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Westinghouse Air Brake Technologies Corp. (WAB)

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Wabtec Fourth Quarter and Year End 2023 Earnings Conference Call and Webcast. 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 today's event is being recorded.

I would now like to turn the conference over to Kristine Kubacki, Vice President of Investor Relations. Please go ahead.

Kristine Kubacki

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

Thank you, operator. Good morning, everyone, and welcome to Wabtec's fourth quarter 2023 earnings call. With us today are President and CEO, Rafael Santana; CFO, John Olin; and Senior Vice President of Finance, John Mastalerz. Today's slide presentation, along with our earnings release and financial disclosures were posted to our website earlier today and can be accessed on our Investor Relations tab on wabteccorp.com.

Some statements we're making are forward-looking and based on our best view of the world and our business today. For more detailed risks, uncertainties and assumptions relating to our forward-looking statements, please see the disclosures in our earnings release and presentation. We will also discuss non-GAAP financial metrics and encourage you to read our disclosures and reconciliation tables carefully as you consider these metrics.

I will now turn the call over to Rafael.

Rafael O. Santana

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

Thanks, Kristine, and good morning, everyone. I'll start with an update on our business, my perspectives on the quarter, our progress against our long-term value creation framework, and then John will cover the financials.

We delivered a strong year with another solid quarter, as evidenced by robust sales growth, margin expansion, and increased earnings and cash flow. We achieved deals despite continued uncertainty in the broader economy and in the North America rail industry.

Sales were $2.5 billion, which was up 9.5% versus prior year. Revenue growth was driven by strong performance from both the Freight and Transit segments. And adjusted EPS was up 18.5% from the year ago quarter, driven by margin expansion across both segments.

Total cash flow from operations for the quarter was $686 million, and total year cash flow was $1.2 billion. The 12-month backlog was $7.5 billion, up 10%, signifying continued momentum and visibility across the business into 2024. And total multi-year backlog was $22 billion.

Overall, the Wabtec team delivered a strong year. Looking forward, I'm encouraged by both the underlying momentum across the business and the team's unrelenting focus on delivering for our customers. I believe Wabtec is well-positioned to drive profitable growth ahead.

Our financial position remains strong. We continue to execute against our capital allocation framework to maximize shareholder value by investing for future growth and returning cash to shareholders.

And as a result of our performance in 2023 and our confidence in the future of the company, our board of directors approved an 18% increase in the quarterly dividend and $1 billion share buyback authorization that replaces our existing program.

Shifting our focus to slide 5. Let's talk about 2024 and market expectations in more details. While key metrics across our Freight business remain mixed, we continue to be encouraged by the strength of the business, international markets and our robust pipeline of opportunities across geographies.

North American carloads were up 2.8% in the quarter, while the active locomotive fleet was down slightly when compared to where the industry exited last year. Yet, we continue to see significant opportunities across the globe in demand for new locomotives, modernizations, and digital technologies as our customers invest in solutions that continue to drive reliability, productivity, safety and fuel efficiency.

Looking at the North America railcar build, demand for new railcars showed growth in 2023 at approximately 45,000 cars. The industry outlook for 2024 is for about 38,000 cars to be delivered.

Internationally, activity is strong across core markets such as Latin America, Australia, Africa and Kazakhstan. Significant investments to expand and upgrade infrastructure are continuing to support our robust international orders pipeline. In mining, commodity prices and an aging fleet are supporting activity to refresh and upgrade the truck fleet.

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

Next, let's turn to slide 6 to discuss a few recent business highlights. In North America, we won a multi-year order for over 200 modernizations from CSX, demonstrating customer demand for a best-in-class solution to improve productivity, while driving down fuel usage and emissions.

Looking at our mining business, we are seeing continued momentum and visibility. The team signed orders totaling over $300 million in the quarter, which is up double-digits versus last year.

In Transit, we won a major order worth over $150 million to supply high-performance brake systems in India. These brake systems will provide improved operating performance, efficiency and safety for a new line of 1,200 electric locomotives.

Also, during the quarter, we announced our entrance into the railcar telematics market. Our innovative telematics platform will improve shipment visibility. It will increase on-time performance and expand asset utilization to make shipping freight by rail more competitive.

Finally, during December, we acquired the remaining 50% of our JV in Kazakhstan. This strategic acquisition enhances our manufacturing capability, both globally and in a region poised for continued long-term growth. All of this demonstrates the continued momentum across the business, the team's relentless focus on delivering for our customer and strong pipeline of opportunities we're executing on. Wabtec is well-positioned to capture profitable growth with innovative and scalable technologies that address our customers' most pressing needs.

Moving to slide 7. Before turning it over to John, I want to briefly discuss our ability to deliver strong results through the economic cycle. Over the last four years, Wabtec has demonstrated a solid track record of managing through challenging markets and significant disruptions.

We believe our favorable end markets, combined with our leading technologies and solutions will enable us to remain resilient and more predictable. Our 12-month backlog of $7.5 billion provides significant visibility and support for growth. The 12-month backlog has consistently grown over the past four years despite a challenging North American rail market and a volatile macro economy.

And finally, we have consistently demonstrated our ability to execute our strategies, generate strong cash flow, deliver growth and create value through disciplined capital allocation. Our track record of strong operating margin expansion across the business is evidence of our ability to deliver productivity, manage costs, and price for inflation.

Our execution combines with the strength of our business, leading products and technologies, which result in Wabtec being resilient through economic cycles, delivering predictable earnings and superior shareholder returns.

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 fourth quarter results in more detail. We finished the year with another solid quarter of operational and financial performance. Sales for the fourth quarter were $2.53 billion, which reflects a 9.5% increase versus the prior year. Sales were driven by strong growth across both the Freight and Transit segments.

For the quarter, GAAP operating income was $308 million, driven by higher sales, improved gross margin and focused cost management. Adjusted operating margin in Q4 was 17.0%, up 1.7 percentage points versus the prior year. This increase was driven by a higher gross margin of 1.2 percentage points and 0.5 percentage points of lower SG&A and engineering expenses as a percent of sales.

GAAP earnings per diluted share were $1.20, which was up 39.5% versus the fourth quarter a year ago. During the quarter, we had pre-tax charges of $47 million, of which $19 million was 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 addition, we are exiting some small non-strategic product lines and related assets, which generated a Q4 charge of $28 million. Finally, in the quarter, our acquisition of the remaining 50% interest in our LKZ assembly joint venture generated a gain of $35 million on our existing ownership interest. I will talk more about our progress on Integration 2.0 and portfolio optimization in more detail in a few minutes.

In the quarter, adjusted earnings per diluted share were $1.54, up 18.5% versus prior year. Overall, Wabtec delivered another solid quarter, demonstrating the underlying strength of the business.

Turning to slide 9. Let's review our product lines in more detail. Fourth quarter consolidated sales were up 9.5%. Equipment sales were down 19.3% from last year as higher mining sales were more than offset by lower locomotive deliveries during the quarter.

Recall that second half locomotive deliveries as planned were significantly skewed to the third quarter. Total equipment sales for the year were up a very strong 15.8%. Component sales were up 17.4% versus last year, largely driven by the higher demand for railcar products along with increased sales from industrial products. Sales also benefited from the acquisition of L&M earlier in the year by $32 million.

Digital Intelligence sales were down 6.7% from last year, which was driven by lower revenues in our North American market, partially offset by higher demand for international PTC, next-gen onboard locomotive products and digital mining. Our services sales grew 23.9%. Sales growth was driven by significantly higher modernization deliveries.

In contrast to new locomotive sales, our planned second half mods deliveries were significantly skewed to the fourth quarter. Additionally, parts sales continued to show strength as our customers continue to recognize the superior performance, reliability, efficiency and availability across their Wabtec locomotive fleets.

Across our Transit segment, OE and aftermarket sales increased versus last year. Segment sales were up 14.3% to $728 million behind execution of our growing backlog. The momentum in this segment is strong across our core markets and secular drivers such as urbanization and decarbonization, accelerate the need for global investments in sustainable infrastructure.

Moving to slide 10. GAAP gross margin was 30.3%, which was up 2.0 percentage points from Q4 last year. Adjusted gross profit margin was up 1.2 percentage points, driven by higher sales, favorable price mix and foreign currency exchange, as well as improved productivity. Our team continues to execute well to mitigate the impact of continued cost pressures by driving operational productivity and lean initiatives.

Now turning to slide 11. For the fourth quarter, GAAP operating margin was 12.2%, which was up 1.5 percentage points versus last year, while adjusted operating margin improved 1.7 percentage points to 17.0%. GAAP and adjusted SG&A expenses were down as a percentage of revenue as we leverage higher sales with a strong focus on managing costs.

Engineering expense was $61 million, about flat with Q4 last year. We continue to invest engineering resources in current business opportunities, but more importantly, we are investing in our future as an industry leader in decarbonization and digital technologies that improve our customers' productivity, capacity utilization and safety.

Now let's take a look at segment results on slide 12. Starting with the Freight segment. As I already discussed, Freight segment sales were up 7.7% during the quarter. GAAP segment operating income was $246 million for an operating margin of 13.7%, up 1.2 percentage points versus last year. GAAP operating income includes $28 million of portfolio optimization costs.

Adjusted operating income for the Freight segment was $347 million, up 22.2% versus the prior year. Adjusted operating margin in the Freight segment was up 2.3 percentage points from the prior year at 19.3%. The increase was driven by significantly higher gross margin, which benefited from higher sales, favorable price mix and improved productivity and absorption. At the same time, SG&A and engineering expenses were lower as a percentage of revenue.

Finally, segment 12-month backlog was $5.45 billion, up 11.2% from the same period a year ago. The multi-year backlog was $17.83 billion, down 4.3% from the prior year. Both our 12-month and multi-year backlogs demonstrate good visibility into 2024 and beyond.

Turning to slide 13. Transit segment sales were up 14.3% to $728 million. When adjusting for foreign currency, Transit sales were up 9.9%. GAAP operating income was $86 million, up 36.5%. Restructuring costs related to Integration 2.0 activities were $17 million in Q4.

Adjusted segment operating income was $108 million, which was up 13.7%. Adjusted operating margin of 14.9% was up 0.1 percentage points from last year, driven by the benefits of volume growth and Integration 2.0 savings. Finally, Transit segment 12-month backlog for the quarter was $2.01 billion, up 8.0% versus a year ago. The multi-year backlog was also up 9.7% to $4.17 billion.

Moving to slide 14. Over the next two slides, I would like to touch on both our progress against our Integration 2.0 initiative, as well as provide details on our portfolio optimization. The efforts of both these programs in 2024 will unlock greater profitability and margin expansion across the portfolio.

With regards to Integration 2.0, recall that during our Investor Day in 2022, we announced a restructuring program comprised of estimated one-time expenses between $135 million and $165 million that would yield an incremental $75 million to $90 million of run rate savings by 2025. These savings are to be achieved through a combination of actions, which simplify, streamline and consolidate parts of our operations.

With program to-date restructuring expenses of $118 million, we achieved $22 million of run rate savings as we exited 2023. We expect savings to ramp more meaningfully in 2024, and we remain on track to meet our 2025 goals.

Now turning to slide 15. As you are aware, we are very focused on driving improved shareholder value through the addition of strategic bolt-on acquisitions with accretive earnings, margins and return on invested capital. In the second quarter of 2023, we acquired L&M, a business that is very complementary to our heat transfer portfolio and enhances our mining installed base.

In the short time that we have owned this business, we are pleased with its performance. And more importantly, we are excited about its future potential for driving long-term profitable growth for Wabtec.

Also, as Rafael stated, late in the fourth quarter, we acquired the remaining 50% stake of our unconsolidated LKZ assembly joint venture in Kazakhstan for $81 million net of cash received. As a result of the transaction, we recorded a $35 million non-cash gain in the quarter, which is excluded from adjusted earnings.

Going forward, this business will be 100% owned by Wabtec and consolidated in our financial results. We would expect virtually no impact to sales and limited benefit to earnings in 2024.

We are also announcing today the exit of some non-strategic product lines in 2024. Pruning of these product lines will improve focus and profitability while reducing manufacturing complexity.

Sales from these product lines totaled about $110 million of sales in 2023 and represented a lower-than-average margin profile. The expected net exit charges of roughly $85 million are largely non-cash, of which we recognized $28 million of non-cash charges in our Q4 GAAP results. Both our progress against our Integration 2.0 initiative and the announced portfolio moves will help position Wabtec to drive multi-year margin expansion.

Now, let's turn to our financial position on slide 16. Fourth quarter cash generation was strong at $686 million, resulting in total cash from operations of $1.2 billion versus $1.04 billion in the prior year, an increase of 15.7%. Cash flow benefited from higher earnings and improved working capital.

Our balance sheet and financial position continued to be strong. We ended the quarter with liquidity of $2.12 billion. And our net debt leverage ratio was 1.9 times at the end of the fourth quarter, which was favorable versus the prior year's 2.2 times debt leverage.

During 2023, we invested $308 million on the strategic acquisitions of L&M and the LKZ joint venture and returned $532 million to shareholders through share repurchases and dividends. Finally, we improved ROIC during the year by 1.2 percentage points. We continue to allocate capital in a disciplined and balanced way to maximize returns for our shareholders.

Moving to slide 17, quickly recapping the year. Overall, the team delivered a strong year for all our stakeholders. Despite macro challenges, we drove strong revenue growth, expanded our operating margins and generated robust cash flows. The resiliency of the business and strong execution provides us with a solid foundation for profitable growth as we enter 2024.

With that, I'd like to turn the call back over to Rafael to provide our 2024 financial guidance.

Rafael O. Santana

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

Thanks, John. Now let's turn to slide 18 to discuss our 2024 outlook and guidance. We believe that the underlying customer demand for our products and solutions continues across our business. This is the strongest order pipeline we've had since 2019. Our 12-month and multi-year backlogs as well as our orders pipeline continue to be strong, providing solid visibility for profitable growth ahead.

The team is committed to driving top line growth and margin expansion in 2024, despite an uncertain macro environment. With these factors in mind, we expect 2024 sales of $10.2 billion at the midpoint, over 5% growth versus last year and adjusted EPS midpoint of $6.70 per share, up about 13% from last year. We also expect cash flow conversion to be greater than 90%. Looking ahead, I'm confident that Wabtec is well-positioned to drive profitable growth in 2024, which is aligned to our long-term financial framework.

Now let's wrap up on slide 19. As you've heard today, our team delivered a solid quarter to finish out a very strong year, thanks in large part to our resilient install base, world class team, innovative technologies and our continued focus on our customers. These results were in line with our long-term value creation framework.

I'd like to take a moment to thank all the employees of Wabtec, whose dedication and focus on execution made these strong results possible. With solid underlying demand across the portfolio, increased visibility through our backlog and intense focus on continuous improvement, 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. I'll turn the call over to Kristine to begin the Q&A portion of our discussion. Kristine?

Kristine Kubacki

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

Thank you, Rafael. We will now move on to questions. But before we do and out of consideration for others on the call, I ask that you limit yourself to one question and one follow-up question. If you have additional questions, please rejoin the queue. Operator, we're ready for our first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Today's first question comes from Justin Long with Stephens. Please go ahead.

Justin Long
Analyst, Stephens, Inc.

Q

Thanks, and good morning.

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

A

Good morning, Justin.

Justin Long
Analyst, Stephens, Inc.

Q

So maybe to start with the question on freight margins. If you look at the fourth quarter, we saw a decline relative to the third quarter, despite mix looking like it, got better. Equipment sales were down a lot sequentially. Services revenue was up a lot sequentially.

So can you talk about what drove that pressure, kind of quarter-to-quarter in freight margins and what you're anticipating for the progression of freight margins as we look at the 2024 guide?

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

A

Yes. Justin, this is John. I probably wouldn't characterize it as pressure between the third and the fourth quarter. A lot of that is just seasonality of our overall margin structure. We've talked about the back half margins versus a year ago being the strongest in the back half and even stronger in the fourth quarter, and that's exactly what we saw with the fourth quarter, company margins being up 1.7%.

But when we dig down a little bit deeper into that and we look at the Freight segment, they were up 2.3 percentage points. So again, we feel real good about those margins that we did deliver in the fourth quarter in the Freight segment.

When we look forward, we've talked about the overall guidance. You've seen the guidance, and we would expect both our Freight and Transit segments to grow revenue as well as margin in 2024.

Justin Long
Analyst, Stephens, Inc.

Q

Okay. Great. That's helpful. And I guess as a follow-up, I know we can see some lumpiness in the business on a quarterly basis because of mix and the timing of deliveries, similar to what we saw here in the fourth quarter. So as we think about the 2024 guidance, is there anything you can share on the expected quarterly cadence of revenue and earnings?

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

A

Yeah. Let's keep that – talking about it in half to half. Again, Justin, any given quarter can be moved pretty much by a handful or two of locomotives. So the most important part is that we expect 2024 revenue and operating margins to be up versus 2023 and generally in line with our long-term growth framework.

But more specifically, in 2024, we expect to see higher revenue growth in the first half versus the second half, and we also expect to see modestly higher margin growth in the first half than the second half. So when we look at the drivers of the cadence, one continues to be on the volume side, hinges on the timing of our loco and mods deliveries and comping against higher 2023 margins in the second half.

Justin Long
Analyst, Stephens, Inc.

Q

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

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

A

Thanks.

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

A

Thanks Justin.

Operator: Thank you. And our next question today comes from Matt Elkott with TD Cowen. Please go ahead. Pardon me, Mr. Elkott, your line is open or are you perhaps muted?

Matthew Elkott
Analyst, TD Cowen

Q

Sorry about that. Good morning, everyone. Can you guys give us some more insight on the 5% revenue growth at the midpoint, price versus volume. Are there any acquisitions baked in? I also asked because your backlog is 10% higher, and your revenue growth is 5%. Last year, you did 16% revenue growth. Is this just a function of comps being more difficult for revenue this year?

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

A

Matt, a couple of things. First, the fundamentals for the business are strong. We have the coverage. We have the orders to execute here. The portfolio is well-positioned to provide customers with fairly a significant payback.

Fleets are old, and we're still coming out of a trough in terms of customers' investments in their fleets. There's also significant drivers globally. International, as you've heard, is very strong, which drives demand, not just on the locomotive front, but if you think about mining, transit, digital and the overall freight.

Emissions, as you know, it's – as emission regulation is a tailwind for us. We have continued to expand our visibility with really improved backlog coverage, which goes beyond 2024. And that really positions us well to deliver ahead of our long-term guidance.

With that being said, our guidance takes into consideration a number of factors. If you think about 2024, you still have North America carloads continues to be on the low end. We expect parkings to continue to go up, and freight car build is actually down. With that, our approach has consistently ensured really a strong say-do ratio with results ahead of our commitments. And we continue to be committed to over-deliver.

Matthew Elkott Q
Analyst, TD Cowen

That's helpful, Rafael. And my follow-up question, some of the headwinds you mentioned, is that the reason why the freight organic – the organic freight revenue contribution to growth in the fourth quarter was lower than 3Q and basically the lowest in the last couple of years, if I'm doing my numbers correctly? And do you expect that to continue to trend downward in 2024?

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

I'm sorry, Matt, I'm not sure I completely understand the question. Can you repeat the driver of...?

Matthew Elkott Q
Analyst, TD Cowen

Yeah, John, like the $92 million organic freight revenue contribution in the fourth quarter. If I look back over the last two years, it's the lowest number we've seen from organic freight revenue. Is that a function of the headwinds in the North American rail market? And do you expect it to continue to trend downwards?

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

So let me just be clear here. Our backlog is strong. We feel good about it. The pipeline of opportunities show it, as I said, the strongest pipeline we've looked at in the last five years. And despite of some of the dynamics here we just described to you in North America with carloads and so forth, we're continuing to see really customers investing for cost, investing for reliability.

And we continue to see both an element of growth, both for us in North America and international. You're going to have variation here, as John described, quarter-to-quarter, but we're continuing to look at profitable growth as we go in 2024. And most importantly, I think we've got a stronger element of international here that really provides us visibility now into 2025, 2026 and 2027.

Matthew Elkott Q
Analyst, TD Cowen

Got it. Thanks, Rafael. Thanks, John.

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

Thank you.

Operator: Thank you. And our next question comes from Jerry Revich with Goldman Sachs. Please go ahead.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Yes, hi. Good morning, everyone.

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

A

Hi, Jerry.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Rafael. Hi. Rafael, I'm wondering – can you just provide an update on how your customers are thinking about the discussions with California on sub-Tier 4 locomotives in the fleet? And how do you folks see the regulatory process and timeline unfolding?

And is that driving customer preference for new versus mods that wouldn't fit the new CARB proposed standards? Can you just talk about how the ebbs and flows are going and the timeline that you expect to drive from a clarity standpoint for the industry?

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

A

Yes. So Jerry, last November, CARB petitioned the EPA for a waiver and supports for regulation for in-use locomotives. EPA has not responded to California's waiver request, and the ruling became effective beginning of this year. In one end, I'd say the outcome of the rule remains fluid, but we're technically very well-positioned to support our customer share for all outcomes.

We have the best-in-class products, lowest fuel consumption, low emission, best reliability, best availability. And regardless of further regulation, what I'll tell you the good news is our entire installed base will be able to burn bio and renewable fuels. But what's more exciting to me is our newer fleets, they will ultimately go beyond bio and renewable fuel. We firmly believe we can breach customer share to their ultimate near zero emission goals.

We are aggressively testing alternative fuels, hydrogen being part of that mix, in our newer internal combustion engines. And with really an eye towards enabling customer sustainability journey. And in parallel, we're integrating batteries and ultimately hybrid systems into our fleet. So we have not incorporated regulatory change into our guidance, so that would be a tailwind for us.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Super. And then can I just ask, you've been very clear on the cash flow from operations conversion rate at over 90%. The CapEx that we're seeing at 2% of sales, is that the run rate that we should be thinking about, John? Or are there any ebbs and flows as we think about what total net income to free cash flow conversion should be like over the next couple of years depending on your CapEx plan?

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

A

So when we look off over the rest of our investment horizon that we came out with a couple of years ago, we would expect 2% range of CapEx over that entire period of time.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

That's clear. All right. Thank you.

Operator: Thank you. And our next question today comes from Rob Wertheimer with Melius Research. Please go ahead.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thank you. And I guess a little bit similar to Jerry's question, but I think you had a healthy order for mods from CSX that just came through. I wonder if you can give us any sense of where your total number of mods was in 2023? Just for perspective on what that order kind of means in context.

And then more generally, even if we leave aside California, there's also the climate goals that the rails have, and there's a fairly old fleet that they're running, or maybe a record old fleet that they're running.

So in your conversations with your customers in North America, how much are they actually thinking about new locomotives right now with or without California? How is that balance looking? [indiscernible] (00:36:39) they think they can get to their climate goals with just mods, maybe just any color around that level of mods and then how to think about new? Thank you.

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

A

Hey, Rob, our customers invest for returns at the end of the day. So this really comes down to making sure as they look into their fleets, they've got really the opportunity here to continue to drive costs down, to drive reliability up, and improve service levels. And I think that continues.

When I look at that investment, of course, we're coming from trough levels here in the past. We have growth coming into 2023. We have still significant growth in 2024. And the recent order that you just referred to just gives us greater visibility to really continue to grow market. I think we still have, I think, an opportunity to grow here as we get closer here to what I'll call average replacement rates with really the oldest fleet we've had.

I think some of the elements on what customers decide to invest in could be shaped here certainly by regulation. But most importantly, I think it's going to get shaped by some of the elements of technology that we're introducing that allows a faster payback, a greater payback and greater flexibility to really, I'll call, ultimately bridge customers here into a lower emissions environment. And that's how we look at it.

Operator: All right. Thank you. And our next question today comes from Scott Group with Wolfe Research. Please go ahead.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Hey, thanks, good morning. So within the...

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

Hi, Scott.

Scott H. Group
Analyst, Wolfe Research LLC Q

Morning. Within the revenue guidance, just directionally, are you guys expecting better freight or transit growth? And when you just think about all the moving pieces with your growth, how should we think about mix as a tailwind or not this year?

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

Great question, Scott. When we look across our five business groups and look into 2024, we expect equipment to be the fastest growing. Again, for the reasons that Rafael had just mentioned on the last question. And with that, – and actually, in looking at mods as well, we expect both mods and locos combined to be growing at a faster rate than our average – the midpoint of the revenue growth. And that will put a little bit of mix headwind in 2024.

And again, as I've said before, in this world, Scott, there's two kinds of mix. There's good mix and bad mix. And this is a case of really good mix as we mix down a little bit, because we're putting out assets in the marketplace that'll be generating revenues for us for decades to come. So we feel really good. But there will be a little bit of mix headwinds going forward.

Scott H. Group
Analyst, Wolfe Research LLC Q

Okay. Helpful. And then I just want to clarify, just on the mod side, are you seeing – I think you've been talking about pretty consistent double-digit growth in mods the last bunch of years. Do we have that again this year? And then any update on the battery, loco and timing of first delivery and all that? Thank you.

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

With regards to the mods, we tend to look at one or the other mods and new. If we look at combined mods and new, in the year, we said they'd be up double-digit than they were in 2023. As we look forward, as I had just mentioned, we do expect them to grow faster than the average of those combined to grow faster than the average.

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

So strong growth here going to 2024. And Scott, with greater visibility ahead. On your question on battery electric, we're continuing to make progress here in the fourth quarter. As you know, we unveiled the first heavy haul battery electric locomotive with over 7 megawatts of power. These units will start running this year in Australia.

And on that, I think fuel continues to be one of the biggest costs for customers. There's a continued focus here on driving efficiency. We've got a number of pilots and demo projects. And while we do not expect broad adoption of these, there's going to be some really key opportunities here that we're ready to work on and support customers on.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Thank you.

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

A

Thank you.

Operator: And our next question today comes from Allison Poliniak with Wells Fargo. Please go ahead.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Hi, good morning.

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

A

Good morning, Allison.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

I just wanted to see if you could expand on the Digital Intelligence piece of your business, particularly in North America. It seems like that's been a bit slower. Just is – any color there or folks pushing off some of these investments from the cyclical standpoint, understanding the long-term drivers are still there. Just any color on that near term. Thanks.

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

A

Yes. So number one, I think during the quarter, I think in one side, while we saw higher demand from international, when you think about PTC, onboard locomotive, digital mine, we saw really a softer demand here, which is continuing with US, driven by really discretionary OpEx and the commuter signaling business.

What I'd say is the pipeline of opportunities remain strong, driven primarily by international and also by digital mining solutions. I'd say recurring revenues and short-term convertibility continues to be a focus area for the group. But I think what's more exciting here, something we announced in the fourth quarter, which is really tied to us entering the railcar telematics submarket.

We are creating a platform here with proven technology. And this is a market of 1.6 million freight cars. It is a multi-billion-dollar opportunity for us, one that we will be providing real-time data to railcar and tank car owners. And where opportunities like this will keep propelling growth and profitable growth for this business.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Got it. And then on the cost optimization, could you maybe give us any color on how we should think about run rate exiting 2024? And then was that portfolio pruning part of that? Is that incremental? Just any color there. Thanks.

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

A

Yes, Allison, this is John. So they're separate. Integration 2.0, we couldn't be more pleased with the performance of that. And to-date, most of the investment is behind us and most of the savings are in front of us.

So as we exited 2023, we had a run rate of $22 million. And as we exit 2025, the run rate that we will exit at will be $75 million to $90 million. So over the next two years, we would expect a significant ramp in moving from $22 million to the $75 million to $90 million. And they'll probably be somewhat equal as we ramp from here on the exit period.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

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

A

Thank you.

Operator: And our next question today comes from Ken Hoexter with Bank of America. Please go ahead.

Ken Hoexter
Analyst, BofA Securities, Inc.

Q

Great. Good morning. So Rafael and John, can you talk a bit about the – you've kind of gone over the mix of product type, but how about international versus domestic? And kind of maybe talk us through to understand margin differentials or mix issues as one is growing versus the other within your 5% growth outlook?

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

A

Yeah. When I think of revenues, I think you heard me describing stronger international pipeline, which I think ultimately wants to reflect stronger growth internationally as we look, especially beyond 2024 in that regard. So we see a strong pipeline of deals. Some of them signed last year, we'll see a part of those converting into backlog this year, which we'll continue to see really the strength that we've got longer term in the business.

I think with regards to specific margins, I mean this is really project by project driven. As John described, I think there's an element of still headwinds just associated with pace in which we grow both the new locomotive business, but also the mods business at a growth rate faster than the overall company.

Ken Hoexter
Analyst, BofA Securities, Inc.

Q

So maybe we can delve into that for a quick one for my follow-up. Just the backlog conversion, it looks like the backlog is building up maybe double-digit rates, right? Freight is up 11%, Transit up 8%.

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

A

Yeah.

Ken Hoexter
Analyst, BofA Securities, Inc.
Q

Just wondering, is that a good signal or read-through for that revenue growth? I mean, you're targeting 5%. The backlog is growing near double-digit. How do we reconcile the two? Where is their loss, I guess, in the conversion?

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

Sure. So a couple of things. I mean we will have variation here at quarter-to-quarter. Just reflect on last four quarters. I mean, we have quarters on low single digits. We had quarters on double-digits. And I think you're going to see some of that variation.

How we run the business, making sure that we've got that convertibility built out 12 months out, 18 months out, and we got to really think about the lead times we've got associated with our products. So it's making sure that we have that coverage.

If you think in specific about 2024, I think there's some elements of coverage, especially for the flow products that really need to – really be executed through the year. And if you keep in mind, you've got things like the freight car build, which is down. So you do have some elements here that play out through the year. But bottom line is, we feel strong about both the coverage and about the ability here to continue to drive profitable growth with the pipeline we have.

Ken Hoexter
Analyst, BofA Securities, Inc.
Q

Thanks, Rafael.

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

Thank you.

Operator: And our next question comes from Angel Castillo with Morgan Stanley. Please go ahead.

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

Hi, good morning. Thanks for taking the question. Just maybe kind of expanding on that in a little bit longer term. As you think about your book-to-bill for 2024, focused in particularly on locomotives, and new locomotives, how are you thinking about that kind of evolving? It sounds like deliveries will be ramping up during the year, but just based on what you're hearing from your conversations with your customers, how do you see that throughout the year in terms of above 1, below 1? Just any more color there would be helpful?

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

Well, Angel on average, we expect our book-to-bill to be over 1, because we expect to continue to grow in the mid-single digits over the sustainable future, right?

But again, going back to some of these orders can be lumpy from time to time, and a lot of them are multiyear. So – we're not – we don't provide a guidance in terms of what we expect forward-looking book-to-bill be. But over time, we would certainly expect it to be over 1.

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

Q

Got it. And then maybe just on the portfolio divestitures or pruning that you talked about. Could you quantify that from an EPS perspective, how much of that is kind of – what was kind of the impact embedded in the guidance? And any kind of incremental pruning that you see as kind of opportunities here?

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

A

Yeah. So when we look at portfolio optimization, again, we're looking very focused on overall company profitability. And certainly, Integration 2.0 is helping to drive that.

But in addition to that, we're looking at – taking a hard look at the portfolio and looking at the product lines that are not carrying the weight or not delivering the profitability that we expect or the value that we expect. And with that, we're going out and removing about $110 million of revenue.

So when you look at our overall guidance, you got to realize, too, that this revenue isn't going to be there in 2024. So that's putting a little bit of headwind on the overall midpoint that we've given. But to answer your question, this is very low margin or no margin, Angel. So it's not having an impact on our profitability going forward, but it is bringing our revenue down. And therefore, we would expect a little bit upward pressure on – our upward momentum on margin percent.

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

Q

Very helpful. Thank you.

Operator: And our next question today comes from Saree Boroditsky with Jefferies. Please go ahead.

Saree Boroditsky
Analyst, Jefferies LLC

Q

Thanks for fitting me in. So you announced the $1 billion in share buyback authorization. Can you just talk about how you're thinking about using the cash flow this year between repurchases and M&A, the expected timeline for completing this authorization and is any of this baked into your EPS guidance for the year?

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

A

So Saree, number one is in terms of capital allocation, we are on track to do what we've done in 2023. Again, we couldn't be more pleased with the balance that we had in 2023. When you look at the free cash of about $900 million, operating cash of $1.2 billion, it would sound pretty split between M&A and share repurchases.

When we look forward, as you know, we will prioritize M&A over share repurchases as long as we have good strategic bolt-on M&A. And if not, we will return excess cash to our shareholders in the form of share repurchases. In relationship to the authorization, it replaced the old authorization that we had. So we've got the ability to spend up to $1 billion in share repurchases. And again, that will be determined throughout the year as far as what we have in M&A opportunities.

Saree Boroditsky Q
Analyst, Jefferies LLC

But is it fair to say that any of that – any additional share buybacks this year is not included in your EPS guidance?

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

Our guidance includes all of our business aspects as well as the use of cash in 2024.

Saree Boroditsky Q
Analyst, Jefferies LLC

Okay. So it does include share buybacks?

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

Share buybacks, M&A or use of that cash. Yes.

Saree Boroditsky Q
Analyst, Jefferies LLC

Okay. And then for next question, I know you're hesitant to kind of put a number on freight margin performance for this year, but maybe comment on incremental margins in freight, because I think you should have easier comps with the absence of the strike, you have higher volumes and you're exiting lower-margin products. So what can we think about for incremental freight margins this year?

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

Well, overall, you can figure out where we're – what we're looking at for incremental margins on a company in total. Freight will certainly be a driver of that, but we also expect margin growth on the Transit side. When you look at – we are lapping some impact to the strike that we had, and that's been incorporated in our overall guidance, right? So when we look at the margins in general, we're looking at favorable productivity and absorption. And certainly, the benefits of Integration 2.0 as well as portfolio optimization that you mentioned. Now again, there's going to be some headwinds to that on unfavorable mix.

Saree Boroditsky Q
Analyst, Jefferies LLC

Great. Thanks for taking my question.

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

Thank you.

Operator: And our next question today comes from Chris Wetherbee with Citigroup. Please go ahead.

Q

Hey, thank you, operator. And good morning, everyone. This is [ph] Rob (00:52:24) on for Chris. If I could dig a little bit further into Integration 2.0, it looks like on a run rate basis exiting 2024, you're more than double the savings. Can you give us a sense of the cadence you're expecting to realize that run rate to route 2024?

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

A

Yeah. We wouldn't expect any unusual aspect of that. There's numerous projects that make up Integration 2.0, and most of them have all been executed. And now it is just different levels of – as the savings start to drive forward, so for purposes of modeling, [ph] probably (00:53:06) more straight line is more accurate than any other way to look at them, that build.

Q

That's really helpful. And then just to kind of circle back on Justin's question about the cadence of earnings and revenue growth. Can you give us any – can you fine-tune kind of the percentage of revenue you're expecting in the first half versus the second half? Clearly, it's going to be more weighted to the first half, but...

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

A

Yeah. We would just expect revenue growth to be higher in the first half than the second half. Again, largely how we have some of our delivery of the high-ticket items planned. But again, whenever you move a few locomotives from one period to the other or deliveries are a little bit ahead or behind, it's hard to get too fine-tuned on that. So suffice to say that the first half revenue growth will be a little bit higher than the second half.

Q

Understood. Appreciate the color.

Operator: Thank you. And our next question comes from Bascome Majors with Susquehanna. Please go ahead.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP

Q

You talked about a roughly neutral volume environment for North American rail. How much would that have to deteriorate to start to meaningfully impact your service revenue on the locomotive contracts?

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

A

So what we described was carloads being, I'll call it, to some extent muted for the year. That has, of course, been included into our guidance. What I think you have that more than offsets this is the continued opportunity here for customers to really invest for returns. It's really by driving productivity, lowering costs, replacing, in some cases, three units for two units. And I think those dynamics are remain in place and remain in place, not just for 2024 as you see reflected here by the orders that we just got.

We think, at least from a fleet perspective and parkings, service levels have really – the focus on service levels has really kept the active fleets relatively stable. And we would expect us to continue to be – have a favorable market dynamics for North America included.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP

Q

And moving to international. On the buyout in Kazakhstan, you talked about not much 2024 impact from that. As you look at longer-term, is the deal structured in a way where all of the benefits from any of this $2 billion-plus of MOUs converting to orders would accrue to Wabtec? And just longer-term, when could that become a meaningful contributor to your overall profit profile? Thank you.

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

A

Bascome, I would think about the LKZ venture that we have as an assembly joint venture. So it doesn't have any impact on our overall revenue growth or growth into the CIS region. What it does is it improves our supply chain, right? A lot of the things that we were driving through the joint venture were kits that we would make and a lot of the parts were made in other parts of the world and shipped in there, and the JV was for the assembly side of it. So now this just gives us a great operational – complete control over the operational supply chain in an area of the world that we believe is going to show significant growth going forward.

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

A

We have significant growth in 2024. We have significant growth in 2025. And we have an opportunity here to utilize that installed – that manufacturing footprint to export outside of Kazakhstan, and I think that's a significant element here on the top of this – just had some really strong returns for us.

Bascome Majors
Analyst, Susquehanna Financial Group LLLP

Q

Thank you.

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

A

Thank you.

Operator: Thank you. And our next question comes from Steve Barger with KeyBanc Capital Markets. Please go ahead.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, thanks. John, you said equipment will be the fastest-growing group. But if I'm remembering right, that category is pretty evenly split between locomotive and mining, marine and drilling. Are you thinking locomotive outgrows the industrial products? Or do you expect more equal growth from those kind of two categories?

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

A

Yeah. We don't break it out specifically, Steve. But when we look at 2024, our equipment group, we expect good growth out of both locomotives as well as mining equipment.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc. Q

Got it. Thanks. So similar growth rates, no big variance between the two?

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

Steve, it's, I think, a challenge here. We might have, again, variation as we go through it. But they're strong...

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

Yeah.

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

...both strong. And a lot of it really internationally driven and beyond 2024.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc. Q

Got it. And for Transit, you're coming off a tough comp, but really the best growth in years. And with equipment and services on the freight side outgrowing consolidated guidance, does that mean Freight is more like high single-digit for the year and Transit low single-digit?

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

We won't get into the specifics [indiscernible] (00:58:30) for Transit or for Freight. What I'll tell you, on Transit, the fundamentals for the business continue to be strong. Book-to-bill ratio closed over 1 for the year.

While we are pleased with the progress we're continuing to do significant work here to simplify the footprint. This business will deliver on margin expansion in 2024. Integration 2.0 is a significant contributor to that. But we will continue to have variation quarter-to-quarter, driven by really mix and timing of projects.

Steve Barger
Analyst, KeyBanc Capital Markets, Inc. Q

Understood. Thanks.

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

Thank you.

Operator: And ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to Kristine Kubacki for any closing remarks.

Kristine Kubacki

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

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

Operator: Thank you. This concludes today's conference call. We thank you all for attending today's presentation.

You may now disconnect your lines, and have a wonderful day.