in mind in Freight, we report PTC. So don't forget the regulatory requirement at the end of the year for deployment. And there's a big push by the FRA and the federal government to make sure that the railroads, not just the Class 1s, but all railroads comply. So, that's another big driver.

Saree Boroditsky  
Analyst, Deutsche Bank Securities, Inc.

Did you quantify the impact of PTC in Freight in the quarter?

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

Yeah, we don't break it down by Freight and Transit, but I can tell you that for the company, so consolidated PTC was about $71 million in the second quarter, signaling about $37 million. So, combined, it's about $109 million.

Saree Boroditsky  
Analyst, Deutsche Bank Securities, Inc.

Great. And then quickly just focusing a little bit on the bigger picture, one of the most exciting opportunities I think with the GE Transportation merger is the combination of your digital platform. Can you just talk about how you're thinking about the combination of your technologies? And then if there's any overlap today with PTC and GE's Trip Optimizer or any other technologies?

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

No, there's no overlap with Trip Optimizer. And as far as the combination goes, there's — I think I mentioned in the last call, if you superimpose our product roadmap over theirs or vice versa, there's a lot of complementary products and technologies that the combined business will be able to leverage. So I think in terms of our opportunities going forward, they are pretty significant in terms of being able to hopefully reduce R&D costs and, at the same time, get to market faster with a competitive product in. And we do not — we're not communicating that autonomous is a one-step process. It's a multi-step process that we think will go through phased approaches with maybe a reduction of one driver or one attendant in the cab, something like that. So I think in terms of technology evolution, the opportunities are very significant.

Saree Boroditsky  
Analyst, Deutsche Bank Securities, Inc.

Thank you. Congratulations on the strong results.

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

Thank you.

Operator: The next question comes from Matt Brooklier with Buckingham Research. Please go ahead.
Matthew Brooklier  
*Analyst, Buckingham Research*

Yeah. Thanks. Good morning.

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

Hi, Matt.

Matthew Brooklier  
*Analyst, Buckingham Research*

So, question for Pat. I think your SG&A guidance is up about $5 million if I look at what you provided on the call versus the last go around. Maybe can you talk to what's contributing to an increased SG&A from the second half of the year?

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

Well. There're two things. I mean, FX does impact our SG&A cost, so the absolute dollar number kind of comes up a little bit. You also have full quarter impact from acquisitions we would have done. But we're definitely with the higher growth of revenue compared to previous years and quarters. We do have a little bit of extra costs, and those are reflected in the SG&A.

Matthew Brooklier  
*Analyst, Buckingham Research*

Okay. That's helpful. And then you disclosed the all-in PTC number for 2Q, I think that's up pretty meaningfully from first quarter. I think your guidance for the year called for about 5% growth in the combined PTC-signaling category with most of the growth coming from PTC. Just curious if you have updated thoughts on that guidance given it looks like the first half of the year is off to a stronger start.

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

Yeah. I think the PTC and signaling revenues are probably about higher, about 10% from what the original numbers were. So, about 10% higher than last year.

Matthew Brooklier  
*Analyst, Buckingham Research*

Okay. So, I guess, 5% becomes a 10% growth number, is that what we're seeing for 2018?

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

Right. Right.

Matthew Brooklier  
*Analyst, Buckingham Research*

Okay. That's all I got. Thank you.
Patrick David Dugan  
Chief Financial Officer & Executive Vice President, Westinghouse Air Brake Technologies Corp.

Thanks.

**Operator:** The next question comes from Liam Burke with B. Riley FBR. Please go ahead.

Liam Burke  
Analyst, B. Riley FBR, Inc.

Thank you. Good morning.

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

Hi, Liam.

Liam Burke  
Analyst, B. Riley FBR, Inc.

Ray, on the PTC front, on the Transit side, how has that business been rolling out and how much is that influencing your outlook for Transit margins?

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

So that business — to a large extent, the PTC hardware net business is relatively small, but the project-based business is relatively large. So, we have a pretty significant portfolio of projects that we're executing right now. We actually have about 20 projects in total at various stages of completion. And for the most part, the margins are good.

Liam Burke  
Analyst, B. Riley FBR, Inc.

Okay. And we can see the Freight volumes on the Class 1s are improving. Could you give us a sense on how the outlook is on the international front for Freight?

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

I think the international front is also improving for the most part, but it's, I think, a lot slower, Liam, than what we see here. In some countries, like China, for three years, there were no new freight cars being produced. They’re running at about 40,000 a year right now. India is starting to pick up slightly. Australia has come back. So, they're picking up around the world, but slower. But in Brazil, it looked like it was picking up and dropped again. So, I think that's a reflection of the economy. It will come back there, I believe. But the overall growth is much slower, the impact, than North America.

Liam Burke  
Analyst, B. Riley FBR, Inc.

Great. Thank you, Ray.
Operator: The next question comes from Willard Milby with Seaport Global. Please go ahead.

Willard Milby
Analyst, Seaport Global Securities LLC

Hey, good morning, everybody. Just wanted to...

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

Good morning.

Willard Milby
Analyst, Seaport Global Securities LLC

...touch back on the revenue guidance. And, Pat, I know you talked a little bit about cadence with the seasonal European slowdown in Q3. That's mainly focused on the Transit business, right? Is there any reason to think that there should be an outsized slowdown at Freight?

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

Well, I think, yes. I think the answer is yes. I mean, what we specially see in the years that I've been here is that some of the services business, the maintenance, the refurbished products that we will do on — will definitely have a seasonality. Just kind of off the top of my head, usually, for us is the first and fourth quarters, the strongest, and second and next — and the third, the least. It's just it's not as — because it's a smaller percentage of the overall revenue, it's just not as noticeable. But there is Freight impact on seasonality.

Willard Milby
Analyst, Seaport Global Securities LLC

And with that, was there any kind of pull-forward of business here into Q2 as Freight volumes increased and the congestion continued as we look domestically?

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

No, I don't think so. I mean, I think if you look at the backlog, it's remained strong. You would kind of see it show up in reduced backlog. So...

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

The one area we did get a little bit of a lift was in PTC, because these railroads are trying to finish deployment. And we did see a little bit of hardware pull-forward to Q2 that we had anticipated in Q3. So, we're obviously going to watch how that evolves through the rest of the year.
All right. Thanks. And just one housekeeping item. Did you all give a depreciation number for the quarter?

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

Yeah, it's -- I'll look up my sheet. It was $16 million for the quarter. And amortization was $10 million, but...

$16 million?

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

Yes, 1-6. And amortization was $10 million.

All right. Thanks very much for the time, guys.

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

Sure.

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

Thank you.

Operator: Next question comes from Steve Barger with KeyBanc Capital Markets. Please go ahead.

Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Thanks. Good morning.

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

Hi, Steve.

Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Ray, you talked through a whole lot of puts and takes on the near term for those Transit margins as you described that recent presentation to the board. Can you just give us your current thinking on how you see structural Transit margin over next few years and what can that segment generate in terms of normalized incremental margin once you get everything where you wanted?
Raymond T. Betler  
President, Chief Executive Officer & Director, Westinghouse Air Brake Technologies Corp.

And so, well, at the investor conference, we talked about a goal, 1% improvement year-on-year on the bottom line, and that’s our goal. And I think that with a lot of diligence, cost reductions, focus on the bottom line that we’ll be able to achieve that. It takes a while in that business because of the long-term nature of projects, but that’s why the focus on cost is so critical in addition to execution. Another big impact is that we bid jobs more effectively. And if we don’t take on jobs that we don’t believe we can perform. When we do take on jobs, we structure them properly in terms of financial structure when we do the bid. I think, overall, as far as where the margins can end up, I think we’ve talked about the margins will never be as high as in Transit as in Freight. But we think that with good performance, we could get the margin profile with the mix of aftermarket and OEM up to about 15%.

Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

And so, do you think in terms of structuring the contracts and moving through these low-margin contracts, all that work gets done in the back half of 2018 to the point where you’re tracking towards that goal in 2019?

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

No, what we can focus on short-term that will have the biggest impact is cost. Process improvements will take much longer to have an impact, Steve, because these are running projects. We have hundreds, if not thousands of projects that we’re in the process of executing. So, I think the process improvements are things that roll out over the course of our strat period. The cost impacts will have more short-term impact.

Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Thanks. And just one quick one for Pat. Thinking about free cash flow for the remainder of the year, will you continue to incur extra expenses for the transaction costs or the financing, or is a lot of that spending behind you now?

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

Well, so overall, the plan is, is that we’ll have to replace the bridge with permanent capital, and the timing of that is still kind of to be determined. Obviously, we have a timeline, but nothing that we can announce. And so the answer is, is there will be cost that will be incurred and as we as progress on that plan.

Steve Barger  
Analyst, KeyBanc Capital Markets, Inc.

Okay. Thanks.

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

Thank you.
Scott H. Group  
Analyst, Wolfe Research LLC

Hey, thanks, guys. Just a quick follow-up here. Can you maybe share the revenue expectations for Freight and Transit for the year within the guidance? I'm just trying to understand how much of this margin ramp is just a better mix of Freight versus Transit revenue.

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

Yeah, Scott. I mean, we don't usually give this split. I think that you're just going to have to look at it and make some assumptions.

Timothy R. Wesley  
VP-Investor Relations, Westinghouse Air Brake Technologies Corp.

Yeah, we said the revenue – the guidance we gave was that the segments would grow in 2018 versus 2017, and that's both the revenue comment and the operating or income from operations comment, but we didn't give specific segment guidance for revenues.

Scott H. Group  
Analyst, Wolfe Research LLC

Okay. Can you – okay. The margin issue, the contract issue, is that more of a gross margin or an operating margin issue?

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

I guess I would answer it's more of a contribution margin. It's a – so it has impact on both.

Scott H. Group  
Analyst, Wolfe Research LLC

Okay. Okay. And then my last thing on this. Ray, it sounds like your point is we're going to cycle through some of this, but not all of it by the end of this year will – you said a little bit that lingers into the beginning of next year. How much of this do you think we get through by the end of this year? I'm just, again, trying to understand like what the run rate margin is once we get through this, right? You're saying it's 14.5% in the back half of the year even with some of this margin overhang, so I'm just – how much – I guess I'm trying to figure out how much better you can get from that once we fully cycle through this.

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

So as far as the projects that are going through, Scott, the largest project will be completed – it is scheduled to be completed by the end of this year. That's the largest project in the UK that we referred to several times over previous discussions. So there will be revenue with low margin next year. The overall portfolio of Transit OEM projects, as we discussed in Investor Day, is traditionally low. So, our focus has got to be obviously in parallel with improving our project margins to improve our cost structure to be able to get – make the impact if we need to achieve our overall profitability.
Scott H. Group
Analyst, Wolfe Research LLC

Okay. All right. Thank you, guys. Appreciate the time.

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

Thank you.

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

Timothy R. Wesley
VP-Investor Relations, Westinghouse Air Brake Technologies Corp.

Okay. Thanks, Anita. Thanks, everybody, for joining us. And we'll talk to you in about three months if we don't see you between now and then.

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

Thank you.

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

Thank you.

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