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CORPORATE PARTICIPANTS

Kathy Powers *Modine Manufacturing Co. - VP, Treasurer, IR, Tax*

Tom Burke *Modine Manufacturing Co. - President, CEO*

Mick Lucareli *Modine Manufacturing Co. - VP Finance, CFO*

CONFERENCE CALL PARTICIPANTS

Matthew Paige *Gabelli & Co. - Analyst*

David Leiker *RW Baird & Co. - Analyst*

Mike Shlisky *Seaport Global - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Modine Manufacturing Company's Third Quarter Fiscal 2017 Conference Call. (Operator instructions) As a reminder, this conference call is being recorded. I would now like to turn the call over to your host, Ms. Kathy Powers, Vice President, Treasurer, Investor Relations, and Tax. Ma'am, go ahead.

Kathy Powers - Modine Manufacturing Co. - VP, Treasurer, IR, Tax

Thank you. Thank you for joining us today for Modine's Third Quarter Fiscal 2017 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 the webcast link as well as a 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 two 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, an update on our Strengthen, Diversify and Grow strategic initiative including the Luvata HTS acquisition, and provide an update to our revenue and earnings guidance for Fiscal 2017. 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 our 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.

Tom Burke - Modine Manufacturing Co. - President, CEO

Thank you, Kathy, and good morning, everyone. On today's call I will discuss our third quarter results and provide an update on our Strengthen, Diversify, and Grow strategic transformation, including the acquisition of the Luvata HTS business. After that, Mick will provide a more detailed review of our consolidated financial results and will update our revenue and earnings guidance for Fiscal 2017. I will then provide a few closing remarks prior to opening the call for questions.

As you know, we completed the Luvata HTS acquisition on November 30. We are now operating this business as our Commercial and Industrial Solutions segment. We will refer to this as CIS going forward. Completing this acquisition was a key component of achieving our objectives of our SDG strategic framework introduced over 15 months ago.



In addition to completing the acquisition, we have also continued to identify savings from other components of our SDG initiative, and I will provide an update on where we stand versus our targets in a few minutes.

Moving on to our third quarter results, sales were up on a constant currency basis including \$35 million of sales from our CIS business in the month of December. Our non-CIS, or base business, was down 3% on a constant currency basis, primarily due to lower sales in the Americas and Europe segments, partially offset by strong sales in the Asia segment.

Our adjusted operating income was \$17.7 million, up 3% from the prior year. As I mentioned in our last call, I was very disappointed with our Q2 performance due to several operating inefficiencies in the Americas and Building HVAC segments. We have fully and appropriately addressed the large majority of the issues resulting in significant improvement sequentially in the third quarter. A few remaining items have already been, or will be corrected in Q4. In addition, I am very pleased with the strong performances in our Asia and Europe segments which also contributed to the improved earnings performance this quarter.

Our adjusted earnings per share were \$0.21 for the quarter, down \$0.01 from the prior year, primarily due to an increase in interest expense from the debt taken on to finance the acquisition. Of note, December is seasonally one of the slowest months for our CIS business, so its contribution to our operating income was not material.

As I review each segment, I will update our market outlook for calendar 2017. We are currently in the middle of our Fiscal 2018 planning process, so I'll be able to provide a market outlook for Fiscal 2018 with our fourth quarter results.

Now, I'd like to briefly review the segment results.

Turning to page 6, sales for the Americas segment were down roughly 10% to \$123.4 million, and were significantly impacted by lower sales to heavy-duty truck customers, which were down 42% from the prior year. We did not expect to see significant improvement to the North America markets this year. However, the markets have declined more than our initial expectations and we expect these conditions to continue into our fourth fiscal quarter.

Markets in Brazil continue to be weak across the board, with the exception of the agricultural equipment markets, where we are seeing some improvements. However, this is offset by a significant decline in our aftermarket sales, which continue to be lower than our expectation.

The automotive aftermarket in Brazil tends to be a stable market, even during a recession. However, in the past couple of quarters, we have seen a 20% year-over-year decline in this market, evidence of just how deep the Brazilian recession is reaching. We are the heat transfer market leader in the Brazilian automotive aftermarket and are maintaining this position despite the dip in sales caused by the market decline.

The drop in sales volume negatively impacted our third quarter gross margin, which is down 170 basis points. While the markets have not been entirely kind, we recognize that many things are within our control, and we have continued to do some significant work in the segment to improve our cost basis of our operations. This includes completing the Washington, Iowa plant closure, and accelerating significant procurement savings. We were also able to offset much of the drop in gross profit with a \$2.1 million year-over-year reduction in SG&A expense.

During the third quarter, we had a higher recovery of development costs, and savings from headcount reductions in conjunction with our SDG initiatives. Taking all those pushes and pulls together, adjusted operating income for the Americas segment was \$6.8 million, down \$2.8 million from the prior year, but significantly up from the second quarter.

Next quarter, we will update our outlook for our 2018 fiscal year, but given the state of the markets we do not expect improvement in our North America markets in calendar 2017, and unfortunately we are planning for additional declines in commercial vehicles and off-highway equipment. We expect the automotive market to be flat, which is a small but growing component of our North America business. We also expect to see some improvement in the markets in Brazil, and as I mentioned, we have already started to see some volume increases in the agricultural market. However, after significant declines we have seen in the past couple years, these increases are off of a low base.



Please turn to page 7. As anticipated, sales for our Europe segment were down 4% in the third quarter on a constant currency basis, as a result of planned program wind-downs and lower sales to off-highway customers. The planned program wind-downs included \$5 million of commercial vehicles and \$2 million with BMW. This was partially offset by higher automotive sales.

Gross margin improved by 170 basis points from the prior year, despite the decrease in sales. Similar to last quarter, we achieved a higher gross margin on lower sales due to favorable operating performance and sales mix. We continue to see better operating performance due to our purchasing initiatives and labor and overhead improvement.

Operationally, we continued to transfer production of certain products to Hungary and have broken ground on the expansion at our largest facility in Hungary. This was an important step in ensuring that we have the capacity to absorb all newly awarded and transferred business, so that we can continue to realize gross margin improvements like we have for the past five quarters. Adjusted operating income was up 12% to \$8.4 million, due primarily to the higher gross profit.

We expect the European automotive market to remain stable, the commercial vehicle market to be down about 1%, and the off-highway market to be down about 5% in calendar 2017. We expect that we will continue to see growth in our automotive programs as we launch new business, where this will be offset by planned wind-downs in the low-margin commercial vehicle programs that began last quarter. We are continuing to focus on supporting our European automotive customers as they intensify the development of their electrification strategy. As I mentioned last quarter, this is a major area of investment for our European customers which expect major growth in these product offerings in the near future.

Please turn to page 8. Sales for our Asia segment were up 60% compared to the prior year on a constant currency basis. This significant improvement related primarily to higher sales to automotive and off-highway customers in China, and incremental sales from our new joint venture. The sales growth we have seen over the past two years has been largely driven by significant volume of layered-core oil coolers for programs that we were awarded beginning in 2012. At that time, we mentioned that we expected significant volume increases over the next several years, as we launched this critically important product. We continue to aggressively ramp up production towards our mature volumes on these programs, and expect double-digit sales growth to continue in this segment as new programs continue to launch.

I am also encouraged by the continued improvements in the off-highway markets in China and Korea, which have also contributed to our sales growth over the past two quarters. Higher sales volume led to \$2.4 million improvement in gross profit, nearly doubling from the prior year. Gross margin improved by 370 basis points to 17.6%, delivering the highest gross margin of our vehicular segments. Adjusted operating income for the Asia segment increased \$2.4 million in the third quarter, compared to the prior year, primarily due to higher sales volumes and lower SG&A expenses.

We expect the growth trends to continue in Asia, with continued improvement in the construction markets in China and Korea. We will continue to benefit from higher volumes of automotive oil coolers as our programs continue to launch. We also expect both the automotive and commercial vehicle markets in India to grow 5%, which is great news for our high-performing India operations.

Turning to page 9, sales for our Building HVAC segment were flat compared to the prior year on a constant currency basis. Lower sales of heating and ventilation products in North America were partially offset by higher precision air conditioning sales in the UK. North American heating sales were below expectations due to the mild weather, except for a short spike during the cold snap in December.

Our gross margin fell 160 basis points to 32.4%, but was significantly higher than 25.8% reported in the second quarter. The improvement for the second quarter was due to the seasonally higher heating sales in North America and the benefits from cost reduction efforts. We remain focused on improving our cost structure, particularly in the UK business. We are seeing the benefit of our past actions including early retirements and other workforce reductions, and we will continue to see ongoing improvements.

In addition, we are reviewing all of our business practices for this segment in detail, with the goal of bringing our gross margins back to historical levels. This year-over-year decrease in gross margin was mainly due to unfavorable product mix in the UK as we sold higher volumes of lower-margin product. We have seen a shift in our UK business, as the "Brexit" has caused a decline in overall investment in our core markets. In response, we have instituted an across the board price increase in September, and are attacking our cost structure from top to bottom. Our goal is to significantly improve our gross margin, while maintaining a competitive position in the marketplace.



Adjusted operating income was down slightly from the prior year, but improved as a percentage of sales. This decline in gross profit was offset by lower SG&A expense, resulting from cost saving initiatives. I am encouraged by the improvement of the segment since the second quarter, but there is still additional work to do particularly in the UK business.

As I mentioned last quarter, we have made significant leadership changes that are focused on making improvements to our UK business. As expected, we started seeing results this quarter, and should see continued improvements in the fourth quarter. However, we are lowering our overall expectations for this segment for the remainder of the fiscal year, as the warm weather in January will most likely result in fourth quarter heating sales that are below our original forecast.

Please turn to page 10. Before turning it over to Mick, I'd like to give an update on our Strengthen, Diversify and Grow objectives, including some initial thoughts on our acquisition of Luvata HTS.

I have personally visited seven of the CIS locations and have been met with genuine enthusiasm about the joining of our two businesses. Both the CIS management team and the general workforce around the world are excited to be part of the Modine family. We are actively working on the integration of this business, and we see many opportunities to create future value together. Our dedicated integration management office has been tasked with driving synergy savings throughout the organization, and we have identified actions to reach our initial target of \$15 million of cost synergies over the next three to four years.

A significant amount of savings will come from procurement optimization, operational improvements, and organizational efficiencies. We also have challenges to address in our new CIS segment, particularly related to a temporary change in product mix with a large data center customer. This change has resulted in lower year-over-year volumes and margins, which we knew prior to completing the acquisition. We will continue to work closely with this important customer to ensure that we have sufficient and timely information to support our planning and production processes.

At Modine, we pride ourselves on our focus on continuous improvements through a methodology we call the Modine Operating System, or "MOS". Through MOS, we strive to improve every process, every day, and create a culture of mentoring at all levels of the organization, from administrative offices to the shop floor. We are looking forward to bringing the benefits of MOS to our new CIS business.

This acquisition clearly brings together all of the key attributes of our Strengthen, Diversify and Grow strategy, providing us with significant commercial and industrial revenue in transforming our business into a more diversified thermal management company. The transaction effectively completed all of our diversification and growth transformational goals associated with the SDG strategy.

In terms of our core operational goals, our actions during the past 15 months have significantly strengthened our business, leading to over \$50 million in annual run rate savings, exceeding our original target. We have achieved a portion of these savings this year and have already seen the positive impact of our results. We estimate that we will achieve an additional \$20 million of savings next year, including the full benefit of the closure of the Washington, Iowa plant, and incremental procurement savings. These savings are critically important to offset the increased costs related to wage inflation, higher material costs, and contractual price down commitments. This, along with volume improvements from the eventual recovery of some of our key markets, will allow us to reach our 7% to 8% operating margin target.

With that, I'd like to turn it over to Mick for an overview of our consolidated financial results, including review of the results of our CIS business for the month of December, and to provide an update for Fiscal 2017 guidance.

Mick Lucareli - Modine Manufacturing Co. - VP Finance, CFO

Thanks, Tom. Please turn to slide 12. I'd like to start by saying I'm pleased with the significant improvement over the prior quarter, and effort of our employees to drive earnings while dealing with the volume challenges. As anticipated, we were able to improve earnings significantly after a difficult Q2, but not able to fully offset additional volume drops in North America, South America, and Heating.



Beginning with the top-line, our third quarter sales increased \$21.1 million, including \$34.7 million of sales from the Luvata HTS acquisition. Excluding CIS, constant currency sales were down \$9.5 million, or 3% year-over-year. Reported gross profit of \$58.7 million was up slightly for the quarter, however, this includes a negative \$2.9 million purchase accounting adjustment related to inventory.

As a result, gross margin had a negative 80 basis point impact from the inventory step-up estimated fair value. Excluding CIS and this adjustment, gross margin on the base business improved 30 basis points over the prior year, to 18.1%, and this is on lower sales.

Moving on to SG&A, we are keeping a relentless focus on cost control. SG&A of \$51.1 million includes two significant items worth noting. First, we incurred professional fees of \$7.2 million for transaction and integration costs related to the acquisition. Second, the CIS segment included \$4.7 million of SG&A. Excluding these items, core SG&A was down \$4.1 million, or 9% lower than the prior year.

Also during the quarter, we recorded \$1.6 million of restructuring expenses. These primarily relate to equipment transfers and plant consolidation in the Americas.

Interest expense was up \$1.8 million over the prior year, primarily due to the additional acquisition-related debt. Third quarter adjusted operating income of \$17.7 million was up half a million, or 3%, and our adjusted earnings per share was \$0.21, down \$0.01 compared to last year.

Given only one month of results, the CIS impact was not material to our adjusted operating income. Our EPS was negatively impacted by approximately \$0.02 from the incremental interest expense due to the acquisition.

The lower table shows the walk of our adjusted operating income. As usual, we've included a full reconciliation between our reported results and adjusted operating results in the appendix. Our US GAAP income statement is included in the appendix of this presentation and in our earnings release.

Turning to slide 13, in the quarter adjusted free cash flow was \$16.6 million and much improved from last quarter. Year-to-date operating cash flow has been temporarily impacted by cash restructuring and acquisition-related costs. Adjusted free cash flow year-to-date is \$10.8 million, which is down from last year. This is due to the combination of several items. These include slightly lower cash earnings, tooling payments, higher working capital, and the timing of capital expenditures.

Consistent with the past few years, we expect our full-year capital spending will remain in the \$60 million to \$65 million range, including CIS. The adjustments include restructuring payments of \$12.1 million which are related to plant consolidation and severance, with the remaining items mainly related to acquisition activities.

Turning to slide 14, I want to review Modine's capital structure which changed significantly as a result of the acquisition. The table on the upper left breaks down our current capital structure, including total debt of \$514 million. This includes \$71 million of short-term debt and \$443 million of long-term debt. In conjunction with the acquisition, we entered into an amended and extended credit agreement with a syndicate of banks. This includes a renewed \$175 million, five-year revolving credit facility, and a new \$275 million, five-year term loan facility. We also entered into a new \$50 million, 10-year private placement.

The table on the right shows our net debt position, along with our current leverage ratio. Modine currently has \$464 million of net debt, up \$370 million from the prior year-end. Our leverage ratio is now 2.8, up from 1.2 at the prior year end. We have previously communicated our steady-state goal to keep Modine's leverage ratio between 1.5 and 2.5, and plan to reduce our overall leverage during the next year.

For added cushion, I'd like to point out that our debt agreements allow for our leverage ratio to be temporarily raised after the acquisition. Currently, our max leverage ratio covenant is 3.75 through the second quarter of Fiscal 2018. Then, it drops to 3.5 through the first quarter of Fiscal 2019 and finally reverts to 3.25 thereafter.

Turning to slide 15, I want to take a few minutes to review the financial implications of the CIS acquisition and its potential earnings profile. We are early in the integration process, but so far things have been going smoothly. We have a dedicated integration team in place that is helping to

facilitate a smooth transaction, and they are now quickly shifting their focus to synergy execution. As most of you know, purchase accounting can be complex, and we are currently in the middle of our analysis.

With the December close, we have included our best estimate of the opening balance sheet and associated increase in non-cash fixed costs, which will show up as depreciation and amortization. Our goal is to complete all purchase accounting adjustments in Q4 even though a few topics may continue into Fiscal 2018 as the various items are fully evaluated.

As I mentioned earlier, our Q3 included only one month of CIS sales, and the adjusted operating income impact was immaterial. Based on initial estimates, CIS incurred \$1 million of additional intangible amortization and fixed asset depreciation expense created through the acquisition.

As we look ahead to our fourth quarter forecast for CIS, I want to highlight that the numbers are in line with our pre-close expectations. We anticipate CIS sales in the \$125 million to \$135 million range, and adjusted operating income of \$4 million to \$5 million. Keep in mind that this includes at least \$3 million of increased amortization and depreciation expense due to the purchase accounting impact.

Now switching gears to full-year expectations, our detailed Fiscal 2018 guidance will be provided next quarter, but we expect CIS to be accretive in the first full fiscal year. To put things in perspective, prior to the acquisition, Luvata HTS annual sales were approximately \$500 million with an operating margin of 8% to 9%. Going forward, we will have to adjust for purchase accounting, which we estimate will have an annual impact of \$13 million to \$14 million through increased non-cash depreciation and amortization expenses. We also anticipate an incremental annual interest expense of \$14 million to \$15 million. On a pro forma basis, this clearly leads to significant earnings accretion, both on operating income and EPS.

In addition, our goal is to offset incremental depreciation, amortization, and improve earnings through cost synergies. I will provide more information on those costs, benefits and timing next quarter. Even though we are only about 60 days into the acquisition, I continue to be optimistic about the financial impact from CIS.

Now, let's turn to our Fiscal 2017 guidance on slide 16.

We are updating our Fiscal 2017 guidance following the CIS acquisition and other market factors in our base business, including the recent rise in metal prices, the change in exchange rates, and a declining outlook in Americas and Building HVAC since we last updated in October. We now expect sales to be up 9% to 11% from the prior year. This includes four months of sales from CIS of approximately \$160 million to \$170 million. This also reflects the strengthening of the US dollar, which has had a negative impact on our sales. The increase from CIS is partially offset by the lower sales outlook in our base business, which we estimate will be down 1% to 3%.

We expect adjusted operating income to remain in the same range of \$65 million to \$71 million based on the moving parts I just described. This equates to an increase of 3% to 12% over the prior year. In addition to the lower sales outlook, we have considered the rapid increase in commodity metal prices since September, both for aluminum and copper.

Improvements in Europe and Asia, along with further SG&A cost reductions, have helped to offset the economic challenges. Last but not least, the addition of CIS is also offsetting these headwinds.

We expect the adjusted EPS to be between \$0.74 and \$0.80, down from the prior range of \$0.77 to \$0.87. This change is primarily driven by \$5 million of incremental interest resulting from the acquisition.

So, to wrap up, we made a lot of progress in achieving our second half targets, and a lot of hard work remains. As Tom noted, we are seeing the operational improvements in all regions with further opportunity in the fourth quarter. We are clearly facing some market headwinds in the Americas, and HVAC segments. But, we're glad to have CIS onboard and lead the way into Fiscal 2018.

Integration plans are well under way, and we are pleased with the opportunities that are being presented. So, with that, Tom, I'll turn it back to you.



Tom Burke - *Modine Manufacturing Co. - President, CEO*

Thanks, Mick. And as Mick mentioned last quarter, we mentioned that we expected that our second half performance would improve significantly from the first half of the year, and we have delivered with our third quarter results. I am pleased with the excellent progress being made on addressing the majority of the second quarter operational issues, and can confirm that we continue to remediate remaining issues that impacted our third quarter results and expect continued and sustained improvements in Q4.

However, as we look forward, we see continued market-driven volume challenges in the Americas and Building HVAC segments. In addition, we expect higher metal prices and foreign exchange will continue to pressure our earnings. I am pleased that earnings accretion from the addition of the CIS business will offset some of these challenges, and although it is still early, we are very confident this acquisition will deliver to Modine and its shareholders the value we anticipated.

That being said, there's plenty of hard work being done around this organization to build a stronger, more diversified industrial company. We will deliver the cost savings objectives of our SDG strategy and continue to benefit from our actions into the Fiscal 2018 and beyond. The work on our cost structure will allow us to continue to provide our customers with superior products at competitive prices.

In addition, the creation of the Commercial and Industrial Solutions business, through the acquisition of Luvata HTS, allows us to expand our presence in familiar markets with products and technologies that are squarely in our wheelhouse. We are actively working on the integration of this business into Modine, and look forward to providing updates along the way.

With that, we'll take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator instructions) Our first question comes from Gabelli & Company. Your line is now open.

Matthew Paige - *Gabelli & Co. - Analyst*

Hey, good morning, everybody.

Tom Burke - *Modine Manufacturing Co. - President, CEO*

Good morning.

Mick Lucareli - *Modine Manufacturing Co. - VP Finance, CFO*

Good morning.

Matthew Paige - *Gabelli & Co. - Analyst*

Just wanted to start off the first question with, about recent proposals that we've seen regarding tax policies. I guess given your diverse geographic end markets, how much benefit do you think you could even get from a lower corporate tax rate? And along those lines, could you also speak to the impacts that you see from a potential border adjustment tax?



Mick Lucareli - *Modine Manufacturing Co. - VP Finance, CFO*

Yes, we're getting a lot of questions on that, and I think the short answer is, we really need to wait to see how all the policies shake out before we can assess the impact to Modine. I think if there's any type of tax change, there's clearly going to be a short-term, non-cash impact, as we adjust our balance sheet. All companies will have to adjust for taxed assets and liabilities. And then, going forward from a cash basis, really have to assess and hopefully that will only be positive news from a cash tax basis going forward.

Matthew Paige - *Gabelli & Co. - Analyst*

All right, and then you also mentioned earlier potential benefits from electric vehicles. Could you speak to some of the products that serve those, and how you view the potential growth in that market?

Tom Burke - *Modine Manufacturing Co. - President, CEO*

Sure. Obviously, this market is really heating up. We've had initial success in North America, with North American-based companies providing, whether it be what we call chillers, which is part of the overall system of cooling batteries and the passenger compartment, that's expanded into higher content into other what we call power train coolant products. So, the overall system, and then looking at battery plates. So that's been our basis over the last couple years in North America, but this is picking up globally now. So, as I mentioned, the Europe customers really in the last year have accelerated their electrification strategies and we are very involved in those products. So, think of battery plate coolers, think of chillers that manage the overall system performance, and specific components that manage the overall what we call power train, that is the balance between heating and cooling of drive train and passenger thermal management compartments. So, a lot of potential content, but a lot of acceleration going into this market with some big edicts that are going on in the world. We're saying that they expect to see a significant increase starting in electric vehicles over the next five years.

Matthew Paige - *Gabelli & Co. - Analyst*

Great, and then the last one for me, just a little housekeeping question. Do you have the share count at the end of the quarter?

Mick Lucareli - *Modine Manufacturing Co. - VP Finance, CFO*

Yes, I'll grab that for you. So in the quarter, 47.3.

Matthew Paige - *Gabelli & Co. - Analyst*

Okay.

Mick Lucareli - *Modine Manufacturing Co. - VP Finance, CFO*

Did you catch that, at the end of the quarter [47.3 million]. And then in the press release you see the weighted average shares used in the quarter, [48.5 million].

Matthew Paige - *Gabelli & Co. - Analyst*

Got it, okay. Appreciate it.



Tom Burke - *Modine Manufacturing Co. - President, CEO*

Thank you.

Operator

Our next question comes from David Leiker from Baird, your line is now open.

David Leiker - *RW Baird & Co. - Analyst*

Good morning, everyone.

Tom Burke - *Modine Manufacturing Co. - President, CEO*

Hi, David.

David Leiker - *RW Baird & Co. - Analyst*

First on CIS, I guess just a housekeeping item to start with. Is CIS all of Luvata in CIS, and is CIS only Luvata, or are there some moving pieces between the other segments?

Tom Burke - *Modine Manufacturing Co. - President, CEO*

CIS is Luvata plus the coils business that we have established in North America. So think about that, \$50 million to \$60 million worth of coils business in North America that we've had for some time, that is being folded into that business as well, as we speak.

David Leiker - *RW Baird & Co. - Analyst*

But that's not in the numbers for the quarter?

Tom Burke - *Modine Manufacturing Co. - President, CEO*

I'm saying that as a big picture, that's where we're going. So for the quarter, Mick, go ahead.

Mick Lucareli - *Modine Manufacturing Co. - VP Finance, CFO*

Yes, for the quarter and then really the plan will be for the next fiscal year while we're integrating Luvata, the business Tom referenced will stay in the Americas section and I have plans operationally that'll be run and let out immediately by our new leadership team at CIS. But, from an accounting standpoint, we'll go through as part of our integration, how to move that from an accounting standpoint from the Americas into the CIS segment. That'll probably take most of, into Fiscal 2018, David.

David Leiker - *RW Baird & Co. - Analyst*

Okay. And then on the -- Tom, when you talk about the data center, I know you talked to this a little bit but can you frame that for us in terms of size and timing? And what needs to happen there? On the CIS, or Luvata?

Tom Burke - *Modine Manufacturing Co. - President, CEO*

Okay, the impact I mentioned, the large customer --

David Leiker - *RW Baird & Co. - Analyst*

The large data center customer.

Tom Burke - *Modine Manufacturing Co. - President, CEO*

Yes, right, yes. So yes, we saw in due diligence, and discovered and of course confirmed that there is a transition of product mix going on with the large customer in a data center market. That's again been confirmed both internally and with the customers, they transition from one product platform to another. So, there's kind of a -- think of it as a lull, okay, as they make that transition to this temporary position, to a new, let's call it, product platform I guess, the best way to call it, a significant product platform of content. But, so again, we're pleased with the customer relationship and the opportunity, as we transition, think of it from one product platform to another there's this transition phase that we're going through and that leaves a lower margin product, that's from earlier. The product platform they transitioned to, the new one. So, that's kind of the mix story going on.

So, I can't give you any timing focus on that, but that transition we will inform of course our shareholders and investors as that moves forward. But again, it's as we saw, and as right as we planned for and we'll see that transition over the next several quarters.

David Leiker - *RW Baird & Co. - Analyst*

Okay. And then, on China, the Asia business -- it's nice seeing those volumes up at these levels. I'm sure that's exciting for you folks.

Tom Burke - *Modine Manufacturing Co. - President, CEO*

Very exciting.

David Leiker - *RW Baird & Co. - Analyst*

As you continue to ramp the contracts you have there, I mean, you're pushing \$30 million a quarter run rate there. How much more upside is there on the volume out of Asia?

Tom Burke - *Modine Manufacturing Co. - President, CEO*

Well, we have not hit our mature levels yet, so we still have upside to where we're running right now, and especially we're really encouraged just to see that as we gain share in the automotive side, which we've been really targeting, is that we're seeing some strengthening in the construction business as well which is encouraging. So, all in all, I'd say we feel very positive. As I mentioned, we continue to expect to see double-digit growth in that segment.

David Leiker - *RW Baird & Co. - Analyst*

Yes, if we look at what the mix of that revenue is today between the automotive and the construction side, what would you think it is?

Tom Burke - Modine Manufacturing Co. - President, CEO

It's approaching a 50% automotive now, where it used to be about 80% construction. So, it's about a 50% automotive, 35% construction probably, and the rest commercial vehicle.

David Leiker - RW Baird & Co. - Analyst

Okay, great. And then what about the profitability there? Nice margins there, what's your longer-term targets, so do you think that's up a little bit?

Mick Lucareli - Modine Manufacturing Co. - VP Finance, CFO

Yes, I mean, it's been a while, David. I'm not sure I'd see a day where we talk about a quarter where Asia had the highest operating margin of all of our segments. I think from here on out, it's going to be -- I think it's really going to be, we're going to reach a normalization here, I think. I think in the 17% to 18% type gross margins, SG&A is being tightly managed. So, more inflationary levels. So, I think from here it's all going to be about a volume story, with barely stable margins.

David Leiker - RW Baird & Co. - Analyst

Okay, and then one last item on China. With the tax there on the automotive side and some pre-buy activity in December, I know that folks are just coming back from the New Years, but do you have any sense of what the build rates are currently running as we settle into the new tax regime there?

Tom Burke - Modine Manufacturing Co. - President, CEO

I don't. I don't have that, but we can get back on that, we'll find that out.

David Leiker - RW Baird & Co. - Analyst

No one seems to have it. Okay, thanks.

Tom Burke - Modine Manufacturing Co. - President, CEO

Thank you, David.

Operator

(Operator instructions) The next question comes from Mike Shlisky from Seaport Global. Your line is now open.

Mike Shlisky - Seaport Global - Analyst

Hey guys, good morning.

Tom Burke - Modine Manufacturing Co. - President, CEO

Good morning, Mike.



Mick Lucareli - Modine Manufacturing Co. - VP Finance, CFO

Hi, Mike.

Mike Shlisky - Seaport Global - Analyst

Wanted to touch on a few things, here. First, on Luvata, on CIS, the annual interest expense of \$14 million to \$15 million you put in your slides and comments, does that assume no repayment from today onward, and can you maybe comment for us a little bit on the cadence of when some of the debt might be paid down, either in calendar 2017 or in Fiscal 2018?

Mick Lucareli - Modine Manufacturing Co. - VP Finance, CFO

Yes, so that is a full year annualized interest rate, interest payment, Mike, assuming that that debt does stay on for the full year. Really, it's fairly -- we've modeled and are looking at it, even though we're in our planning season, as fairly evenly-spread quarter-to-quarter. It'll partly depend on our final cash flows next year, that'll be the main driver of it. We do have plans to pay down the debt. So, I think we'd like to say the \$14 million to \$15 million is worst case, but I can't comment on the opportunity for it to go lower until we really complete our plan and the timing of cash flow.

Mike Shlisky - Seaport Global - Analyst

Okay, got it. Then I also wanted to ask about your outlook for North America, both heavy-duty and medium-duty. Is it fair to say on heavy-duty that perhaps the worst part of it, as far as declines year-over-year, could be in your fiscal fourth quarter or the calendar first quarter here? It might not be quite as negative as we go through Fiscal 2018?

Tom Burke - Modine Manufacturing Co. - President, CEO

We certainly hope it's not as bad, that's for sure, but yes, it's been a real drop the last two quarters, the end of Q3 and what we anticipate this quarter. If it would even out more, that would be great.

Mick Lucareli - Modine Manufacturing Co. - VP Finance, CFO

We're not, so far Mike, we're not -- just to add to that -- looking at it really any differently than the other market data sources. If they're correct in that there's a stabilization, or even start to improve in the second half of calendar 2017, to your question, that could be good for us as we come out of 2017 and even to our Q4, which would be early 2018, obviously.

Mike Shlisky - Seaport Global - Analyst

Okay, got it, and then kind of following up on that question, on medium-duty I see your outlook here is for a decline of 5% in calendar 2017, but some of the forecasters are saying up 5% or 6% on the positive side. I was wondering what you're seeing differently between the big forecasters and what your business is?

Tom Burke - Modine Manufacturing Co. - President, CEO

Well, it's just what we anticipate, obviously with the planning process of 2018, we will re-look at that going forward, and next quarter we can give a higher outlook. But right now, that's kind of what our -- we've kind of triangulated with information both from external sources and internally,



what our people are thinking. So, it has not been effective as much, clearly. We have a strong position in medium-duty, that we feel great about that. So, we'll get back to you next quarter when we see that outlook going forward.

Mike Shlisky - Seaport Global - Analyst

Okay, and one last one for me. I just want to clarify, did you say that mix is going to be a benefit for you in calendar 2017 in Europe, as we saw the business in Fiscal 2017?

Tom Burke - Modine Manufacturing Co. - President, CEO

The mix of commercial truck volume going down, you're talking about?

Mike Shlisky - Seaport Global - Analyst

It sounds to me as though you were just kind of talking about your overall margin, your overall margin mix with exiting some stuff in calendar 2016 that will improve your outlook for margins in Europe in calendar 2017. Is that what you were referring to? I just wanted to clarify.

Mick Lucareli - Modine Manufacturing Co. - VP Finance, CFO

Yes, I think as we -- as Tom was describing, as we continue -- is what you've seen the last few quarters is, we continue to launch the automotive engine program, that's offsetting the wind-down of the commercial vehicle radiator program. We would expect that to be a positive mix shift.

Mike Shlisky - Seaport Global - Analyst

Okay, I think that clears it up. Thank you very much, guys.

Operator

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

Mick Lucareli - Modine Manufacturing Co. - VP Finance, CFO

Yes, this is Mick -- one comment Kathy, before I turn it back to you. I just wanted to correct on the first question on the shares outstanding, as of December 31, 50.1 million, and then as of March 31, 2016, 47.4 million. So, March 31, 2016 47.4, and December 31, 2016, 50.1.

Kathy Powers - Modine Manufacturing Co. - VP, Treasurer, IR, Tax

All right, thank you, Mick. This concludes today's call. Thank you for joining us this morning, and thanks again for your interest in Modine.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now all disconnect. Everyone have a great day.



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