Garrett Motion Inc.

Q4 and Full Year 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

Eric Birge – *Head, Investor Relations*

Olivier Rabiller – *President and Chief Executive Officer*

Sean Deason – *Senior Vice President and Chief Financial Officer*

PRESENTATION

Operator
Good morning, everyone and welcome to the Q4 and Full Year 2023 Garrett Motion Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero.

After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star than one using a touchtone telephone. To withdraw your questions, you may press star than two. Please also note, today’s event is being recorded.

At this time, I’d like to turn the floor over to Eric Birge, Head of Investor Relations. Please go ahead.

Eric Birge
Thank you, Jamie. Good morning and welcome everyone. Thank you for attending the Garrett Motion Fourth Quarter and Full Year Results Conference call.

Before we begin, I would like to mention that today's presentation and earnings release are available on the IR section of the Garrett Motion website at investors.garrettmotion.com. There you will also find links to our SEC filings, along with other important information about our company.

Turning to Slide 2, we note that the presentation contains forward-looking statements within the meanings of the Securities and Exchange Act. We encourage you to read the risks contained within our filings and with the Securities and Exchange Commission. Become aware of these risks and uncertainties in our business and understand that forward-looking statements are only estimates of future performance and should be taken as such. The forward-looking statements represent management's expectations only as of today and the company disclaims any obligation to update them.

Today's presentation also includes non-GAAP measures to describe how we manage and operate our business. We reconcile each of these measures to the most directly comparable GAAP measure and you're encouraged to examine those reconciliations in the appendix to the press release and the slide presentation.

Also in today's presentation and comments, we may refer to light vehicle diesel and light vehicle gasoline product by using terms diesel and gasoline only.

With us on today's call is Olivier Rabiller, Garrett's President and Chief Executive Officer and Sean Deason, Garrett's Senior Vice President and Chief Financial Officer.

I will now hand the call over to Olivier.

Olivier Rabiller
Thanks, Eric and thanks, everyone, for joining Garrett's Fourth Quarter and Full Year Earnings Conference call. I will begin today's remarks on Slide 3.

I am very pleased to report today that Garrett delivered a great performance in 2023, achieving full year results above midpoint guidance across all financial metrics with record net sales of $3.9 billion and record adjusted EBITDA of $635 million. Our full year adjusted free cash flow came in at a very robust $422 million at a conversion rate of 66% on full year adjusted EBITDA.

Our first [ph 3:02] quarter financials contributed to the full year results with net sales of $945 million, up

5% from the same period last year and adjusted EBITDA of $145 million and adjusted free cash flow of $137 million.

I would like to thank the entire Garrett team for their contributions and dedication to our customers and operational excellence, which continues to enable us to perform in all economic cycles. Once again, our very strong cash flow generation in 2023 has allowed us to execute a thoughtful approach to capital allocation priorities. We simplified our capital structure to welcome new equity holders, strengthen our liquidity position and flexibility and return value to our shareholders through our share repurchase program.

In 2023, we repurchased $213 million of common stock in addition to the preferred stock redemptions, while investing more than half of our RD&E into zero-emission technologies. We also meaningfully delevered by paying down $200 million of our term loan to bring our net leverage ratio under 2.2x and finished the year with $829 million of liquidity.

Garrett's continued exceptional financial performance and cash flow generation allows us to take a similar approach to capital allocation for 2024. I am pleased to announce that our board has authorized a new $350 million share repurchase program.

From a macro perspective, we are anticipating the global industry to be flattish with light vehicle production expected to be flat to down and commercial vehicle production expected to be flat to up. With these expectations, we have once again proactively implemented productivity and efficiency actions to achieve and sustain our financial performance through a flat to down economic cycle in 2024.

This year, we will continue to increase our investment in zero-emission technologies supported by increasing momentum across all verticals for our differentiated technologies. We also expect to see close to $20 million revenue from our industry leading high efficiency fuel cell compressor when, at the same time, we are continuing to see increasing demand for our turbo technologies.

Turning now to Slide 4. As I just mentioned, the increasing momentum across all product verticals allows us to continue to strengthen our leadership position in turbo offerings and further develop our differentiated zero-emissions technology. Our turbo business once again achieved more than 50%-win rate and we won a series production awards in several hybrid and alternative fuel application.

In light vehicles, we won two additional high volume electric compressor applications and within commercial vehicle, we successfully launched our Hydrogen Ice application or H2ICE with JCB for off highway equipment. Our H2ICE applications are gaining heightened attention from our commercial vehicle customer as they progress towards their decarbonization targets.

This trend towards zero-emission technology continue to drive increased interest and demand for our fuel cell compressor, E-Powertrain and E-Cooling compressors. We have the broadest range of fuel cell compressors in the industry and we achieved an additional series production award in Q4. We have also added another predevelopment award for our breakthrough high-speed and high-power density E-Powertrain. Finally, we added three more predevelopment awards for our game-changing centrifugal E-Cooling compressor. These achievements are proof that our zero-emission technologies address the evolving needs of our customers as they develop new generations of electrified vehicles.

Consistent with our last Investor Day presentation, we see still significant runaway ahead as we progress towards our target of $1 billion of annual sales of zero-emission products by 2030.

I will now turn the call to Sean to provide more insight into our financial results and outlook for 2024.

Sean Deason
Thanks, Olivier and welcome, everyone. I will begin my remarks on Slide 5.

Starting with reported net sales on the upper left-hand graph, you will see net sales for the last 2 years with Q4 2023 at $945 million, up from Q4 of 2022 by 5% on a GAAP basis and up 3% on a constant currency basis. This increase was driven primarily by ramp-ups of small engine gasoline applications, partially offset by lower sales of commercial vehicles.

Moving to the upper right-hand side of the page, the increased sales translated into higher adjusted EBITDA in the fourth quarter of $145 million, up 4% or $5 million from $140 million last year. This reflects our continued strong productivity and operational execution net of unfavorable product mix I mentioned earlier. As a result, the adjusted EBITDA margin was 15.3%, down from 15.6% last year.

On the bottom left graph, we show the Garrett-generated positive adjusted free cash flow of $137 million in Q4 of 2023, up slightly from $132 million in Q4 of 2022. Compared to last year, this increase is driven by working capital efficiency due to stronger year-end collections, partially offset by higher tax, interest and capital expenditures. We continue to see our adjusted free cash flow conversion to adjusted EBITDA trend above 60%, which is in line with our capital allocation framework.

Turning to Slide 6. At the top of the page, we show our Q4 net sales bridge by product category, as compared with the same period last year. As mentioned, Q4 net sales were up 5% on a GAAP basis and 3% on a constant currency basis, reflecting an increase of $47 million over Q4 of 2022.

Gasoline products were up 11% at constant currency, adding $39 million in sales. Gasoline products now comprise 45% of reported net sales, up 42% from last year, driven primarily by small engine product ramp-ups in China and North America.

Diesel products increased 5% at constant currency, primarily from higher production volumes on existing platforms in Europe, an increase of $12 million to sales and comprising 25% of total sales flat from last year.

Commercial vehicle sales decreased 16% at constant currency, or $27 million, driven by industry weakness as a high interest rate environment and softness in the construction and real estate markets continued to pressure growth. Commercial vehicle products represented 16% of total net sales in Q4 of 2023, down from 19% in Q4 of 2022.

Our aftermarket business decreased 2% at constant currency, or $2 million. It comprises 12% of net sales, down from 13% in Q4 2022. Finally, we saw a favorable impact of $19 million due to foreign exchange on a year-over-year basis.

Moving now to the bottom of the page, we show our full year net sales bridge by product category as compared with last year. Net sales are up 8% on both a GAAP basis and constant currency basis, reflecting an increase of $283 million over the full year 2022, allowing us to achieve record net sales this year of $3.9 billion, as Olivier mentioned.

Gasoline products were up 17% at constant currency, adding $255 million in sales. Gasoline now comprises 44% of reported net sales, up from 41% last year, driven by light vehicle industry recovery and product ramp-ups, primarily in China and Europe.

Diesel products increased 3% at constant currency, an increase of $33 million to sales and comprised

25% of total sales, down slightly from 26% last year.

Commercial vehicle sales declined 1% at constant currency, a decrease of $10 million to sales, again, driven by a high interest rate environment and softness in the construction and real estate markets, primarily in the second half of the year. Commercial vehicles represented 17% of total net sales in 2023, down from 19% in 2022.

Our aftermarket business increased 3% at constant currency, an increase of $12 million. It comprises 12% of net sales, flat to 2022. Finally, on a full year basis, we saw an unfavorable impact of $14 million due to foreign exchange.

Turning now to Slide 7. At the top of the page, we show our Q4 adjusted EBITDA bridge compared with the same period last year. In Q4, we delivered an adjusted EBITDA of $145 million, representing a $5 million improvement over the same period last year. Increased volumes, driven mainly from gasoline, were offset by weaker commercial vehicle volumes, resulting in a net product mix headwind as previously mentioned, impacting adjusted EBITDA by $33 million. Overall, operating performance was a net positive of $24 million as we continue to successfully pass through inflation and generate productivity, while dedicating over 50% of the total R&D expenditures to zero-emissions technologies.

Moving to the bottom of the page, we have our full year adjusted EBITDA bridge compared with 2022. This year, we delivered record adjusted EBITDA of $635 million, which was above our midpoint outlook of $630 million. This represented a $65 million improvement over the prior year. Our full year adjusted EBITDA margin also came in 10 basis points better than our midpoint outlook at 16.3%, in line with our financial framework.

Strong growth in volumes in the first half of the year contributed $89 million and was partially offset by $79 million of unfavorable product mix impact, as strong double-digit growth in small engine gasoline applications was partially offset by weaker commercial vehicle volumes. Our overall operating performance was a net positive of $55 million and we consistently delivered productivity throughout 2023 and passed through inflation. All this while growing our spend on zero-emission technology development by $14 million versus the prior year.

Moving now to Slide 8. We show the adjusted EBITDA to adjusted free cash flow bridge for 2023. Garrett delivered a record adjusted free cash flow of $422 million for a very healthy adjusted free cash flow conversion of 66% of adjusted EBITDA. This performance was driven by higher earnings that we once again converted into cash, as well as an improvement in working capital of $23 million, primarily due to improvements in inventory and payables.

Capital expenditures and cash taxes were in line with expectations and cash interest increased to $89 million due to the issuance of our $700 million Term Loan B used to facilitate the normalization of our capital structure earlier in the year.

Turning now to Slide 9. We ended 2023 with a strong liquidity position of $829 million, up $108 million versus 2022. This was comprised of $570 million of capacity on our undrawn revolving credit facility and $259 million of unrestricted cash.

We finished 2023 with a net leverage ratio under 2.2x, ahead of our expectations and driven by strong cash generation for the year, coupled with $200 million of delevering in the second half. The normalization of our capital structure, delevering and Garrett's strong and consistent cash generation also resulted in a ratings upgrade from S&P to BB- with a stable outlook in Q3.

During the quarter, we repurchased $35 million of common stock for a total of $213 million repurchased during 2023, close to 10% of our market capitalization, as we continue to use our earnings and cash generation to return value to our shareholders.

As Olivier mentioned earlier, our board has authorized a new share repurchase program of $350 million for 2024. Our consistent and robust cash generation and capital light financial framework enables us to return significant value to our shareholders and maintain a healthy balance sheet. Our current level of adjusted free cash flow is close to 20% of our market capitalization and we think that a share repurchase program is a good use of cash given current financial market conditions.

Moving to Slide 10. On this slide, you can see the assumptions we used in planning our 2024 outlook in financial ranges that imply the following midpoints. Net sales of $3.9 billion; net sales growth flat at constant currency; net income of $253 million; adjusted EBITDA of $620 million, implying a margin of 16%; net cash provided by operating activities of $420 million and adjusted free cash flow of $375 million. Our robust new business win rate of greater than 50% on average over the past 5 years is driving share of demand gains. This, when coupled with increasing turbo penetration on internal combustion engines, allows us to offset both an increase in average BEV penetration of 3%, as well as a decrease in light vehicle production compared to the prior year.

In this flattish revenue environment, we plan to deliver productivity and pass through inflation to offset mixed and inflationary headlands in 2024. At the same time, increasing customer interest across key regions and verticals for our zero-emissions products drives us to responsibly increase our research, development and engineering spend to 4.5% of sales, up 30 basis points from 2023. We expect to dedicate roughly 60% of our research, development and engineering spending in 2024 to zero-emissions technologies.

With that, I will now turn the call back to Olivier to wrap up.

Olivier Rabiller
Thanks, Sean. Turning to Slide 11. It was a great year and once again, we delivered strong financials in a challenging macro environment. We continue to strengthen our leadership position in turbo, once again, winning greater than 50% of the available business in 2023. Additionally, interest in our zero-emission technologies and applications continues to intensify with new series production and preproduction contract— predevelopment contracts awarded in Q4 across multiple regions and customers.

We expect to maintain our strong financial performance once again in 2024 in a flat to down industry and have taken decisive productivity actions to control fixed costs and to adapt our highly variable cost structure to these environments. We also plan to return value to our shareholders through our new $350 million share repurchase program supported by Garrett's ability to constantly generate strong cash flow even in tough times.

Thank you for your time. Operator, we are now ready for the Q&A session.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time, we'll begin the question and answer session. To ask a question, you may press star then one on a touchtone telephone. If you are using a speakerphone, we do ask that you please pick up your headset prior to pressing the keys to ensure the best sound quality. To withdraw your questions, you may press the star and two. We will pause momentarily to assemble the roster.

Our first question today comes from Hamed Khorsand from BWS Financial. Please go ahead with your question.

Hamed Khorsand
Hi, good morning or good afternoon, as well. First off, could you just talk about the environment that you're going into? You talk about being flattish. Are you taking market share right now— what your expectations are there and do you feel like there's any sort of inventory stocking or destocking happening that's also being reflected in your guidance?

Olivier Rabiller
So, Hamed, that's a very good question. Obviously, let me unpack a little bit what we mean by flattish to down. When we say flattish to down, we are referring to the light vehicle production worldwide. I think we are very consistent in our forecasts with the consultants and from what I've seen from our peers reporting for the last few weeks, we are very consistent as well.

In that environment, we are planning to have increased turbo penetration and increase our demand, which at the end is the reason why we are maintaining our revenue flat despite a forecasted growth of battery electric vehicle that is about 300 basis point, which also is very consistent with everyone into the industry since we have not seen yet into the predictions the impact of the so-called slowdown of battery electric vehicle. So, we are planning for 15% battery electric vehicle.

Some people may say it's a bit aggressive at 15% or conservative depending on the way you— where you place yourself in the short-term, but we'd rather plan like everyone for the timing and the results of all that is despite that expected growth on the EVs, we are winning our share of the business that's growing. Yes, we are getting the share of demand gains.

Hamed Khorsand
Okay. Great. As far as the battery electric goes, what is Garrett's timing as to being able to generate revenue from there? I know you've been talking about it a lot more in recent quarters.

Olivier Rabiller
We have— I think we have explained several times that we are planning to get to $1 billion revenue on zero-emission technology by 2030, which comprises of three technologies. The first one is on fuel cell compressors. So, it's for hydrogen fuel cell vehicle. It's not for battery electric vehicle, but these are zero-emission solutions as well. This is a business where we are already recording revenue. I think we've said that today that we are expecting about $20 million of revenue already on fuel cell compressors in 2024.

The second technology is the high-speed electric motors coupled with a gearbox and inverter, which is a technology that is specific to us and unique to us with high-power density, where we have recorded already a number of predevelopment contracts. Obviously, there is a significant portion of that $1 billion outlook that is coming from that technology.

The last one is E-Compressors. The idea is to use centrifugal electric— high-speed electric compressor technology, that once again is unique to us, to provide a step change to our customers in terms of power and power density when it comes to the huge needs of coolings that you have for battery electric vehicle. So that technology once again will be applicable to a battery electric vehicle. This is a technology where we have recorded again three more predevelopment contracts during Q4.

So more to come. Today, what we say is that we are confirming the trajectory that we had highlighted in October during our Investor Day.

Hamed Khorsand
Okay. One last question. What's the plan or allocation for free cash flows here? Is it going to be the same— more about stock buyback versus debt or any plans to reduce debt this year?

Sean Deason
Yeah. We take a balanced approach to capital allocation. As we stated before, first and foremost, we fund the business, which you see we're doing per our guide. Then second, we were looking to do a mix of deleveraging and share buyback, but that's subject to how the market develops and the year develops. But as you can see, we've got very good optionality and very robust cash flow generation. So, we have the ability to do both.

Hamed Khorsand
Okay. Great. Thank you.

Operator
Our next question comes from Michael Ward from Freedom Capital. Please go ahead with your question.

Michael Ward
Thank you. Good morning, everyone. I just wondered if you could talk a little bit about your ability to adjust to shifting market trends. And also, as we look in the markets, hybrids are a bigger percentage of the European market and how is the turbo content in Europe versus the US? And then what impact does it have if you start to see an increased shift in the US towards hybrids away from just strict ICE engines?

Olivier Rabiller
So, Michael, that's a very good question. What we see in Europe is that the turbo penetration of— that you have on hybrids is higher than the turbo penetration that we have on non-hybrid vehicle. So, you would expect the same to happen in the US, if there is more hybrids. Obviously, in the short-term, that should come at the expense to some level of BEVs or maybe that's an opportunity on that side and at the same time, that's an opportunity for us for an increased turbo penetration. But more than the increased turbo penetration, it's also the increased level of technology that you have for the turbo on hybrid application, which tends to be higher than what you have on non-hybrid application as well. So, it's higher turbo penetration and more technology.

Michael Ward
So what type of— when you look at the technology, what type of impact does that have on content? Is it a 20% to 30% increase in content per unit?

Olivier Rabiller
I think we published, by the way, recently the content per vehicle that we have on the different technologies. So, we can refer to that again. If we move to a valuable [ph 27:48] geometry turbo charger, we are obviously increasing the content by a percentage. Then if we move to electric turbo charging or electric boosting, there is another increase that can even double the price of the turbo charging system.

Michael Ward
Okay. And just as far as turbo penetration, I see good data on the US market on where we are with turbos and it's like 42%. How does that compare in Europe? And in Europe, you have a higher hybrid concentration, smaller vehicles. Obviously, driven by the higher gas prices in Europe, relative to the US. Do you have a kind of turbo penetration number for the European market and what it looks like relative to North America?

Olivier Rabiller

In Europe, we are between 85% and 90%.

Michael Ward
Okay. It looks like if we start to go—

Olivier Rabiller
And if you look at the three regions that we are serving between— just to make a stop gap [ph 28:45] between Europe, China and the US, the US are lagging behind the two other regions. So the potential in the US is huge.

Michael Ward
Okay. And then in addition, you get the increase if you go to hybrids and presumably higher tech, so you get growth and then additional content. So, I'm looking at the right things.

Olivier Rabiller
Yes. You're looking at it [indiscernible]. Absolutely.

Michael Ward
Thanks very much.

Operator
Once again, if you would like to ask a question, please press star and then one. To remove yourself from the question queue, you may press star and two.

CONCLUSION

Operator
Ladies and gentlemen, in showing no additional questions, I'd like to turn the floor back over to Eric Birge for any closing remarks.

Eric Birge
I want to thank everybody for the time you spent today reviewing our 2023 results and our outlook for 2024. Please contact me directly if you have any further questions. Thank you.

Operator
Ladies and gentlemen, with that, we'll conclude today's conference call and presentation. We thank you for joining. You may now disconnect your lines.