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Westinghouse Air Brake Technologies Corp. (WAB)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Wabtec Q1 2021 Earnings Call. [Operator Instructions] Please note that this event is being recorded. Now I'd like to turn the conference over to Ms. 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 first quarter 2021 earnings call. With us today are President and CEO, Rafael Santana; CFO, Pat Dugan; and Senior VP of Finance, John Mastalerz. Today's slide presentation, along with our earnings release and financial disclosures were posted on our website earlier today and can be accessed on our Investor Relations tab on wabteccorp.com.

Some statements we're making today 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. We appreciate you joining us today. Turning to slide 3. We continue to see a recovery across the global freight and transit rail markets with North American freight volumes and equipment utilization sequentially improving in the first quarter and investments in transit infrastructure continuing. These directional trends, along with the focused performance of our team and execution against our strategic plan are reflected in our first quarter results.

Total sales for the quarter were $1.8 billion. This was largely driven by international freight markets, services and a recovery in transit, but offset by continued weakness in the North America OEM market. Adjusted operating margin was 15.1%, driven by lean initiatives, cost actions and favorable mix from mining and mods.

Cash conversion was strong with cash flow from operations of $292 million. Cash generation was due in large part to good working capital management, allowing us to deliver on our financial priorities, including strategic acquisition of Nordco, which I'll touch up on more in a moment.

Total multiyear backlog was $21.7 billion, up sequentially over the prior quarter, providing us better visibility into 2021 and beyond. Overall, we ended the quarter with adjusted EPS of $0.89, a strong reinforcement that our teams are continuing to take the necessary steps to control what we can, deliver long-term growth of the company and increase shareholder value.

In the area of synergies, we're on track to deliver the full run rate of $250 million in synergies this year and we have positioned the company for long-term profitable growth. In the first quarter, we exited all shared service agreements stemming from the GE Transportation merger ahead of schedule. This was a tremendous execution by the team on a complex transaction.

In addition, we continued to take aggressive actions on structural cost. This includes reducing total operational square footage by 5% since January of last year, and we will further reduce our square footage by an additional 2% for the remainder of 2021.

Moving forward, we'll continue to drive additional cost reductions through lean initiatives and balance our focus on execution with strategic investments in high-return opportunities that drive long-term profitable growth. You saw that with our recent acquisition of Nordco, which is a leader in the maintenance-of-way space, with 60% of its revenues coming from aftermarket services and a significant installed base of over 5,000 units.

We really like this business and its leading edge technologies. It opens up significant opportunities to expand domestically and internationally in the growing maintenance-of-way segment, while driving long-term profitable growth. Integration activities are already underway, and we expect this strategic acquisition to be accretive to earnings, cash flow and return on invested capital in 2021.

On the commercial front, we're also focused on driving growth and won some key orders in the quarter despite a challenging environment. This included a significant deal for our FDL Advantage product, which is a fuel upgrade kit. As we have shared before, there are more than 10,000 FDL locomotives running globally. With this next-gen technology, we're opening up a multimillion-dollar pipeline of opportunity that is helping customers drive down fuel consumption by up to 5% as well as drive down emissions. That means for a single locomotive, burning 250,000 gallons of fuel, it can translate into a $25,000 in savings per year.

Also, when it comes to technology differentiation and sustainable transportation, we completed a significant operational milestone with our FLXdrive battery electric locomotive, testing it in revenue services with BNSF across more than 13,000 miles of track. Through this demonstration, the FLXdrive was able to reduce both fuel consumption and emissions by more than 11%, a game changer in decarbonizing rail.

We continue to see growing interest in this next-gen technology from customers in both North America and internationally. And we expect our battery electric locomotive to become an important area of growth for the company over the long term. In digital and electronics, we're also leading the way in rail safety and utilization. We closed a key order for positive train control internationally, and we are encouraged by the strong order pipeline for international PTC expansion.

Finally, we had a solid quarter in transit, winning new brakes, doors, and HVAC contracts in India, Taiwan and France, including a significant order for platform doors and gates at over 30 train stations in Marseille. Overall, our order pipeline continues to strengthen, driven by multiyear orders in freight services, equipment and digital electronics. Based on these factors and orders, Wabtec is in a strong position to drive profitable growth and perform for our shareholders, for our customers and for our employees.

With that, I'll turn the call over to Pat, who will review the quarter, segment performance and our overall financial position.

Patrick David Dugan

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

Thanks, Rafael, and good morning, everyone. We had a solid operational start to the year, despite the challenges in our North America OE end markets and ongoing disruption from the pandemic, we demonstrated our ability to deliver on synergies, generate cash flow, invest for the future and position Wabtec for profitable growth.

Turning to slide 4, I'll review the first quarter in more detail. Sales for the first quarter were $1.8 billion, which reflects a 5% decrease versus the prior year, driven by lower North America OE freight markets as a result of the disruption caused by the pandemic. For the quarter, operating income was $192 million and adjusted operating income was $277 million, which was down 9% year-over-year.

Adjusted operating income excluded pre-tax expenses of $85 million of which $70 million was for non-cash amortization and $16 million of restructuring and transaction costs related to the acquisition of Nordco, along with restructuring due to the 2021 locomotive volumes and restructuring in our UK operations.

Adjusted operating margin was 60 basis points lower than the first quarter last year, but up 110 basis points from the fourth quarter. Versus last year, adjusted operating margin was impacted by under absorption costs at our manufacturing facilities, stemming from fewer locomotive deliveries, as well as sales mix, impacted from lower digital electronics and a higher level of transit sales.

At March 31, our multi-year backlog was $21.7 billion, up quarter-over-quarter. Our rolling 12-month backlog, which is a subset of the multi-year was $5.7 billion and continues to provide good visibility into the year.

Looking at some of the detailed line items for the first quarter, adjusted SG&A declined 2% year-over-year to $224 million. This was the result of cost actions during the downturn and excludes $11 million of restructuring and transaction expenses. SG&A expense benefited from head count reductions and the realization of synergies.

For the full year, we expect SG&A to be up about 5% versus 2020, driven by the normalization of costs following the COVID disruption. That said, we will continue to aggressively manage head count and structural costs. Engineering expenses decreased from last year. This was largely due to the lower locomotive volume outlook for the year, as well as some changes in project timing. Overall, our investment in technology is still expected to be about 6% to 7% of sales.

Amortization expense were $70 million. For 2021, we expect non-cash amortization expense to be about $285 million and depreciation expense of about $195 million. Our adjusted effective tax rate was 27.5%, which was higher than year-over-year due to certain discrete items during the quarter. We expect the full year 2021 effective tax rate to be about 26%. The first quarter GAAP earnings per diluted share were $0.59 and adjusted earnings per diluted share were $0.89.

Now let's take a look at the segment results on slide 5. Across the freight segment, total sales decreased 9% from last year to $1.2 billion, primarily driven by North America OE end markets, but partially offset by strong services and aftermarket growth. In terms of our product lines, equipment sales were down 36% year-over-year, mainly due to zero deliveries in North America, which resulted in roughly 50% fewer locomotive deliveries versus last year, a dynamic that unfortunately persists.

However, mining was a bright spot with units and revenues up double digits during the quarter. In line with improving freight traffic, our services sales improved a solid 13% versus last year and was up 3% sequentially. This was largely driven by strong modernization deliveries, and higher aftermarket sales from the unparking of locomotives due to the extreme weather in the quarter.

I'd note that the timing of mod deliveries vary from quarter-to-quarter, but we expect our services sales to improve with the gradual recovery in freight volumes. Digital electronics sales were down 10% year-over-year as orders shifted to the right in North America due to the COVID disruption. Yet we had another quarter of strong momentum for multiyear orders and continue to see a significant pipeline of opportunities in our digital electronics product line as customers focus on safety and improved productivity.

Component sales were down 8% year-over-year. This is compared to a 45% lower railcar build year-over-year, demonstrating the diversification within our components business. We continue to see signs of improvement in demand for aftermarket components as more railcars come out of storage.

Freight segment adjusted operating income was $214 million for an adjusted margin of 18.1% versus last year. The benefit of synergies and cost actions were offset by sales mix, as well as under absorption due to lower locomotive deliveries. We will continue to execute on our synergy plans and further improve cost to drive margin improvement. Finally, freight segment backlog was $18 billion, up from the prior quarter on broad multiyear order momentum across the segment.

Turning to slide 6. Across our transit segment, sales increased 3% year-over-year to $647 million, driven largely by steady aftermarket sales and favorable foreign exchange rates, offset somewhat by the disruption from the COVID-19 pandemic. OE sales were roughly flat year-over-year, demonstrating continued investments in green infrastructure.

Aftermarket sales were up about 5% from last year. We expect aftermarket sales to continue to improve as transit ridership and services increase globally. Adjusted segment operating income was $79 million, which was up 6% year-over-year for an adjusted operating margin of 12.2%.

Across the segment, we continue to drive down cost and improved project execution, demonstrated by our good operating performance despite a challenging environment due to the pandemic. We are pleased with the momentum underway, and the teams are committed to execute on more actions to drive 100 basis points of margin improvement for this segment in 2021. Finally, transit segment backlog was $3.7 billion.

Now let's turn to our financial position on slide 7. Despite a seasonally challenging quarter, we generated $292 million of operating cash flow, demonstrating the resiliency and quality of our business portfolio. Cash flow was driven largely by good conversion of net income and focused working capital management, including a $93 million incremental benefit from accounts receivable securitization, which provides attractive financing and provide liquidity.

During the quarter, total CapEx was $27 million. 2021, we expect CapEx to be about $180 million or about 2% of our expected sales. Overall, our strong cash generation allowed us to execute on strategic plans and capital allocation priorities, including the strategic acquisition of Nordco, which will drive profitable growth for Wabtec.

Our adjusted net leverage ratio at the end of the first quarter was 2.7 times, and our liquidity is robust at $1.7 billion. As you can see in these results, our balance sheet remains strong, and we are confident we can continue to drive solid cash flow generation, giving us the liquidity and flexibility to allocate capital to grow shareholder value.

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

Rafael O. Santana

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

Thanks, Pat. Turning to slide 8. Let's look at some of the market dynamics by segment. Overall, we're seeing a gradual recovery across most end markets as global economic activity improves. And we're continuing to monitor the evolving COVID situation in regions like India. This aligns with what you've heard from our customers as well. While, we continue to work through the trough in the OE North America market, where new loco orders remain stagnant, we are encouraged by the sequential improvement in freight volumes and a broad recovery across the agriculture, intermodal, and the industrial markets.

Locomotive parkings, after peaking to a record high in 2020, are improving as a result of increased freight traffic and demand is stemming from weather disruptions during the quarter. We expect demand for reliability and productivity to improve as railroads continue to recover. This will put us in a position of strength across our freight portfolio.

When it comes to North America railcar build, railcars are coming back into use. More than 20% of the North American railcar fleet remains in storage, but it's back to pre-COVID levels. Industry orders for new railcars remain weak. And forecast, estimate the railcar build this year to be below 30,000 cars. We have a strong order pipeline internationally, and we expect long-term revenue growth in several of these markets going forward. And in mining, market conditions are also improving.

Transitioning to the transit sector, rider shift is uneven, but recovering as economies open up. We are watching short-term dynamics as the pandemic evolves in several geographies, including India and Europe. Overall, the long-term market drivers for passenger transport remains strong and infrastructure spending for green initiatives continue to be a focus, especially as governments globally turn to rail for clean, safe and efficient transport.

Turning to guidance for the year. We are updating our sales guidance to $7.7 billion to $7.9 billion and updating adjusted EPS guidance to a range of $4.05 to $4.30. This largely reflects upside from the acquisition of Nordco, our operational execution to date and visibility to backlog. Consistent with our initial forecast for 2021, with more growth weighted to the second half of the year, we expect second quarter earnings only slightly higher than the first quarter. This is in line with the positive and gradual trends in our freight markets.

That said, we are seeing disruption from the resurgence of COVID, especially in a key region for us like India, and we will continue to take swift and necessary action as conditions evolve. Finally, we remain confident in delivering strong cash generation for the year, as well as margin expansion to prioritize cost actions.

Turning to slide 9 and to conclude, I'm proud of the strong execution by the team in the first quarter despite a challenging environment. As we go forward, we will continue to lean into the strong long-term fundamentals of the company and remain committed to executing on our strategic plan. This includes reducing costs and executing on synergies, driving margin expansion across our freight and transit segments, generating strong cash flow and delivering long-term profitable growth.

As we've said before, Wabtec's mission holds a larger purpose, to move and to improve the world and our teams globally live up to this mission every day. After demonstrating a strong performance in 2020 and in the first quarter of 2021, I'm confident that this company will drive profitable long-term growth and be a leader in transitioning our customers and the industry to a more sustainable future.

With that, I'll turn the call back to Kristine to begin the Q&A portion of our discussion.

Kristine Kubacki

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

Thank you, Rafael. We will now move on to questions. [Operator Instructions] . Operator, we are now ready for our first question.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] First question comes from Jerry Revich, Goldman Sachs. Please go ahead.

Ashok Sivamohan

Analyst, Goldman Sachs & Co. LLC

Q

Hi everyone. This is Ashok Sivamohan on for Jerry Revich. With investments stepping up in the decarbonization product portfolio, I'm wondering if you can provide any details on the proportion of total R&D related to next-generation fuel technology?

Rafael O. Santana

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

A

We're continuing to step up investments there. I think we've been clear around the 6% to 7% range of investments tied to the overall sales. We're very much committed to lead the path here to decarbonization. We're working on a number of the areas with customers. Those includes really developing some of the elements of upgrade kits. We're working on a number of areas to introduce biofuels, renewable fuels, but taking all the way to electric. And we're also, of course, working along the lines to lead in fuel cells, and that's kind of the stairway we see on progressing through it.

Ashok Sivamohan
Analyst, Goldman Sachs & Co. LLC

Q

Great. And then I'm just wondering if you can comment on the pace of mods activity and sort of how that's trending in 2021, how that compares to 2020?

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

A

We've had a significant step up, healthy double-digit growth. You see that reflected in the first quarter, where we have significant positive from that and we believe mods will continue to be an area of growth for us. It's clearly a pathway for us to introduce what I'll call upgrades into the fleet and make them more fuel efficient, make them safer and more overall, just efficient.

Ashok Sivamohan
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you.

Operator: Thank you. Next question is from Justin Long of Stephens. Please go ahead.

Justin Long
Analyst, Stephens, Inc.

Q

Thanks and good morning.

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

A

Morning.

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

A

Hey, good morning, Justin.

Justin Long
Analyst, Stephens, Inc.

Q

I wanted to ask about the guidance and I was curious if you could share the revenue and EPS impact that you're baking in from the Nordco acquisition this year. And if you set that acquisition aside, can you just talk from a high level about any other changes that you've made to some of the assumptions that are underlying that 2021 guidance?

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

A

Let me start, then I'll let Pat continue. But we have narrowed the guidance. We have raised the midpoint given the strong operational start to the year. I think in the quarter, the positives include mining, execution of modernizations, and so we're continuing to see strong numbers around locomotives being unparked. And we also have the acquisition of Nordco.

At the same time, Justin, we're continuing to see supply chain headwinds with disruptions driven by COVID. I think most impactful is situation we currently have in India, which we're following on. But certainly, headwinds when it comes to transportation costs and commodity prices over all of that is reflected in the guidance we've provided. I'd say overall momentum is positive, and we are continuing to see a gradual recovery across most of our end markets.

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

A

Yes. Hey Justin, so – this is Pat. So the – we're similar to what we had disclosed when we did the earnings – the press release on the Nordco acquisition, about $175 million of sales on an annual basis and $40 million of EBITDA for – on an annual basis. So we bought it basically at the end of the first quarter, beginning of second quarter, so we kind of pro rata for the rest of the year.

The EPS impact, we've talked about it, around $0.06 for the full year. So that's included in the guidance and gave us a lot of the confidence, obviously, to increase the bottom end of the range, plus some of our good performance so far, ultimately, where we guided today.

Justin Long
Analyst, Stephens, Inc.

Q

Okay. Great. That's helpful. And secondly, I wanted to follow-up, Rafael, on something you mentioned a couple times on parked locomotives. Could you give us a sense for how locomotive utilization has recently trended? And what percentage of the fleet is still in storage today?

And then also, as you answer that, I'm curious, what percentage of that stored fleet you feel like is actually usable. Because on the railcar side, we always hear that we're effectively fully utilized with, call it, mid-teens, maybe low teens percentage of that fleet in storage. Would love to get your thoughts around that?

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

A

Yes. Justin, overall, the industry is not back to pre-COVID levels yet from just the locomotive parkings perspective. We feel good with the progress, especially regarding our fleets. I think we're ahead of the overall industry, which is a positive for us when we look at our overall fleet operating globally. So, that's certainly a positive trend.

So, you still have a little bit, I think, left from units that were part, what I call post-COVID. Now, when you look at the units that were parked pre-COVID, those units, it's a smaller number that it can potentially be utilizing here. So, I think the momentum is positive. We're going to continue to watch that closely here, especially as we go into the second half of the year. And we're especially pleased with the performance we are having with customers in terms of reliability and availability, which ultimately is really the differentiator for us to winning more share of wallet, so positive.

The last piece I would mention, you've probably seen a number of customers who are looking for, what I'll call, spare power available out there, including some recent announcements. I would say the good news is those are Wabtec locomotives, it's a positive for us.

Justin Long
Analyst, Stephens, Inc.

Q

Great. That's helpful. I appreciate the time.

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

Thank you.

Operator: Thank you. Next question from Scott Group of Wolfe Research. Please go ahead.

Scott H. Group
Analyst, Wolfe Research LLC Q

Hey, thanks. Morning, guys.

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

Morning Scott.

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

Morning.

Scott H. Group
Analyst, Wolfe Research LLC Q

Just going back to the guidance here, so it looks like that you're assuming the second half is about 30% higher than the first half of the year from an earnings standpoint, give or take. And we don't typically see that level of seasonality. Can you just help us understand what's driving such a big ramp in the second half of the year?

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

Scott, I think consistent with the initial forecast we have for 2021, we have more growth weighted to the second half of the year. I think in that regard, we're continuing to see sequential improvements. In the first quarter if you think about the orders, the book-to-bill, it's increased to 1.2. Some of these are multi-year orders. While there's an impact in 2021, the impact goes beyond 2021. I think our pipeline of deals has continued to strengthen. So I think there's just good momentum coming out of a tough year being last year, and we have also good progress quarter-to-date. Our 12-month rolling backlog is up about 3.5% and we've got good momentum, and the focus is really on convertible of our pipeline of orders into this year and building forward.

I think just with regards to the second quarter, maybe, as we – as previously discussed, I think we've got some elements of volatility, especially tied to COVID disruptions. We think those are contained very much into the quarter, but that situation we'll continue to monitor, especially with regards to India, which is an important market for us.

Scott H. Group
Analyst, Wolfe Research LLC Q

Okay. And just to follow-up there. So, is the second half more about transit or freight or domestic versus international? Just some additional color would be great.

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

I think international markets continue to be robust. If you think about it, just in terms of sales, we grew – we've grown our business more internationally than in the US. So, I think largely, the North America market is going to be tied to the continued unparking of locomotives. Internationally, I think growth has been, I'll call, more robust in some ways. The team is very much focused on, convertibility. We've got some very important opportunities around the OE side, that the team's working to convert between here, second and third quarter. So those are critical elements of continuing to build profitable growth ahead.

Scott H. Group
Analyst, Wolfe Research LLC
Q

And would you say international is back at pre-COVID levels?

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

I'd say largely, when you think about the services front [ph] definitely (00:31:45) Scott, I think there is room for, I'll call it, more momentum forward. And if you think about it on how much of our business was, let's say, last year, international versus now, I mean, it's gained about 5 basis points, in terms of momentum there.

So if you think about it, we're probably at a rate close to 65% in the first quarter was international. So that gives you a sense of, I'll call, both the strength there, but the weakness in North America.

Scott H. Group
Analyst, Wolfe Research LLC
Q

Okay. Thank you, guys. Appreciate it.

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

Thank you.

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

Thanks.

Operator: Next question is from is Chris Wetherbee of Citi. Please go ahead.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.
Q

Hey, hi thanks. Good morning guys. I wanted to ask about freight and maybe how we can think about in the context of that sort of ramp in the second half of the year. How can you think about sort of incremental margins in that business?

I know you have the synergies that you're working through. The fixed cost absorption, obviously, has been one of the challenges for you as the volume and revenue dynamic has been more challenging over the course of last several quarters. So is that something where we could see potentially a somewhat large snapback, as we move into the second half of the year?

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

A

Let me answer in two ways. Number one, we are committed to, I'll call, improved margins on both, the freight and the transit side. On the transit side, I think we've been more clear in terms of what we expect that to be. And the team is certainly working towards driving 100 basis points.

We expect improvement on the freight side. We're working through some of those dynamics here, taking the necessary actions. When it comes to the OE side, there's probably really not much opportunity in terms of really gaining volume for the year. But there's certainly opportunity when it comes to the services side.

And we also have mining really improving overall. So mining is also a positive here for us into the year. So that's maybe the way to think about it.

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

A

Yeah. Chris, what I keep reminding everybody is that quarter-to-quarter, there can be some margin impact from the timing of projects and the type of deliveries. But you really need to look at the full year margin. And we talked about a transit improvement explicitly for the full company.

At least a 40 basis point improvement in overall margin for – as we progress through the year, it's being driven by a combination of synergies being achieved, of the volumes coming back, offset a little bit by some cost and absorption items and normalization of our – of other costs in the SG&A. But that overall improvement really is a year view and a full year view and should be considered.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.

Q

Okay, all right. That's helpful. I appreciate that. And then, just picking up on the synergy comment, obviously, you have a target for this year. As you think beyond 2021, what do you think the opportunity is?

Obviously, you've had the combined company now for a period of time, had the opportunity to kind of go through and see what the opportunities are. And obviously, it's a challenging macro backdrop to say the least.

As we go into 2022 and maybe get on more firmer footing, can you give us a sense of what you think the potential, sort of, bigger picture synergy opportunities might be?

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

A

I think I'll qualify those beyond this year less about synergies. I think we're really working hard to make sure that we progress with a lean culture approach. And I think there is a lot to be done there. I think we've started in a number of key and critical sites. And I think more in terms of how we think about productivity gains, how we continue some of the work around really rationalizing our footprint, doing more. I think some of – well, you think about the acquisition of Nordco, I think it provides us a good opportunity to expand internationally and utilize that footprint to support customers. And volume recovery will also be, I'd say, a positive in that regard. So it's all around productivity efficiency, really a lean mindset and making sure that we drive productivity.

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

A

Yes, I would just add to that is, we've been – we've tried to be very disciplined about how we look at synergies and communicate that because it was such a big part of the strategic rationale of putting the companies together. But truthfully, the DNA of the company has always been about productivity gains, lean initiatives, all the things that Rafael just referred to. So we just continuously look at how we can improve margin going into future years.

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

A

Largely, if you think about our sites, there has been a focus here to date, especially in 15 of them. We've got to expand that to really drive broader impact in terms of productivity moving forward.

Chris Wetherbee
Analyst, Citigroup Global Markets, Inc.

Q

Okay. That's helpful. Thanks for the time. Appreciate it.

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

A

Thank you.

Operator: Thank you. Next call – question is from Allison Poliniak of 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

Hi, Allison.

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

A

Good morning, Allison.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Just turning to the digital side, it sounded like your comments suggested an incredibly active market, and the guidance for flattish growth, it certainly leads to that as well. Could you maybe help us understand the progression of digital through the year to get to that flattish? I mean it sounds like it's going to be a significantly stronger second half for you? Is this something where the time from order to, I would say, implementation is pretty short, that gives you that comfort here?

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

A

So Allison, I think we continue to see a strong commitment here from customers. We certainly saw that internationally. Our book-to-bill was strong in both fourth quarter of last year and first quarter this year. So that just provides back into what I just said. But customers, when you look at last year, they pushed out some of those investments due to COVID.

With that being said, both efficiency, productivity and safety remain an imperative. We expect those multiyear orders to continue. The team is very focused on convertibility for the year at this point. So with the strong book-to-bill, we saw some of that impact beyond this year. So really a lot of focus on convertibility for this year.

At this point, we're continuing to invest in the business. That business will continue to provide long-term growth for us. I think there's more an element here of delay. And keep in mind also the element of locomotive shipments. Whenever we ship locomotives into North America that goes with a significant number of – what I call, digital software and hardware. So – and with that drop, we're not seeing that. So that's another element of impact that I just want to highlight.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you. And then just on the lines of locomotives, the FLXdrive that you've completed the test in revenue service. You mentioned some interest in the locomotive. How should we think about those in terms of the quality of the inquiries? Is this something that could be revenue-generating in, sort of, 2022 or is it more of a 2023 timeframe for you?

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

A

Allison, the interest is strong. We have proposals out. There would not be an impact from next year, specifically, but we expect battery electric to be part of long-term growth with the company. And so we see a number of areas where that could be applied. So we're having some strong discussions with customers and this really combines with a strong focus from the ESG side. And I think the FLXdrive is a very unique product to address these challenges. So I do expect that momentum to continue. And we're working with customers on a number of pilots out there.

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

Thanks.

Operator: Thank you. The next question is from Matt Elkott of Cowen. Please go ahead.

Matt Elkott
Analyst, Cowen and Company

Q

Good morning. Thank you. So I think your total backlog increased by $80 million sequentially from December. But your 12-month backlog increased by about $186 million. So I was wondering if there was some pull forwards from the out years or if you guys had any cancellations in the out years that were more than offset by new orders for the next 12-months, if that makes any sense.

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

A

Let me start with the end part of your question. We've not had cancellations. And I think we're continuing to see momentum on both segments, whether if it's freight and whether if it's transit.

Of course, there's an element of projects into our business, which can lead to some lumpiness quarter-by-quarter. But momentum is good. We see that with the book-to-bill. And quarter-to-date, we've also had, I think, good momentum to continue on that trend. That's kind of it.

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

A

Yes. So I would also – there's an element of FX that impacted the backlog number. And if you imagine that our international operations are more long multi-year projects, and the international impact of those can be spread out over a longer period of time. And we have foreign exchange hurt our backlog number by about $170 million. And so I think that, that FX impact is more overly weighted into the full number, not the 12-month number.

Matt Elkott
Analyst, Cowen and Company

Q

Got it. That's helpful. And then just for my second question. It's been over a year now since the beginning of the pandemic, and there were a lot of concerns about the long-term prospects of transit, Pat and Rafael. Now do you have any more clarity from your conversations with customers about a potential secular shift in transit long-term?

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

A

We're seeing both customers and governments very committed to transit overall. So with that, just reiterating, no cancellations of orders received, projects are moving forward. You see very much systems continue to operate, and that's shown in the resilience of our service numbers.

On the top of that, I think we're continuing to see just transit part of the solution in terms of how you decarbonize things moving forward. I think there is a number of improvements being thought through, but strong fundamentals for that business moving forward.

Matt Elkott
Analyst, Cowen and Company

Q

Got it. Thank you very much.

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

A

Thank you.

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

A

Thank you.

Operator: Thank you. Next question is from Ari Rosa of Bank of America. Please go ahead.

Ariel Rosa
Analyst, BofA Securities, Inc.
Q

Yeah. Hi, good morning. So you've mentioned COVID impacts in India. And obviously, we're seeing a regrettable surge in cases there. Maybe you could go into a little more detail around kind of what you're seeing there, what you think the potential impact could be and if you've had any discussions with customers there. I know India has been a big focus area in terms of the growth. Do you see that kind of shifting the timeline there or the prospects?

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

Well, so first, no really shift in terms of the prospects as you look longer term. In fact, if you think about freight volumes in India, it's actually positive year-to-date. So just to give you a perspective. So this is really more tied to disruptions associated with lockdown, certainly impacting our suppliers, sub-suppliers, our customers as well. We're following up that closely. To this point, we think we see it more as an impact potentially to the quarter. But we'll continue to monitor and take the necessary actions here, and we will report on any relevant changes.

Ariel Rosa
Analyst, BofA Securities, Inc.
Q

Got it. Understood. Very helpful. And then just if we could return to kind of the North American market. Maybe if you could give your latest thoughts on where we are in terms of emerging from a cycle compared to past cycles; how do things look in terms of the timeline? Do you think by 2022, 2023, we could get back to kind of a more normalized rate of demand from customers? Or do you see this kind of lingering for longer?

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

It's good to see the momentum here. We're walking into the first half of the year. We are working with customers closely, and watching on that momentum towards the second half of the year, which I think will be determinant in terms of how customers will think about their fleet strategies, which will include continuing modernizations.

There are certainly opportunities here for parts as they continue to consider unparking of units, and new locomotives is also going to be part of the discussions with customers. So I see that largely as a second half discussion based on continued momentum here through the first half of the year.

Ariel Rosa
Analyst, BofA Securities, Inc.
Q

And do you typically see – between locomotives and railcars, do you typically see one piece of that business lead the other?

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

I think it tends to be connected, but I mean just could be variances just tied to the levels of parking. If you think about freight cars, we're already back to pre-COVID levels. If you think from an overall locomotive fleet, we're not yet back to pre-COVID level. So there could be some elements of delays there, which are sometimes really driven by just think about velocity and dwell times in the network, which ultimately could be very determinant factors on these.

Ariel Rosa
Analyst, BofA Securities, Inc. Q

Got it. Great, Thank you for the time.

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

Thanks.

Operator: Thank you. Next question comes from Saree Boroditsky from Jefferies. Please go ahead.

Saree Boroditsky
Analyst, Jefferies LLC Q

Hi. Thanks for taking the question. Locomotives were down almost 50% in the quarter, and you noted it's largely due to North American shipments, even positive on the long-term view of international locomotives. But just for clarity, were international locomotives also down in the quarter, and should they decline for the full year?

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

I think we're seeing more of a – growth opportunities when I think about the international markets. So, to your point, I think largely the impact here in the quarter was driven by drop by 50% on those. I think if you look at our – especially our equipment business, I think you've got to keep in mind that some of that we've been able to offset by really double-digit growth in mining. So, that's been a positive. And I think even more significant growth in our mods business. So, there's opportunities there.

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

So, Saree, just to – specific to your question about the variance quarter-over-quarter – or year-over-year is, is that we had a large number of international loco shipments in Q1 of 2020, specific to the Middle East. I think we've talked about this at various time. So we had an overweighting of the locos in the first quarter of last year versus this year. But our full year locomotive phasing for international purposes are going to be largely the same as for the full year.

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

And we've got long-term orders. They're tied to some key markets, which includes India, includes Brazil, includes Kazakhstan. So that's the other element to keep in mind.

Saree Boroditsky
Analyst, Jefferies LLC Q

Great. And then could you just provide a little bit more color on freight margins? You've done a great job realizing synergies. They are obviously being impacted by under absorption. When do you think you'd get back to 2019 levels, and what revenue do you need for that?

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

A

Yes, I think, I don't know that we've talked about any kind of breakeven or kind of, contribution margin impact. I think the way to look at it is, is that last year the decremental margin on the lower volume was in the low 20% range, and I think that you would imagine what you would expect that we would have a similar kind of impact with volume recovering.

But you always have to consider the mix in the timing and projects, how that volume comes back. Obviously, services and parts, and modernizations really are – and digital and electronics tend to be positive mix. Some of the OE elements of this can be below the company average.

Ultimately, what we're focused on is that – as we talked about earlier in the call, is that we're achieving synergies, driving lean initiatives, productivity gains, and all the normal continuous improvement type activity that Wabtec is always focused on.

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

A

We're committed to improve margins across Wabtec, and that includes on both segments for this year. And that's really what we're driving forward going into next year as well.

Saree Boroditsky
Analyst, Jefferies LLC

Q

Okay. But just given that service, parts and mods, and digital are all positive to the margin mix and you have synergies, is it fair to say that you should be able to reach 2019 margins on a lower revenue base?

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

A

I think at this point it's – to give that kind of guidance and when we would get to back to 2019 margins is a little early. But where we see – we're committed to that driving that margin up. I think that it's early in 2021, and we see a lot of really good things happening with the volume recovery, and I think we've considered that in the guidance for the year.

Saree Boroditsky
Analyst, Jefferies LLC

Q

Okay. Thanks for taking my questions.

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

A

Thank you.

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

A

Thanks.

Operator: This concludes the question and answer session. Now, I'd like to turn the conference back over to Ms. Kristine Kubacki. Please go ahead.

Kristine Kubacki

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

Thank you, Nick. Thank you for everyone's participation today. We look forward to speaking with you next quarter. Everyone have a great day.

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