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MOD - Q1 2018 Modine Manufacturing Co Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Modine Manufacturing Company's First Quarter Fiscal 2018 Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, Ms. Kathy Powers, Vice President, Treasurer, Investor Relations and Tax. You may begin.

Kathleen T. Powers - *Modine Manufacturing Company - VP of IR & Tax and Treasurer*

Thank you. Thank you for joining us today for Modine's First Quarter Fiscal 2018 Earnings Call. With me today are Modine's President and CEO, Tom Burke; and Michael Lucareli, our Vice President of Finance and Chief Financial Officer. We'll be using slides with today's presentation. Those links are available through both the webcast link as well as the PDF file posted on the Investor Relations section of our company website, modine.com. Also, should you need to exit the call prior to its conclusion, a replay will be available through our website beginning approximately two hours after the call concludes. On slide 2 is an outline for today's call. Tom and Mick will provide comments on our first quarter results and review our revenue and earnings guidance for fiscal '18. At the end of the call, there will be a question-and-answer session. On Slide 3 is our notice regarding forward-looking statements. I want to remind you that this call may contain forward-looking statements as outlined in our earnings release as well as in our company's filings with the Securities and Exchange Commission. With that, it's my pleasure to turn the call over to Tom Burke.

Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Thank you, Kathy, and good morning, everyone. On today's call, I will discuss our first quarter results and provide an update on the status of our end markets and on the integration of our CIS business. After that, Mick will provide a more detailed review of our consolidated financial results, and we'll also discuss our revenue and earnings guidance for fiscal 2018. I'll then provide a few closing remarks prior to opening up the call for questions. I am pleased to report another strong quarter, with significant sales and earnings improvements, largely driven by the addition of our recently acquired CIS segment and solid organic growth as well. Sales increased 50% on a constant currency basis including $158 million of sales from our CIS business in the quarter. Our non-CIS or base business increased 4% on a constant-currency basis, primarily due to higher sales in the Americas, Asia and Building HVAC segments, partially offset by lower sales in the Europe segment. Our adjusted operating income was $31.6 million, a 62% increase from the prior year, primarily due to the addition of the CIS business, which contributed $10.8 million of operating income in the quarter. Our adjusted earnings per share were $0.39 for the quarter, a $0.16 increase from the prior year, primarily due to higher operator -- operating earnings, partially offset by higher interest expense from the debt taken on to finance the Luvata acquisition. The integration of the CIS business is proceeding as planned and our cultures and business processes are meshing together well. In fact, based on our short-term momentum, we believe we are positioned to exceed our goal of $15 million of annual cost synergies and we'll meet it ahead of our 3- to 4-year timeline. Now I'd like to briefly review the segment results for the first quarter, and review our market outlook for fiscal 2018. Turning to Page 6, sales for the Americas segment increased 5% on a constant currency basis to $148.3 million. This improvement was driven by higher sales to major North American off-highway customers and stronger sales in Brazil. We are seeing improved order quantities from our off-highway customers, which confirms early

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signs of recovery in this critical market. In Brazil, we had increases in sales to commercial vehicle and off-highway customers, along with higher after-market sales. This is certainly an encouraging sign after the multi-year declines we have seen in the Brazilian markets. In North America, improvements in the off-highway sales were partially offset by lower sales to commercial vehicle and automotive customers. The decrease in commercial vehicle sales were partially due to lower service sales and program wind-downs by gains -- and program wind-downs offset by gains in specialty vehicles. As we continue to diversify our business, we may accept changes in market share as we hold to our capital allocation discipline, particularly in highly competitive markets. I am pleased that we did have several automotive launches in North America but these volumes were offset by lower EGR cooler sales due to an automotive program that ended last year. Adjusted operating income for the Americas segment was $13.7 million, an increase of 16% or $1.9 million from the prior year, driven by higher sales volume and lower SG&A expense. I am very encouraged by the improving markets in North America. We have adjusted our market outlook for the year for commercial vehicles in both North America and Brazil. In addition, we now expect the Construction and Mining segments in North America to be up 5% to 10% over the prior year. Please turn to Page 7. Sales for our Europe segment decreased 4% on a constant currency basis to $136.3 million, primarily driven by the planned wind-down of certain commercial vehicle programs. As we mentioned last year, we expect to see lower sales in our Europe segment this year due to continued wind-down of low margin Origami radiator programs that started in the third quarter of last year. Overall, sales to commercial vehicle customers decreased 20% from the prior year. This was partially offset by higher sales to off-highway customers but this is a much smaller component of our European sales segment. Gross margin decreased 310 basis points to 14.2%. As a reminder, Europe had a very strong first quarter last year, reporting its highest gross margin of the year. The decrease in margin this year is due to a significantly higher material cost and lower sales volume. Although higher metal prices impact all of our segments this quarter, the largest impact was in Europe. This was primarily due to the timing in nature of our past-through agreements. We have started to see the positive impacts of these agreements in our Europe segment but expect additional benefits later this year. This should result in improved margin performances as we progress through fiscal 2018. Adjusted operating income decreased $6.8 million to $8.2 million from the strong first quarter of last year. The decrease is due to the lower gross profit and slightly higher SG&A expenses. We expect more favorable earnings comparisons in Europe -- in the Europe segment for the remainder of the year. Please turn to Page 8. We had an exciting quarter across our Asia segment as sales increased 45% compared with the prior year on a constant currency basis. This segment -- this significant improvement was driven by stronger sales to automotive and off-highway customers in China, India and Korea. Higher sales volume led to a 43% increase in gross profit and a 10 basis point improvement in gross margin to 17.7%. As I mentioned last quarter, we are investing in capital equipment to meet our growing market demand, further assisting with the capacity constraints and positioning us for a solid performance in the future. Operating income for the Asia segment increased $1.8 million, more than double our operating earnings last year. This is primarily due to the higher sales volumes and flat SG&A year-over-year. I'm also very pleased that we were able to keep our SG&A flat given the strong growth we have seen over the past year. As I mentioned, we continue to see improvements in our off-highway sales in Asia, which is being driven by improved markets for excavators. We have increased our market outlook for excavators in China to up to 20% for the year from our previous outlook of up 10%. Turning to Page 9. Sales for our Building HVAC segment increased 13% compared with the prior year on a constant currency basis, with improvements across the board in air conditioning, ventilation and heating products. We had our particularly strong sales in school products, which increased 17% with corresponding peak volume shipments during June and July during the summer school break. Overall, market conditions remain positive with both residential and nonresidential construction up over the prior year. Our gross profit increased 11% and gross margin improved by 80 basis points to 25.9%. SG&A expenses were lower by $700,000 or a decrease of 8% due to actions taken last year to reduce cost. This resulted in adjusted operating income of $3.1 million, more than double that of the prior year. After facing many challenges last year, it's very encouraging to see this level of sales growth and profitability in this segment. It's a real tribute to the team's collective focus. Please turn to Page 10. The CIS segment reported $157.5 million in sales. Gross profit was $25.3 million which resulted in a gross margin of 16%. The segment reported operating income of $10.8 million. As a reminder, this includes $3.2 million in depreciation and amortization expense recorded as a result of purchase accounting, split equally between cost of sales and SG&A. As I mentioned last quarter, we are addressing a change in product mix with a large data center customer that's resulted in lower sales volumes and margins than in prior years. We knew about this change prior to completing the acquisition and understand that these sales volumes can be somewhat unpredictable. Higher sales volumes in North America were offsetting some of this impact, and overall, the CIS business is performing in line with our expectations. As I previously mentioned, our integration is well underway and we are confident that we will exceed our goal of delivering $15 million of annual cost synergies ahead of our 3 to 4-year timeline. Our focus this year is on absorbing the corporate functions that were not acquired with the business, aligning and combining the coils organizations in North America and conducting a complete assessment of our manufacturing operations. We're also working hard to capture ongoing purchasing synergies, following on to the global procurement initiatives started as part of our SDG program. We are well on our way to harmonizing our controls and compliance framework to be sure that our internal control structure and safety standards and compliance and ethics policies and practices are fully in line with Modine's standards. Significant future actions include ERP integration, shared-service opportunities and further evaluation of our combined manufacturing footprint. These items will certainly bring some upfront investment but they would result in significant savings. We are

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balancing the timing of any such investments with our priority to delever the balance -- to delever the business by quickly repaying our debt. Our goal is to have our leverage ratio below 2.5x debt to EBITDA by the end of the fiscal year and I am confident that we will achieve this target. With that, I'd like to turn it over to Mick for an overview of our consolidated financial results. Mick will also provide revenue and earnings guidance for fiscal 2018.

Michael B. Lucareli - *Modine Manufacturing Company - VP of Finance, CFO & CAO*

Thanks, Tom. Good morning. Please turn to Slide 12. We are pleased with the results this quarter and off to a very good start for fiscal 2018. Beginning with the top line, our first quarter sales increased $173 million on a constant currency basis. Sales in our recently acquired CIS segment totaled $158 million. Excluding CIS, constant currency sales were up $15 million or 4%. Gross profit of $88.5 million was up $26 million or 42%. This includes $25.3 million from CIS. Excluding CIS, and a $700,000 negative FX impact, gross profit was up $1.6 million or 50 basis points. This improvement was driven by higher sales volume in the Americas, Asia and Building HVAC, but was mostly offset by higher metals' cost. As discussed last quarter, we anticipated a negative metals impact for most of fiscal '18. However, the negative impact should improve as we pass through -- as our pass-through agreements begin to take effect later this year. SG&A of $59.2 million was up $15 million. The CIS segment added the majority of this increase. Excluding CIS, SG&A was up only $500,000 or 1% from the prior year. Our SDG actions are truly helping to offset wage and benefit inflation. Please note that during the quarter, we added back $2.1 million of acquisition-related items, which includes integration costs. We also recorded $1.7 million of restructuring expenses. These expenses primarily relate to equipment transfer and severance costs in the Americas segment. First quarter adjusted operating income of $31.6 million was up $12.1 million or 62%, and our adjusted earnings per share was $0.39, up $0.16 compared to last year. Our EPS was positively impacted by the tax benefit associated with our plant expansion in Hungary. As a reminder, our U.S. GAAP income statement is included in the appendix of this presentation and in our earnings release. This includes a full reconciliation between our reported results and adjusted operating results. Turning to Slide 13. In the quarter, operating cash flow was $18.7 million, which is significantly better than the prior year. The year-over-year increase was due to the combination of several items, starting with higher cash earnings, as the quarter benefited from our CIS segment. Lower working capital also contributed to the improved cash flow. Higher operating cash flow was partially offset by the timing of capital expenditures, which were higher than the prior year by $7 million. We expect CapEx spending for the full year to be in line with fiscal 2017. We reported negative free cash flow of $2.9 million, which was better than the prior year by $10 million. However, this includes $11.9 million of special items. The free cash flow adjustments include restructuring payments of $4.5 million, which are related to plant consolidation and severance, $4.7 million for the payment related to the settlement of the Brazil legal matter we previously disclosed, and the remaining payments were for acquisition and integration type activities. Finally, our debt leverage ratio is currently 3.0x; this is well below our covenant ratio requirement of 3.75x as shown in the table in the upper right. We continue to anticipate much improved cash flow in fiscal 2018. We remain focused on paying down our debt and getting our leverage ratio back below 2.5x by the end of the fiscal year. Now let's turn to our fiscal 2018 guidance on Slide 14. We are excited with our first quarter results and pleased to report we are confirming our fiscal 2018 guidance. As Tom discussed in the segments slides, it appears that we may have a few market tailwinds, and the global off-highway market in particular is showing signs of growth. CIS is performing in line with our expectations, and synergy identification is proceeding ahead of schedule. Also we have included a number of synergies in our guidance. Building HVAC sales are recovering after a down year and are expected to grow in all markets served. To summarize, we project sales to be up 25% to 30% from the prior year. We expect adjusted operating income to be in the range of $100 million to $110 million or an increase of 39% to 52%. SDG cost savings and CIS synergies are more than offsetting the negative impacts of certain commercial pricing agreements, normal economic cost increases and the higher metals prices. The full year impact of CIS will be a big driver of growth in operating income in fiscal '18. We expect adjusted EBITDA to be in the range of $175 million to $185 million, which equates to an increase of more than 40% over the prior year. We provided some key assumptions with our guidance last quarter, and I want to review these briefly with you. First, we have summarized our market assumptions on the previous slides; next, we anticipate that copper and aluminum will hold at current levels which average about 20% higher than last year. Our current outlook includes approximately $15 million to $20 million of temporary cost increases as we absorb the higher metals costs during the customary lag period; third, we expect the U.S. dollar to hold to current levels versus most major currencies; finally, we assume interest expense of approximately $26 million. Moving on, we expect adjusted EPS to be between $1.20 and $1.35, which is up significantly from $0.78 in fiscal 2017. To reiterate from last quarter, we are including the impact of the tax credit associated with the plant expansion in Hungary. This tax benefit is expected to lower our adjusted tax expense significantly to the 15% range in 2018. We expect our effective tax rate to return to 28% to 30% in fiscal 2019. Finally, with regards to the quarterly run rate, we expect the customary seasonal pattern as we proceed through the year. On a sequential basis, we expect the second quarter results will be lower than the first quarter given the seasonal slowdowns in our vehicular business, yet significantly higher than the prior year's results. We anticipate that Q2 will be followed by sequential improvements in Q3 and in Q4. For the

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past two quarters, we've been able to take advantage of some tailwinds and we look forward to reporting more good news in the upcoming quarters. Tom, I'll turn it back to you.

Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Thanks, Mick. We have started the year on a very strong note, with positive signs of improvement in many of our core markets. I'm confident that we will deliver strong results on revenue and earnings growth outlined in our guidance. That being said, our priorities are clear. We will continue with the rapid integration of the CIS business so that we can exceed the synergy objectives to which we committed. We will focus on cash flow generation so that we can repay our debt and reach the top end of our target leverage range by the end of this fiscal year. At the same time, we'll be very disciplined with our capital allocation strategy, making sure that we are investing where we need to grow including our plant and capacity expansions at Hungary and China. I'm very pleased with the quarter we just reported and optimistic about our outlook for the balance of the year. And with that, we will take your questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Matthew Paige of Gabelli and Company.

Matthew T. Paige - *G. Research, LLC - Research Analyst*

Congratulations on a nice quarter.

Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Thank you, Matthew.

Matthew T. Paige - *G. Research, LLC - Research Analyst*

The first question was, Asia was strong again obviously in the quarter. Is this growth rate sustainable in the near term? And along those lines, could you update us on content per vehicle in Asia and if that's continuing to grow?

Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Well, obviously the tailwind of the excavator market is very encouraging to see which is the base business that we've established in Asia for some time now. And our growing content on the automotive business that we have with our expansion of diversifying the business with our oil cooler product which is -- we're investing in significantly right now. So we see in the near term that, that growth rate will continue. That will slow down in out-years a little bit as that matures. Content per vehicle, we really haven't provided that. I know that it's significant from an excavator standpoint. On a vehicular basis, on the automotive side, it's equal with what our content is on the oil cooler products in our mature markets in Europe and North America.

Matthew T. Paige - *G. Research, LLC - Research Analyst*

Great. And then moving to the HVAC side, could you just, kind of, speak to the weather impact that the business faces and what conditions typically drive growth and how has that played out so far this summer?

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Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Yes, well it's a great question. It is a very seasonal business. Obviously, traditionally, we've had a very strong heating season which really kicks off in late summer, going into fall. So that's the upcoming question of how that heating season will -- stocking orders will come in and so on. So that's anticipated to be stronger as we approach that season. And of course, I mentioned our school products, which kind of helps balance that seasonality out with stronger summer sales with air conditioning for school systems going in over the summer. So again, I mentioned we had strong school product sales this season with a strong June and July, okay? That we just are wrapping up. So we're pleased with that. So with that behind us, which really contributed to a strong first quarter in Building HVAC market, we anticipate and are planning for an improved heating season sales pattern to start later this summer, going into the fall.

Matthew T. Paige - *G. Research, LLC - Research Analyst*

Great. And the last question from me and I'll pass it on, could you just remind us how your pass-through agreements work and typical time delays and any retroactive charges that you can get?

Michael B. Lucareli - *Modine Manufacturing Company - VP of Finance, CFO & CAO*

Yes, it's Mick here. The -- we average -- we shoot for quarterly and we go anywhere from quarterly pass-throughs to semiannual and then we have a few larger customers that go up to a year or an annual price adjustment. So I would say it kind of floats on an average between that 3 to 6-month lag. And then, it does vary a little bit by region. As Tom mentioned in his opening comments, the business in Europe tends to have more of the longer-term agreements. North America averages a little bit shorter but I would say a 3 to 6-month lag is kind of typical, the average across the company.

Operator

And our next question comes from Mike Shlisky of Seaport Global.

Jordan Maxwell Bender - *Seaport Global Securities LLC, Research Division - Associate Analyst*

Good morning, this is Jordan Bender on for Mike this morning. You guys recently upgraded -- I guess, you upgraded your heavy-duty outlook to about 15%. It seems net-net there, overall, market outlook has improved. Are you guys leaning on the side of conservatism by reaffirming your EPS guidance?

Michael B. Lucareli - *Modine Manufacturing Company - VP of Finance, CFO & CAO*

Yes, I'll let Tom comment. We've got a lot of moving -- I'll let Tom comment specifically to your truck question. There's a lot of moving pieces between our truck outlook and then specifics going on with each of our programs behind that. From just the total company and how we looked at the outlook and guidance from in the year, clearly, we came out with a really strong start and we're really pleased with it. When we look at the discussion we just had with the remainder of the year left and a big portion of the heating season to come, we'd like to get another quarter through and see how the preseason heating orders are looking heading into the fall. We are still getting a really good -- great quarter for commercial industrial solutions, there's the Luvata. We're still getting a handle on them. We do know that, that is a very short lead time business, very much more like our Building HVAC. So we'd like to have another solid quarter there before raising guidance. So really, it's just -- really, we'd like to have another quarter run rate before we look at that. As Tom mentioned, we're definitely trending towards the higher end, which is great news. Tom, anything you would -- you want to add just on the truck side?

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Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Yes, on trucks specifically, on your question. We are raising guidance as far as heavy-duty trucks in North America to 15% as you mentioned. There are some dynamics changing there. I mentioned a drop-in service orders that we did receive this year that's impacting our projection a little bit on that. And there are some shifting elements globally. As I mentioned in Europe, we've had some wind-downs because the Origami production, and again as I mentioned, I think it's important to note, with our diversification strategy really developing well, okay? I mentioned a couple of times our capital allocation discipline as far as putting investment towards returns that guide us towards our overall objectives. So we are going to look carefully at those competitive assessments and making sure that we're putting that money wisely to use. Saying that, on the commercial vehicle market, you know we invested significantly to move footprint to low-cost country in North America as well as in the process in Europe, so that we are prepared for our product strategy and a competitive assessment going forward.

Jordan Maxwell Bender - *Seaport Global Securities LLC, Research Division - Associate Analyst*

Okay. And then dig into the outlook a little bit more. Most of the HVAC folks out there are saying mid single-digit growth in calendar 2017 and even off-highway the construction companies are mostly looking for double-digit growth. Are there any major concerns maybe surrounding your market share with that?

Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

I'm sorry, I missed that, was that the off-highway you're talking about as far as...

Jordan Maxwell Bender - *Seaport Global Securities LLC, Research Division - Associate Analyst*

Yes, the HVAC outlook and the off-highway.

Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

HVAC and off-highway. Well, let me see. Right now, we feel very strong about our -- let's start with HVAC position. The product offerings that we brought along, and strengthening our core positions in the heating and air-conditioning markets with improved ventilation products in North America. We feel very strong about the holding or increasing our opportunity to gain share as we've proven that in heating over the last several seasons of gaining share. And in the off-highway segment, again, a very strong segment for us, something that's globally driven with strong product platforms, we feel very good about the win rates we see in every region that we participate in. So recent business wins confirm that. So I really see ourselves holding or gaining opportunity to gain share in the market sub segments that we play in, in the off-highway side.

Jordan Maxwell Bender - *Seaport Global Securities LLC, Research Division - Associate Analyst*

Okay. And I just want to follow up on -- from the first question. It looks like that Luvata had a pretty strong quarter at least compared to what we were expecting. Are you guys running at the $150 million per quarter run rate at this point or is there something with seasonality for their shipments that mean fiscal first quarter are higher than average quarter?

Michael B. Lucareli - *Modine Manufacturing Company - VP of Finance, CFO & CAO*

Yes, great question. The -- clearly if we annualize Q1, that would be well above what we've talked about in the past for a pro forma, outlook as we go to this year. So, I think, a couple of things going on there. It's definitely a seasonal pattern. We're still learning it, but I would point to when we first reported on them, and our December quarter. So they will -- our projections show and their seasonal pattern would show their weakest quarter would be the December quarter. So there's definitely a seasonal pattern there that you should expect to see. And then secondly, we are doing well on the synergies side, so if we continue to build those in and get confidence, that's a potential upside to a lot of the pro forma numbers that we've

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used in the past. So, second half of the year opportunity would be synergy, but definitely plan on not of a steady 4-quarter run rate. There'll be a significant dip if things go as normal in the December or our Q3.

Operator

(Operator Instructions) And our next question comes from David Leiker of Baird.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Hey guys, this is Joe Vruwink for David. Can you maybe recalibrate the synergy targets and timelines for Luvata? So 3% to 4% is going to be -- or 3 to 4 years is going to be shorter, $15 million is going to be higher. Just any more specifics around those 2?

Michael B. Lucareli - *Modine Manufacturing Company - VP of Finance, CFO & CAO*

Yes, I'll give you the short-term view and then Tom can add some more color. The -- as Tom said, we originally came out before we closed and we were able to, kind of, go through all the details with the new team on board. We wanted to set a target we know we could hit with very, very high confidence. So as we've gone forward, we have a very high confidence of hitting and exceeding the $15 million. Tom and I are pushing that to get that down to more of the 2-year window, not the 3- to 4-year window. As we headed into this year, I mentioned we had some synergies built in. We had a target and we're pushing to get north of $5 million in this fiscal year. And a portion of that was in our earnings guidance and our planning when we set up the fiscal year. So as we get more confidence and runway, I would think that's an opportunity for us to continue to roll more of these in, in the second half of the year. Tom, anything?

Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Yes, Joe, it's a great question. I'll remind everybody that we invested in a strong integration management office way back even before the close of the deal. We have an executive experienced leader leading now with a dedicated team focused on every element. So again, that started off with our expectation assumptions based on the due diligence, that's then gone into -- once the deal was closed, to confirm that. So those assumptions have matured. The timing ability to move things forward, we feel confident about it as Mick said. And so we can strongly say that we will exceed the $15 million and that 2-year time frame is what we're looking at. So, again, it's a result of a lot of good effort and organization and discipline that the team is making. So -- and really supporting the fact of the due diligence assumptions that we made going into the close.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Any revenue synergies yet between CIS and your traditional Building HVAC business?

Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Yes, it's a great question, one I'm not prepared to give an answer today, other than saying that we're investigating several interesting revenue synergies that are available to us. So they're in the works and you can look for some updates, probably getting into the next call.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Okay. And then switching back to the vehicle business. If I look at your Europe and commercial vehicle, I think you said was down 20% and that's 1/3 of the business. So it would actually imply the remainder is growing pretty nicely and off-highway markets are good, automotive volumes were actually as an industry down in this quarter. So it would seem like Europe automotive is launching a fair amount of content. I'm just wondering if that's true, if I did my reconciliation correctly. And then, what sort of products or programs are you seeing demand for in that region?

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Thomas A. Burke - *Modine Manufacturing Company - President, CEO & Director*

Well, your assessment is correct. Good work as usual, Joe. Yes, we're pleased with the launching of a lot of engine product related to the automotive industry in Europe. Oil cooler platform, the LC product line is the baseline for that, but that's expanding into -- including liquid charger coolers and other LC products going into subsystems and also a lot of interest going in with the EV opportunities looking forward. Again, nothing to report there yet but a lot of activity. So, pleased with that side. Again, the commercial vehicle market, we are repositioning ourselves coming out of the Origami wind-down and investing towards Hungary, as we've said. Hungarian expansion is on track, I might add, with equipment being sold as we speak, with launch is scheduled to take -- to support the growth in the automotive side that I just mentioned and support the future commercial vehicle business needs that we have in the region. So again, good points on your side.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

And then the last question for me. Your fiscal Q2 has been a tough one to predict in recent years and we've ended up with fairly large Q1 to Q2 decremental margins. It seems like you've added more revenue diversity, so that should help. Any additional guidance so -- we trying to model, don't miss it like we have been. Q1, Q2, what's your contribution margin at the EBIT line should end up being?

Michael B. Lucareli - *Modine Manufacturing Company - VP of Finance, CFO & CAO*

Yes, another great question, Joe, and I'd say, last year for sure, if you recall, that was not only the normal seasonality but we ran into a number of operational issues that we've then since had to correct in the second half. So by no means are we looking at that magnitude of a drop from what happened a year ago. I guess, maybe to just help out and so you're right, we kind of -- we get it -- level set with you guys. We are looking, there will be little bit of a revenue drop that's due to the seasonality, and mainly in our vehicular business, North America and Europe with the summer shutdowns. And then with that volume, it's really volume related. There'll be a little bit of a margin decline too with an operating margin this quarter being in the 6% range. We'd probably be more in a 4.5% to 5% kind of range in Q2 with -- on a little bit lower volume. But again, significantly up from the prior year. And then as we get into Q3 and Q4, not only will Q3 and Q4 should be at or above prior years but Q3 will be above Q2 and Q4 will be above Q3. Lots to go there but that's as it closes we want to go without getting into quarterly guidance. Hope that helps.

Operator

And I'm showing no further questions at this time. I would like to turn conference back to Kathy Powers.

Kathleen T. Powers - *Modine Manufacturing Company - VP of IR & Tax and Treasurer*

Thank you. This concludes today's call. Thank you for joining us this morning and thanks for your interest in Modine. Goodbye.

Operator

And ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day.

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