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# Westinghouse Air Brake Technologies Corp. (WAB)

## Q3 2020 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, and welcome to Wabtec Quarterly Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to 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 Third Quarter 2020 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 the Investor Relations tab on wabteccorp.com. Some statements we're making are forward-looking and based on the 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 presentations. We will also discuss non-GAAP financial metrics and encourage you to read our disclosures and reconciliation tables carefully as you consider these metrics.

And now I will turn the call over to 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. I hope you and your families remain healthy and safe.

Turning to slide 3, while we continue to see the impact of COVID globally, a gradual recovery across the global freight and transit rail markets is continuing. North America freight volumes and equipment utilization sequentially improved in the third quarter, and transit ridership is also slowly resuming. These directional trends, along with the focused performance of our teams, are reflected in our third quarter results.

Total sales for the quarter were $1.9 billion, driven largely by international freight markets and a recovery in transit, but offset by global disruption due to the COVID pandemic. Total adjusted operating income was $293 million, impacted primarily by the drop in Freight sales, but somewhat offset by a more than 20% increase in Transit segment income.

Adjusted operating margin was 15.7%, driven by cost actions and execution on our synergies as well as margin improvement in Transit, which was up 270 basis points for the quarter due to synergies, improved productivity and better project execution.

In third quarter, we had a solid cash conversion, with cash flow from operations of $230 million, driven by good working capital management. This allowed us to further strengthen the balance sheet by reducing debt by over

$200 million in the quarter. Our liquidity position remained strong at $1.9 billion. Total multiyear backlog was over $21 billion despite current market conditions.

Finally, we ended up the quarter with adjusted EPS of $0.95, further reinforcing that our teams are continuing to take the necessary steps to control what we can, protect the long-term growth of the company and deliver shareholder value.

In the area of synergies, we are accelerating our progress and we are on track to deliver $150 million of net synergies in 2020 as well as deliver on the full run rate of $250 million in synergies before the end of 2022.

To achieve these goals, we continue to take actions on structural costs. And in the third quarter, we further reduced head count by another 3%, taking our total reductions to roughly 13% year-over-year. We also have reduced our operational footprint year-over-year, and we are actively driving cost reductions through lean initiatives. To date, we have exited of 75% of the shared services from GE Transportation merger ahead of the schedule and we are on track to exit over 90% of these activities by year-end.

Overall, our team delivered a strong quarter in a challenging and dynamic environment and won several orders, including a significant deal with New York City Transit to extend battery technology to passenger transit and drive down emissions. This is a key win that directly aligns with our own sustainability strategy, as we outlined in our 2020 Sustainability Report issued earlier this week.

We also closed a $160 million multi-year mining order for [ph] advanced drive (05:39) systems, our single largest mining order to date. In digital electronics, we won our first order with the Class I railroads for our advanced Trip Optimizer Zero-to-Zero solution. This deal will reduce emissions and will drive increased fuel savings, and is another significant step towards autonomous rail.

Finally, we had a solid quarter in Transit, winning new brakes, doors and HVAC contracts in Australia, Germany, France and the UK, as well as our first order for the metro industry's most advanced braking system, the Metroflexx, in Asia.

Looking ahead, the rail transportation market continues to recover from trough levels in the second quarter. We are encouraged by the evidence of a recovery, as noted by the ongoing improvement in our international freight markets, the sequential improvement in North America rail volumes and increasing global transit activity.

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

## Patrick David Dugan

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

Thanks, Rafael, and good morning, everyone. Turning to slide 4, sales for the third quarter were $1.9 billion, which reflects a 7% decrease versus the prior year. The decline in year-over-year sales was mainly due to the ongoing disruption across our Freight and Transit segments caused by COVID-19. For the quarter, operating income was $207 million and adjusted operating income was $293 million, which was down 12% year-over-year, mainly driven by lower sales and disruption in our operations as a result of the pandemic, offset somewhat by variable cost actions and the continued realization of synergies.

In the third quarter, adjusted operating income excluded pre-tax expenses of $87 million, of which $70 million was for non-cash amortization and $16 million of restructuring and transaction costs. Please see Appendix D in our press release for the reconciliation of these details.

Now looking at some of the detailed line items. Adjusted SG&A declined 4% year-over-year to $241 million, which is excluding $12 million of the restructuring and transaction expenses I just discussed. SG&A expense benefited from structural cost actions across the business and the realization of synergies. As expected, we did see a resumption of certain discretionary and compensation expenses that we eliminated during the depths of the pandemic. For the full year, we expect adjusted SG&A to be around $900 million.

Engineering expenses decreased to $37 million, or down 38% from last year. This was largely due to the lower volume outlook as well as some changes in project timing. Amortization expenses were $70 million. For 2020, we expect non-cash amortization expense to be about $285 million, and depreciation expense to be about $180 million.

In the third quarter, we had GAAP earnings per diluted share of $0.67 and adjusted earnings per diluted share of $0.95. The details which bridge GAAP earnings per share to adjusted earnings per share of $0.95 can be found attached to our press release.

As of September 30, our multi-year backlog was $21.4 billion. Backlog is about flat quarter-over-quarter. Our rolling 12-month backlog, which is a subset of the multi-year backlog, was $5.2 billion and continues to provide good visibility across both Freight and Transit segments.

Now let's take a look at the segment results on slide 5. Across the Freight segment, total sales decreased 7% to $1.2 billion in the third quarter. In terms of product lines, equipment sales were up 35% year-over-year as a result of higher locomotive deliveries, which, as we have discussed, can often vary quarter-to-quarter due to timing. In the fourth quarter, we expect locomotive deliveries to be slightly higher when compared to the third quarter, but down versus last year.

In line with improving Freight traffic from the second quarter, our services sales improved sequentially, but were down 19% from a seasonally strong period last year. This was largely driven by lower part sales due to continued record high locomotive parkings as well as the timing of mods, deliveries and overhauls. We expect our part sales to continue to improve with the gradual recovery in Freight volumes and unparking of locomotives.

Digital electronics sales were down 13% year-over-year as orders shift to the right in North America due to COVID disruption. Overall, we continue to see a significant pipeline of opportunities in our digital electronics product line, providing productivity and improved safety for our customers.

Component sales were down 16% year-over-year on a 45% lower railcar build versus the prior year, demonstrating the diversification within our components business. Since September, we have seen early signs of improvement in demand for aftermarket railcar components as more railcars are beginning to come out of storage.

Despite the top line headwinds and higher mix of OE locomotives during the quarter, our execution on synergies continued to drive positive impact as reflected in our segment adjusted operating income of $234 million and adjusted margin of 18.9%. Finally, segment backlog was $17.8 billion, down just slightly from the prior quarter.

Turning to slide 6. Across our Transit segment, sales decreased 6% year-over-year to $628 million, driven largely by disruptions stemming from the COVID-19. OE sales were down 2% year-over-year. It's important to note that this is a strong improvement from the second quarter due in large part to improving transit ridership and service levels around the globe. Aftermarket sales were down 10% from last year. We remain positive on the aftermarket and expect sales to continue to improve as transit services increase globally.

Adjusted segment operating income was $75 million, which was up 21% year-over-year for an adjusted operating margin of 12%. Across the segment, we continued to drive down cost and improved project execution, as noted by our strong operating performance. While early days, we are pleased with the momentum underway and will continue to execute on more actions to drive increased profitability for the segment. Finally, Transit segment backlog was $3.5 billion, which was up slightly versus last quarter.

Now let's turn to our financial position on slide 7. Cash flow generation during the quarter was strong at $230 million, driven largely by working capital management, including improved inventory levels and higher customer deposits. I'd also note that there was no material change from the AR securitization in the quarter. We had about $15 million of onetime impacts on cash flow during the quarter and about $170 million for the full year, mainly due to prior year restructuring, transaction and litigation charges.

Throughout the quarter, we continued to strengthen our financial position and reduced net debt by approximately $460 million since the same quarter a year ago. Our adjusted leverage ratio at the end of the third quarter was 2.6 times, down slightly from the last quarter. And our liquidity is still robust at $1.9 billion.

In summary, our balance sheet is strong, and we are confident we can drive solid cash flow generation, giving us the liquidity and flexibility to execute our strategic plans.

With that, let's move to slide 8, and I will turn the call back over to Rafael.

## Rafael O. Santana

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

Thanks, Pat. Looking ahead, we are seeing a gradual recovery across most freight and transit end markets as global economic activity and commuter travel improves. In North America, rail volumes increased dramatically from the second quarter due to a broad recovery in agricultural, intermodal, metals and automotive volumes.

Locomotive parkings after peaking to a record high in the second quarter have improved but are still more than 20% higher than pre-COVID levels. As railroads enter into recovery and we accelerate technology improvements, we expect demand for reliability and productivity to be even greater, putting us in a position of strength for modernizations, overhauls and parts demand.

In terms of North America railcar builds, railcars are slowly moving out of storage. However, more than 25% of the North American railcar fleet still remains in storage. Builders are taking [ph] continued step (15:43) to slow production lines. The industry forecast currently indicates that railcar build for 2020 will be less than 30,000 cars.

Internationally, where economies have started to open, we continue to see encouraging signs. In Brazil, demand remained steady with greater dependency on agriculture products following a record harvest. In Australia, rail activity has shown good momentum, following the COVID lockdown. In Kazakhstan, year-to-date, car volumes are up, driven by growth in volumes from China. And in India, after long lockdowns, activity has recently improved with the gradual reopening of the region.

Overall, we have a strong order pipeline internationally in places like Brazil, Russia, CIS, Africa and Australia. And we expect revenue growth in several of these markets throughout 2021.

In mining, end markets remain stable and we remain optimistic that the mining market conditions are improving. Transitioning to the transit sector, ridership is continuing to recover from the historic lows, particularly in Europe and Asia, and in line with an operational recovery in transit globally.

Looking forward, the long-term market drivers for the passenger transport remains strong. Infrastructure spending and support for green initiatives continues to be a focus, especially as governments globally look to rail for clean, safe and efficient transport.

Turning to guidance for the year. We are updating our sales guidance to $7.5 billion to $7.6 billion, which is the higher end of our previous range. And we are updating adjusted EPS guidance to the range of $3.75 to $3.85, due largely to our operational execution to date, ongoing actions to align variable and fixed cost to the volume realities we face, and visibility to our backlog. Finally, we remain confident in delivering strong cash generation for the year.

Turning to slide 9, and to conclude, I'm proud of the strong execution by the team in the third quarter despite a challenging environment. Our team remains vigilant on monitoring COVID-19 globally and is laser-focused on keeping our employees safe, while executing through today's volatile environment to deliver for our customers.

As we go forward, we remain committed to executing on our strategic plan, reducing costs, aggressively managing cash, delivering on our synergy targets and focusing on what we can control. We will continue to lean into the strong long-term fundamentals of this company and invest in technologies that advanced our competitive advantage, help us successfully manage today's market headwinds over the long term and emerge as a more resilient company.

Before I turn the call over to questions, I want to personally thank each and every member of the Wabtec team for all that they are doing. This year has been a significant stress test for our organization, as we have navigated a complex integration, an industrial recession, a market reset in addition to the pandemic. Yet despite all these headwinds, we are performing well and we have continued to deliver, as demonstrated by our synergy execution, strong cash flow and overall performance.

Looking ahead, we are encouraged by the constructive trends we are seeing across the global transit and freight market. Demand should continue to improve sequentially across most of the portfolio. Recovery will remain somewhat mixed, but our business is uniquely positioned to drive long-term profitable growth.

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

## Kristine Kubacki

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

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

# QUESTION AND ANSWER SECTION

**Operator**: [Operator Instructions] Your first question comes from Allison Poliniak from Wells Fargo. Please go ahead.

**Allison Poliniak**
*Analyst, Wells Fargo Securities, LLC*
Q

Good morning.

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

Good morning, Allison.

**Allison Poliniak**
*Analyst, Wells Fargo Securities, LLC*
Q

Could we talk to Transit a little bit? I think the performance in that segment was quite a bit more resilient than folks, including myself, would have thought. Is there a way to – just given the backdrop of COVID, it sounds like Europe and Asia are starting to recover quite a bit faster. Is there a way to kind of quantify the headwind that you're seeing from North America? And then just how do you think the segment evolves in terms of the future just with COVID and the concern folks will never get back on a commuter rail again?

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

Let me start first with the following. I mean, we're working, of course, very closely with our customers. I think while transit authorities around the globe, they're seeing operating budget constraints, I think there is really a strong support in terms of government stimulus for them to navigate through this.

At this point, we haven't seen any project cancellations. We're continuing to work with customers. And I think the dynamics at this point, I mean, they remain positive. I think there's still going to be volatility in terms of all – some of the measures that you see, being – taking place in places like Europe. But we don't feel that that's going to go back to, what I'll call, the worst trough levels of COVID. So overall, positive trends.

Well, a couple other comments here. If you think about Transit, I think it's been slower in the US versus other markets. I call out that the US market represents only 15% of what we do in the Transit market. So I think that's also not an important element.

And with that, I think I'm really proud to see how the team has embraced change. They are driving improvement. We see that coming into our orders backlog, I think I've said it before, and the trend continues. Our backlog today has got margins that are 100% at least higher than they were a year ago. We see improved execution. And I think we're moving in the right direction with that business. So we're committed to continue to improve margins over time.

**Allison Poliniak**
*Analyst, Wells Fargo Securities, LLC*
Q

Great. And then just a question on margins within Freight, if I recall, the equipment margins were a little bit – could be a little bit lower just in terms of the mix. Can you help quantify, if there's a way to do that, sort of, the mix impact from sort of the product dynamics in the quarter within Freight, in terms of could it – would it have been better, I guess, if the equipment weren't so strong?

**Rafael O. Santana** A

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

You got it. So I mean margins were primarily impacted by mix. And Allison, I mean just very straightforward, right? So when I've got equipment growing at 35% in the quarter and, at the same time, I've got services, which is a much larger business with digital electronics, I mean services was down 19%, with digital electronics at 13%, that's really what drove that. I mean, we can have those variation just based on mix. I just – we remain focused on improving margins. I think we're taking a lot of the right actions in different areas. We're delivering on synergies. We've been taking action on SG&A and indirect costs and we're going to continue to move in that direction.

**Allison Poliniak** Q

*Analyst, Wells Fargo Securities, LLC*

Great. Thanks. I'll pass it along.

**Operator**: Thank you. Your next question comes from Justin Long from Stephens. Please go ahead.

**Justin Long** Q

*Analyst, Stephens, Inc.*

Thanks and good morning.

**Rafael O. Santana** A

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

Good morning.

**Justin Long** Q

*Analyst, Stephens, Inc.*

So I wanted to start with the question on the North American freight aftermarket business. I'm curious how that trended sequentially in the third quarter and your expectations going forward. And maybe within that business, it would be helpful to hear about the cadence of mods, 2Q to 3Q, and maybe even 3Q to 4Q as well, just because I know that can move things around a good bit.

**Rafael O. Santana** A

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

Okay. So, let me take a step back first to the second quarter on services, because I think it's important just to understand. I mean think of carloads in the second quarter were down close to 20%. We saw on the other side, our revenues came down about 9%. Now when you come into the third quarter – so there's clearly a lag there, when you come into the third quarter, while carloads were down, I think 7.5%, we've seen, I'll call, improvement about 1%.

Here's some things to keep in mind, right? I think there is naturally a lag there. What I'll tell you, what we're seeing from a services perspective, there's clearly a pickup in terms of, I'll call it, recovery. It started first in our international markets. And we saw fleets getting [ph] on (26:08) parts. And I think we're seeing volumes continue to move in the right direction. There was a lag into North America but we've also seen that improving as things continue to move forward. It's a shorter cycle business but the trends that I look at right now, Justin, they're positive for the services business.

And you asked specifically on mods. I think there's pent-up demand being created in terms of fleets that didn't run, so overhauls that have pushed to the right, potential investments in the fleets that have not been done in the course of the last couple years that have also pushed to the right, and that pent-up demand is going to come. So we do expect growth in mods moving forward.

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

Okay.

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

I'll stay away from providing you any specifics in quarter-over-quarter because we can have variation on that, but I think positive dynamics there in the services business.

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

Okay. Thanks. And secondly, I wanted to ask about your thoughts on buybacks, just given where the valuation metrics for the stock are today. And as you think about closing that valuation gap to the market and peers, were there any major takeaways from the investor perception study that you recently completed? Just curious if there are any actions you're planning to take after completing that exercise.

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

So let me start with the last part. Yes, we have done that study, really great turn out. So I think the amount of feedback was great, very specific, very candor answers. So we're continuing to work on that.

With that, a couple things in mind. Number one, I think there is an element of providing, I'll call, a little more details in terms of some of our segments, which we're going to work with you to make sure that we're looking to those as we go into next year.

On capital allocation, what I'd like to tell you is, number one, we are committed to drive organic growth and continue the R&D investments that really drive differentiation and innovation for our customers. That's top of mind. And of course, we're looking reprioritizing, and as we look at current environment, very committed there.

We're also confident about our ability to drive cash and to reduce debt. Just think about just last 12 months, we have paid down $490 million of debt. And at the same time, we were driving over $190 million of both stock buybacks and dividends. Right now, and as I look at it, our current stock price presents significant opportunity to return value to shareholders. We currently have a share repurchase authorization for $400 million, and we are intensifying buybacks. That's a focus now.

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

Great, very helpful. I appreciate the time.

 

**Operator**: Thank you. Your next question is from Chris Wetherbee from Citigroup. Please go ahead.

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

Thanks, good morning, guys.

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

Morning.

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

Good morning, Chris.

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

I was wondering about sort of the resource – the return of resources in the Freight segment as we see volumes continue to improve in 4Q and potentially first half of next year and beyond. Specifically on the head count side, what are the learnings that you've had from sort of this downturn, is there the ability to hold off on bringing folks back to try to drive maybe stronger sequential incremental margins than what we saw just initially here in the third quarter?

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

The answer is yes. Number one, I think if you look at our head count numbers, we reduced 3% quarter-over-quarter, 13% versus a year ago. I think there's a lot of learnings that came from just the COVID period. I mean, we've looked at different areas. And I got to tell you, I mean there is an opportunity here to win even more productivity for certain areas of the company if you work remotely. There's some other ones that that's not the case. But we do see the opportunity to drive, I'll call, increased leverage and we will be growing margins as a result of volume growth ahead.

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

Okay. Okay. That's helpful. And then maybe a bigger picture question on sort of synergies. So, I think you talked about achieving full run rate out – sometime during 2022. Can you talk about some of the sort of puts and takes that might influence that timing a little bit? Sort of maybe forgetting about sort of the macro to some degree with what's in your control, are there any potential drivers that could maybe pull that forward a little bit? What could they be and sort of what's the risk of kind of pushing that out a little bit?

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

I'll tell you what's pushing that out a little bit right now and it's just a function of volume. But with the guidance of what we provided of the $150 million for the year, we're committed to that, and we're going to deliver on that. We're tracking to that. We have not broken down that on the quarter, but we're tracking to be north of $150 million for the year. And we will deliver the $250 million before end of next year, so moving in that direction. What I'll say is, of course, volume conditions improve, it can only help us there.

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

Okay. Got it. Thanks for the time. I appreciate it.

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

Thank you.

**Operator**: Thank you. Your next question is from Rob Wertheimer from Melius Research. Please go ahead.

**Rob Wertheimer** Q
*Analyst, Melius Research LLC*

Hi and good morning everybody.

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

Good morning.

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

Morning, Rob.

**Rob Wertheimer** Q
*Analyst, Melius Research LLC*

So my question is just on Transit. You had another quarter of good progress on margin. And I wonder if you would just give a general update on what sort of workflows are left to come. I mean you've rolled off some of the unprofitable business. Could you just give us an update on your strategy for continued improvement there? Thanks.

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

Yeah. I'd say this is ongoing work, right? You have a backlog that you've got to work through. I think the comments I'll make is, I think for more than a year now we have been really disciplined about the quality of that backlog and the orders we take, and so the specific terms and conditions that come with those orders. And that's where I say that we've got over 100 base points of margin improvement on that backlog. So it's a continuation. I think execution is a lot better. I think we've got improvement in terms of on-time delivery. The team has really embraced the principles of lean across our operations.

We're going through a significant exercise on making sure that we've got, what I'll call a more – just a more efficient footprint. I mean, I – without mentioning the business here, I run sometimes into businesses where you have eight locations, different groups of engineers in each one of those locations, designing things to, a lot of times, different spec, sometimes to support like similar customers. We have the opportunity here to have, what I call, centers of excellence when it comes down to engineering.

We have some of those established in places like India. So we have the opportunity to significantly reduce cost. In reality, I really don't need those eight sites. I can do that with maybe four or five. And I think that's something we are going to continue to pursue. We're being very disciplined about it. But we're going to continue to drive margins up. So we're committed to the framework that we've highlighted before, which is over 100 basis points in average per year. I think we see the opportunity to do better this year. And we're not going to be pushing for anything less than another 100 basis points next year.

**Rob Wertheimer** Q
*Analyst, Melius Research LLC*

That's very helpful. Thank you. I'm sorry for the clarification but how much is left of [ph] unfavorable (34:36) contracts and backlog that will flow through your positive margin at this point? Thank you.

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

I think the one contract that we've been more open about it was the UK project, that runs out fundamentally by the end of this year. So there's very minimal left. I think for the first quarter of next year. But with that – I mean there's a backlog of contracts that we'll continue to work. I think the importance is we're committed to drive margin improvement with all the levers we have. But Pat, I don't know if you want to comment on it.

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

No, I just think that it's worth mentioning that we're still a run rate of about $25 million of revenue each quarter. It's flat year-over-year and quarter-over-quarter, and it's at a margin that's right around breakeven. So there's no kind of element of that that has made this margin better than in other quarters. This is really – the margin improvement has come from the things that Rafael talked about, cost actions, efficiencies, synergies, all those items and things that we outlined earlier and are executing on now.

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

So the head count reductions...

**Rob Wertheimer** Q
*Analyst, Melius Research LLC*

Thank you.

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

...are really cutting across the business. I mean this is not in one specific area.

**Rob Wertheimer** Q
*Analyst, Melius Research LLC*

Thanks, Rafael. Thank, Pat.

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

Thank you.

**Operator**: Thank you. Your next question is from Courtney Yakavonis from Morgan Stanley. Please go ahead.

**Courtney Yakavonis**
*Analyst, Morgan Stanley & Co. LLC*

Q

Hi. Thanks for the question. If you can just maybe comment high level at your thoughts for Freight in 2021. I think the cadence of OE versus your services and your digital business went a little bit differently than we would have expected this quarter, but it sounds like there's some pent-up demand and you're expecting growth in mods going forward.

You talked about orders shifting to the right in digital electronics. So do you think that there's pent-up demand there? And then you had obviously mentioned a mining service – or a mining contract or a multiyear order, is that going to start to flow through next year and kind of help us think about how locos are shaping up? Thanks.

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

A

So let me give you a sense of our end markets. Of course, I'm not going to get into the elements here of giving guidance into 2021. But the way I look at our end markets, let me just start with maybe the Transit piece of it. I think we're continuing to see positive signs of recovery. If you look at our backlog right now, it's larger than it was a year ago. And I think we're continuing to see good trends there.

The second piece would probably come down to really, I'll call, the Freight side. I think we're positive on services. As I mentioned before, I think we're seeing the pickup on services from the trough levels in the second quarter. Start first in the international markets, then we saw that – a little bit of a lag then it came into North America, and I think we see positive trends there. I think there's, of course – there is a shorter nature of the cycle of that business so things tend to pick up faster.

Now when you go into the equipment side, I think we're kind of seeing similar dynamics, meaning if you think about the pipeline of opportunities that we were working versus six months ago, we see significant improvement. It started once again in the international markets. I think there is positive signs on some of these pipeline actually converting into the fourth quarter, which means, even at a possibility, and specifically in one of these markets to already deliver – so being revenues into 2021. But we're going to see that taking, I'll call, a broader impact across international markets.

I think, ultimately, you're going to see that happening in North America, but there's, of course, a lag there. And when you look at our equipment business, there's an element of, I'll call, longer cycle into that perspective. But as you highlighted, I think there's pent-up demand in terms of just digitalization that didn't happen of fleets during this year, and that has pushed out many elements of maintenance to the right. So there's pent-up demand in that regard.

With that being said, there's, of course, a lot of volatility still. We're working hard. There's a lot of focus in working very closely with our customers because I think we can provide them significant opportunities here to accelerate some of this, I'll call, investment in the fleet. Keep in mind, I think there's been an underinvestment in the fleets and the fleet is aging. And the good news is we are accelerating a lot of the investments we've done in terms of technology to improve, I'll call, efficiency in those fleets.

So if you think about those mods and those overhauls, I expect to be able to deliver to the customer increased fuel efficiency. I expect to increase reliability on those fleets. And with our digital electronics portfolio, we do expect to have an opportunity there to also increase technology. We've just talked about an order we got on Zero-to-Zero with a Class I in North America. That's another building block towards automation. The significance of that, that opens up really room for me to introduce that into a lot of Class Is. Think of like products like Trip Optimizer, this is like something that builds on the top of that. So I think we've got some good dynamics here to work from.

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**Courtney Yakavonis**
*Analyst, Morgan Stanley & Co. LLC*

Q

Thanks. And then, just on Freight margins for the fourth quarter. I think you've historically talked about a 20% to 25% decremental margin framework in Freight. Obviously, it was a little higher this quarter given the mix. But would you expect it, given that you're expecting OE to be down year-over-year in the fourth quarter, to go back to that framework or potentially be a little bit better as the mix improves?

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

A

So again, staying away from commenting on mix and specifics on the quarter. What I'll say is we're confident with the guidance we've provided and we're committed to hit that guidance. And with that, I think there's also an element of cash flows. And I think we're seeing all of our teams working through that. There's, of course, headwinds into the quarter but we feel strong about the guidance we're providing at this point.

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**Courtney Yakavonis**
*Analyst, Morgan Stanley & Co. LLC*

Q

Thank you.

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**Operator**: Thank you. Your next question comes from Jerry Revich from Goldman Sachs. Please go ahead.

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**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC*

Q

Yes, hi. Good morning, everyone.

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

A

Good monring.

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

A

Good monring.

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**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC*

Q

Rafael, I was pleasantly surprised by the booking strength in Freight, really strong book-to-bill even as you had really strong deliveries in the quarter. Can you just expand on your prepared remarks in terms of where you're seeing pockets of strength from orders? And I think you alluded to building international locomotive project pipeline as well. Would you mind just expanding on those two areas, please?

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

So, when I talk about the pipeline of opportunities and the option to convert those into orders, I think we're seeing some positive signs in places like Latin America. And we have the opportunity here to convert some of these orders already in the fourth quarter. The team feels strong about it. We're seeing similar trends in places like Kazakhstan. And – well, there's picked up the activity in some other markets, which I'd rather not open up at this point. I mean, we're certainly – we face strong competition wherever we go, and we want to make sure that we continue to progress in that direction.

**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC* Q

Okay. Thank you. And the bookings in the quarter, can you just expand on what drove such a strong bookings quarter in a really tough environment?

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

I think a piece of it was the order that we announced on New York City Transit. That was certainly a significant element of that. It's a big opportunity for us here to continue to expand on the, I'll call, electrification of our market. So, this battery-electric locomotive, we see this as a great solution for our customers. There has been a great degree of interest. And we're moving into, what I'll call, the Phase 2 of that with a couple different customers. So we expect that to continue. [indiscernible] (44:08)

**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC* Q

And...

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

And the other piece I will mention to you is mining. I think mining has demonstrated resilience. And even as we go forward here, I think there's really an element of resilience, especially, when you look at iron ore, copper and some specific commodities. So that's also another resilient part of the business.

**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC* Q

Okay. Thank you. And can you talk about how the productivity ramp has gone on the facilities in India, in particular? Are you getting the productivity that you were targeting?

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

So two things. There has been significant improvement in productivity and in efficiency. I look at the last two years, which significantly improved the product – the profitability of the contracts that we are executing. So it's a positive there.

When you talk about the last quarter, I mean, it's, of course, it's been very disruptive. I mean between COVID hit, between monsoon season, I can't say things have been necessarily easy, but I think the team is continuing to progress. We have delivered more than 130 locomotives at this point. And I'd say the team is very much committed to deliver the minimum 100 locomotives per year. So we feel positive about the dynamics, but very tough dynamics in the course of the last 90-plus days.

**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. Appreciate the discussion. Thanks.

**Operator**: Thank you. Your next question is from Scott Group from Wolfe Research. Please go ahead.

**Scott H. Group**
*Analyst, Wolfe Research LLC*

Q

Hey, thanks. Morning guys.

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

A

Good morning, Scott.

**Scott H. Group**
*Analyst, Wolfe Research LLC*

Q

Rafael, can you just talk, directionally, how you see the loco and railcar markets for next year, directionally, just sort of up or down or flattish? And then I'm wondering, can you talk at all about some of the things you're doing with electric or alternative locos on the Freight side?

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

A

Yes. So a couple things. I mean on the freight cars side, I think you all look at the same, I'll call, reports we do. I think for this year, the number for freight cars is probably around 30,000. As you look into next year, there is an expectation for that to drop down to potentially mid-20s. I guess the question here is there's potentially some stimulus incentive that could improve those numbers. But right now – and I'll be thinking about numbers around 25,000 to 30,000 depending on how that plays out.

When I think about locomotives, I think you got to break out the elements of North America and international. I think international, we continue to see a robust pipeline and good opportunities here for us. I think North America, as I had mentioned, there's a lag here, so – and keep in mind, the longer cycle nature of these orders in order to be fulfilled. So those are, maybe, I think – hopefully, that answers part of your question. I think mining, which is another element here, I think we see mining resilience at this point.

On electrification, which you asked about it, we see the opportunity here to enter into some areas of electrification with differentiation, which would mean driving value for both our customers and for ourselves. I'll talk to you more about it in the first quarter of next year, but that's an exciting area that will also help us, I think, accelerate growth in the business.

So I think there's an element of pent-up demand that I talked to you about it. There's an element of, for me, accelerating technology into our fleets, which will ultimately accelerate just the investments. So you have more reliable and more efficient fleets. And there's an element here of stepping into new areas. So we're really working hard to build on the right set of dynamics to drive growth. And on mods, we do see positive trends going to next year.

**Scott H. Group**
*Analyst, Wolfe Research LLC*

Q

Okay. Helpful. And then just lastly, one of the opportunities with the GE deal was, I think, improving the content per loco on the legacy Wabtec side. Can you just give us an update on where we stand on that front? Are we seeing that yet? Is that still on the come? Any thoughts there? Thank you.

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

A

I think we've seen a little bit, but it's – I mean in the scheme of things, I could call it immaterial. I think what's been important is we see an element of – the opportunity is real. It takes sometimes a little bit longer just in terms of, well, customers wanting to test it before they fully adopt it. But we're doing that across the board.

I think broader than that, we've seen the fact that we're so penetrated in so many different regions. We see now [ph] teams pooling of (49:38) different products that before we couldn't even think about selling. I mean we're selling – our heat exchanger business here in the US would have never been able to reach the kind of businesses we're getting on in Russia. We just signed about a $5 million deal. While it's small, it just gives you the sense of how we can really take these products into a broader sense.

We're educating our teams through it. I think there is a sense of really having a broader product portfolio that we can win share out there. And the fact that we're improving now profitability in Transit, it also allows us to be a lot more aggressive on going after market share in some areas and drive profitable growth, so just a stronger team together.

**Scott H. Group**
*Analyst, Wolfe Research LLC*

Q

Okay. Thank you, guys.

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

A

Okay.

**Operator**: Thank you. Your next question comes from Matt Elkott from Cowen. Please go ahead.

**Matt Elkott**
*Analyst, Cowen & Co. LLC*

Q

Good morning. Thank you. Rafael. I think you highlighted some pockets of revenue growth opportunities for next year. But did you say if you guys expect to grow revenue – total revenue next year?

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

A

Okay. So a couple things. We're not giving guidance into next year. I think what I provided was just a perspective on how do I see the recovery taking place. I think there's an element of our business, which is tied to services, which is shorter cycle, and we're seeing the recovery there. So with shorter cycle, you're able to deliver, most of the time, in what I'll call, less than six months. Right? There's an element of equipment, which is longer cycle. And I'll say, a lot of cases, you're looking at deliveries above 12 months.

And I think the signs we're seeing is of order recovery. We started to see that, as I described to you, with the pipeline. That started first internationally and we do expect some of those conversions to already start here in the fourth quarter, but North America has been lagging behind.

**Matt Elkott**
*Analyst, Cowen & Co. LLC*
Q

Got it. That's helpful. And then, maybe switching over to the Transit side. Does this – I mean the New York City Transit hybrid locomotive order is very encouraging. But can you help us understand how this is happening at a time when – if this is with, actually, the MTA, I mean, I think they're expecting a deficit of $16 billion through 2024, if there is not a federal emergency funding. So is this order basically contingent upon a blue wave scenario next week?

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

Well, a couple things. Number one, we're not going to comment on any specific customers and customer orders or transactions. But I'd say transit authorities around the globe, they're really seeing operating budget constraints. We haven't seen, as I told you before, project cancellations at this point. I think there's a significant opportunity for those transit authorities to also drive, what I'll call, a shift to green. And we're seeing significant investments on that, and that helps a lot of these elements. So that's maybe where I'll finish.

**Matt Elkott**
*Analyst, Cowen & Co. LLC*
Q

Got it. And you did mention that you're having more of these conversations with different customers around the world, about the trends in hybrid locomotive?

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

I think there's a huge interest on it. There's clearly an opportunity to already apply some of these in some specific routes. So we've got – well, we're going to start a pilot here very soon in California. And we've started some of the elements of, what I'll call, the next phase and I think there's some real interest.

I mean if you think about the elements of fuel efficiency that could be gained from this significantly. And due to all the dynamics you see in the automotive industry, we're seeing really a significant progress, in terms of just the power density on those batteries, life continues to improve and cost continues to come down. And that's really, I think, accelerating some of the opportunity here that we see.

**Matt Elkott**
*Analyst, Cowen & Co. LLC*
Q

Okay. And then you mentioned California, which kind of reminded me of something that's probably much, much longer term and it's probably contingent on more aggressive energy policies. But I think California, a few years ago, we're talking about Tier 5 locomotive, this is on Freight side. Do you think if we have a more aggressive push to implement green policies in the US, do you think we could start talking about the next-generation of locomotives sometime in the next five years?

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

Well, a couple comments there. Number one, let's just talk about from Tier 4, right, and how much has been adopted and how much has become a significant part of the installed base. And I think – I mean, if I look at it, I think still under – it's maybe 1,200 units of Tier 4 installed. And if you consider the installed base, I mean it's minimum, at this point. So, before we jump into the next wave, I think it's important to look at what is available out there and make sure that I think, ultimately, taking advantage of the products that have been developed.

Now when it comes down to Tier 5, I think battery-electric, as I described to you, can really potentially drive, I think, even more benefits than simply thinking about like whatever Tier 5 would mean. So we're talking here 15% to 30-plus percent reduction on fuel on routes. And that's like massive, right? That's probably not been obtained through any of the other programs that have been done in the past. So that's why we look at battery-electric as really a leap forward.

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**Matt Elkott**
*Analyst, Cowen & Co. LLC*
Q

Great. Thank you very much.

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

Thank you.

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**Operator**: Thank you. Your next question is from Saree Boroditsky from Jefferies. Please go ahead. Saree, your line is now live. Please go ahead.

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**Saree Boroditsky**
*Analyst, Jefferies LLC*
Q

Hi. Sorry, I was on mute. Could you just talk about the margin profile on international locomotives? And as you target international locomotive growth, would you expect to see any margin headwinds? And then for my follow-up question, could you just provide the impact on the contract adjustment on Freight margins in the quarter? And how should we think about that impact going into 2021, as the Egypt contract rolls off? Thank you.

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

Okay. Saree, yeah. So in the quarter, the impact of that below market intangibles of $12.5 million, so lower than previous quarters. And we expect for the full year that, as we've talked and with – is that it's about flat year-over-year. And then from a profile standpoint, we definitely see that coming down. The specific accounting that you're referring to is those locomotive units will have been falling off, and we'll see the number decline into next year.

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

Well, let me be very specific. As we go into next year, we're going to see that number to be less than [ph] 50 (58:09), and it's going to be limited to the India contracts. So I just want to remove any sense that there is, I'm going to call, a lack of profitability associated with international contracts.

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**Saree Boroditsky**
*Analyst, Jefferies LLC*

Q

Thank you. And just could you – I mean could you provide any color on what is the margin profile in international locomotives and maybe how the India contract differs from the contracts that you're looking to gain going forward?

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

A

So yeah, Saree. So the margin on international projects for locomotives is good. It's obviously higher. The specific accounting item that you're asking about was just really related to two new markets, new markets where costs were incurred and it's part of localization of initial engineering, that's nonrecurring, and very typical with brand new product development and business development opportunities.

But on a go-forward basis, we have pockets of international projects where the profitability level is really good. It can be higher than average. It can be – it's not really appropriate to kind of look at it as international projects are less profitable in locomotives than kind of the average. It's just – it really comes down to how long we've been established and have been operating in those locations.

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

A

Let me give you more color here. When you look at countries that we've had, I'll call, established presence that's been mature with a product that's also been mature, good profitability. And I can speak of places like Brazil. I can speak of places like Kazakhstan, right? I can speak to places like Australia, of course, the US market.

Now and as you go into new markets, as Pat described, which was the case of India, investing on a brand new platform. So you're designing a product for the first time, you're investing in infrastructure, and that's where you'll see those be on the lower end side. Even in Africa, I mean we went through that in the beginning and I mean today is a mature market. We have established a mature presence there. 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

And these decisions to enter into these markets, really, it's because they're a strategic opportunity. And so you get yourself established, you have a long-lived contract with opportunity for lean activities and variable cost productivity improvements. And so when you get into – and the initial cost is behind you, you end up with add-on orders and additional units that really enjoy a good margin.

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

A

And ultimately, installed base, that it's going to be there for the next 30 years that you're going to be serving on the aftermarket side.

**Saree Boroditsky**
*Analyst, Jefferies LLC*

Q

I appreciate the color, guys. Thank you for clearing that up.

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

Thank you.

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

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**Ari Rosa**
*Analyst, Bank of America Merrill Lynch* Q

Hi, good morning. You've touched on the demand side quite a bit but I just wanted to see if we could dig into that a little bit more. Mentioning strength in Latin America, Kazakhstan, some other regions, maybe you could give us an indication of is that enough to support the backlog – or growth in the backlog? Or should we expect this kind of secular decline in the backlog until we see kind of a pickup in demand from North America? Maybe if you could just give us a little more color on the magnitude of the demand that you're seeing and where there are pockets of strength.

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

Yeah. So I'll just take your question being very focused on the locomotive side. I mean we are like at trough levels here on the locomotive side, right? And by the time you get pretty close to zero, I mean, I'd tend to think things go up, right? So the question for me here is more on the pacing. So it's more on the pace of recovery. And that's why I started with the elements of international, I think we see a robust pipeline versus what we saw six months ago and we're starting to see some good indications of potentially converting that. North America's lagging behind.

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**Ari Rosa**
*Analyst, Bank of America Merrill Lynch* Q

Okay. That's helpful. Makes sense. Can't go below zero, that's for sure.

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

Exactly.

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**Ari Rosa**
*Analyst, Bank of America Merrill Lynch* Q

And on the – just on the Transit side, maybe if you could give a little more color. You had mentioned that municipal budgets in transit authorities are seeing some pressure. Maybe if you could give some color on how that's changing the nature of the discussions with those organizations. Are they looking for more price concessions or that sort of thing? Just how do you see contracts kind of evolving in that space, given that budget pressure that they're facing?

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

So we had a meeting just two days ago with one of those authorities in Europe. And what I'll tell you right now is they're maintaining their budgets at this point. So of course, there is a lot of volatility, as he would have described it, in terms of what happens here on this wave two. But they're committed to keep the fleets running at this point. And they do not, at this point pin down to any project cancellation.

So I'm just trying to give you a perspective, one customer. And of course, we're working with various customers very closely. So I think something to continue to watch. I think the commitment to have trains running and operating, I think it's there. Could we have a risk that if this thing delays further that, at a certain point, there's delay in projects? I guess, that could be a possibility. I wouldn't be speculating at this time. So right now, I think the trends and even as you look into some of the, I'll call, industry reports, those point out to, I'll call, growth ahead. So I think we've got some good indications there at this point.

**Ari Rosa**
*Analyst, Bank of America Merrill Lynch*

Q

That's great color. Thanks for the time.

**Operator**: Thank you. That does conclude our question-and-answer session. I would like to turn the conference back over to Ms. Kubacki for any closing remarks.

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

Thank you, Rachel. And thank you, everyone, for participating today. We look forward to catching up with your next quarter. Thank you.

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