Modine Manufacturing Company
First Quarter Fiscal 2027 Earnings Conference Call
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Presenters
Kathy Powers, Vice president, Treasurer, Investor Relations
Neil Brinker, President, Chief Executive Officer
Mick Lucareli, Executive Vice President, Chief Financial Officer

Q&A Participants
Noah Kaye - Oppenheimer & Co.
Matt Summerville - D.A. Davidson & Co.
Neal Burk - UBS Investment Bank
David Tarantino - KeyBanc Capital Markets Inc.
Brian Drab - William Blair & Company
Jeff Van Sinderen - B. Riley Securities
Chris Moore - CJS Securities, Inc.

Operator
Good morning, ladies and gentlemen, and welcome to Modine's First Quarter Fiscal 2027 Earnings Conference Call.

At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow, at that time. If anyone should require assistance during the conference, please press "*", and then "0" on your telephone keypad.

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 and Investor Relations.

Kathy Powers
Hello, and good morning. Welcome to our conference call to discuss Modine's first quarter fiscal 2027 results. I'm joined by Neil Brinker, our President and Chief Executive Officer, and Mick Lucarelli, our Executive Vice President and Chief Financial Officer.

The slides that we will be using with today's presentation are available on the Investor Relations section of our website, modine.com.

On Slide 3 of that deck is our notice regarding forward-looking statements. This call will 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, I'll turn the call over to Neil.

Neil Brinker
Thank you, Kathy, and good morning, everyone. Before covering the quarterly results, I'd like to share a couple of personnel updates. As we've recently announced, Michael Mahan has joined Modine as the new President of our Commercial HVAC segment, reporting to me. We are very excited to have Michael join our team, bringing extensive experience managing global P&Ls, executing portfolio transformations and driving product development and technical innovation.

The priorities of this segment have not changed. We are focused on improving margins throughout the segment, while driving organic growth and pursuing inorganic growth opportunities. We expect to create significant value in this segment through our ongoing 80/20 work and through the integration of our last three acquisitions. Michael is the right leader to help us achieve these goals.

Secondly, Art Laszlo, who has been leading our global Data Center business, has resigned from his role at Modine for unexpected personal reasons and will be leaving at the end of July. We are grateful for his contributions over these four years and wish him the best for his next chapter. We have initiated a search for his replacement. In the interim, I will step in to lead this organization.

Given the level of growth and complexity of this business, I will be spending a great deal of my time and focus on making sure that we are executing on all of our many priorities in this segment. This includes launching and ramping production in North America to support our strategic customers and their growth targets, including ensuring that we are ready to perform on our long-term capacity commitments, starting in 2027. This is a heavy lift, but I have confidence in our global team and our ability to delight our customers while staying at the forefront of technology.

Please turn to Slide 4. This is the first quarter that we are reporting under our new three-segment structure: Data Centers, Commercial HVAC and Performance Technologies.

Starting with the Data Center segment, revenues increased 90% from the prior year, but were down, sequentially, from the previous quarter, as expected. As we discussed last quarter, we began experiencing supply chain shortages of certain key components that impacted production volumes in the quarter. In response, we started taking decisive action to secure supply. Our existing suppliers are expanding capacity to meet market demand, and we are negotiating commitments to secure the volume of components we need for fiscal '27 and beyond.

While we regularly assess our supply chain risks, recent component shortages materialized, even earlier than anticipated. We quickly activated our contingency plans, which included dynamically resequencing our capacity rollouts. Because we are actively staffing and preparing our broader network for significantly higher volume, these sudden part shortages caused temporary downtime and lower-than-planned capacity utilization, across our expansion sites. As a result, both labor efficiency and overhead absorption were below our normal levels, which negatively impacted our margins in the quarter.

The key takeaway here is that these margin pressures are a transitional timing issue, not a structural one. While these supply chain realities expand the time line to reach full operating efficiency across our network, they do not impact our ability to meet our recently announced long-term capacity agreements or our financial targets for this year.

Most importantly, the underlying demand for our products is unprecedented. We just logged our third consecutive quarter of record order intake, driving another significant increase in our backlog. We remain firmly focused on executing our expansion and securing critical components so that as the supply chain normalizes, our facilities are primed to effectively deliver on this massive demand.

Commercially, we continue to focus on our strategic customers and perfect prospects, which include high-quality hyperscalers, Neoclouds and colocation customers, and our new product launches have been a commercial success.

I spent time, last week, visiting our Data Center plants in North America, and I just want to reiterate my confidence in this team. As I jump in to lead this business over these next few months, my focus is ensuring that we are executing on our capacity expansion to support our strategic growth plan.

I anticipate that we will have periodic challenges and setbacks with this exponential growth business. Over the last three years, we have grown revenue at a compound annual growth rate of more than 80%. Even with temporary cost or margin headwinds, very few companies can grow earnings at these exceptionally high double-digit rates. Our visibility and confidence in revenue and earnings growth over the next two to three years remains as high as it's ever been.

Please turn to Slide 5. Our Commercial HVAC business delivered a strong quarter with revenues up 22%. This was largely driven by our acquisition last year and higher coil sales to our Data Center customers. As I previously mentioned, Michael Mahan will be leading this next phase of the 80/20, including a renewed vertical segmentation, which will help to accelerate our acquisition integration, along with very specific targets and actions for each of our general managers.

We are taking strategic actions to optimize our manufacturing footprint in this segment in support of our 80/20 focus and to improve our overall cost structure.

Product lines are being consolidated into our Owatonna, Minnesota, facility, which was part of the CDI acquisition, last year. In addition, we have consolidated coils production in Grenada and Juarez, in order to allow for the capacity expansion for the chiller lines in Granada, while preserving capacity for growth in coils to support our Data Center customers.

Commercially, we're also taking decisive pricing actions to offset inflationary cost increases, including materials and tariffs. This, along with ongoing 80/20 focus, will help improve margins through simplification and efficiency.

Please turn to Page 6. The Performance Technology team continues to focus on preparations for the planned spin-off and merger with Gentherm and was able to hit several significant milestones since our last update. Gentherm completed its S-4 submission to the SEC and once it becomes effective, they will request approval for the transaction from their shareholders.

We have also completed the filing required for an IRS determination letter on the tax treatment of the Reverse Morris Trust transaction and expect to receive a favorable ruling, prior to close.

Internally, we have been working on the IT separation and legal entity reorganization to allow us to deliver a stand-alone operating business to Gentherm.

Overall, these processes remain on track, and we are still expecting to close the transaction before the end of the calendar year, presuming that all the necessary approvals are received and closing conditions are met.

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

Mick Lucareli
Thanks, Neil, and good morning, everyone. Please turn to Slide 7 to review the Q1 segment results.

As Neil mentioned, this is the first quarter reporting results under the new operating segments: Data Centers, Commercial HVAC and Performance Technologies. Please refer to the 8-K filed last week for the historic recast of our results under this new structure.

Beginning with Data Centers, this segment continues to grow at an exponential rate with a 90% increase in sales. Americas sales grew 112% and EMEA sales increased 18%, mainly from growth with strategic hyperscale and colocation customers. As we discussed last quarter, we anticipated that Q1 revenue would be up significantly year-over-year, but down sequentially from Q4. This was due to a significant impact from supply chain shortages that limited our production volume in the quarter and which ended up lasting longer than we originally anticipated.

In addition, we also had a customer program delay and a few delayed shipments at the end of the quarter. The entire industry is continually adjusting to supply and demand changes and despite a few challenges this quarter, the segment was able to deliver well above-average earnings growth.

Adjusted EBITDA grew 27%, resulting in an adjusted EBITDA margin of 14.8%. As expected, the adjusted EBITDA margin was down versus the prior year. This decline was due to a few temporary factors.

First, there was a 150 basis point warranty variance, year-over-year, which was due to a large warranty settlement in the prior year. Also, as part of our production ramp to meet future customer volumes, we've added significant labor and overhead costs. The supply chain shortages caused significant inefficiencies in our plants as we ramped our labor and manufacturing capacity to handle higher volumes. The excess labor, along with unfavorable overhead absorption on the lower volumes, had a 450 to 550 basis point impact on margins during the quarter.

Last, we experienced unfavorable product mix, combined with some higher material costs, partially related to supply chain shortages. These will be addressed through our commercial agreements, and we expect this will contribute to sequential margin improvement, next quarter.

With regards to the operating income and adjusted EBITDA margins, our rate of revenue growth is far exceeding the increase in SG&A spending, which had a positive impact on our margins. SG&A was down nearly 400 basis points as a percentage of sales.

As supply chain catches up, capacity comes online and revenue grows, we expect adjusted EBITDA margin to improve. We fully expect the segment margin will improve in Q2 and continue that trend in the second half of fiscal '27.

Despite some periodic growing pains, we're excited about the overall momentum in this segment. Based on our revenue and margin outlook, we anticipate that the Data Center segment will generate earnings growth in excess of 85%, this year.

Please turn to Slide 8 to review the Commercial HVAC segment.

Commercial HVAC also delivered strong revenue growth with a 22% increase in sales. HVAC Technologies sales increased $24 million, or 45%, with acquisitions contributing $20 million of revenue in the quarter. Heat Transfer Solutions sales improved 7%, or $11 million, with strong volume in North America coils supporting Data Center customers. Adjusted EBITDA increased 7%, while the margin was down 220 basis points versus the prior year.

Similar to the Data Center segment, we anticipated a negative margin comparison for Q1, mostly due to a temporary business mix. First, the recent acquisitions have contributed to a lower mix impact on adjusted EBITDA margin. As part of the integration plan, the team is consolidating the manufacturing footprint, and that resulted in some inefficiencies in the quarter. We also had some unfavorable revenue mix with a higher mix of lower-margin coil business and a lower mix of our higher-margin heating and coolers businesses.

Overall, Commercial HVAC is on track for the year with great opportunities for this leadership team to drive both growth and margin expansion, through new 80/20 initiatives. We're anticipating double-digit earnings growth this fiscal year with incremental improvements in adjusted EBITDA margin, each quarter.

Please turn to Slide 9. Performance Technologies revenues remain impacted by challenging end market demand. Heavy-duty equipment sales were higher by 1%, or $1 million, driven by higher GenSet product sales, partially offset by lower sales to off-highway agricultural equipment customers.

On-highway application sales decreased 5%, or $9 million, due to lower end market demand from automotive and commercial vehicle customers. The segment adjusted EBITDA declined 3% from the prior year and adjusted EBITDA margin decreased 10 basis points to 13%. The margin decline was mostly driven by lower sales volume and the lag effect of recovering higher commodity metals and tariffs.

Based on the current metals trends, we do believe this situation will become more favorable in future quarters.

Cost savings initiatives resulted in a $2 million reduction in SG&A expenses this quarter, helping to partially offset these impacts. Despite these challenging market conditions, the team remains focused on delivering higher margins and earnings for the segment this fiscal year. As Neil covered, the separation plan and merger with Gentherm is progressing nicely and remains on track.

Now let's review the total company results. Please turn to Slide 10. First quarter sales increased 28%, driven by the revenue growth in Data Centers and Commercial HVAC. Gross margin declined 340 basis points to 20.8%, driven by the lower margins across all three segments.

We continue to invest in incremental SG&A to support strong growth in Data Centers while redeploying resources across all areas of the company from an 80/20 perspective. Incremental spending has been partially offset by lower SG&A in Performance Technologies. In addition, corporate SG&A includes $7.1 million of expenses, directly related to the PT spin-off, primarily for professional services to prepare for the transaction. As revenue continues to accelerate at a faster pace than SG&A, total company SG&A declined 60 basis points as a percentage of sales to 11.8%.

Adjusted EBITDA grew 5%, resulting in a $5.1 million year-over-year increase. Due to the specific items I reviewed in each segment, the adjusted EBITDA margin was down 270 basis points to 12.2%. Again, as I previously covered, we anticipated most of the change in margins. This includes working through supply chain shortages in the Data Center segment, along with a Q1 negative mix impact in commercial HVAC and reflecting the low market volumes and rising costs and tariffs in PT. We believe these are all transitory, and we have very specific actions to improve margins in all three segments as the year progresses, and we remain on track to deliver our full year targets.

Last but not least, from an EPS perspective, adjusted earnings per share was $1.53, or 44% higher than the prior year. This includes a favorable income tax benefit related to shares issued for stock-based incentive compensation awards, during the quarter. However, we expect this benefit to be largely offset in the remaining quarters by other offsetting items, and our full year effective tax rate will be generally in line with our previous estimate.

Now moving to the cash flow metrics, please turn to Slide 11. Free cash flow was slightly negative in the first quarter. This was lower than the prior year by $5 million, mostly due to a few factors.

First, we had higher capital expenditures versus the prior year. In addition, the first quarter had over $60 million of other cash flow items, including higher contract assets related to revenue recognition, cash taxes and incentive compensation. These were partially offset by favorable working capital improvements. Last, first quarter free cash flow included $14.9 million of cash payments, primarily related to restructuring and disposition-related costs.

Net debt of $433 million was $70 million higher than the prior fiscal year-end, driven mostly by the repurchase of treasury stock in connection with Modine's share-based compensation program. Participants are allowed to sell a portion of their shares back to the company to cover their income tax withholding requirements. However, the shares are repurchased and held as treasury stock, reducing the number of shares outstanding used to calculate earnings per share.

Our balance sheet remains strong with a leverage ratio of 0.9, and based on our current outlook for earnings and cash flow, we anticipate the leverage ratio will decrease further, by year-end.

Now let's turn to Slide 12 for our fiscal 2027 outlook. As announced in our press release, our current revenue and earnings outlook is unchanged. Delivering on these results would represent our fifth consecutive year of record results. Also, our outlook includes Performance Technologies for the full fiscal year. Once we know when the pending transaction will close, we'll provide an update on our full year outlook for the remaining business. Then we'll report the historical results for PT in discontinued operations starting for the quarter in which the transaction closes.

For fiscal '27, we expect total company sales to grow in the range of 20% to 35%. For the Data Center segment, we expect sales to grow 60% to 80%. For Commercial HVAC, we expect sales to grow 5% to 10%, this year. For Performance Technologies, we anticipate sales to be flat to up 5%, driven primarily by pricing mechanisms in our customer contracts for higher materials. We're expecting most markets to be flat with an opportunity for improvement in the back half of the year.

We expect fiscal '27 adjusted EBITDA to be in the range of $650 million to $680 million, representing a growth rate in excess of 40%. And this implies at least 100 to 200 basis points of margin improvement, driven by a margin increase in all three segments. And from a sequential standpoint, we expect a step-up in margins from Q1 to Q2. And for the remaining three quarters, we anticipate that each quarter will result in strong double-digit year-over-year earnings growth, along with favorable margin comparisons.

From a free cash flow perspective, we expect that we'll generate a higher level of free cash flow. And as a percentage of sales, we believe full year free cash flow will be between 4% and 6%.

Please see the appendix in this presentation for all the key assumptions, including interest expense, taxes, depreciation and amortization.

As we currently look at the next several quarters, we expect that margins and earnings will increase sequentially through the year, driven by the Data Center trends and our material cost recovery plans.

To wrap up, we remain excited about fiscal ‘27 and expect to deliver another year of record sales and adjusted EBITDA.

Despite a few margin-related headwinds in the first quarter, we remain confident that our strategy and investments will generate continued long-term and sustainable growth for Modine shareholders.

With that, Neil and I will take your questions.

Operator
If you have a question at this time, please press the “*”, then “1” key on your telephone. A confirmation tone will indicate your line is in the question queue. You may press “*”, then “2” if you’d like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset, before pressing the star keys.

Our first question comes from Noah Kaye with Oppenheimer. Please go ahead.

Noah Kaye

Hi, good morning. Thanks for taking the questions, Neil and Mick. I think just trying to unpack the outlook here, implied in the 85% segment earnings growth for the Data Center segment, some pretty healthy margin expansion there for the full year. Maybe that's a good place to start. Can you help us understand the trajectory as you see it moving through the year? I know you talked about sequential improvement, but just how to think about the shaping of that if possible. And it would really, I think, get into kind of level of confidence around supply chain issues abating and improving deliveries. So maybe you can comment on all that.

Mick Lucareli
Let me go first, Neil. All right. Hey, Noah, it's Mick. So just kind of level set again and we provided the recast, we had talked about over the last several quarters last year, the Data Center business hovering around the 20% EBITDA level, and we can go through any more questions with regard to the current quarter. But Q4, we were between 19% and 20%. Q1, a year ago, I mentioned the warranty issue where we had a large settlement, but that was about 20% normalized.

When we look at going into Q2, we would expect, right now, a lift to be back between 19% and 20%, really driven by a significant lift in the volume recovering. We expect to see about $100 million of incremental revenue, which would put us back ahead of our Q4 level. And with that, we'd recover or capitalize on those fixed costs. So from a sequential and a step-up around our confidence in that, we see Q2 getting quickly back to where we've proven we can be and where we've been even with, even all the expansions.

And then the second part of your question, second half, we continue to have more and more as a percentage of our total capacity online, and the throughput will continue to flow through at higher incrementals. So we see the second half of the year clearly to get to our targets, we'd see a step-up in Q3 from Q2 in margin and then another step-up in Q4 from Q3.

Obviously, the plan here is our second half would be operating for the first time in a while with the higher volumes above that 20% EBITDA margin range second half of the year. Neil, did I miss anything?

Noah Kaye
Sorry, Neil, if you want to add anything else, but that's extremely helpful, Mick. I think the question around demand, I think your results continue to speak to that. A third record quarter of orders. You talked about the backlog sort of more than doubling. Maybe you can talk a little bit about kind of conversion cycle times on backlog, at this point. Are you seeing kind of backlog extend out, and how does that factor into your capacity planning?

Neil Brinker
Yeah, thanks, Noah. This is Neil. Certainly, it does factor into the capacity planning, especially when we have to arrange the schedules within our plants based on available parts. So we take these orders, we bring in and build our backlog and we base it upon our launch schedules of our

product lines, as well as existing lines that we have. So, the backlog isn't totally made up of just product that needs to be produced in chiller facilities, we also have a great amount of backlog on our air handling units and with Scott Springfield as well, which has very stable manufacturing at this time. So yeah, those are considered. We factor that into our forecast. We factor that into our materials planning, as well as our product launches inside the facilities.

Noah Kaye
All right.

Operator
Our next question comes from Matt Summerville with D.A. Davidson. Please go ahead.

Matt Summerville
Thanks, a couple of questions. First, can you talk about whether you've started to see your A-Quad customer begin to execute orders against that capacity LTA? And based on your ongoing discussions with this customer, how you see that LTA cadencing out between '27, '28, and '29. And then I have a follow-up. Thank you.

Neil Brinker
This is Neil. Thanks, Matt. Yes, we are seeing that. We've taken a couple of orders, already. We anticipate more orders, as early as next week. And that is right in line with what we expect for orders for order intake in Q4. So typically, we would suggest it'd be anywhere between a four to six-month lead time in order to prepare for that, and we're right in line with what our expectations were.

In regards to the rollout in '27, '28 and '29, it's 20% to 25% in '27. And then, Kathy, it's 40?

Kathy Powers
Thirty five.

Neil Brinker
Thirty five percent to 40% in '28 and '29.

Matt Summerville
Got it. As a follow-up then, maybe walk through exactly what's kind of been happening supply chain-wise, and help us better appreciate your confidence in your ability to lock down the remaining supply you need for this fiscal year and talk through whether or not you're considering a longer-term sort of supply LTA, if you will, to synergize with your own capacity agreement?

Neil Brinker
Sure, that's a good question. Yes, the answer is yes. And with our critical suppliers, we are actively engaged and in discussions with LTAs and would expect to have that for FY '28, as well

as FY '29 in place, soon. In regards to today and now, I've been very public about the amount of suppliers that we've worked with. We doubled our supply chain spend year after year after year as we've grown the business, and this was yet another year of that.

So this is something that we're familiar with in how we manage it. And I was pretty public that we would have four suppliers that we would put into that category that would potentially make us vulnerable. And we identified that early on in our risk management process.

The issue here was the timing. The shortages hit faster than we anticipated. With that, we decisively engaged our current suppliers, and we're expanding our own capacity, and we're aggressively taking additional steps to mitigate this. In one instance, we're even considering vertical integration.

So, we have done some pretty interesting things. I'll give a lot of credit to the operations team. We really upskilled in operations. We've really invested in operations and brought in some key talent, particularly in the plants and at the most senior levels that are negotiating these long-term contracts, as well as helping us dynamically balance our launch schedules in line with the available capacity.

Matt Summerville
And then just I'm going to sneak in one more. When do you envision activating the remaining chiller lines in Grenada, Jefferson City and the Dallas area? And I dropped for a second, so I apologize if you already covered that. And then are you thinking any differently about the 50% to 70% Data Center organic framework you initially laid out and supported on your last earnings call for fiscal '28? I think that was a comment from Mick, last quarter. Thanks.

Neil Brinker
Yes, we're confident in the numbers that we put out, Matt. And we're going to get the flow from the materials corrected. We're going to get our supply chain situation resolved, and we'll be able to catch up and we'll be able to deliver on those numbers as we ramp lines.

But certainly, the capacity that we would anticipate that we are expanding in those regions you just asked about, by the end of the fiscal year, we'll be back on track and on schedule.
Meaning, the lines will be up and established at some level of efficiency by the end of the fiscal year for each of those regions.

Matt Summerville
Understood. Thank you, guys.

Operator
Our next question comes from Neal Burke with UBS. Please go ahead.

Neal Burk

Thanks for the questions. You mentioned backlog doubling. I know you don't quantify this, but can you provide some indication of the level of coverage you have relative to sales expectations for this year? I just wonder in maybe like a more negative scenario with the supply chain issues, is there potential for some of the strong demand in the Data Center market to maybe be met by others who are less, kind of restricted on supply chain?

Mick Lucareli
Yeah, I'll go first. It's Mick. Probably the best way to think about the revenue outlook and order book is when we start a year, we have probably 70%, 80% of it in firm orders or for us being a March year-end, we'll typically talk about really -- and also Neil said typical POs being, call it, six months or so, really, really firm six months out, two quarters. That's about production supply chain execution, a little bit softer a third quarter and our fourth is customers are there. They're giving us full visibility, but we always say we don't have firm POs.

As we're moving through the year now and it will be the roll forward, Neil was talking about and about also the LTA we have with the hyperscaler, the orders and POs for our Q4 will start coming in. And that's another reason why, each year, we've tried to start with a wider band and make sure we have contingency plans in there with our hope is as the year goes on, we're not only firming up our Data Center revenue but hopefully pushing it to the higher end. Neil, anything you want to add on the second part?

Neil Brinker
Yeah, and to your question, Neal, could they go somewhere else for that capacity? I would be more concerned if we were a commodity, but we're not. We have a value-added product that our customers desire to help solve their critical challenges and help them with their efficiency goals that they want to gain.

So what we have to do is we have to approach this in the right manner, which is leveraging 80/20 on how we handle these commercial engagements. So our largest customers get priority. So when we see these shortages, we make sure that we keep up with demand with our largest customers at our key accounts, which means we have to have some more difficult conversations with some of our smaller customers, which we have. And with our smaller customers, they understand as long as we give them enough time and we give them enough visibility, they're willing to work with us because they want the product.

Fortunately, for us, there's longer lead time issues in the Data Center supply chain that when we are building Data Centers, there are some things that are beyond even some of our longest lead times. So if we give them the proper visibility and they can plan for it, we don't surprise them, then we maintain those orders and those relationships and sales.

Neal Burk
That's helpful. And one other question, Mick, you mentioned that you expect Data Center revenues, I think, up $100 million in 2Q. And you mentioned that volume and margin

improvements, as the quarter progressed. So any indication like we're towards the end of July here, like any indication how the month is trending in terms of availability and Data Center volumes? Thank you.

Mick Lucareli

Yeah, sure thing. Neil, I'll let you go first with regards to anything with regards to -- are you really -- you're kind of asking about how the first month here of the quarter is kind of looking?

Neal Burk

Yes, yes.

Neil Brinker

So, we've secured supply chain for going forward for this year. Assuming that they deliver on what our expectations are and what we've agreed to, then we'll have the supply chain necessary to meet our demand.

Neal Burk

All right, that's clear. Thank you.

Operator

Our next question comes from David Tarantino with KeyBanc Capital Markets. Please go ahead.

David Tarantino

Hey, good morning, guys.

Neil Brinker

Good morning.

David Tarantino

I just want to follow up on those last comments you're making, Neil. I think you said that the supply chain issues hit faster than expected, but I think in the release, you also mentioned that you saw improvement as the quarter progressed. So maybe just kind of paint us a picture on how it progressed through the quarter, maybe give us some color on how it kind of progressed through June and July and how that the actions you've taken showed through, sequentially.

Neil Brinker

Yeah, so when a few suppliers, critical suppliers across this space, and I think you've seen it with some of our competitors, we've even seen this with it, these critical suppliers essentially shut a lot of us down with a hard stop, and then we had to go in to negotiate specific volumes. The original projected volumes that they provided us were not going to be accepted. And the team did a really good job punching above their weight in order to secure supply, considering that everybody in the industry needed these components.

So, we were able to negotiate with them and secure that supply and then get the facilities back up and running. Now during that period of time, we had to make a decision, right? We've got some lines that are in the middle of launching that require these parts. They require these components. And we now have to reposition these parts that become available to our highest producing, most efficient lines so that we can get the throughput necessary, which means you have to idle some other areas, which means you have to carry overhead and you have to carry the labor in order to do this, knowing that this is a short-term problem.

So those are the decisions we make. We're going to continue to train our employee base. We're going to carry that additional overhead. We're going to carry that labor because we know this is a short-term issue that we're going to be able to get through in a couple of months, while we start to establish these long-term agreements with these suppliers. And then look at other ways to risk mitigate this. So, there's multiple ways that the teams are working on risk mitigation, so when we have these types of issues, we can pivot and we can adjust faster.

Mick Lucareli
Yeah, just one thing to add to that. I want to make sure, too, when we look at the margins and the growth and the outlook, to me, from the finance standpoint, it's all about volume and the throughput. You always talk the product is there, the demand is there. It's a premium product.

Even when we look at the quarter, I can tell you that, to your question, the third month or the month of June, we were right where we normally want to be from a margin standpoint. So I won't go into details by month, but I can tell you, the first month or two where we're really having the shortage and where we finished the third month of the quarter was right back where we'd expect to be and where we've been.

And then, so when we look at Q2, it's like Neil said, assuming parts are there, it's all about the volume, the conversion, the margin will come through.

David Tarantino
Okay, great. Yeah, that's very helpful color. And then you talked about record orders, backlog in Data Center. So maybe could you give us some color on the drivers between customer types and technologies here? And maybe just update us on the pipeline opportunities beyond the orders you received in the quarter and how that's evolved, particularly relative to kind of some of the incremental growth opportunities around both new products and customers.

Neil Brinker
A big driver of that was with a couple of hyperscalers for us that they continue to provide larger forecasts, as we see the growth with their Data Center build-outs. And then the third one was with a large Neocloud provider that we've worked with, closely. So it's basically the three largest customers that we have that are hyperscaler and Neocloud that continue to increase their forecast with us.

David Tarantino
Okay, great. Thanks, guys.

Operator
Our next question comes from Brian Drab with William Blair. Please go ahead.

Brian Drab
Okay, thanks for taking my questions. That last one was going to be my first question, so I got that answer. Neil, can you just address, again, are you seeing any change in demand for chillers related to evolving cooling system architectures and inlet fluid temperature spec for future GPU designs?

Neil Brinker
Yeah, I mean, it’s improving. It's increasing for us because of the technology that we have with free cooling. As these temperatures increase, we have, I think, a really strong product to support that. And it just will continue to enhance in terms of the desire and the need for chillers. You saw that with the LTA that we took with a large hyperscaler out into '29. And we continue to see that with increased forecasts, as we introduce the chiller product line. And our enhanced 3-megawatt chiller as well to our customers are very, very excited.

Brian Drab
So, it is the idea that the idea that's driving the continued demand even if inlet temperatures are going to be higher. So I mean, really, is it the combination of your chiller technology with the free cooling and the chiller, it has to be there for almost like an insurance policy, even if it's used maybe fewer days throughout the year than it would have been otherwise?

Neil Brinker
That's exactly correct. So, even if you're running at a higher inlet temperature, that's great because you can drive further efficiency and reduce the amount of power consumed to the Data Center. We're all for that. And that's why we want to go into that free cooling mode. But in the event where you reach a temperature above that, then you have put everything at risk if you don't have the insurance policy of the chiller in the refrigerant cycle.

Brian Drab
And can you give any sense for the last wave of orders that you've gotten, pick the time period in the last six months or a year? Do you have a sense for the breakdown of your chiller demand across the two categories of facility cooling versus incorporation into direct-to-chip liquid cooling system?

Neil Brinker
Well, they support both. So it's hard for us to kind of delineate between the two because you'll have similar models and SKUs on the same rooftop of a Data Center that does both. So without getting inside of the DC, it's hard for us to measure that. But I can tell you that the orders have

increased, and that's where we're seeing the backlog, in particular, with our air handling units, as well as our chillers.

Brian Drab
Okay. And then last one, if I could. You essentially sold most of your chiller capacity, I believe, with that LTA and like more than half of it at least and probably well more than half in the out years. So I'm wondering if you're seeing other customers maybe step up and more strongly considering an LTA to get their share of the product, going forward.

Neil Brinker
Yeah, I'd say about half of it was part of the LTA, and I think that will be reduced over time, as we get more efficient with our product manufacturing, as well as when we launched the 3-megawatt chiller. We'll be able to produce more and the capacity will increase based on the ratio of 2 megawatt versus 3 megawatt.

But certainly, we're in conversations with folks on timing. I don't see any LTAs of the same level of significance that we had with our first hyper. But definitely, there are conversations as this -- as we continue to scale and ramp our facilities. We're looking at agreements that 12 to 18 months that are not necessarily as long as the 3-year agreement we had with the hybrid.

Brian Drab
Got it. Okay, thanks very much.

Operator
Our next question comes from Jeff Van Sinderen with B. Riley Securities. Please go ahead.

Jeff Van Sinderen
Good morning, everyone. Just regarding the customer-driven delays that I think you mentioned in your prepared comments, are there any other major delays or shifts in timing by your customers that are potentially pending that they maybe made you aware of, that you're watching closely, that could impact demand timing? And then also, are any of those factored into guidance that could shift in or shift out? And then finally, what's the root cause of the delays? Is it centered around supply chain?

Neil Brinker
I'll take the last one in terms of what the root cause is. That is based on new product launch. So that is a design that we're doing with a specific hyperscaler around a unique product that's for the hyperscaler that we're in probably the third iteration of the design cycle. And when we went through some updates to the print and some updates to the overall specifications of the product, and it adjusted it out of the quarter for the build.

Mick Lucareli

Yeah, and second, Jeff, we have at all times in our forecast with the nature of the markets and some of the large construction projects attached, we do have contingencies and we try to take different scenarios to this. I think, candidly, in Q2 was just a little bit of a perfect storm of some of the supply base items Neil talked about were deeper or longer. And then when the parts come in, these are such large components, you can't just make them up in a week or two with the lines and labor, even though parts are coming in the door.

And then combined with what Neil said, and I reiterate that, it wasn't like chiller orders getting canceled or pushed out. That was a new product launch. But going forward, we do try to build in contingencies and flexibility into our outlook, knowing things are going to go. We see ins and outs almost daily in the order intake and the production plans.

Jeff Van Sinderen
Okay, that's helpful. And then just kind of regarding the fiscal Q2 metric framework, wondering how you're thinking about order of magnitude for EBITDA or just EBITDA margin recovery. Do you think it's kind of more gradual maybe in Q2 and then sharper in Q3 and Q4? Or how are you thinking about that for the remaining quarters of the year?

Mick Lucareli
Yeah, so a couple of thing and Performance Technologies, I think we'll just address that. We expect pretty much the next quarter or two about the same. It's at the same market conditions, and they are doing a nice job to offset any cost or inflation there. So kind of similar level of margin there. Q2, we see a step-up with commercial HVAC. I already mentioned on the call a large step-up in Q2 for Data Centers, really getting back to where we've been in that range again. And if you put that all together for us, it would be a nice step-up in our Q2 here, probably a 200, 250 basis point lift.

And I mentioned on the call, we see Q2, 3 and 4 having more favorable year-over-year, obviously, margin comparisons, as well. So a pretty good step-up in Q2. And then someone had asked earlier, obviously, what's implied for the full year with Data Center is we would expect a margin step up in Q3 and in Q4, as well. So that will be a big driver of our second half.

Jeff Van Sinderen
Okay, great. Thanks for taking my question. I'll take the rest offline.

Operator
Our next question comes from Chris Moore with CJS Securities. Please go ahead.

Chris Moore
Hey, good morning, guys. Just in terms of the product launches you were talking about, I wasn't sure if you were -- I know in the past, you've talked about modular Data Centers and you're partnering with one hyperscaler working on the second generation, soon to be third

generation. Were you talking about the modular Data Center, or is that a separate topic to discuss here?

Neil Brinker
No, that was it, Chris. It was the same with that product.

Chris Moore
Got you. Okay. And just in terms of kind of as we move forward with Out Performance Technologies, looking at when things normalize a little bit, just maybe from a gross margin perspective, looking at Data Center and looking at commercial HVAC, is there kind of a normalized level that we should be thinking about? Or which of those segments, likely, is going to drive the higher gross margin, moving forward?

Mick Lucareli
A really good question. And we haven't yet done the official pro forma for you, but I'll let you guys do that math. Clearly, part of the challenge on the PT side has been around the gross margin.

Frankly, the commercial HVAC and Data Center, Neil and I have talked about their ability to operate at like a 30% type gross margin. Some of those businesses within there have already been there, are there and have been there. And I think in the case of Data Centers, Neil and I said that's a direction to go as we start to get more level loaded in a capacity utilization or a fixed cost absorption.

But you're right, if you back out Performance Technologies, we're probably thinking about somewhere between a 7% to 10% type gross margin lift when we are a pure HVAC Data Center company.

Chris Moore
Got it. Very helpful. I'll leave it there. Appreciate it, guys.

Operator
Our next question comes from Matt Summerville with D.A. Davidson. Please go ahead.

Matt Summerville
I just have a quick follow-up. Kind of where are you, I guess, in your decisioning on whether or not Modine will ultimately need incremental fixed capacity or thinking about migrating more towards a variable model, as you think about being able to more broadly address some of the hyperscalers that weren't part of the discussion when you referenced three specific customers as being the main driving force behind your air handlers and your chiller orders and backlog?

Neil Brinker

Yeah, we certainly have these conversations in terms of our manufacturing footprint and our supply chain strategy. And it's also at the forefront of our design, as well. So as we think about our design, we're designing for the ability to be more modular, not the modular unit, but modular as a term, meaning we have more flexibility because you have more of a systems approach in the factory.

So, when we think about that, the range is right around $4 billion that we feel we have the capacity for, over time, with the existing CapEx deployment as well as the facilities and rooftops we have in place, today. To get beyond that, it would be a different level of CapEx outlay, if we were to choose to do that, or it could be a combination of both incremental additional facility or more efficiency on the existing lines and then leveraging some supply chain to help produce that overflow capacity.

So I think we've got time to figure that out, and we will. But certainly, we get more and more confidence that this is a problem that we are happy to solve for, as we see the backlog and order increase.

Matt Summerville
Perfect. And then I just want to make sure I understood Mick, correctly. So the Data Center side of the business in the month of June was hitting sort of your desired profitability objective you kind of laid out for the September quarter in that 19% to 20% range and July is functioning along those same lines. Did I interpret that correctly, or am I interpreting that, correctly?

Mick Lucareli
You are. You're adding a little color, but that's okay. It is, but that was my point. I'm not tracking margins mid-month here. But what I wanted to make sure, it was a good question, I think, from David. When we went through the quarter, we really saw the impact of that supply chain and having the plants waiting for parts. But I was really happy to see when we started the lines up again, we finished the quarter. I think what I was saying, I'd say is it was up much more in range with where we'd expect it to be.

So yes, you heard it right. I didn't comment on July but, frankly, that's just because I'm not tracking. I'll get profitability reports here as we come to the end of the month next week, but I did want to say that June was a big uptick, and that's a really positive signal.

Matt Summerville
Perfect. Thank you, guys.

Operator
Our next question is from David Tarantino with KeyBanc Capital Markets. Please go ahead.

David Tarantino

Hey, just had two quick follow-ups. Maybe on commercial HVAC, we haven't touched on that yet. Just good to see some updates here on 80/20 initiatives here. But now that we can see the margins here more clearly, could you frame for us the opportunity here and how we should expect margins to progress both this year and kind of what the opportunity on 80/20 is, longer term?

Mick Lucareli
Yeah, I'll take it and Neil can add any color if we want. Yeah, I mean, that HVAC business, especially when we look at our heating business as one of the most profitable across our companies, in a normal environment, I think we'd like to see that operating north of 20 or in the low 20s from an EBITDA percentage. I mentioned that we're going to see an uptick here in Q2, probably 150 basis points or so. And we still think this business will end the year somewhere between 18% and 20%. But from an 80/20 perspective, that is the opportunity set that I think you're asking about. Last year, it was about 16.7, so the goal here is to add a 200 basis points, this year. And then I would expect we could do it again the following year.

Frankly, the products are there, the business is there and the demand. We're doing a lot of plant consolidation right now, from an 80/20 perspective, and we can drive significant margin improvements through leveraging 80/20 from an operations standpoint.

David Tarantino
Okay. Great. And then maybe just a quick one on capital allocation. Clearly, organic investments is a focus, but balance sheet still remains pretty clean. So just following the drawback here in shares, like would you consider leaning more into buybacks?

Mick Lucareli
Yeah, well, I know we have regular dialogue, Neil and I, with the Board on that. And yeah, for sure. I think the two things we've said and, hopefully, we'll come here to the last stretch of the spin-off. But we've said we'll also need to gear up with an M&A outlook post that. But obviously, with the shares trading down, we'll always have that discussion with the Board, as well.

David Tarantino
Great, thanks, guys.

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

Kathy Powers
Thank you and thanks to everyone for joining our call, this morning. The replay will be available through our website in a couple of hours. We hope everybody has a great day. Thanks.

Operator
This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.