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MOD - Q3 2016 Modine Manufacturing Co Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Modine Manufacturing Company's third-quarter fiscal 2016 conference call. (Operator Instructions). As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host, Ms. Kathy Powers, Vice President, Treasurer, and Investor Relations.

Kathleen Powers - Modine Manufacturing Company – VP, Treasurer and Investor Relations

Thank you. Thank you for joining us today for Modine's third-quarter fiscal 2016 earnings call. With me today are Modine's President and CEO, Tom Burke; and Mick Lucareli, our Vice President, Finance, and Chief Financial Officer. We will be using slides for today's presentation. Those links are available through both the webcast link as well as the PDF file posted on the Investor Relations section of our Company website, Modine.com.

Also, should you need to exit the call prior to its conclusion, a replay will be available through our website beginning approximately 2 hours after the call concludes. On slide 2 is an outline for today's call. Tom and Mick will provide comments on our third-quarter results and provide an update to our revenue and earnings guidance for fiscal 2016. At the end of the call, there will be a question-and-answer session.

On slide 3 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 as in our Company's filings with the Securities and Exchange Commission.

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

Thomas Burke - Modine Manufacturing Company – President and CEO

Thank you, Kathy, and good morning, everyone. On today's call, I will discuss our third-quarter results and provide an update on the various activities taking place with regard to our Strengthen, Diversify, and Grow strategic transformation that we announced last quarter. After that, Mick will provide a more detailed review of our financial results and then I will provide final remarks prior to opening up the call for questions.

Sales in the third quarter were down 2% on a constant currency basis, with decreases in the Americas, Building HVAC, and Asia segments more than offsetting increases in the Europe segment. We continue to see significant weakness in the heavy-duty construction and agriculture equipment markets, and are also beginning to see some softening in the North America commercial vehicle market. In addition, the warm winter weather had a negative impact on heating sales in our Building HVAC segment. Brazil remains in a deep recession, and the economy in China continues to stagnate. Offsetting some of these headwinds have been strong auto sales in Europe and North America. German premium auto sales, which remain one of the true bright spots of our markets, helped drive the strong performance in our Europe segment this quarter.

Despite our overall decrease in sales this quarter, I'm pleased to report that our adjusted operating income of \$17.2 million was up 21% from the prior year. On a constant currency basis, adjusted operating income was up 30% from the prior year.

This increase was driven by a 140 basis point improvement in gross margin, which benefited from favorable materials cost, improved plant performance, and savings from the closure of the McHenry, Illinois, manufacturing facility.



The restructuring initiatives we have taken over the past few years have clearly benefited our margins and provide an excellent foundation for us to execute on the strategies outlined in our Strengthen, Diversify, and Grow plan moving forward.

Turning to page 6. Sales for the Americas segment decreased 6% year-over-year on a constant currency basis, with sales in Brazil down 14% due to decreases to both vehicular OE and aftermarket customers. Volumes continue to decline in Brazil, and we are currently not planning for any appreciable improvement there for the next 12 to 18 months.

As reported last quarter, we implemented a four-day work week in Brazil. This has significantly lowered our cost basis, allowing us to continue to generate positive operating income despite the significant reduction in volume levels.

In North America, sales were down 5%, with lower sales to off-highway and commercial vehicle customers. Our off-highway sales are under pressure from weak conditions in the heavy-duty construction and agricultural sectors. We expect this trend to continue as both oil and overall commodity prices are projected to remain low for the foreseeable future. We also saw a drop in orders from commercial vehicle customers, as that market slowed last quarter.

However, despite this drop in sales, gross margin improved by 190 basis points from the prior year to 16.5%. This is a continuation of the trend we saw last quarter, as the impact from lower sales volume was more than offset by improved operating performance, lower material costs, and savings from plant consolidation.

Adjusted operating income for the Americas segment was up \$2.7 million to \$9.6 million despite the significant drop in sales. The actions we have taken to reduce costs have been critically important, given the continued market weakness in this segment. The closure of the McHenry plant and the various cost-saving initiatives in Brazil have allowed us not only to remain profitable, but to even improve our profitability in this challenging environment.

We expect these difficult market conditions to continue in 2016. In North America, the truck market has begun to soften, and we expect volumes to be down 20% in 2016. We also expect the heavy-duty construction and agricultural equipment markets to continue to decline further. Autos continue to be relatively strong, and we expect the market to hold at flat to possibly up 5%.

In Brazil, we expect the commercial vehicle and agricultural equipment markets each to be down another 10%, and the aftermarket to be flat to possibly up 5%.

Please turn to page 7. Sales for our Europe segment increased 5% in the third quarter on a constant currency basis as a result of the higher sales to automotive and commercial vehicle customers. The European automotive and commercial vehicle markets remain strong, and we expect low to moderate growth to continue through 2016.

Gross margin improved by 340 basis points from the prior year, driven by higher sales volume, favorable material cost, and improved operating performance. We are still experiencing very high volumes at certain European plants, but have made significant progress in adding needed capacity, which has improved our efficiency and greatly reduced our order backlog.

As mentioned last quarter, we are adding furnace capacity at our plant in the Netherlands, and expect to have this complete by the end of March. In addition, we are moving ahead with capacity expansion in Hungary. This incremental capacity, scheduled to be completed in 24 months, will take additional pressure off our high-volume plants, lead to further operational improvements, and enable additional sales growth.

Adjusted operating income in Europe was up \$4.2 million to \$7.5 million, including a negative \$1.1 million currency impact. The increase was primarily due to volume and gross margin improvements.

Please turn to page 8. Sales for our Asia segment were down 3% compared to the prior year on a constant currency basis. Lower sales to off-highway customers in China and Korea and lower tooling sales were partially offset by higher sales to automotive customers as volumes continued to grow at a fast pace with the many programs we have been awarded.

Adjusted operating income increased \$0.5 million to \$0.2 million in the third quarter, primarily due to continued cost control efforts.

We believe that the off-highway market is finally nearing bottom in Asia, but we're not expecting any meaningful near-term recovery. Since the 2011 construction peak in China, our excavator sales have dropped about 60% or \$16 million. We are offsetting this loss with market share gains in the China automotive and truck segments, and we expect this to accelerate with our recently announced joint venture with Puxin. Overall, we expect to see flat to 5% growth in the China automotive market in 2016, and continued strength in our primary end markets in India.



Turning to page 9. Sales for our Building HVAC segment were down 8% for the quarter on a constant currency basis, with decreases in both North America and in the UK. The decrease in North America was largely driven by lower heating sales, due to the warmer-than-normal temperatures in December. We remain very confident in our ability to grow this business, with new products scheduled for introduction in fiscal 2017.

In the U.K., a softer euro-to-pound exchange rate created pricing pressure, as the euro-based competitors were able to reduce prices in the U.K., impacting our win rate in the precision air conditioning market. However, our order intake for our air handling and chiller business remains strong, and we are currently working through a backlog of orders.

Gross margin for this segment decreased 70 basis points on the lower sales volume during the quarter, and adjusted operating income was down \$2.9 million to \$6.9 million. Last year's results included \$2 million of business interruption insurance recoveries.

We completed the move back to our new Airedale manufacturing facility in the U.K. after the building was destroyed by fire in 2013. Although it has been a challenging 2 1/2 years for our team in the U.K., they have done a great job serving our customers from the temporary facilities used during the rebuild period. The good news is that we are now operating in a state-of-the-art manufacturing and product testing facility, which will allow us to continue to improve our competitive position over time.

Please turn to page 10. Before turning it over to Mick, I would like to give an update on some of the activities we've been working on as part of our Strengthen, Diversify, and Grow transformation. As I mentioned last quarter, we expect this program will enable us to evolve into a more competitive and diversified thermal management company, one that increases long-term shareholder value.

As a reminder, the program has three major components: first, to strengthen our business by implementing a true global, product-based organization; second, to diversify our business by investing in our industrial business, namely the Building HVAC and coils businesses; and, third, to grow our business, primarily by aggressively pursuing strategic acquisitions, but also by organically growing those parts of Modine's business that have a right to win in the market.

Our plan includes a number of cost discipline initiatives designed to improve our operating margins. This will be accomplished through expansion of our current low-cost manufacturing footprint, savings achieved through our global procurement project, and SG&A and personnel-related savings. Overall, we are targeting \$40 million to \$50 million of annual savings from these initiatives over the next five quarters, and based on all of our activities to date, I remain very confident in this goal.

A significant component of our Strengthen objective is to optimize our manufacturing footprint. The transfer of production from our Washington, Iowa facility is running ahead of schedule and we plan to have this facility closed in fiscal 2017. The expansion of our Nuevo Laredo facility is nearing completion and as I previously mentioned, we are making progress on the early phases of our plant expansion in Hungary.

For our procurement initiative, we have finalized the structure of our procurement organization and are currently focused on supplier negotiations. Based upon current activities, we believe that we are approximately 25% of the way towards our targeted annual procurement savings.

In an effort to accelerate SG&A savings, we offered an early retirement program to eligible U.S. employees. We had a large number of employees elect to participate in the program. Based on these and other actions, we are targeting annualized salary savings of \$7 million.

We have implemented the first series of the changes in our new product-based organization structure and are in the process of rolling these through the organization. These changes will enable a more thorough analysis of our product platforms to further develop and drive our global strategies for each product group.

As I mentioned earlier, we recently announced the formation of a new joint venture in China. Puxin is a manufacturer of stainless steel heat exchangers located in Yangzhou, China, approximately 200 miles northwest of Shanghai. Through this joint venture, we will primarily produce stainless steel heat exchangers for the China light-, medium-, and heavy-duty commercial vehicle markets. This is an exciting investment for Modine that will not only allow us to expand our product offering in China, but will also serve to diversify our customer base and expand our low-cost manufacturing footprint.

And, finally, last quarter we announced a new share repurchase program. During the quarter we repurchased approximately \$2.1 million, or 230 (sic, see press release, "230,000") shares, at an average price of \$9.04 per share.

With that, I'd like to turn it over to Mick for an overview of our consolidated financial results, and to update our fiscal 2016 guidance.

Michael Lucareli - Modine Manufacturing Company – VP, Finance and CFO



Thanks, Tom. Please turn to slide 12. Our third-quarter sales decreased 10% as we continued to experience significant foreign currency headwinds and weakness in certain end markets. Early winter warm weather, along with declines in the North American commercial-vehicle and off-highway orders, contributed to the sales decline. However, the vast majority of our sales decline was due to changes in exchange rates.

As Tom mentioned, sales decreased 2% on a constant currency basis, excluding an unfavorable currency exchange impact of \$26 million. Fortunately, we expect the year-over-year impact of foreign currency to be less significant, starting in Q4.

I am pleased to report that our gross margin improved by 140 basis points to 17.8%, despite the decline in sales. This improvement was driven by lower commodity prices and operational improvements. Similar to last quarter, a portion of the lower material cost was attributed to the significant drop in aluminum transaction premium.

In addition, we delivered operational improvements at our plants. As expected and discussed last quarter, we had better conversion in our Europe segment, driven by production efficiencies. Excluding a \$3.4 million negative foreign currency exchange impact, our gross profit was up 4% in the quarter on the lower sales.

Moving on to SG&A, costs were lower than the prior year by 4%. The exchange rate impact was \$2 million favorable in the quarter, but this benefit was offset by \$2 million from business interruption insurance recoveries last year. Cost control efforts continue at each of our global locations, and they will continue further as we execute on our Strengthen, Diversify, and Grow initiatives.

Our reported SG&A number includes several items that were backed out to arrive at our adjusted operating income. These include a \$900,000 non-pension settlement loss related to our lump sum payout program that was offered last quarter. To date, we have made \$62 million in lump sum payments from pension fund assets under this program. We also adjusted \$300,000 for third-party legal and due diligence costs related to the new joint venture in China.

In addition, we recorded \$1.6 million of restructuring expenses during the quarter. The majority of these restructuring charges related to employee severance, equipment transfer, and plant consolidation cost in the Americas segment.

As usual, we show a full reconciliation between our reported results and adjusted operating results in the press release and the appendix following these slides.

Q3 adjusted operating income of \$17.2 million was up 21% from last year. On a constant currency basis, adjusted operating income was up \$4 million or 30%. In addition, I want to point out that we incurred \$1.3 million of expenses related to our procurement project during the quarter. As I mentioned last quarter, the costs are front-end loaded, with savings to follow. Adjusted EPS was \$0.22, up \$0.07 compared to last year.

Overall, we are pleased with the financial performance this quarter. In spite of the lower sales volume, we improved our gross margin and reduced our SG&A spending.

In last quarter, we discussed the outlook for a much stronger second half. On a sequential basis, we more than doubled our adjusted Q2 earnings, and remain on track for further improvement in Q4.

Turning to slide 13. Free cash flow in the quarter was \$25.6 million. Our cash flow benefited from reductions in working capital. Year to date, we have generated free cash flow of more than \$31 million. Our balance sheet provides plenty of liquidity to support our growth and strategic initiatives. We ended the quarter with over \$80 million of cash on hand, and a leverage ratio of 0.68.

Also, Tom mentioned we repurchased stock during the first two months of the stock buyback program we announced last quarter. In the quarter, we purchased 230,000 shares of stock. We remain committed to balance future share repurchases with our strategic priorities to make investments that will lead to diversification and growth.

So let's turn to our fiscal 2016 full-year guidance on slide 14. Tom and I discussed the major challenges in our third quarter, and we expect many to remain through our fourth quarter.

First, the US dollar has continued to strengthen. We estimate the full-year exchange rate impact at approximately \$110 million on the top line. Next, the warm winter weather negatively impacted heating sales. Last, our off-highway and commercial vehicle production schedules in Americas have softened.

Despite some of the challenging markets, we continue to expect stronger earnings in the fourth quarter, both sequentially and year-over-year. This outlook is based on several factors. Our sales will benefit from new automotive program launches. We expect a favorable tailwind from commodity metals pricing, especially the year-over-year transaction premiums. We will continue to realize manufacturing cost reductions in North America and Brazil, and we anticipate further operating efficiencies in several of our European plants.



After considering each of the factors, we are adjusting our full-year sales and earnings guidance. We now expect sales to be down 8% to 10% from the prior year. On a constant currency basis, this equates to sales that are flat to down 2%. We expect adjusted operating income to be \$62 million to \$66 million, slightly lower than our previous guidance of \$65 million to \$70 million. And on a constant currency basis, this equates to an increase of 2% to 8%. And we anticipate adjusted EPS to be \$0.70 to \$0.76, or up 11% to 21% compared with the prior year.

With that, I will turn it over to Tom to wrap up.

Thomas Burke - Modine Manufacturing Company – President and CEO

Thanks, Mick. There is no doubt that the markets we serve are facing some challenges, and some of them are quite significant. However, despite the decrease in sales during fiscal 2016, I'm very pleased by the performance of our Company. We are in a strong competitive position because of our product portfolio and cost structure.

We have significant quote activity in our vehicular business, and we are winning our fair share of new programs. Just this past quarter, we won several new auto programs in North America and in Europe, some of which will have production both in-region and in China. We also won business with agricultural equipment customer and specialty vehicle customer in North America, and with two commercial vehicle customers in Europe. In Asia, in addition to the incremental aluminum oil cooler awards, we won multiple new genset awards, and an agriculture equipment award that will include production from our new joint venture. In Brazil, we have been awarded multiple agricultural and construction customer awards.

There are a lot of 2016 market uncertainties, but we are encouraged by our win rate and our Strengthen, Diversify, and Grow initiatives. We are in the middle of our planning process, and will provide fiscal 2017 guidance in our fourth quarter, but we fully anticipate an increase in our earnings next year.

And, with that, we would like to take your questions.

QUESTION AND ANSWER

Operator

(Operator Instructions). **Joe Vruwink for David Leiker - Robert W. Baird – Analyst**

Joe Vruwink for David Leiker - Robert W. Baird - Analyst

Good morning. It's Joe Vruwink for David. A handful of questions on gross margins. Maybe to begin, do you have finer details on the year-over-year improvements, split between maybe pure materials versus any early procurement savings, versus some of these operational gains you cited?

Michael Lucareli - Modine Manufacturing Company – VP, Finance and CFO

Yes, Joe. It's Mick. The high level, there's clearly an impact of materials. And you got to think of that between the transaction premium and then just the pure LME. Because last year, if you recall, we absorbed really the doubling of the transaction premium, and this year we benefited as that comes down and that will stay as part of our operating performance going forward. The LME is the more traditional pass-through portion.

So about \$3.5 million was a benefit, the benefit from the LME portion of that. We had over \$4 million of plant performance, year-over-year plant improvements and performance in the quarter. Also in that gross margin which is negative, there's about \$1.3 million of our procurement expenses and so far, that's been a net cost to the company. We do expect Q4 will start to turn that corner, and start moving towards not only neutral; but beginning in the Q4 and into certainly next fiscal year, a net positive from the procurement projects.

So hopefully that answers your question.

Joe Vruwink for David Leiker - Robert W. Baird - Analyst

Yes, that's great detail. I think when you go region by region, you are seeing margin improvement, gross margin improvement, in a lot of the areas the market, and a lot of investors are worried about the most. So, Americas facing the Brazil headwinds, margins are up; Asia, margins are up. Europe is arguably one of the stronger regions, from an end market standpoint, and margins are way up.



When you look into next year, as you said, the end market headwinds don't subside. But you are already at the point where things are pretty dicey in a lot of those markets, and there's margin improvement. So, it's probably not too much of a stretch, correct me if I'm wrong, to think that a lot of these gains you are realizing already continue at the gross profit line into next year.

Michael Lucareli - Modine Manufacturing Company – VP, Finance and CFO

Yes. I think what's really encouraging to us is we've been talking for a while about getting the Company to 16% to 18% gross margin, and, this quarter, getting awfully close to an 18% gross margin. And that's due to the hard work everybody has been doing at the Company to reduce our operating costs, manufacturing costs, SG&A.

There's a portion of this year-to-date, of our gross margin that's going to be a materials pass-through. But as we look at the numbers, the first two quarters were basically neutral from materials and then as I said, Q3 portion of materials was about \$3.5 million. That means to us, eventually, we will pass that through to the customer. But everything else, from my side, is sustainable.

Tom, would you add anything to that?

Thomas Burke - Modine Manufacturing Company – President and CEO

No, I think it's pretty good and I think we're getting much more confidence in continuing this momentum with our Strengthen, Diversify, and Grow initiatives that are going to keep that momentum on margins increasing, despite potential headwinds.

Joe Vruwink for David Leiker - Robert W. Baird - Analyst

And then just one last question from me. The fiscal 2018 targets and getting EBIT margins to 7% to 8%, that's quite a bit of improvement in essentially two years' time. So any detail maybe on timing? Is it equal between fiscal 2017 and 2018 and then source, whether we should expect maybe equal between COGS and SG&A, or concentrated one way or another, just any detail on kind of the ramp and margin improvement?

Michael Lucareli - Modine Manufacturing Company – VP, Finance and CFO

Joe, it's Mick again. When we announced this, and we discussed the program internally. We had always targeted that we had a fiscal 2018 goal, and a ramp to get there. We think we can get about a quarter of the savings in fiscal 2017 for the next fiscal year. But our goal is to have, in fiscal 2018, the \$40 million to \$50 million of savings. So about a quarter, we think we can get next fiscal year and Tom walked you through. We've got a really good run rate, or about a quarter of the way of our targeted procurement savings. About \$7 million run rate of personnel-related cost reductions and already we see significant improvement just from our plant closure and our ramp-up in Nuevo Laredo, moving from Illinois to Nuevo Laredo, Mexico. So that \$40 million to \$50 million is about 50% of it, we are thinking of is roughly procurement. So clearly that's in a cost of goods line.

The other part is fairly equally split between say a quarter of it from our plant consolidation operational improvements. That will show up obviously in the gross profit line. And then another quarter-ish of the \$40 million to \$50 million is SG&A and personnel costs and that will be split between SG&A and overhead. So I would say it's a good piece up in cost of goods sold, Joe, and also at least a quarter or so in SG&A.

Joe Vruwink for David Leiker - Robert W. Baird - Analyst

And it seems like you have a lot of visibility on a large dollar piece of a lot of these items. I'm just thinking if you are already at a \$7 million personnel run rate, and SG&A is a quarter of total, at \$7 million of \$11 million, you are most of the way there. Obviously procurement is not a given, but it seems like you have visibility there. And then the operational gains from plant consolidation. I think Europe in this quarter shows you are getting those. So we would seem like, while nothing is easy, there is visibility on each or three of these things.

Thomas Burke - Modine Manufacturing Company – President and CEO

Yes, good summary, Joe. That's why I said I'm very confident in our ability to hit these targets going forward.

Michael Lucareli - Modine Manufacturing Company – VP, Finance and CFO



Joe, one other thing to add to that. The biggest challenge for us is the ramp rate on any of the savings. So, we launched an early retirement program here, and that was very well received, and that gives us a very good run rate.

What we're working through now is when all of those individuals, what each of those retirement dates are over the next, it can be anything from a month out to six months out. Some of those positions will have to be back-filled, as well. So those are the things we need, when we talk about the run rate between now and fiscal 2018.

And then on procurement, it's the same thing. Even though we will complete a negotiation with a supplier, there's the whole process of ramping down. If it is a transition to one supplier or away from one, there's a whole process, obviously, of working off existing inventory and beginning to ramp up and then you have to get a full year's worth of volume to reach that annualized savings.

Joe Vruwink for David Leiker - Robert W. Baird - Analyst

Great. That's very helpful. Thanks, guys.

Operator

Brian Sponheimer, *Gabelli & Company*

Brian Sponheimer - Gabelli & Company, Inc. - Analyst

One question. You mentioned, with Europe, German auto being a bright spot. And we've clearly seen some real excess inventory building in the U.S., and elsewhere on the German sedan side. Any concern, as you look into fiscal 2017, that you are going to have to potentially dial back your expectations for what you're seeing from Europe auto, just based on the German luxury makers?

Thomas Burke - Modine Manufacturing Company - President and CEO

We do not see any indications of that, Brian. Right now, we are running 24/7 at two of our facilities that really support those German premiums almost 100%. So we've been able to get on top of that. That's been a big reason for the improvement in Europe's performance because of getting through the operating inefficiencies of that. But right now, we do not see anything that's giving us signal to pull back at all. Clearly, from the releases, and clearly they're not signaling that at all.

Brian Sponheimer - Gabelli & Company, Inc. - Analyst

Do you have any -- just remind me, do you have any more exposure to diesel versus gas, when it comes to the German luxury manufacturers?

Thomas Burke - Modine Manufacturing Company - President and CEO

We supply both, as there is a significant diesel proportion in Europe that we support. But yes, I think it's pretty evenly distributed between, proportionally between the German OEs, split between diesel and petrol.

Brian Sponheimer - Gabelli & Company, Inc. - Analyst

Okay. All right. One thing: it's very clear that you have some very defined runway for cost improvement over the course of the next couple of years, and it is bucketed very well. But if you take a step back and take a look at where your shares are trading, and where you expect them to trade and you've got a Building HVAC business that you are currently or at least shareholders currently aren't being effectively paid for in the market. Would it ever occur to the Board, or to you, Tom, to consider separating the two businesses to potentially surface that value for that Building HVAC business?

Thomas Burke - Modine Manufacturing Company - President and CEO

Well, first, let me say that the stock is not trading anywhere near where we expect it to trade, to your opening comment. Building HVAC and the coils business, we are kind of terming the industrial business as a key part of our diversification play. And, yes, it is a different business, versus the B2B aspect of the vehicular side. But it is a more controllable channel that we really like and enjoy; and enjoy the higher margins, less capital intensity, more flexibility we have in bringing new products through those channels.

So we feel we really have the right to expand that side of the business and grow that diversification benefit across the whole Company. There are a lot of things that relate between the thermal aspects of components going to vehicular, and systems that we create on the Building HVAC side. A natural synergy, we feel, makes it very



natural for us to build off that strategy and build a better diversified Company and getting higher mix; and, thus, a better return to our shareholders that's more identified and clearer to our shareholders.

Brian Sponheimer - Gabelli & Company, Inc. – Analyst

All right. Thank you for having me on.

Operator

Mike Shlisky - Seaport Global Securities – Analyst

Mike Shlisky - Seaport Global Securities – Analyst

I want to start off with a two-part question. First part of it would be on the U.S. Class 8 markets. Could your fiscal fourth-quarter or calendar first quarter be worse than the 20% that you are talking about for the full 2016, given some of the OEMs need to balance their dealer inventories with their production?

And then the other part of the question would be on the Building HVAC side. Perhaps some of the heating business may have been lost, back in your fiscal third quarter. But was there any catch-up thus far in your fiscal fourth quarter? It got a little bit colder, at least, in some parts of the country.

Thomas Burke - Modine Manufacturing Company – President and CEO

Okay, so I want you to repeat the second part of that question, because I was still thinking about the first part when you jumped to the second.

Mike Shlisky - Seaport Global Securities – Analyst

Okay, sure. I was just was wondering on the HVAC side. Sure, you did lose some business perhaps in the fourth quarter, because it was a bit warmer than normal. But things have normalized a bit in the first quarter, or the first calendar quarter here. So could you see a catch-up on the HVAC side in your fiscal fourth quarter?

Thomas Burke - Modine Manufacturing Company – President and CEO

Yes, okay, I'm going to let Mick take the second part of that. On the commercial truck in North America, yes, I know there's some reports out that there's inventory issues out there potentially that may slow production rates potentially. I haven't seen anything, we have not seen anything to say that we're suggesting anything below what we've identified. But I know there's some reports that that's possible, that it could normalize through the second half of the year.

Right now, our mix of who we supply, we feel comfortable with what we've guided on this 20% number, and we see that in our releases thus far.

Mick, you want to talk about second portion?

Michael Lucareli - Modine Manufacturing Company – VP, Finance and CFO

Yes, clearly, from the early part, say, the fall pre-heating season, and when we were with you last, in October, to now -- there was a significant drop in the outlook for not just our sales, but the overall really heating market. And that was due to the early warm winter, first part. We have lowered a big portion of our lowered top line and earnings guidance was due to trying to reflect that. Both Q3 and Q4, Mike, is who we tried to take down both numbers.

Frankly, one of the things we're watching and what are concerned about, we'll need to make sure is that how full that channel is. In the heating season everybody works overtime, pre-heating sales, and you fill the channel from our warehouse to our distributors' warehouse. And the challenge we'll have right now, even though the weather has started to cooperate, is how full the entire channel is, from the distributor back to Modine.

So we're not planning on any kind of recovery. We hope we have a conservative forecast. But we have to watch this, call it the channel, how much pull-through we will see.



Mike Shlisky - Seaport Global Securities – Analyst

Okay, great. I also wanted to turn to Europe for a moment. I might have misheard this, but it sounds like you've got some quarters to go here before your Hungary expansion is up and running, maybe even two years, if I heard it right. Are you concerned at all that the market could turn by the time this is all up and running, and that the auto market and truck markets don't last for more than a couple of years here? Or do you feel pretty confident that you are long enough for those markets?

Thomas Burke - Modine Manufacturing Company – President and CEO

Well, the expansion is driven by business wins directly, Mike. So we're expanding based on business wins that we're getting right now. So really, I can say here it's a share increase on our part that we need to expand our capacity to meet the demand that's coming. Now, where the market goes at that time, as far as off-peak or below, is the question. But this is not speculative building. It's tied to program wins, so that's the two-year time frame we have to prepare for the launch of new programs.

Mike Shlisky - Seaport Global Securities – Analyst

Okay. I also wanted to ask about the share repurchase. Clearly, you bought back at \$9, so you clearly were thinking that \$9 might have been a little bit [on the value side]. And now it looks like we're about \$5.50 or less, at this point. Have you considered buying back more shares in pretty short order here, or perhaps entering into some kind of accelerated share repurchase program?

Michael Lucareli - Modine Manufacturing Company – VP, Finance and CFO

Yes, it's Mick, Mike. We're clearly well, we'll balance any of the or obviously organic growth, but also acquisition opportunities. While balancing those, we will clearly be more aggressive on the share buyback side.

Mike Shlisky - Seaport Global Securities – Analyst

Okay. And I've got one last one for you on M&A. Can you give us a sense as to how that that's looking right now? Are you able to, with your good cash generation, find some good deals out there on some of the smaller companies out there, given where the overall market is today?

Thomas Burke - Modine Manufacturing Company – President and CEO

Well, we've been, for a couple years now, really been aggressively evaluating opportunities in this space and being very disciplined about it. And there are opportunities. Obviously, we're very pleased to announce the Puxin. Although smallish, it really fits a portfolio need that we have in the Asia segment. But yes, we see opportunities and we are aggressively pursuing those. And we will report when we can, as appropriate, what we see. But, yes, we think there are clear opportunities.

Mike Shlisky - Seaport Global Securities – Analyst

Okay. Fair enough. I'll leave it there, guys. Thank you.

Operator

I'm showing no further questions at this time.

I would now like to turn the call back over to Ms. Kathy Powers.

Kathleen Powers - Modine Manufacturing Company – VP, Treasurer and Investor Relations

Thank you. This concludes today's call. Thank you for joining us this morning, and thanks for your interest in Modine. Goodbye.



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