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Allison Transmission Holdings, Inc. (ALSN)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. Thank you for standing by. Welcome to Allison Transmission's First Quarter 2024 Earnings Conference Call. My name is Doug, and I'll be your conference call operator today. At this time, all participants are in a listen-only mode. After prepared remarks, Allison Transmission executives will conduct a question-and-answer session and the conference call participants will be given instructions at that time. As a reminder, this conference call is being recorded. [Operator Instructions]

I would now like to turn the call over to Jackie Bolles, Executive Director of Treasury and Investor Relations. Go ahead, Jackie.

Jacalyn C. Bolles
Executive Director-Treasury & Investor Relations, Allison Transmission Holdings, Inc.

Thank you, Doug. Good afternoon and thank you for joining us for our first quarter 2024 earnings conference call. With me this afternoon are Dave Graziosi, our Chair and Chief Executive Officer; and Fred Bohley, our Senior Vice President, Chief Financial Officer and Treasurer. As a reminder, this conference call, webcast and this afternoon's presentation are available on the Investor Relations section of allisontransmission.com. A replay of this call will be available through May 9.

As noted on slide 2 of the presentation, many of our remarks today contain forward-looking statements based on current expectations. These forward-looking statements are subject to known and unknown risks, including those set forth in our first quarter 2024 earnings press release, our Annual Report on Form 10-K for the year ended December 31, 2023, as well as other general economic factors. Should one or more of these risks or uncertainties materialize or should underlying assumptions or estimates prove incorrect, actual results may vary materially from those that we express today.

In addition, as noted on slide 3 of the presentation, some of our remarks today contain non-GAAP financial measures as defined by the SEC. You can find reconciliations of the non-GAAP financial measures to the most comparable GAAP measures attached as an appendix to the presentation and to our first quarter 2024 earnings press release. Today's call is set to end at 5:45 PM Eastern Time. In order to maximize participation opportunities on the call, we'll take just one question from each analyst.

Please turn to slide 4 of the presentation for the call agenda. During today's call, Fred will review our first quarter 2024 financial performance and full year 2024 guidance. Dave will then close with an update on recent announcements across our business, prior to commencing the Q&A.

Now, I'll turn the call over to Fred Bohley.

G. Frederick Bohley

Senior Vice President, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

Thank you, Jackie. Good afternoon and thank you for joining us. Building on record performance in 2023, first quarter 2024 results demonstrate the continued momentum in our business. First quarter net sales were a record $789 million, an increase of 6% from the same period in 2023. Our year-over-year top line increase was driven by robust Global On-Highway demand, as well as strength in our Defense and Outside North America Off-Highway end markets.

Please turn to slide 5 of the presentation for the Q1 2024 performance summary. Year-over-year, net sales increased 6% from the same period in 2023 to a record of $789 million. The increase in the year-over-year results was led by a 12% increase in the North American On-Highway end market, driven by strength in demand for Class 8 vocational and medium-duty trucks and price increases on certain products.

Our Defense end market net sales increased 78% from the first quarter of 2023, principally driven by higher demand for tracked vehicle applications. Year-over-year results increased 83% in our Outside North America Off-Highway end market, principally driven by strength in demand from the energy, mining and construction sectors. Net sales in the Outside North American On-Highway end market increased by 6%, leading to record first quarter net sales, principally driven by higher demand in Asia and price increases on certain products, partially offset by lower demand in Europe.

Gross profit for the quarter was $366 million, an increase of $5 million from $361 million for the same period in 2023. The increase in gross profit was principally driven by increased net sales and price increases on certain products, partially offset by higher manufacturing expense, including $13 million of non-reoccurring UAW contract signing incentives, and higher direct material cost.

Net income for the quarter was $169 million, a decrease of $1 million from the same period in 2023. The decrease was principally driven by higher manufacturing expense, $14 million of non-reoccurring UAW contract signing incentives, $10 million of unrealized mark-to-market adjustments for marketable securities and higher direct material costs, partially offset by increased net sales, price increases on certain products and lower income tax expense.

Adjusted EBITDA for the quarter was $289 million compared to $276 million for the same period in 2023. The increase in adjusted EBITDA was principally driven by increased net sales and price increases on certain products, partially offset by higher manufacturing expense and higher direct material cost.

Diluted earnings per share increased 3% from the same period in 2023 to $1.90, which includes a $0.13 impact from $14 million of non-recurring UAW contract signing incentives incurred in the quarter. A detailed overview of our net sales by end market and Q1 2024 financial performance can be found on slides 6 and 7 of the presentation.

Please turn to slide 8 of the presentation for the Q1 2024 cash flow performance summary. Adjusted free cash flow for the quarter was $162 million compared to $169 million for the same period in 2023. The decrease was principally driven by higher cash incentive compensation payments and non-reoccurring UAW contract signing incentive payments, partially offset by higher gross profit and lower capital expenditures.

During the first quarter, we paid a dividend of $0.25 per share and repurchased $52 million of our common stock. We ended the quarter with a net leverage ratio of 1.7 times, $551 million of cash and $745 million of available revolving credit facility commitments. In addition, we continue to maintain a flexible, long-dated and covenant-light debt structure. Of our $2.4 billion of outstanding debt, $518 million is subject to variable interest rates, of which $500 million is hedged, resulting in nearly all of our debt being fixed through the third quarter of 2025.

Please turn to slide 9 of the presentation for the 2024 guidance. We are reaffirming our full year 2024 guidance provided to the market on February 13. Allison expects net sales to be in the range of $3,050 million to $3,150 million. In addition to Allison's 2024 net sales guidance, we anticipate net income in the range of $635 million to $685 million; adjusted EBITDA in the range of $1,070 million to $1,130 million; net cash provided by operating activities in the range of $700 million to $760 million; and capital expenditures in the range of $125 million to $135 million; and adjusted free cash flow in the range of $575 million to $625 million.

Thank you. I'll now turn the call over to Dave for an update on recent announcements.

David S. Graziosi

Chairman & Chief Executive Officer, Allison Transmission Holdings, Inc.

Thank you, Fred. We continue to make investments and realize initiatives in order to grow our business in new markets and regions where automatic transmission penetration remains low. Today, I would like to highlight a few recent announcements relating to our Outside North America On-Highway end market.

In 2022, we highlighted our growing presence in the South American agriculture sector since our entrance in 2015. At the time, we noted that leading OEMs in Argentina selected the Allison 2000 series and 3000 Series transmissions for use in their agricultural sprayers due to the enhanced performance in soft soil, which is critical in this application. Today, in Argentina, most ag sprayers are now equipped with Allison fully automatic transmissions, where traditionally hydrostatic or manual transmissions were used.

During the first quarter, we announced that the first Allison-equipped agricultural sprayer built in Brazil was showcased at an industry trade show in the region. After adoption in Argentina, our successful entry into the Brazilian ag sprayer market is a milestone in our strategic initiatives as we target growth in new markets and applications around the world. We look forward to expanding our global presence as we enter a new application in South America's largest agricultural economy.

Also in our Outside North America On-Highway end market, we recently highlighted our collaboration with Yutong, a leading Chinese bus OEM, in their delivery of transit buses to Rwanda, Rwanda's capital city will once again upgrade its fleet with Allison-equipped buses. Yutong buses utilizing Allison fully automatic transmissions have been in service in Rwanda since 2014, enabling easy and efficient operation while optimizing driver and rider experience. We are pleased to collaborate with global OEMs and customers, showcasing Allison's commitment and initiatives towards growth in global export markets.

Continuing in our Outside North America On-Highway end market, last week, we announced the expansion of our partnership with SANY to provide our 4000 Series specialty transmissions for integration into their 500-ton all-terrain cranes. Our partnership with SANY spans several construction and mining applications, including SANY's 60-ton crane and wide body mining dump trucks. Our proven performance in severe duty-cycles and harsh conditions will provide increased productivity and maneuverability for cranes operating in remote areas of China, including desert and mountain terrain. We are pleased to expand this partnership and look forward to continued success with our products across SANY's portfolio.

For our Defense end market, we maintain our outlook and target for realization of $100 million of incremental annual revenue, as we capitalize on the Defense upcycle both internationally through increased defense investments globally amidst geopolitical uncertainties and domestically through opportunities with the United States modernization programs, as well as increased international sales to (sic) [through] the US Department of Defense.

In support of our international Defense growth and our $100 million incremental annual revenue opportunity, last week, we announced delivery of the first X1100 cross-drive transmissions to Turkey for their Firtina Self-Propelled Howitzer program. Partnering with HST Otomotiv, Allison's licensed manufacturer in Turkey, Allison's X1100 transmission will be utilized by the Turkish Armed Forces in their next generation tracked vehicle. As part of the initial delivery, 10 transmissions have been successfully provided to Turkey, with several already installed in vehicles. Full production of the new vehicle is scheduled for mid-2024, with a total of 140 Firtina Howitzers expected to be delivered to the Turkish Armed Forces.

Finally, in our North America On-Highway end market, in the last few years, we have made numerous announcements of transit properties across the United States selecting the Allison eGen Flex electric hybrid system for their city buses. During the first quarter, we added the New Orleans Regional Transit Authority or RTA to the list. Emergency preparedness is critical for the New Orleans RTA, and during a natural disaster, access to the electrical grid can be disrupted, leaving fully electric vehicles no ability to charge.

The eGen Flex hybrid system does not face the same limitations and can continue to operate using diesel fuel in situations where grid accessibility may not be available, as well as the battery system for fully electric engine-off propulsion. We were pleased to add the New Orleans RTA to our list of transit properties in states such as Indiana, Wisconsin, Nevada, California and Texas that recently selected the eGen Flex as their propulsion solution of choice. We are excited for this partnership and remain committed to collaborating with transit agencies nationwide to support them in both emissions reduction goals and emergency preparedness plans.

Just this week, also in our North America On-Highway end market, we announced that the Allison 3414 Regional Haul Series and 4000 Series are available to order as the exclusive fully automatic transmission in Navistar International's RH and HX Series trucks respectively. We previously launched the 3414 RHS with Navistar in 2020, paired with the A26 engine, and have seen adoption by some of the largest fleets in North America, including leading wholesale food distributors. We are proud to collaborate with International Truck to further release both the 3414 RHS and 4000 Series transmissions in the new Navistar S13 engine, and we look forward to further success and adoption across the regional haul market.

Also during the first quarter, we completed a refinancing of our revolving credit facility and term loan. As part of the refinancing, we increased commitments under our revolving credit facility to $750 million, extending the maturity date to 2029, and refinanced $518 million of term loan debt, paying down $101 million of existing term loan debt and extending the maturity to 2031. We maintain our long-standing commitment to prudent balance sheet management and our focus on a low-cost, flexible and pre-payable debt structure with long-dated maturities.

In addition to our commitment to prudent balance sheet management, we remain committed to returning capital to shareholders through our share repurchase program and quarterly dividend. During the first quarter, we repurchased nearly 1% of our outstanding shares and increased our quarterly dividend by 9% to $0.25 per share, the fifth consecutive annual increase to our quarterly dividend. In summary, Allison's first quarter results demonstrate not only the current strong performance of our business, but the notable growth opportunities to come. We continue to invest in our business in order to achieve our growth ambitions, while returning capital to shareholders and delivering on our brand promise to improve the way the world works.

This concludes our prepared remarks. Doug, please open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, at this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Ian Zaffino with Oppenheimer. Please proceed with your question.

Ian Zaffino
Analyst, Oppenheimer & Co., Inc.

Q

Hey. Great. Nice quarter, guys. Congratulations. My question would be on the On-Highway business specifically in North America. Very, very strong. How are we looking at it throughout the year? Can we maintain that strength throughout the second quarter and maybe the back half of the year? And then, also on the renegotiations, I know you've been honoring pre-COVID contracts and a lot of that business. Have you started any of those negotiations yet, talking about what the pricing is going to look like when those contracts expire or any other kind of detail you could give us? And if you could remind us what that – the benefit might be as you renegotiate these and get kind of the pricing back that you've been honoring previously. Thanks.

David S. Graziosi
Chairman & Chief Executive Officer, Allison Transmission Holdings, Inc.

A

Hey, Ian. It's Dave. Good afternoon and thank you for the questions. So, on the North America On-Highway timing, I guess, as you laid out your question, comparing Q1 to the balance of the year, as we said on the fourth quarter call, we were expecting relatively strong conditions entering the year for both medium-duty and Class 8 vocational. That certainly has played out, as other – some of the public OEMs have already reported and you're receiving other commentary. So, I think our view has not changed in terms of the strength of the underlying markets.

We continue, in certain cases, to see some level of supply chain challenges out there. So, I think that mitigates some level of extrapolating the first quarter through the balance of the year. So, I think overall, there's also seasonality, as you know, with some of the underlying users of medium-duty, and obviously, Class 8 vocational. So, having said all that, we continue to stay very close to the OEMs, as well as end users with the underlying demand for the products. Our expectation at this point, as we see the year playing out, is a strong first half.

As you know, seasonality kicks in, and typically in the fourth quarter, there's less production days because of holidays, et cetera. We don't think that's going to be different for Q4 of this year, as it has been slightly off-cycle there the last few years just because of the displacement from the pandemic. We see the market normalizing more in that direction from a seasonality perspective. So, as we think about the balance of the year, again, what I would think about and stay focused on is really the first half, second half. I'd also say our understanding, at least from meetings with OEMs and otherwise, is that's a relatively consistent view.

On your second question in terms of long-term agreement negotiations for North America On-Highway, it's still relatively early in the year for that. Majority of them are calendar year agreements. So, we'll get to that as we get further in into the year, I think to Fred's comments on the fourth quarter call. The point stands in terms of your ask there and trying to quantify what the potential impact is. We are not in a position to quantify that at this stage, but it's worth repeating though, roughly 60% of that North America book of business is subject to those LTAs.

So, I think you can run your own sensitivities in that regard. And I think it goes also without saying that, as we've said before, we sell our products based on the value that they deliver. It's clear that the services provided by those vehicles are up, labor rates are up. So, the inflation underlying from those services reflects the additional value that our product provides relative to safety, driver training, reliability, uptime, total cost of ownership, et cetera, so – and very much aligned with what you've seen in terms of vehicle pricing.

Ian Zaffino
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you very much.

Operator: Our next question comes from the line of Rob Wertheimer with Melius Research. Please proceed with your question.

Justin Pellegrino
Analyst, Melius Research LLC

Q

Hi, everybody. This is Justin Pellegrino on for Rob. Thanks for taking our questions. We were just curious if you could kind of dive into gross margin a little bit. It was down a little bit this quarter. We were just hoping if you could maybe talk about some mix or different things that were going on on the gross margin line. Thanks.

G. Frederick Bohley
Senior Vice President, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Sure, Justin. This is Fred. As you mentioned, down – gross margin down. I think the one thing you need to take into consideration is that through gross margin runs UAW contract signing incentives. That was $13 million. So, if you exclude those and you look at our gross margins on a sequential basis, they're actually up 10% (sic) [10 basis points]. And then, if you look at EBITDA margins on a sequential basis, our EBITDA margins are up 90 basis points. So, gross margin up 10 basis points excluding the signing bonus and then up 90 basis points on EBITDA margins.

Justin Pellegrino
Analyst, Melius Research LLC

Q

Wonderful. Thank you.

Operator: Our next question comes from the line of Tami Zakaria with JPMorgan. Please proceed with your question.

Tami Zakaria
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you so much. So, my first question is, could you provide some pointers regarding how to think about the second quarter sales and margins versus what we saw in the first quarter?

G. Frederick Bohley
Senior Vice President, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Yeah. Tami, this is Fred. And Dave talked to kind of timing earlier, the biggest end market in North America On-Highway. But as we have things laid out from a margin profile, we have EBITDA margin in the second quarter very close to what we saw in Q1, and then we have things softer in the back half of the year, particularly our Q4, just based on an expectation that there's going to be lower top line revenue. From a cost standpoint, things feel fairly stable. Clearly, we understand our hourly labor cost, anticipate – anticipating SG&A being relatively flat for the year. Engineering R&D will probably step up a little bit off of Q1, but pretty close to what you saw in the back half of 2023.

Tami Zakaria
Analyst, JPMorgan Securities LLC

Q

Got it. And so, from a top line perspective, should we expect also sequentially a similar number? I'm just trying to understand first half versus second half. Second half is weaker. Is 2Q sort of in line with the run rate we saw in 1Q for sales?

G. Frederick Bohley
Senior Vice President, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Yes, directionally. Obviously, it's still quite a bit to go in Q2. But I think that's a good expectation is that it would be in line with Q1, and really looking relatively consistent across the first three quarters, with the fourth quarter being a little lower just based on the number of workdays.

Tami Zakaria
Analyst, JPMorgan Securities LLC

Q

Got it. And if I can ask one quick follow-up, I think services revenue decline was a little weaker than we were expecting. Is there anything one-off to call out there or do you still expect services growth to be about down 2% for the year?

G. Frederick Bohley
Senior Vice President, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Yeah, I think the one thing to call out and that's a good point. If you think about the cadence of revenue in 2023, we came into the first part of 2023 with some backlog that got solved in the first quarter and then somewhat into the second quarter. So, when you look at the Service Parts revenue that we ran for Q1, it's almost exactly on top of where we were for the fourth quarter of 2023. So, it's really the more challenging comp on a year-over-year basis.

Tami Zakaria
Analyst, JPMorgan Securities LLC

Q

Okay. Wonderful. Thank you.

Operator: Our next question comes from the line of Angel Castillo with Morgan Stanley. Please proceed with your question.

Angel O. Castillo
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Thanks for taking my question. Just first maybe on On-Highway, I was hoping you could kind of parse out a little bit more kind of the specific growth that you saw within vocational as well as the medium-duty, kind of those two separate. And then, also could you just give us a little bit more color just regarding the supply chain challenges that you noted? Any particular kind of step change? It seemed like there's maybe potential that some of these things are getting a little bit worse. So, if you could just give us a little bit more color there, that'd be helpful.

David S. Graziosi
Chairman & Chief Executive Officer, Allison Transmission Holdings, Inc.

A

Hi. It's Dave. I appreciate the questions there. So, North America, just to be clear, as you know, the Allison team, over probably the last decade now, has gained share in the Class 8 vocational market. There are a number of reasons for that. As we talked about, the value proposition of the product, that continues to be the case. If nothing else, I think COVID further highlighted the advantages of our product when you start to get into – we all talk about labor constraints constantly, the demographics where you have people retiring and effectively exiting the industry with certain skills.

Our product does not require the, I would say, training experience to manage a manual gearbox. So, it's a fully automatic product. That has proven to be even more attractive in the context of limited labor availability. So, we continue to experience a fairly high level of demand for our Class 8 straight products. So, whether that'd be the – that are applicable in our 3000, 4000 Series. So, that's effectively what we continue to see and experience in the market. Tremendous amount of demand for those.

Customers have become very accustomed to those products and have really built, if you will, their fleets, the content as well as the labor pool. So, we saw those – that play out as we entered first quarter. We also talked on the fourth quarter call about the fact that there was a bit of pent-up demand, as you know, vocational not being produced as close to demand as end users would like [ph] it at. So, we entered – (00:29:28) you could see that starting to develop in the second half of 2023. That's carried into 2024. So, we're also a beneficiary of that level of demand that carried into 2024.

As I said earlier, our expectation currently, based on what we're hearing from OEMs and end users, is we expect it to continue to be a very busy year on the vocational front. Medium-duty had also a level of lack of supply post the pandemic. That market has improved in terms of supply-demand balance. We're seeing fleets do some level of resizing. That's not surprising, frankly, when you start to look at the developments in certain segments of the medium-duty market. So, that is firming up a bit in terms of supply-demand. That continues to be a relatively busy market for us.

So, as we think about, again, that playing out throughout the year, when you look at the level of simultaneous demand that you see, especially in the vocational market across the entire industry, it can be rather challenging for the industry, as you're dealing with relatively high levels of pull for certain components. So, again, the industry is not necessarily fully capacitized for that type of sustained peak. So, that is now certainly – is causing many parties to address some of those underlying constraints.

I won't get specific in terms of what those are, but I would just offer that, as far as I'm aware, all the industry participants are trying their best to produce to those levels of demand. But I would describe that demand at some level being almost unprecedented in terms of overall response pull from the market right now. So, we'll continue to manage through that process. And the team here is certainly committed to deliver to the best of our abilities and make sure that the end users are receiving the level of support that they need.

But I would just offer the labor issue more broadly, leaving aside the cost issues that we've and others have addressed, it's an availability challenge across the board. So – and I think that's one that we're working very closely with both our internal team and our supply base to make sure that we're doing our best in terms of making that labor available. But it's one that – one issue that I think will continue to be challenging as we get further into the year.

Angel O. Castillo
Analyst, Morgan Stanley & Co. LLC

Q

Very helpful. Thank you.

Operator: [Operator Instructions] Our next question comes from the line of Jerry Revich with Goldman Sachs. Please proceed with your question.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good afternoon and good evening. I'm wondering if you could just talk about your views on truck industry inventories for Class 5 through 7. Just the total unit counts on dealer lots is up at cyclically high levels, and I'm wondering if you could tell what type of equipment that is and to what extent it's one of the factors that you're considering, Fred, when you're talking about potentially softer revenue outlook in the back half of the year. Just if you could share your views around that dynamic, that'd be helpful.

G. Frederick Bohley
Senior Vice President, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Yeah. Jerry, this is Fred. I mean, my earlier comments were more around typical seasonality. Our read-through through our sales force is that inventory is still pretty tight. I think the question may be how much is at a dealer versus at bodybuilders. And I think relative to bodybuilders and their ability to get all the parts to complete the trucks, I think there's some challenges there.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Oh, interesting. So, you think the hold-up in terms of the building dealer inventory is because of the constraints at the final assemblers?

G. Frederick Bohley
Senior Vice President, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Yeah. I think there's more challenges in that piece of the chain than – as opposed to just excess vehicles sitting on dealers' lots.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then, separately, continued good margin performance by the team despite being hamstrung on the part of your business where you folks haven't been able to raise pricing. Outside of North America On-Highway, are there any other pockets of pricing opportunities from here? Can you update us on your price realization in the quarter and potential pockets of pricing updates for 2025 ahead of the bigger pricing opportunity that you mentioned last quarter?

G. Frederick Bohley
Senior Vice President, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Sure, Jerry. It's Fred again. Most of the pricing actions were effective January 1. But with demand as robust as it is, we're certainly in a position where some end customer incentives that maybe you've historically done to conquest new customers, you can you can pull back on those somewhat. And then, relative to the book of business available to price in 2025, clearly, we've talked about what's available North America On-Highway, which is the meaningful – the 60-plus-percent. But there is more available to price across the other end markets. So, we're obviously spending a lot of time thinking about that. And as Dave mentioned, it's too early to really be in negotiations with customers. But there is a broader book of business available to price than just the 60% of North America On-Highway.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Appreciate it. Thank you.

Operator: There are no further questions in the queue. I'd like to hand it back to Dave Graziosi for closing remarks.

David S. Graziosi
Chairman & Chief Executive Officer, Allison Transmission Holdings, Inc.

Thank you for your continued interest in Allison and for participating on today's call. Enjoy your evening.

Operator: Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time, and have a wonderful day.