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MOD - Q1 2016 Modine Manufacturing Co Earnings Call

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CORPORATE PARTICIPANTS

Kathy Powers *Modine Manufacturing Company - VP, Treasurer and Investor Relations*

Tom Burke *Modine Manufacturing Company – President and CEO*

Mick Lucareli *Modine Manufacturing Company – VP, Finance and CFO*

CONFERENCE CALL PARTICIPANTS

Mike Shlisky *Global Hunter Securities, LLC - Analyst*

David Leiker *Robert W. Baird & Company, Inc. - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen and welcome to Modine Manufacturing Company's first quarter fiscal 2016 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. (Operator Instructions). As a reminder, this conference call is being recorded. I would now like to turn the conference over to your host, Ms. Kathy Powers, VP, Treasurer, and Investor Relations. Thank you.

Kathy Powers - *Modine Manufacturing Company - VP, Treasurer and Investor Relations*

Thank you. And thank you for joining us today for Modine's first quarter fiscal 2016 earnings call. With me today is Modine's President and CEO, Tom Burke, and Mick Lucareli our Vice President Finance and Chief Financial Officer. We'll be using slides with today's presentation. Those links are available through both the web cast link, as well as the PDF file posted on the investors relations section of our Company's website, Modine.com. Also, should you need to exit the call prior to its conclusion, a replay will be available through the website beginning approximately 2 hours after the call concludes. On slide two is an outline for today's call.

Tom and Mick will provide comments on our first quarter results and confirm our revenue and earnings guidance for fiscal 2016. At the end of the call, there will be a question and answer session. On slide three is our notice regarding forward-looking statements. I want to remind you that this call may contain forward-looking statements as outlined in today's earnings release as well in our Company's filings with the Securities and Exchange Commission.

With that, it's my pleasure to turn the call over to Tom Burke.

Tom Burke - *Modine Manufacturing Company – President and CEO*

Thank you, Kathy, and good morning, everyone. This morning we reported our first quarter results. Largely due to foreign currency, sales were down 12% as compared to the first quarter of fiscal 2015. Excluding this currency impact, sales were only down 2%. On a constant currency basis sales increased in our Europe and Building HVAC segment and decreased in the Americas and Asia segments.

We expect foreign currency will negatively affect our sales comparisons for the first three quarters of this fiscal year. Adjusted operating income of $14.2 million was down $10.7 million from the prior year. This was due to unfavorable currency conditions, including the impact on material costs in Europe and Brazil, and business interruption insurance recoveries in the prior year.

As a result, we reported adjusted earnings per share of $0.14 compared to $0.30 in the prior year. As we mentioned when providing our initial fiscal 2016 guidance last quarter, from a quarterly run-rate perspective, we anticipate that the second half of fiscal 2016 will be significantly stronger than the first half, both in terms of absolute earnings and year-over-year comparables. I'm pleased to report that our quote activity remained high during the quarter, resulting in significant business wins.

We continue to make progress on our manufacturing footprint in both North America and Europe, and we also continue to focus on our growth strategy.

I'll give you updates on these topics as I go through the segment results. Mick will go through the consolidated results in greater detail but first, now I'd like to review the segment performance and update our end market expectations for fiscal 2016. Turning to page six, as I mentioned last quarter, we combined the management of our North and South America operations so they now function as one operating segment.

We're still in the early stages of this change, but the combined team is highly engaged and there is strong alignment among the functional areas. We're exploring opportunities for sharing productive resources that will lead to future efficiencies. Given this change in management structure, we have combined the reporting of these segments into one Americas segment. Sales for the Americas segment decreased 7% on a constant currency basis with lower sales in both North America and Brazil.

Sales in Brazil were down 12% on a constant currency basis with decreases to both vehicular OE and aftermarket customer. The Brazilian economy has not improved and actually, the markets have continued to decline. We're seeing significantly lower volumes in the off highway and commercial vehicle markets, but are seeing lesser declines in the aftermarket.

As a result we're taking further restructuring actions as we identify synergies between our North and South America businesses. We're implementing further headcount reductions in Brazil and will transition to a 4-day workweek schedule in September. We expect to see the savings from these actions, cost reduction efforts, in the second half of year. On the positive side, we continue to quote and be awarded new business in Brazil.

We recently were awarded a cooling package on a combine program and believe the new emissions regulations will give us new opportunities in the Brazil construction market. We have a very strong market position in Brazil and are successfully defending this position while addressing our cost structure to ensure we remain profitable through the recession. In North America sales were down 6%, with lower sales to off-highway and commercial vehicle customers partially offset by higher sales to automotive customers.

Despite the strength in the North American commercial vehicle market, we experienced limited benefit in the quarter due to lower service sales and shifting market shares among the North American truck customers. Our off-highway sales were down due to continued weakness in the agricultural equipment and mining sectors. We have strong quoting activity in North America and are seeing the positive effects of our ongoing cost reduction initiatives.

As a result, we're winning a significant amount of new business particularly in the off-highway programs. These wins include two backhoe loader programs in the light construction market, an Agricultural module program, and a new industrial Genset program.

Our McHenry plant is now closed and we will begin to see those savings in the current fiscal year. Additionally, we're negotiating with the union on the effects portion of the closure of the Washington, Iowa facility.

As we have previously stated, production at these facilities is being moved to other Modine facilities and will result in significant cost savings once completed. As part of this transition, we'll be expanding production capacity at our Nuevo Laredo, Mexico location.

This is a critical step for Modine as we continuously focus on lowering our cost structure by leveraging our low-cost country footprint. I want to take a minute and talk to you about our coils business, which is reported under the Americas segment.

We manufacture coils alongside the heat exchangers used by our vehicle customers, but these products are primarily used in HVAC applications. In addition to providing custom-designed heat exchangers for the residential, industrial, and commercial HVAC markets, we also use these coils in our own HVAC products providing some us with a vertical integration advantage. This is a relatively small business for us today, but we believe there's great growth opportunities for us in this area. Earlier this month, we announced a significant business award with a major North American appliance manufacturer. This is an exciting award as it demonstrates potential growth opportunity and also highlights the role this business can play in our goal to further diversify our business. We plan to expand our presence in this market so it becomes a bigger portion of our business overall.

This will be a critical focus area for our acquisition strategy. Adjusted operating income for the Americas segment was down $4.4 million primarily due to lower sales volume and higher material costs in Brazil. As I mentioned last quarter, underlying commodity prices are typically fixed in US dollars and when the US dollar strengthens, we pay higher prices for materials when purchased in the local currency.

We estimate this impact on year-over-year results in the Americas region to be approximately $1 million in the quarter. Our outlook for the fiscal 2016 North American end markets is the same as previously reported.

We expect continued strength in heavy duty trucks to be offset by significant weakness in agricultural equipment and certain portions of the construction market, particularly heavy construction and mining, where we have a concentration. We believe that the weak Brazilian market conditions will continue in fiscal 2016 and have lowered our market expectations for this year. Our expectation for the commercial vehicle market is to be down 30% and the agricultural equipment market to be down 20% to 25%. Please turn to page seven.

Sales for our Europe segment increased 2% in the first quarter excluding currency impacts. In US dollar terms, sales decreased 17% in the quarter driven by the impact of a stronger US dollar versus the Euro. Sales of automotive customers were up 9% driven by strong oil cooler and condensers sales. Sales to commercial vehicle customers were up 10% driven by radiators and EGR's. These increases were partially offset by lower off-highway sales which were down 28% from the prior year. Gross margin decreased 250 basis points from the prior year. The positive impacts from higher volumes were more than offset by unfavorable material costs including the negative currency impact that I just mentioned.

We estimate this impact in our year-over-year earnings for Europe to be approximately $3 million in the quarter. Significant market demand for our engine products in Europe is challenging our capacity levels, which is putting pressure on certain production facilities. This pressure has driven increased costs for shift premiums and expedited freight. We're adding additional capacity to address this positive yet challenging opportunity.

We've made significant progress with our European manufacturing footprint, including the recent closure of a plant in Germany. However, we are not yet satisfied with our performance on our power train cooling products for the commercial vehicle market. For these reasons, we have made the decision to expand our low-cost country manufacturing capacity in Eastern Europe. It's very important that we have the ability to quote competitively to grow our market share with a cost structure that will ensure we get the returns that meet our and our shareholders expectations.

I'll provide quarterly updates as we define our strategy for the future state of our European manufacturing footprint. Our 2016 market outlook for Europe is improving with continued demand for premium automotive components where Modine Europe has a strong presence. Please turn to page eight.

Sales for our Asia segment were down 3% compared to the prior year on a constant currency basis. Sales to off-highway customers were down more than 30% in the quarter as the slowing China economy continues to impact infrastructure investment and has had a direct impact on excavator sales in China and Korea. This was partially offset by higher sales to automotive customers which more than tripled during the quarter as launch activity for automotive coolers continues to ramp. We expect to produce double the number of automotive coolers this year as compared to last for a total of 1.5 million pieces produced.

At maturity, we expect to be producing more than 4 million oil coolers a year.

We also continue to see year-over-year revenue increases in India with sales increases to automotive, commercial vehicle and off-highway customers as our strong market presence is benefiting from the strengthening India economy.

Our outlook for the automotive market in China and for the commercial vehicle market in India is for continued strength; however, we expect the overall Asian excavator market to remain weak, down 20%. Turn to page nine. Our Building HVAC segment had a very good quarter.

The segment sales increased 6% in the quarter on a constant currency basis. This increase was largely driven by higher sales of cooling products to the school market in North America, along with higher North American heating and ventilation sales. Our UK business was roughly flat on a constant currency basis, but our order intake during the quarter was strong. Gross margin for this segment increased 340 basis points on the higher sales volume during the quarter with improvements in both North America and the UK.

The increase in SG&A related to the business interruption insurance recoveries in the prior year. Excluding this, SG&A was flat and operating income would have been up $1.5 million over the prior year. Our outlook for the building HVAC markets is for continued strength in each of our served markets. With that, I'd like to turn it over to Mick for an overview of our consolidated financial results and guidance.

Mick Lucareli - ***Modine Manufacturing Company - VP Finance and CFO***

Thanks, Tom, and good morning everybody. Please turn to slide 11. As anticipated, we experienced significant market and foreign exchange head winds. As most of you know, more than half of Modine's sales are generated outside of the United States. In addition, last year's strong start made year-over-year comparables quite difficult. After analyzing the multiple currency impacts, we are pleased with the underlying operating performance.

As Tom mentioned, sales decreased 2% on a constant currency basis, excluding the unfavorable exchange rate impact of $40 million.

We expect currency to be a significant headwind through the first three quarters of the fiscal year, with better comparisons in Q4. On a constant currency basis improved sales in Europe and Building HVAC were more than offset by decreases in the Americas and Asia. In the quarter, gross profit decreased $10.7 million and we estimate that approximately $9 million of the decrease relates to the change in foreign exchange rates. First, $4.7 million relates to an unfavorable exchange rate impact on the translation of our foreign earnings. In addition to the translation impact, the stronger US dollar negatively impacted the price we paid for commodities in Europe and Brazil.

This resulted in approximately $4 million of higher material costs. Moving on to SG&A, costs were flat with the prior year. The exchange rate impact was favorable, about $3.6 million. This was partially offset by the absence of a $2.6 million recovery from business interruption insurance recognized during the first quarter of fiscal 2015. As a reminder, this resulted in a reduction to our SG&A last year and relates to lost profits due to the fire in the UK.

We also recorded $2.6 million of restructuring expenses during the quarter. This was primarily due to severance expenses relating to the planned closure of our Washington, Iowa plant, which we announced earlier this year. Q1's adjusted operating income of $14.2 million represents a $10.7 million decrease from the prior year. Approximately $8 million of this decrease was due to FX, including the FX impact on purchased materials and insurance recoveries in the prior year. As Tom highlighted, the balance of the decline, or approximately $3 million, was mostly due to lower volumes, particularly in Brazil and in the global off-highway markets.

Adjusted earnings per share of $0.14 was down $0.16 from the prior year, including the impact of a higher tax rate this quarter. Turning to slide 12. As anticipated, free cash flow in the quarter was negative and was impacted by the timing of compensation and other benefit-related payments. These cash items are customary and typical in our first quarter. In addition, our capital expenditures of $16 million were up from the prior year. As you know, these can be somewhat lumpy from quarter-to-quarter.

Please note that we expect our full-year free cash flow to be positive, and we continue to maintain a strong balance sheet position and ended the quarter with a net debt-to-capital ratio at 20%. Over the last year, I've been happy to report the growing cash position and borrowing capacity at Modine.

I would like to point out that a portion of cash is tied to insurance receipts and will be used as we complete the rebuild of the UK facility. In addition, we have a large portion of our cash held in foreign locations. As Tom mentioned earlier, we are actively looking for opportunities to invest our cash in the business, including potential acquisitions. We believe that reinvesting in the business supports long-term growth and is in the best interest of our shareholders.

However, if we're not successful in finding the right investments, then we will consider other uses for our cash and borrowing capacity. Now let's turn to our fiscal 2016 guidance on slide 13. As we look to the remainder of the year, our message remains consistent. We continue to face challenges in many of our end markets. This includes continued weakness in Brazil and in the global agricultural, heavy construction and mining markets. We certainly felt the significant head winds due to the exchange rate environment this quarter, and we expect this to continue through our third quarter. We estimate the full-year exchange rate impact will be $100 million on the top line.

We expect to see continued sales and cost improvement as we move through the year. We have new program launches in each of our OE segments, some of which Tom mentioned today. We're approaching the heating season in our Building HVAC segment, which typically provides higher sales and solid profitability. In addition, we should see additional benefits from our restructuring actions in Brazil and North America.

Lastly, we'll start to recover some of the FX impacts on materials.

I would like to note that we launched a supply chain project, which we expect to yield significant savings for the Company. Our primary goal is to achieve savings through optimization of our supply base.

We are currently in the assessment phase and will begin to move into the execution phase shortly. Given that we purchase $700 - $800 million of goods and services on an annual basis, we believe there's a significant savings opportunity at Modine.

I will be able to provide more information about this program next quarter, including timing and financial targets. In addition to these operational improvements, Tom highlighted the focus our team has on strategic acquisitions and I'm excited about this opportunity as well.

Reviewing our guidance on the top of this slide, we maintain and confirm the outlook for fiscal 2016 as follows; sales flat to down 5% from the prior year. On a constant currency basis, we expect sales to be up 1% to 6%. Adjusted operating income in the range of $65 to $70 million. This range is flat to up 7%. On a constant currency basis, this would equate to a 5% to 12% increase, and adjusted earnings per share of $0.75 to $0.82 which is up 19% to 30%. There's one last item I wanted to mention.

We are currently offering certain former employees the option to take a lump sum settlement of their vested pension benefits.

This project will help us to better control our pension expenses and risks in the future and will not have a cash impact on the Company.

As is typical with this type of program, we expect to report a non-cash settlement charge when we complete the program. Right now we estimate this charge will be in the $20 million to $30 million range and be recorded in the second quarter. To wrap things up, we pointed out several times that we see a stronger second half in terms of earnings.

Similar to prior years, we expect a seasonal slowdown in Q2, but anticipate better year-over-year comparables. Then we expect earnings to accelerate in Q3 and Q4. With that, Tom, I'll turn the call back to you.

Tom Burke - ***Modine Manufacturing Company – President and CEO***

Thanks, Mick. There are several challenges impacting our business but we're meeting them head on. At this point we're equally focused on driving growth and aggressively improving our cost structure. As I mentioned, we're increasing our low-cost country manufacturing capacity by expanding our campus in Nuevo Laredo, Mexico and by increasing manufacturing capacity in Eastern Europe. Also, Mick mentioned our supply chain optimization initiative where we are aiming to consolidate our supply base to focus on strategic supplier partnerships that will provide the best quality and service at the lowest total cost.

We have significant expectations for this project and we'll be able to share more specifics next quarter. On the growth side, we're particularly focused on opportunities that will provide us with an increased market diversification. This includes both organic growth in new markets and strategic acquisitions.

I mentioned the potential of our coils business, where we are winning new business and focusing on potential investments. We have a substantial acquisition pipeline and are actively evaluating these targets. To reiterate Mick's point, if we're not able to find the right investment in the near future or if we have excess cash after making other investments, then we'll look at alternative uses for our cash. With that, we would like to take your questions.

QUESTION AND ANSWER

Operator

Thank you. (Operator Instructions). Our first question comes from the line of Mike Shlisky with Global Hunter Securities. Your line is open. Please go ahead.

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

Good morning, guys. How are you?

Tom Burke - ***Modine Manufacturing Company – President and CEO***

Good morning, Mike.

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

Maybe I'll start out with Europe. Looking at some of the OEMs and the truck space, you're getting rapid order increases here. You mentioned you've got some additional freight and other costs here. You also have, if I'm not mistaken pretty high market share and it's a pretty essential product for compliance with some of the rules over there.

I guess can you pass some of that along to the customer? Secondly, on that question, I can see you are passing I can see you're trying to get more growth in your capacity in Eastern Europe, that's great, but I think these people need their product this quarter and next. You've got these trucks built. Is there anything you can do permanently to keep the cost under control there?

Hello? Hello?

Operator

Ladies and gentlemen, please stand by. Your conference will reconnect momentarily. All right, Ms. Powers, you're reconnected.

Kathy Powers - ***Modine Manufacturing Company - VP, Treasurer and Investor Relations***

Thank you.

Mike?

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

Yes, hey, guys, are you there?

Tom Burke - ***Modine Manufacturing Company – President and CEO***

I'm sorry, something happened. You were you talking about the added demand and was that truck or auto? That's before we got cutoff.

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

I was thinking about trucks. It's getting to be a more intensive environment there. I wanted to know if there's anyway, given the process, so essential to compliance and your share is growing there, but will you be able to pass along some of those costs to customers. And then secondly, while I did recognize that you are trying to look into low cost country sourcing over in Europe, it sounds like these folks in the customer base needs the product now. Can you make quick changes here to keep the cost under control?

Tom Burke - ***Modine Manufacturing Company – President and CEO***

Yes, that's obviously what we're doing.

The ability to pass on cost is circumstantial depending on what's driving it. If it's a sudden release by the customer that is up, we'll certainly ask for something because we'll have added costs requirements relating to the cost that we'll negotiate with customers to pass on where we can. If it's on our able not to meet schedules that a different ball game and we have to meet up with premium costs and that typically falls back on our shoulders in that case. The biggest issue that we have that I mentioned was on the automotive side with oil coolers where we're having great success with our product and winning new business and realizing that is we're well over stated capacity because of the demand of that product, and that is where we are definitely working with customers everywhere we can because it is a good news problem to have.

But it is and exceeding, in some cases, customer estimated volumes. So there we work very closely with customers to work out expedited freight and overtime and the cost of ensuring that. It's a good problem to have and we're moving quickly to add to capacity. We're talking about in months adding to capacity on the oil cooler problem to resolve that issue.

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

Okay, great, great, great. I also wanted to touch on building HVAC. You had mentioned in your slide that you've got some good business happening in schools here in North America. I was wondering if you guys are seeing school budgets open up a little bit better this year or is it gains in market share? Any color on what's going on in the school market, I would appreciate it.

Tom Burke - ***Modine Manufacturing Company – President and CEO***

The school market is a combination of retrofitting the old schools to close the schools up for new laws and requirements for inside air quality requirements and noise and temperature control and that type of thing. That's where we've strength there. It's retrofitting of old schools and in that case, there are schools around the country, specific areas that are looking to do that and pass the tax increases to improve school upgrades and that stuff. It a long process. We work closely with School Boards and the engineers supporting them and we're happy with the business that it's really gaining. For us, we have a leading market share position and that's North America and, again, it's very significant contributor to the building HVAC segment.

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

Okay. Going on to the guidance, your outlook for top of the first or second quarter here, I remember last year you had $0.05 of earnings, are you suggesting you might do worse that year than last? I want to get into the timings of the earnings this year more precisely.

Mick Lucareli - ***Modine Manufacturing Company – VP, Finance and CFO***

Yes, this is Mick, Mike. Thanks for the question. Yes, I think we see a frankly Q2s going to be very similar to Q1 in terms of volume. We're going to see a little higher SG&A kick in in Q2, which happens each year due to the timing of a number of items, including the way we do our global salary and benefit adjustments, but we see the typical college summer slowdown in Europe, the pre heating season, then the acceleration into Q3 and Q4. I wanted to communicate; we knew that Q1 would be a tough comparable in line with what we were expecting.

Q2 we'll see similar from a volume, slightly higher SG&A, but what we are expecting as we said better comps year-over-year in Q2, which was to your question. We do expect Q2 to be a little bit better than Q2 last year. Then the biggest issue is a lot of our cost savings and launch activities is going to happen in the second half of the year, including that heating season which is significant for our building HVAC. Last year, Q3 for building HVAC was almost 50% of the full year segment results, just to put some context around that for you. I hope that answers your question Mike.

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

Yes, sure, thanks. And Mick, while I have you, you had mentioned the deals out there, looking to put cash to work, if you can't you might put it back to shareholders. Would you consider going through the repatriation process or is there enough cash for either SG&A or any kind of buy back or dividend here in the US already?

Mick Lucareli - ***Modine Manufacturing Company – VP, Finance and CFO***

Yes. Again, I appreciate the question because we did want to give some color to that. I think one is, when we talk about cash, I wanted to make sure we provide some color around the fact that a portion of cash is about $15 million, plus or minus, tied to the rebuild of our UK facility, so that's timing of insurance money knowing through the Company.

Then we have a significant amount of money that sits. The majority of the remaining cash sits in foreign locations.

From an M&A standpoint, that's our preferred, we think long term that's the best for the Company is to reinvest in the business for the long-term. There's lots of opportunities and options. We have of funding and acquisitions, so repatriation would not be a concern on that side.

As Tom mentioned, we also have a balance sheet that is under a level or conservative at the current standpoint which we can use for acquisition support and/or other uses an certainly we feel at the current stock price, Modine is a value and if we don't find an appropriate investment for us to leverage our balance sheet and use the cash appropriately, we'll look at those other alternatives.

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

Okay. I've got one more to squeeze in here if you don't mind about the mid-west transaction premium. It's been down, it's stayed down. Do you expect to see benefits there to your bottom line in the current quarter and next, depending upon what might develop?

Mick Lucareli - ***Modine Manufacturing Company – VP, Finance and CFO***

Yes. Great question. We have a little bit of a lag and for the others on the call that doubled in the last year. It has recently come back to the normal range. It's now back around $0.10, $0.11 a share. If you think about our run rate, we're still paid a premium year-over-year on that given the lag. Beginning in our Q2, Q3, and Q4, we're talk

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about a 50% year-over-year decline in our transaction premium, year-over-year comparability and we'll start to capture that reduction in our cost to goods moving into Q2 and fully in Q3 and Q4.

Mike Shlisky - ***Global Hunter Securities, LLC - Analyst***

Great. Thanks for the time, guys, I'll pass it along.

Operator

Thank you. Our next question comes from the line of David Leiker with Robert W. Baird. Your line is open. Please go ahead.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

A couple of things here. The European capacity issues you're running into there, what's the time line on correcting those? I presume that there's some impact on margins right now given the way you're running the business relative to what it would be with that volume.

Tom Burke - ***Modine Manufacturing Company – President and CEO***

Great. No, good question, and you're right. We have a couple of things.

It's a very global product as you know so we're able to provide some relief to some plants that have capacity in the world. That provides a logistics cost to us that's our responsibility, then the flat portion of adding actual machine capacity is in process, has been kicked off for a couple of months now and that should be resolved in the next three to four months as far as the oil coolers specific demand that we're seeing in Europe, part of the LCOC product line.

So again, inside of all of that is a lot of discussions and negotiations with customers in some cases where they're above their stated levels for us to capacitize to so we're leveraging all of that and minimizing those costs. In some cases, it's still making an impact on others where we're at stated volumes, so inside of that, we're managing that carefully. The combination of providing products for elsewhere, Modine locations to help meet that need and the added actual machine capacity is in place and should be in the next three to four months. We should see that really be resolved.

Mick Lucareli - ***Modine Manufacturing Company – VP, Finance and CFO***

Tom, Dave it's Mick. You might want to comment, too, that the additional portion of the capacity you talked about is about more volume that we're quoting and running, so that's one - two years out.

Tom Burke - ***Modine Manufacturing Company – President and CEO***

Right. On top of that, we continue to win new business and this product line and others, okay, in power train cooling, but we need more not only capacity, but plant floor space. This is why we're expanding into Eastern Europe to expand existing capacity that we have now. So that's not today's news, but that will be 18 months from now. It's exciting with those launches coming up in the 2017 calendar year.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Then the strong volume that you're getting above what you had capacitized for and the new wins. Can you talk about the common denominator and why you're winning the new business?

Tom Burke - ***Modine Manufacturing Company – President and CEO***

Yes. I'd go back to use our term, building block strategy, the engine oil coolers, call it the LC, product line which is a combination for oil coolers and charged air cooling. It's the same product, that building block where we've got an asset base that we can leverage on a constant basis and have a lot of flexibility giving us ability to quote and win the new business. Especially as we look forward to a future state model of higher scale and lower cost. It's all around this fuel efficiency drive for optimizing power train drive and boosted engine support with charger coolers going on the cars and it's a very encouraging trend.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Okay. So those are, I presume are gasoline?

Tom Burke - ***Modine Manufacturing Company – President and CEO***

Yes. Gasoline turbos, exactly. Then diesel oil coolers as well.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Okay.

Tom Burke - ***Modine Manufacturing Company – President and CEO***

It's both engine sources. We're starting to see in North America as well that these devices are being used to heat oil early to help reduce frictional losses in cold starts. It's a lot of content opportunity both in traditional engine cooling, heating lubricant for better fuel efficiency under cool start and the charger impact with smaller displacement reasons for fuel efficiency reasons on the retro engines.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Okay. One last item here. In terms of actions you're taking on the cost side in North America and Europe. Sounds like you have some of those cost savings coming to you in the back end of the year. You can quantify what the magnitude of those savings are and how those flow in beyond the current fiscal year?

Mick Lucareli - ***Modine Manufacturing Company – VP, Finance and CFO***

Yes. David, its Mick. I can give you an idea of the total savings and to put it into context of the specific programs that we've done; just keep in mind we have other issues behind here. But from a total savings standpoint, in Europe we're looking at approximately an incremental $3 million this year in savings year-over-year. First year here in McHenry as we're closing that facility and getting ready in the second half of the year to launch that. A lot of that product in Mexico, about $2.5 million of savings, and then incremental savings in Brazil this year, year-over-year about $1 million due to a combination of SG&A and then direct and indirect labor reductions. Those are the major pieces and as we said, most of those are second half of the year.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Right. And then is there any carryover with incremental savings in fiscal 2017?

Mick Lucareli - ***Modine Manufacturing Company – VP, Finance and CFO***

Yes. Sorry about that. So right now, the million in Brazil is what we've done to-date. Stay tuned. The teams are working together on the synergy opportunities so I don't have anything to share yet on that side. They're still diving in to how to most efficiently run the combined segments into the one new segment. There's an incremental 2.5, the total savings going to McHenry in the following year in 2017, going to about $7 million, so about $5 million of incremental, that will be the first full year impact of the McHenry and then in Europe, about another $1 million in 2017. So I would say going forward another five to six, plus whatever synergy we would see coming between combining the Brazil and North America operations. Go ahead.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Nope, nope, continue.

Mick Lucareli - ***Modine Manufacturing Company – VP, Finance and CFO***

Washington/Iowa, which we just announced this year, there we expect annual savings of $9 million, but that closure won't be completed until 2018.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Okay. Given where your foot print is today, and where products are and demand is, do you think that with what you know today, obviously, that this gets your footprint with where you need to go or are there other actions still contemplated?

Tom Burke - ***Modine Manufacturing Company – President and CEO***

This gets us a long way down the road David, that's for sure.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Yes, I know.

Tom Burke - ***Modine Manufacturing Company - President, CEO***

As you follow the OE vehicular world, the demands will continue to stay there and I think you sense from our discussions, whether its footprint, purchasing, and synergy's on the overhead side, we're committed to get there. Specifically on our question, our remaining high cross country footprint is going to be very reduced over this process.

We'll have roughly one plant in a two-year period from now, we'll have one plant operate in Germany, we'll have a single digit number of four operations in North America, so it's going to be a strong position that we'll have from that standpoint on our footprint.

Mick Lucareli - ***Modine Manufacturing Company – VP, Finance and CFO***

Another way I guess I look at it is when we look at our quote activity and our success rate and our costs, I feel really good about the competitiveness and the win rate coming out. The economy is down but in Brazil, North America and the expanded Mexico really good success rates and costs.

Asia with the China, India, yes. The biggest one we see that's been an obstacle, both as Tom said volume but also cost is we need that broader Eastern European footprint.

We need a little bit more capacity in Europe that's low cost. That would be the one. To your question, that's what we're addressing right now.

Tom Burke - ***Modine Manufacturing Company – President and CEO***

I'll make a correction. We'll have two plants in Germany. One on the engine side and one on the power train cooling side.

David Leiker - ***Robert W. Baird & Company, Inc. - Analyst***

Okay, great. Thank you very much.

Operator

Thank you. I'm show nothing further questions at this time. I would now like to turn the conference back to Ms. Kathy Powers.

Kathy Powers - ***Modine Manufacturing Company - VP, Treasurer and Investor Relations***

Thank you. This concludes today's call. Thank you for joining us this morning and thank you for your interest in Modine. Good-bye.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program and you may all disconnect. Everyone, have a nice day.