THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MOD - Q1 2019 Modine Manufacturing Co Earnings Call

EVENT DATE/TIME: AUGUST 02, 2018 / 1:00PM GMT

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

Michael Shlisky *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen and welcome to Modine Manufacturing Company First Quarter Fiscal 2019 Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to turn the conference over to your host, Kathy Powers, Vice President, Treasurer, Investor Relations and Tax.

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

Thank you, and good morning. Thank you for joining us in our conference call to discuss Modine's first quarter fiscal 2019 results. I'm here with Modine's President and CEO, Tom Burke; and Mick Lucareli, our Vice President Finance and Chief Financial Officer. We will be using slides for today's presentation, which can be accessed either through the webcast link or by accessing the PDF file posted on the Investor Relations section of our website, www.modine.com. This morning, Tom and Mick will present our first quarter results and confirm our revenue and earnings guidance for fiscal '19. At the end of the call, there will be a question-and-answer session.

On Slide 2 is our notice regarding forward-looking statements. 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. I'm pleased to report that we've started up fiscal 2019 with another strong quarter. Overall, sales increased 10% or 6% on a constant-currency basis. Each of our segments reported sales growth with improvements across most of our major end markets. Our first quarter adjusted operating income was $36 million, up $4 million or 14% from the prior year, with particularly strong contributions from our Vehicular and Commercial Industrial segments.

Now I'd like to briefly review the segment results for the first quarter. Turning to Page 5. As a reminder, this is the first quarter we will be reporting on our new organizational structure with 3 operating segments. Our Vehicular Thermal Solutions, or VTS, segment is a combination of our previous Americas, Europe and Asia segments. In addition, we are now reporting our legacy North America coil sales in the CIS segment. All prior year results have been restated for this change. Sales for the VTS segment increased 12% or 8% on a constant-currency basis to $353 million. This increase was primarily -- driven primarily by a 25% increase in sales to off-highway customers, primarily in North America and in Asia. We also benefited from an 18% increase in sales to automotive customers globally. Commercial vehicle sales were up 5% with increases in Asia and Europe. Commercial vehicle sales in the Americas were flat as program wind-downs in heavy-duty programs offset volume increases in mediums. We are pleased with the ongoing trends in auto and the need for specialized engine cooling products, resulting in a 21% increase in engine product sales. We continue

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

to have significant growth in Asia, where sales were up 51% from the prior year. In addition, sales in the Americas were up 3% and sales in Europe were up 9%. Adjusted operating income for the VTS segment was $26.5 million, 10% higher than the prior year. The increase was primarily due to higher sales volume and a positive impact from foreign currency translation. Adjusted operating margin in VTS segment was 7.5%, down 10 basis points from the prior year. Gross margin was impacted by both higher material costs and operating inefficiencies at 2 of our plants that are working through large volume increases, due to many new program launches. We have assigned additional resources and expertise to address these issues and expect to see improvements in the next few quarters. Effective SG&A cost management within the VTS segment helped to offset the higher material costs.

I would like to take this opportunity to make a few comments on the impact that tariffs are having on our business. In general, we source the vast majority of the raw materials for our U.S. plants from U.S. suppliers. We do have 1 specialty aluminum alloy from Europe that we cannot localize and have applied for an exclusion with the U.S. Government from the 10% tariff. However, some U.S. suppliers raised fabrication costs last fall in anticipation of increased demand. This increase was included in our cost estimates for this fiscal year. We are continuing to feel the impact of the higher demand for domestically-produced aluminum on our business, including increased freight costs as producers reach their capacity limitations. We believe much of this has contributed to a large increase in Midwest transaction premium, which is the premium added to the base cost of the metal to cover logistics costs. Like most manufacturing companies, we're also concerned about the recently announced tariffs with China. For Modine, this includes tariffs on imported heat exchanger components, including some aluminum and stainless steel castings that we currently import from China. These components will now be subject to a 25% tariff, significantly increasing our cost. We will file for exclusions related to these items, but at this point, we're doubtful if they will be granted. These, and any additional rounds of tariffs, could result in additional cost increases if we have to fully absorb the cost. So as a result, we are currently working diligently with our customers to pass along the impact of tariffs through price increases, assuming we cannot get the necessary exclusions. These are certainly challenges for our business, however, we believe that we are in a unique position with regard to these tariff concerns. First, within our VTS segment, we tend to source, manufacture and sell within a given geographic region. So we currently purchase these -- the majority of these base aluminum and stainless steel products for U.S. production from U.S. suppliers. Second, for raw materials for industrial businesses, which together are approaching 50% of total company sales, are generally not affected by the tariffs because of the short-term contracts, where we can move quickly to adjust prices. These are clearly benefits of having an improved diversification of our end markets.

Please turn to Page 7. Sales for our CIS segment increased 7%, or 4% on a constant-currency basis, to $184 million, primarily due to a 61% increase in sales to data center customers in North America and Europe, partially offset by a 24% decrease in sales to the industrial markets. The Industrial market accounts for only about 8% of CIS sales and the decline was anticipated, which was driven primarily by lower sales of transformer oil coolers in China, based on the government's recent pullback in the development of high voltage direct current lines in their grid network. Sales in Asia were down 6%. Sales in the Americas were up 8% and sales in Europe were up about 9%. In Europe, we expect sales to grow in line with GDP growth, with the impact of environmental regulations for refrigerant changes and energy efficiency being generally positive for our business. In the Americas, order intake remains strong with the increases for industrial coils and CO2 gas coolers. From a product standpoint, sales increased for coils, coolers and coatings. Coolers increased by 14%, driven primarily by sales to data center customers, as a significant customer in this space continues to expand data center capacity. This segment reported adjusted operating income of $13.3 million, a $1.9 million or 17% improvement over the prior year. This improvement was due to higher sales volume and synergy savings. The adjusted operating income margin was up 50 basis points from the prior year to 7.2%. This increase is primarily due to the decrease in SG&A as a percent of sales.

Please turn to Page 9. Sales for our Building HVAC segment increased 5% or 2% on a constant-currency basis to $45 million. From an end market perspective, sales to commercial HVAC customers and to data center customers were both increased about 5%. From a product standpoint, the increase in sales is primarily driven by a 10% increase in heating products in North America and a 6% increase in air conditioning products in the U.K. This was partially offset by a 7% decrease in ventilation product sales, with sales declines in both North America and the U.K. Sales in North America were up 6%, driven by higher sales of heating products, partially offset by lower ventilation product sales, while sales in Europe increased 1%, driven by higher air conditioning products sales.

Operating income increased 3% from the prior year to $3.2 million. This increase is driven by a higher gross profit on higher sales, partially offset by higher SG&A, driven by higher sales commissions and development spending.

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

Operating income margin was 7.1%, compared to 7.2% last year. Gross margin was flat at 25.9% for the prior year, and SG&A as a percent of sales increased slightly. We have a very strong order activity in our Building HVAC segment and expect our markets to remain strong. In particular, we expect continued year-over-year improvements in heating and air conditioning sales for the reminder of the year.

With that, I'd like to turn over to Mick, for an overview of our consolidated financial results as well as our financial outlook for fiscal 2019.

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

Thanks, Tom. Good morning, everyone. Please turn to Slide 10. As Tom said, we are happy with Modine's results this quarter and off to a good start in fiscal 2019. Sales increased $51 million or 10% which includes a positive FX impact. On a constant-currency basis, sales increased $32 million or 6%. Revenue improved in all segments and benefited the quarter from a number of items, including favorable market trends, market share gains and maturing program volumes. Gross profit of $94 million was up 7%, with the margin down 50 basis points. We had positive impacts from higher sales volume, FX rates and ongoing purchasing initiatives. We also had a few negative impacts, mainly in our VTS segment. As Tom discussed, these relate to higher material costs and temporary production inefficiencies.

SG&A of $59 million has improved 100 basis points as a percentage of sales as we continue to leverage our top line growth in overall scale. We were able to hold SG&A essentially flat, as several favorable items more than offset normal wage and benefit inflation. Adjusted operating income was $36 million, up $4 million or 14%, including a 30 basis points improvement in our operating margin.

Please note that in the appendix, we include an itemized list of adjustments to operating income and a full reconciliation to our U.S. GAAP results. The adjustments totaled $1.2 million for the quarter and relate to environmental charges, restructuring expenses and the remaining acquisition integration costs.

Income tax expense was $5 million, up $2.3 million over the prior year, resulting in an adjusted tax rate of 25%, compared to 16% in the prior year. This increase was primarily due to a $3.5 million development credit in the prior year. We also reversed the portion of a valuation allowance on our deferred tax assets, resulting in a $2 million benefit in income tax expense. However, the benefit from the reversal was excluded from our calculation of adjusted EPS. Our adjusted earnings per share of $0.41, an improvement of 5% over year-over-year.

Turn to Slide 11, please. As we anticipated, our first quarter operating cash flow was negative, compared with $21 million in the prior year. The decrease was heavily impacted by the timing of cash payments and the combination several other items, including temporary working capital builds, along with higher employee benefit and incentive compensation payments. Inventory increased due to higher expected volumes, along with plant inefficiencies, as Tom previously mentioned. Please note that much of this is seasonal and the temporary increases will be worked down throughout the year.

Capital expenditures were higher than the prior year by $1 million. Full year capital spending is expected to be slightly higher than the prior year. Given the operating cash flow, we reported negative free cash flow in the quarter. As a reminder, it is typical for us to run negative cash flow in Q1, due to the timing of certain cash payments.

In looking at the full year, we do expect positive free cash flow and for it to be stronger than fiscal 2018.

Finally, our net debt increased by $25 million during the quarter and our leverage ratio was at 2.5, which remains within our target range.

Now let's turn to our full year guidance on Slide 12. Modine's first quarter earnings were in line with our expectations and we are pleased to report that we're confirming our fiscal 2019 outlook. To summarize our guidance, we project sales to be up 3% to 8%. We expect ongoing vehicular market growth partially offset by the wind-down of multiple truck programs. For our CIS and Building HVAC markets, we expect low- to mid-single-digit market growth, with our sales outpacing the market. In addition to the revenue growth, we are planning to drive earnings growth through margin improvements across all segments. We expect adjusted operating income to be in the range of $135 million to $145 million. This equates to year-over-year growth of 12% to 21%.

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

As usual, I want to briefly review some of our key assumptions. First, metals have stabilized recently, yet we anticipate this to be an ongoing headwind until our pass through agreements fully adjust. Second, we expect annual interest expense of approximately $24 million. Third, we are using current foreign exchange rates, which result in a slightly negative impact year-over-year. And finally, we are carefully following the tariff situation and our guidance reflects our current expectations in this area.

I also want to spend a moment reviewing our tax environment, which remains fluid and very complicated. We are evaluating various tax planning opportunities that could result in lower income tax expense for the year. However, we've not completed the analysis and have not, therefore, updated our assumptions. Given the current situation, we expect our adjusted tax rate to be approximately 27% to 28% in fiscal 2019 versus 12% in fiscal 2018.

Based on these assumptions, we anticipate our adjusted EPS will be between $1.50 and $1.65. And to wrap up, we're managing all the market dynamics and anticipating positive momentum throughout the remainder fiscal 2019. Tom, I will turn it back to you.

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

Thanks, Mick. Please turn to Page -- for Slide 13. As I mentioned last quarter, we continued to focus our strategy around strengthen, diversify and grow and have been working on developing our next round of short- and long-term targets and the actions that will allow us to achieve them. This strategy has served us quite well over the last years, resulting in a much more diversified portfolio, improved financial metrics and increased shareholder value. In order to continue to strengthen our business, we've completed the strategic portfolio assessment that we started working on last year. This assessment and framework allows us to prioritize those end markets where we have the right products and channel access, along with positive market drivers, to foster growth. At the same time, we're addressing underperforming businesses by actively shifting them back towards growth and profitability or by deciding to deprioritize or exit as we've demonstrated with 2 recent decisions in our Building HVAC segment. We are prioritizing and will allocate our capital based on these drivers. We're now setting multiyear targets, ensuring that future capital is allocated based on our strategic priorities. Finally, under strengthen, we will focus our practice and continue our practice of relentlessly drive in SG&A reduction through process improvement and cost containment.

Secondly, we will continue to diversify our business, following on with the success of our acquisition of the CIS business. Our priority will be higher margin and cash generating businesses that will build upon our Commercial and Industrial and Building HVAC segments. Specifically, we will look for M&A opportunities that will improve our right to win and increase our value add to our customers and to Modine shareholders. Our overall goal is to increase the percentage of our revenue contributed by our industrial businesses. This will allow us to further reduce customer concentration and the impact of economic cycles.

Finally, we will continue to grow by using our capital to drive growth and profitability. Whether the growth comes from inorganic sources or from organic growth, we will continually seek high returns on our invested capital. We will focus on those markets where we have market-leading technology and strong channel access or where there are technology or market drivers that will lead us to success. In our Vehicular markets, this will include thermal solutions for electric vehicles. As I mentioned many times, we are actively working with new and existing customers to provide thermal management solutions for EVs and are winning our fair share of business. In our Industrial markets, we're providing coolant for data centers as the increase in cloud computing drives demand for data center growth. In addition, the rise in farm-to-table delivery of frozen and chilled food and beverages is helping to increase demand for refrigeration and refrigerated transportation products. Greenhouse heating has long been a key subsegment for our Building HVAC business. This market is evolving to include more sophisticated control solutions and we are well positioned to maintain our strength in this market. In addition, we see strong drivers and opportunity and permanent industrial growing as the need expands for HVAC and control solutions. Strengthen, diversify and grow will continue to drive our decisions. I'm very excited for the next phase of our strategic initiatives that will build upon the strong base that our teams have created. We will provide further updates each quarter, including targets and accomplishments towards our goals.

With that, we will take your questions.

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Mike Shlisky with Seaport Global.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

So Tom on your last comment there it sounds like you've got a nice SDG II strategy teed up here. But are there any new targets to watch for on the financial side? Is there a higher margin target or a higher volume target we should be thinking about? And if so, what might the time frame be?

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

Yes, yes. Well, you can expect an update next quarter, okay, with more definition around the targets. We're clearly working very hard right now and clearly the things we can control and opportunities we're evaluating are making sure we come out, that we have a high degree of confidence in those targets. So I expect a good update with each quarter. Mick, would you add anything to that?

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

Yes. Mike, I would say as Tom said, we're regrinding through all of those with the next set of specific actions, actions we've won, SDG I, our target was 7% to 8% operating margin. We've improved probably 200 basis points since that time. This quarter is 6.4%. We haven't crossed the 7%. So for sure, we're pushing Modine to continue to move towards that 7% to 8% operating margin. The other area we're really focused on, we talked about a lot publicly is, free cash flow generation and the amount of free cash flow Modine generates. Again, last 3 years have been really strong and much improved, but we think we can improve as well in our cash flow conversion or free cash flow margin.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

Okay. But let's just be clear, Mick, if you add back some of the intangible amortization from Luvata that you didn't obviously anticipate when you first announced SDG, you would be very close to 7%. Is that correct?

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

Great point, Mike. Yes. Thank you for that.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

I just wanted to make sure. Okay, I also wanted to ask secondly in your comments and slides, I saw that you've got in CIS, you've got a very strong data center business [up 50] plus, but it wasn't quite as high of a growth rate in building [HVAC]. Can you kind of contrast what's going on between each of those 2 segments (inaudible)

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

Yes. It's a great question. If you look at the breakdown, about 14%, 20% of sales went to the data center market inside the CIS and about, just about 28% in the Building HVAC segment. So that was becoming a pretty sizeable piece of our business. Obviously, the drivers that are in that business, the big mega trends are in our favor. You can really say that about that we have 1 large customer in the CIS side that had increased significantly this quarter as I mentioned, but still, we have significant growth across the whole spectrum. In Building HVAC, we supply end items, as a reminder to you. So we're actually serving specific data centers with solutions that are turnkey for them. So that's kind of we're the end item provider. In CIS,

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

we are component supplier or cooler supplier that is a subsystem of the end item. We supply that through multiple providers of Building HVAC systems. So we kind of have full end item approach of precision cooling and chillers in the U.K. serving that market and we have globally with CIS, coil supply and cooler supply that goes across various end item providers. So a really exciting part of our portfolio as we combine those and really, with the mega trends towards digitalization, we see this as a key factor that we're really going to be concentrating on.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

Okay. Thirdly I wanted to ask about the price of aluminum and the price of copper. It looks like as of today, for this quarter so far, both of those are actually down from the prior year, I mean, it's only August. But so far, we're actually down. Could you maybe comment on some of the noncontractual products, like in CIS, where it's just make it and deliver it. Is there a potential margin benefit happening over the prior year for that business? And then secondly, in the part that is contractual, in your VTS contracts, are those -- is there a chance we'll start to see the catch up in the price of commodities in your contracts in the back half of fiscal 2019 here?

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

So Mike, I'll take that first and see if Tom wants to add anything. So a lot of questions you had in there. One is, yes, we've been happy to see the raw material stabilized here. The big -- probably the biggest drivers, though, is Tom referenced the Midwest Transaction premium. So on top of the LME price, there is an adder. A year ago, that was about $0.08 or $0.09 a pound. That is now almost doubled, we've been running in the $0.18 to $0.20 a pound. So that's one impact for us. With regards to the pass-throughs, yes, I think the opportunity for us from a financial standpoint is if they hold where they're at, we will continue to pass through prices and catch up to last year. We had significant price adjustments in our first quarter. Unfortunately, we had an equal rise in -- equal or greater rise in commodity costs to us. The last -- I think, you were also asking about margin improvement. The way that works from just a financial side, on VTS, it's actually, it can be dilutive if you're passing through your costs. So it's definitely not a margin enhancer. It's a complete pass-through. On the other half of our business, the CIS and Building HVAC, as Tom mentioned there too, it's a lot more fluid. Every program, every opportunity is a fresh quote and a fresh pricing opportunity. So we kind of like that aspect to that side of the business. It makes us more flexible.

Operator

Your next question comes from a line of David Leiker with Baird.

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

This is Joe Vruwink for David. Maybe I'll pick it back up with the commodity question. Can you actually quantify the raw material headwind you absorbed this quarter?

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

Yes. Joe, it was about $2.5 million total company and most of that, 90-plus percent of that, almost 98%, 99% of that, was in VTS.

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

So I know, I can't just add it back, but, let's say, I add back that $2.5 million, it looks like your incremental margin at the gross profit line was, call it, 16%. I -- you've talked in the past about a 25% target. Are the ramp up inefficiencies you alluded to really the biggest delta there, between 16% and the target of 25%?

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

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

Yes. Yes. Great, great question. We look at it a very similar when we look at our and analyze our businesses internally. The other factor I would say is there's $18 million of FX impact in revenue that, as you know, isn't, you can't look at an incremental margin on. It's not a volume or a variable. So when we look at, we adjust for metals and FX, our conversion, Joe, was about 19% or 20%. Then the gap to really where we want to be, we had the inefficiencies in the quarter were about $3 million. That would have put us at 30-plus percent type conversion.

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

And so into the back half of this year, when we maybe get some stabilization in commodities, the inefficiencies go away, to be doing an incremental margin of around 30%, that would be your expectation?

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

Yes. And I think what we're going to see is, as we adjust to the volume ramps in those very select locations Tom was alluding to, we're going to be a ramp in our conversion rate. So Q2 will improve over Q1, and we're expecting Q3 to improve over Q2 and so forth. So it won't be a step function, but it will be a ramp as we continue to go through the year. Tom?

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

Yes, Joe, specifically, let me just talk here. 2 plants are both tied to our heaviest launch activity plants. So you saw the 51% growth in Asia this quarter and that specifically is coming down to the high degree of launches going on in China, specifically at our Shanghai facility, where we're just bulging at the seams right now, adding capacity to offset that and obviously some expertise to come and help with some of the specific launches. But we have literally dozens of launches that have occurred in this past quarter between that. And Nuevo Laredo, Mexico is the other one where we've been doing some product transfers over the last couple years as you are well aware of. Those transfers have stabilized and now it's pure launch activity and so the plant is undergoing a lot of stress and strain preparing for that and launching dozens of new programs this year. So it's all been set up to provide this opportunity for growth. We're doing it. We will start improving better, as Mick said, and I feel very confident that you will see that sequentially as we move forward.

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

Okay. Great. If we can focus on CIS for a minute, I think, when you bought this business and you got the look-back financials, it was more typically a 2% to 3% organic grower, a bit stronger than that this quarter. So 2 questions. One is, have you started to realize maybe some revenue synergies between your existing HVAC infrastructure or vice versa really and is that contributing to better organic growth, that will be one question. And then on the second question, with data center customers and how they choose to invest in and build out their supply-chain, it can be incredibly lumpy. So should we be considering some giveback in a future quarter as maybe they work through what they bought from you this quarter? Or just given how robust construction is for data centers overall, can you sustain growth?

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

That's a great point. And I'll start with that one. As it is project based on data center, right? So they're the project based on capacity increases at data centers. So right now, there's -- the trend is very positive. Our order book is still very well, very strong for, let's say, the balance of this fiscal year for sure and we see it going into next fiscal year, but it is lumpy. I should say, it is basically a result of projects being approved by cloud providers and other data center type companies. So it's a good point. Good trend, we're very positive it's going to be a positive effect through the fiscal year into next year, but that is subject to change, good point. As far as sales synergies, we're right at beginning of that, yes, we have some clear things going on with technology conversions from copper to aluminum microchannel and things like that. We're looking at the best way to do that. But that really hasn't impacted that much yet. We see opportunities -- significant opportunities looking forward using some of the product-based

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

platforms that maybe is more vehicular based that can be applied towards things that supply, let's call it, the industrial and/or refrigeration type of end items, our end markets that we can provide like, let's say, plate coolers and things like that. So - being studied, some early indications are positive, but that really hasn't hit yet.

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

Okay. On the vehicle business, so really incredible automotive growth this quarter. I think global volumes are only up 3% or 4%, so the 18% growth is pretty remarkable. As I think about that in the remaining quarters this year and specifically if maybe into next quarter, so we're battling a few things it seems in Europe. Various European automakers have communicated different expectations for what production might ultimately end up being as we implement this new WLTP emissions requirements. Some are impacted. Others say, no change in our schedules. And then in China, there has been, maybe some concern that inventories got a bit elevated last quarter and so we're due for a bit of a giveback this quarter. Anything you're seeing from, it wouldn't be your backlog, obviously, because that's really strong, but from an industry standpoint that maybe moderates growth rates next quarter?

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

Yes, no, you bring up a good point, specifically on the WLTP. We've looked for softening, for instance, in our EGR business. On the automotive side out of our plant in Germany, we have not seen any signs of that yet, that was something we anticipated. Overall, releases remain strong. And again, we're feeling it in our capacity constraints and launch activity. So yes, we watch that very carefully and we read and hear about some of the shifts that may occur, but as of right now, we're not feeling that in this quarter.

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

That's great. And then my last question, can you quantify, there is clearly some tailwinds from the backlog, yet I think you alluded to some truck program roll-offs, which are a bit of a moderating factor. Can you maybe quantify the things to consider that detract a little bit from growth, just so we don't get too ahead of ourselves in modeling out?

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

Yes, Joe. We went into this year -- I think, we talked about either on this call or the prior call, the one before, we went into the year planning on about $20 million plus or minus of truck program wind-down, fairly evenly split between Europe and North America. It's a little bit of a challenge to kind of manage those. I think the positive news is in Q1, they seem to be winding down or ramping down at a slower rate, whether that's just the transition or the strength of the market. So it's been good news. The short answer to your question is if things hold, we'd have about a $20-ish million revenue headwind from the program wind-downs.

Operator

(Operator Instructions) Our next question comes from the line of Matthew Paige with Gabelli.

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

I just have a couple of questions. You mentioned inorganic growth opportunity. Do you have the capacity now, either balance sheet wise or intellectually, to do another acquisition?

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

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

Yes, yes, intellectually. That's interesting.

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

Yes. Yes. I hope you mean bandwidth.

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

Yes, absolutely, that's exactly what I mean.

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

Great question. No, we, within our current bank agreements, we have plenty of flexibility based on the types of acquisitions that we're looking at and the sizes. If you include the plan this year to have equal or greater free cash flow to what we did last year, if we do $50 million to $70 million of free cash flow, as we go through the year, that even expands our balance sheet if you, if you say it that way. And then I'll turn over Tom, I think, we learned a lot, good experience from the Luvata integration, but to do it well takes significant commitment and dedicated resources. So I think we have constant discussions about the bandwidth question.

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

It is a great point. And we have stood up a, what we call strategy and business development section in the company, that we have 3 or 4 key resources constantly focused on our strategic actions, both in each element of strengthen, diversify and grow, but specifically, a lot of attention being put into targeting opportunities that, that can be on inorganic side to build on the strength that we developed with the CIS acquisition. So it remains a key part of our strategy and I feel very, very

positive and confident with our approach. We're not -- running around wildly looking for something. We're looking for something that fits well and adds to the value of the company and value that our shareholders can expect.

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

I know you've mentioned that the focus would be on Building HVAC or CIS, but is there any technology that your portfolio needs in your opinion on the electric vehicle side?

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

Good point. So as systems develop and subsystems, there are things like electronic valves and things that could complement as far as flow, control and balancing the system and optimizing the system for the complete vehicle thermal management needs. So that is something that we can call an adjacency that we would look for an opportunity to develop and it could also be done through partners as well, which we're exploring. So it's a very good question.

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

Got it. And then last question for me. Obviously Asia is a smaller business that's growing rapidly. Is there any structural or competitive reason why that business can't eventually get to within similar size of the Americas and Europe?

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

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

Well, I think, I'll let Mick quantify that for you. Right now we have more activity than I ever imagined at this point. After years of kind of going over there and installing the base assets and technologies for the future, they're all hitting on all cylinders right now. And obviously, China is a key area of focus, but I also want to talk about India. Our India plant is doing phenomenally well, okay, growing with all the key end markets, the vehicular-focused strategy is. We have a Korea JV that's also doing well. So Asia for us, the growth rate of 51% is going to slow down a little bit, but it's just keeping that rate. But it's going to be continued strengthening part of our portfolio. And I also want to add that the bringing the VTS business under 1 segment lead and developing those strategies to prioritize is very important. In the regional focus, we could get out of balance sometimes and have one product or one element of the vehicular business prioritized over another one in a different region. So this whole product business set assessment that I talked about that we completed inside of the SDG assessment, is very, very important so we can make sure that we optimize our investments, both on financial capital and of course our key resources, our teams that are focused on that to make sure we optimize and grow that well.

Operator

Your next question comes from the line of Mike Shlisky with Seaport Global.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

I guess I've just got 2. I guess, first, I mean, just looking at your guidance range for the year. It was a pretty decent quarter. I was curious if you have any way you can maybe tilt us in one direction, do you think, given the good quarter and the good top line, and the improving commodity costs, that you might be tilted towards the high end at this point? Or are you still little a nervous that maybe the low end is still a possibility?

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

Yes. Good question, Mike, and a hard one to answer. I'll tell you the way we think about it and one of our forecast and maybe the risks and opportunities. So definitely a good Q1. From a Building HVAC, as you know, our Building HVAC business really ramps up in the second half of the year. So our visibility there is short and partly tied to weather, although we have -- we feel really good about the order bookings, early pre-season order bookings and order -- also the order bookings in the U.K. and around data centers. So that we kind of look at is we're feeling good, but it's way early. Then we go to CIS, again, same, very short visibility in that type of business, with so much of it being replacement. What we feel good about there, Tom mentioned on the data center there, our order book is, we're feeling really good about that and that is continuing to give us confidence through Q3 and into Q4 as Tom said. When you get to VTS, couple things there. I think, there's an opportunity if metals hold where they are at. And then I think what we're trying to balance here as well, which was new since we launched our fiscal year, was the tariffs, and we're managing those with our customer base. Tom said where we can, we're at, we're trying to get exclusions, that's one. I'd like to see another quarter behind us before we kind of adjust our guidance or guide you to a high end or a low end. I would say we're feeling really good about our range coming out of Q1. And before I would say, we're at the high end, I'd like to see another quarter and address a couple and make sure we have good visibility in a couple of the risk areas that I highlighted.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

Okay. That's fair. And the other question I had, it's a bit out of left field, but I think I have to ask it. A few weeks ago, we heard in the media that Tesla started asking for some of their partners who they've been working with for some cash back on some projects that they may have done over the last few years that maybe didn't pan out as they expected. So I wanted to just confirm, just wanted to check, was Modine asked for any cash back by that partner?

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

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

No. We weren't.

Operator

Your next question comes from the line of David Leiker with Baird.

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

I wanted to ask, by adding CIS, you have a less seasonal business, but in the past, the Q1 to Q2 decremental margins have sometimes been pretty wide. Would you expect something similar, Mick, you said you'd expect the year-over-year incrementals to actually improve as the year goes on, which would imply less seasonality than historically you've seen, but anything to consider in thinking about kind of a Q1 and a Q2 seasonality?

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

Yes, so kind of a macro point and then a micro comment for your more specific. Yes, last year, we were very pleased with more so, Joe, right, than we've ever seen and you've been with us a long time, almost kind of 4 even quarters. And as we go forward, we expect this year would be similar, more level loaded. As we look to Q2, we're not looking for dramatic historic drop or change in our margin. You know that used to be that's when you start entering the slowdown, especially in Europe on the Vehicular side and the shutdown. I would say VTS will have a little bit, from a revenue side, a little bit of the impact of Europe slow down. On the other hand, we start to ramp up sequentially in building HVAC and it also starts to ramp up or continue to ramp up in CIS. So I think short answer is, we shouldn't look for a significant change in Q2 from Q1 other than within the pieces maybe a little bit of the summer slowdown from VTS in Europe and then a sequential growth in CIS and HVAC.

Operator

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

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

Thank you for joining us this morning. A replay of this call will be available through our website in about 2 hours. We hope that you have a great day.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day. You may now disconnect.

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Client Id: 77

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2018, Thomson Reuters. All Rights Reserved.

©2018 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS