

Q3 2018 Earnings Release

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The following information contains, or may be deemed to contain, “forward-looking statements” (as defined in the U.S. Private Securities Litigation Reform Act of 1995). The words “believe,” “expect,” “anticipate,” “intend,” “estimate” and other expressions that are predictions of or indicate future events and trends and that do not relate to historical matters identify forward-looking statements. You should not place undue reliance on these forward-looking statements. Although forward-looking statements reflect management’s good faith beliefs, reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which may cause actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements speak only as of the date the statements are made. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changed circumstances or otherwise. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to: risks related to our substantial indebtedness; our participation in markets that are competitive; the highly cyclical industries in which certain of our end users operate; uncertainty in the global regulatory and business environments in which we operate; the failure of markets outside North America to increase adoption of fully-automatic transmissions; the concentration of our net sales in our top five customers and the loss of any one of these; our ability to prepare for, respond to and successfully achieve our objectives relating to technological and market developments, competitive threats and changing customer needs; U.S. and foreign defense spending; general economic and industry conditions; increases in cost, disruption of supply or shortage of raw materials or components used in our products; the discovery of defects in our products, resulting in delays in new model launches, recall campaigns and/or increased warranty costs and reduction in future sales or damage to our brand and reputation; risks associated with our international operations, including increased trade protectionism; future reductions or changes in government subsidies for hybrid vehicles and other external factors impacting demand; labor strikes, work stoppages or similar labor disputes, which could significantly disrupt our operations or those of our principal customers; and our intention to pay dividends and repurchase shares of our common stock.

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Allison Transmission’s business is subject to numerous risks and uncertainties, which may cause future results of operations to vary significantly from those presented herein. Important factors that could cause actual results to differ materially are discussed in Allison Transmission’s Annual Report on Form 10-K for the year ended December 31, 2017.

Non-GAAP Financial Information

We use Adjusted EBITDA and Adjusted EBITDA as a percent of net sales to measure our operating profitability. We believe that Adjusted EBITDA and Adjusted EBITDA as a percent of net sales provide management, investors and creditors with useful measures of the operational results of our business and increase the period-to-period comparability of our operating profitability and comparability with other companies. Adjusted EBITDA as a percent of net sales is also used in the calculation of management's incentive compensation program. The most directly comparable U.S. generally accepted accounting principles ("GAAP") measure to Adjusted EBITDA is Net income. The most directly comparable GAAP measure to Adjusted EBITDA as a percent of net sales is Net income as a percent of net sales. Adjusted EBITDA is calculated as the earnings before interest expense, income tax expense, amortization of intangible assets, depreciation of property, plant and equipment and other adjustments as defined by Allison Transmission, Inc.'s, the Company's wholly-owned subsidiary, Senior Secured Credit Facility. Adjusted EBITDA as a percent of net sales is calculated as Adjusted EBITDA divided by net sales.

We use Adjusted Free Cash Flow to evaluate the amount of cash generated by our business that, after the capital investment needed to maintain and grow our business and certain mandatory debt service requirements, can be used for repayment of debt, stockholder distributions and strategic opportunities. We believe that Adjusted Free Cash Flow enhances the understanding of the cash flows of our business for management, investors and creditors. Adjusted Free Cash Flow is also used in the calculation of management's incentive compensation program. The most directly comparable GAAP measure to Adjusted Free Cash Flow is Net cash provided by operating activities. Adjusted Free Cash Flow is calculated as Net cash provided by operating activities after additions of long-lived assets and certain other adjustments.

Call Agenda

- **Q3 2018 Performance**
- **2018 Guidance Update**

Q3 2018 Performance Summary

(\$ in millions)	Q3 2018	Q3 2017	% Variance
Net Sales	\$692	\$595	16.3%
Gross Margin %	53.2%	50.8%	240 bps
Net Income	\$167	\$111	50.5%
Adjusted EBITDA ⁽¹⁾	\$295	\$241	22.4%

Commentary

Net Sales: increase was principally driven by higher demand in the Global On-Highway, Outside North America Off-Highway and Service Parts, Support Equipment & Other end markets, price increases on certain products and continued execution of our growth initiatives.

Gross Margin: increase was principally driven by increased net sales, price increases on certain products and favorable material costs.

Net Income: increase was principally driven by increased gross profit and lower income tax expense partially offset by increased selling, general and administrative expenses and increased product initiatives spending.

Adjusted EBITDA: increase was principally driven by increased net sales, price increases on certain products and favorable material costs partially offset by increased selling, general and administrative expenses, increased product initiatives spending, and increased manufacturing expenses commensurate with increased net sales.

(1) See Appendix for a reconciliation of Adjusted EBITDA.

Q3 2018 Sales Performance

(\$ in millions)

End Markets	Q3 2018	Q3 2017	% Variance	Commentary
North America On-Hwy	\$332	\$301	10%	Principally driven by higher demand for Rugged Duty Series models
North America Off-Hwy	\$12	\$17	(29%)	Principally driven by lower demand from hydraulic fracturing applications
Defense	\$42	\$35	20%	Principally driven by higher Tracked and Wheeled demand
Outside North America On-Hwy	\$96	\$89	8%	Principally driven by higher demand in Asia
Outside North America Off-Hwy	\$46	\$14	229%	Principally driven by improved demand in the energy, mining and construction sectors
Service Parts, Support Equipment & Other	\$164	\$139	18%	Principally driven by higher demand for North America service parts and Global support equipment
Total	\$692	\$595	16%	

Q3 2018 Financial Performance

(\$ in millions, except per share data)	Q3 2018	Q3 2017	\$ Var	% Var	Commentary
Net Sales	\$692	\$595	\$97	16.3%	Increase was principally driven by higher demand in the Global On-Highway, Outside North America Off-Highway and Service Parts, Support Equipment & Other end markets, price increases on certain products and continued execution of our growth initiatives
Cost of Sales	\$324	\$293	(\$31)	(10.6%)	
Gross Profit	\$368	\$302	\$66	21.9%	Increase was principally driven by increased net sales, price increases on certain products and favorable material costs partially offset by higher manufacturing expenses commensurate with increased net sales
Operating Expenses					
Selling, General and Administrative	\$89	\$78	(\$11)	(14.1%)	Increase was principally driven by higher warranty expense commensurate with increased net sales, favorable dual power inverter module extended coverage and product warranty adjustments in 2017 that did not recur in 2018 and increased commercial activities spending
Engineering – Research and Development	\$33	\$26	(\$7)	(26.9%)	Increase was principally driven by increased product initiatives spending
Total Operating Expenses	\$122	\$104	(\$18)	(17.3%)	
Operating Income	\$246	\$198	\$48	24.2%	
Interest Expense, net	(\$30)	(\$26)	(\$4)	(15.4%)	Increase was principally driven by interest expense for the 4.75% Senior Notes due October 2027 that were issued in September 2017
Other Income (Expense), net	\$2	(\$2)	\$4	200.0%	Change was principally driven by credits related to post-retirement benefit plan amendments
Income Before Income Taxes	\$218	\$170	\$48	28.2%	
Income Tax Expense	(\$51)	(\$59)	\$8	13.6%	Decrease in the effective tax rate was principally driven by the U.S. Tax Cuts and Jobs Act enacted into law in December 2017
Net Income	\$167	\$111	\$56	50.5%	
Diluted Earnings Per Share	\$1.27	\$0.75	\$0.52	69.3%	Q3 2018: 131M shares; Q3 2017: 147M shares
Adjusted EBITDA⁽¹⁾	\$295	\$241	\$54	22.4%	

(1) See appendix for the reconciliation from Net Income.

Q3 2018 Cash Flow Performance

(\$ in millions)	Q3 2018	Q3 2017	\$ Variance	% Variance	Commentary
Net Cash Provided by Operating Activities	\$239	\$215	\$24	11.2%	Principally driven by increased gross profit and decreased cash interest expense partially offset by higher operating working capital requirements, increased product initiatives spending, increased cash income taxes and increased commercial activities spending
CapEx	\$23	\$20	\$3	15.0%	Principally driven by productivity and replacement programs spending
Adjusted Free Cash Flow ⁽¹⁾	\$216	\$195	\$21	10.8%	Due to increased Net Cash Provided by Operating Activities partially offset by increased capital expenditures

(\$ in millions)	Q3 2018	Q3 2017	\$ Variance	% Variance	Commentary
Operating Working Capital ⁽²⁾ Percentage of LTM Sales	11.4%	11.3%	N/A	10 Bps	Principally driven by increased operating working capital commensurate with increased net sales partially offset with higher net sales
Cash Paid for Interest	\$11	\$16	\$5	31.2%	Principally driven by interest rate hedging settlement payments for contracts terminated in December 2017
Cash Paid for Income Taxes	\$34	\$31	\$3	9.7%	Primarily driven by intra-year timing of payments

(1) See Appendix for a reconciliation of Adjusted Free Cash Flow.

(2) Operating Working Capital = A/R + Inventory – A/P.

2018 Guidance Update

	Guidance	Commentary
Net Sales Change from 2017	18 to 19 percent	Guidance reflects increased demand in the Global On-Highway and Global Off-Highway products, price increases on certain products and continued execution of our growth initiatives
Net Income (\$ in millions)	\$600 to \$620	
Adjusted EBITDA (\$ in millions)	\$1,090 to \$1,110	
Net Cash provided by Operating Activities (\$ in millions)	\$785 to \$805	
CapEx (\$ in millions)	\$90 to \$100	Subject to sourcing and completion milestones
Adjusted Free Cash Flow (\$ in millions)	\$685 to \$715	Net Cash Provided by Operating Activities less CapEx
Cash Income Taxes (\$ in millions)	\$100 to \$110	

APPENDIX

Non-GAAP Financial Information

Non-GAAP Reconciliations (1 of 3)

Adjusted EBITDA reconciliation

\$ in millions, Unaudited	For the year ended December 31,					Three months ended September 30,		Last twelve months ended September 30,
	2013	2014	2015	2016	2017	2017	2018	2018
Net income (GAAP)	\$165	\$229	\$182	\$215	\$504	\$111	\$167	\$707
plus:								
Interest expense, net	133	138	114	101	103	26	30	115
Income tax expense	101	139	107	126	23	59	51	8
Technology-related investment expenses	5	2	—	1	16	—	—	13
Public offering expenses	2	1	—	—	—	—	—	—
Impairments	—	15	81	—	32	—	—	32
Environmental remediation	—	—	14	—	—	—	—	—
Amortization of intangible assets	105	99	97	92	90	22	22	89
Depreciation of property, plant and equipment	99	94	88	84	80	21	19	78
Loss on redemptions and repayments of long-term debt	1	1	1	—	—	—	—	—
Stockholder activism expenses	—	—	—	4	—	—	—	—
Dual power inverter module extended coverage	(2)	1	(2)	1	(2)	(2)	—	—
UAW Local 933 signing bonus	—	—	—	—	10	—	—	10
UAW Local 933 retirement incentive	—	—	—	—	—	—	—	7
Unrealized loss (gain) on commodity hedge contracts	2	(1)	1	(2)	—	—	—	—
Unrealized loss on foreign exchange	2	5	1	1	—	2	3	5
Expenses related to long-term debt refinancing	—	—	25	12	—	—	—	—
Restructuring charges	1	1	—	—	—	—	—	—
Stock-based compensation expense	13	15	11	9	12	2	3	13
Adjusted EBITDA (Non-GAAP)	\$627	\$739	\$720	\$644	\$868	\$241	\$295	\$1,077
Net Sales (GAAP)	\$1,927	\$2,127	\$1,986	\$1,840	\$2,262	\$595	\$692	\$2,654
Net income as a percent of net sales	8.6%	10.8%	9.2%	11.7%	22.3%	18.7%	24.1%	26.6%
Adjusted EBITDA as a percent of net sales	32.5%	34.7%	36.2%	35.0%	38.4%	40.5%	42.6%	40.6%

Non-GAAP Reconciliations (2 of 3)

Adjusted Free Cash Flow reconciliation

\$ in millions, Unaudited	For the year ended December 31,					Three months ended September 30,		Last twelve months ended September 30,
	2013	2014	2015	2016	2017	2017	2018	2018
Net Cash Provided by Operating Activities (GAAP)	\$464	\$573	\$580	\$591	\$658	\$215	\$239	\$771
(Deductions) or Additions:								
Long-lived assets	(75)	(64)	(58)	(71)	(91)	(20)	(23)	(103)
Technology-related license expenses	6	6	—	—	—	—	—	—
Stockholder activism expenses	—	—	—	4	—	—	—	—
Excess tax benefit from stock-based compensation	14	25	8	6	—	—	—	—
Adjusted Free Cash Flow (Non-GAAP)	\$409	\$540	\$530	\$530	\$567	\$195	\$216	\$668

Non-GAAP Reconciliations (3 of 3)

Guidance reconciliation

\$ in millions

	Guidance	
	Year Ending December 31, 2018	
	Low	High
Net Income (GAAP)	\$ 600	\$ 620
plus:		
Income tax expense	171	173
Interest expense, net	122	120
Depreciation and amortization	164	164
UAW Local 933 retirement incentive	14	14
Stock-based compensation expense	13	13
Unrealized loss on foreign exchange	6	6
Adjusted EBITDA (Non-GAAP)	<u>\$ 1,090</u>	<u>\$ 1,110</u>
Net Cash Provided by Operating Activities (GAAP)	\$ 785	\$ 805
Deductions to Reconcile to Adjusted Free Cash Flow:		
Additions of long-lived assets	(100)	(90)
Adjusted Free Cash Flow (Non-GAAP)	<u>\$ 685</u>	<u>\$ 715</u>