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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Modine Manufacturing Company's Fourth Quarter Fiscal 2017 Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

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

Kathleen T. Powers - *Modine Manufacturing Company - VP of IR & Tax and Treasurer*

Thank you. And thank you for joining us today for Modine's Fourth Quarter Fiscal 2017 Earnings Call. With me today are Modine's President and CEO, Tom Burke; and Mick Lucareli, our Vice President of Finance and Chief Financial Officer. They'll 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 fourth quarter and full year results, and provide our revenue and earnings guidance for fiscal '18. 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

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Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

Thank you, Kathy, and good morning, everyone. On today's call, I will discuss our fourth quarter and full year results and provide an update on our integration of Luvata HTS business that we acquired in the third quarter and now operate as our Commercial & Industrial Solutions segment. After that, Mick will provide a more detailed review of our consolidated financial results. Then we'll also provide our revenue and earnings guidance for fiscal 2018. I'll then provide a few closing remarks prior to opening up the call for questions.

Fiscal 2017 was a year of transformation for Modine and the basis for that transformation was the Strengthen, Diversify and Grow strategy we announced over 18 months ago. During fiscal 2017, we strengthened Modine by achieving our $40 million to $50 million of annual savings target

and diversified and grew the company by acquiring Luvata HTS. The integration of this business is well underway and we remain focused on executing the actions required to achieve our synergy targets.

As importantly, we ended the year on a strong note in our base business. In other words, our vehicular and building HVAC business. We're encouraged to see signs of recovery in some of our key markets, but that comes with some short-term pressures due to rising metals prices. As you know, we have material pass-through agreements that allow us to pass through metal cost increases, there is often a lag of 6 months or more. So in the short term, we expect our earnings will be impacted by higher metals prices. We are confident we will be more than able to offset these costs with savings from the various cost savings initiatives taken over the past 2 years.

Moving on to our fourth quarter results. Sales were up 44% on a constant currency basis, including $143 million of sales from our CIS business in the quarter. Our non-CIS, or base business, was up 2% on a constant currency basis, primarily due to higher sales in the Asia segment partially offset by lower sales in the Americas segment.

Our adjusted operating income was $29.2 million, up 23% from the prior year, primarily due to the addition of the CIS business which contributed $7.8 million of operating earnings in the quarter. In our base business, the procurement savings were offset by higher material cost and higher compensation and benefits expense.

Our adjusted earnings per share were $0.35 for the quarter, down $0.01 from the prior year, as expected, primarily due to the increase of interest expense from the debt taken on to finance the acquisition.

For the full year, sales were up 12% on a constant currency basis from the prior year, and adjusted operating income of $69.3 million was up 10% from the prior year. Adjusted earnings per share of $0.78 were up $0.02 from the prior year.

Now I'd like to briefly review the segment results for the fourth quarter and provide an update to our market outlook for fiscal 2018.

Turning to Page 6. Sales for the Americas segment were down 2.5% on a constant currency basis to $144.6 million. Once again, sales were significantly impacted by continued weakness in the heavy-duty commercial vehicle market. This is partially offset by higher sales to off-highway customers in both North America and Brazil. I am encouraged to finally see some improvements in the off-highway markets.

Gross margin was up slightly to 18.9%. Although we saw an increase in raw material prices during the quarter, we were able to more than offset this impact with savings from procurement and other cost-reduction initiatives.

SG&A expense was up $1.3 million to $13.4 million during the quarter, primarily due to higher incentive compensation and benefits expense. All together, adjusted operating income for the Americas segment was $14.3 million, down $2 million from the prior year but up significantly from the previous 3 quarters.

As I mentioned last quarter, we're not expecting significant improvement in our North America markets in fiscal 2018. We expect the automotive, heavy-duty truck and off-highway markets to be flat; the medium-duty truck market to be flat to up 5%; and some additional declines in agricultural equipment market. We expect to see improvement in Brazil from the currently depressed levels. As I mentioned, we saw some improvement in our off-highway sales in the fourth quarter and expect these markets to grow 10% to 15% in fiscal '18, albeit off a low base.

Looking forward, we are forecasting sales growth in the Americas to be driven by new automotive programs. I am also encouraged by a number of new business wins and opportunities with off-highway and commercial vehicle customers. We expect profitability to improve from the actions taken this past year in conjunction with our SDG program, including the closure of the Washington, Iowa plant. However, we expect these improvements will be somewhat offset by higher raw material cost.

Please turn to Page 7. Sales for our Europe segment were flat in a constant currency basis as higher automotive sales were offset by planned reductions to commercial vehicle customers. Gross margin improved by 50 basis points from the prior year to 15.7%, primarily due to procurement

savings and favorable sales mix, partially offset by unfavorable raw material costs. SG&A expense was up slightly due to higher compensation and benefits expense, resulting in adjusted operating income of $10.6 million, down 5% from the prior year.

We expect the European automotive market to remain stable, the commercial vehicle market to be flat to up 5% and the off-highway markets to be flat to down 5% in fiscal 2018. We also expect sales in Europe to continue to be impacted by planned wind-downs of our low-margin commercial vehicle programs, offset by continued growth in our automotive products.

Operationally, we continue to execute significant changes to our manufacturing footprint. We are well on our way with the expansion of one of our facilities in Hungary, and we'll transfer production of various product lines throughout the year. Expanding our low-cost country footprint in Europe is critical to our continued competitiveness in the region. These industrial transfers are always challenging, but they allow us to achieve our long-range earnings target.

We've done a number of these transfers over the past few years and are confident we will manage the Hungary expansion without any customer disruptions. We are very pleased with the business environment and climate -- the business environment in Hungary and will benefit from the significant tax incentives in fiscal '18.

Please turn to Page 8. Sales for our Asia segment were up 49% compared with the prior year on a constant currency basis. This significant improvement was driven by higher sales to automotive and off-highway customers in China, India and Korea. Higher sales volume led to a $1.6 million improvement in gross profit. Gross margin was down 50 basis points as the fourth quarter of the prior year was particularly strong.

Also with our strong sales growth, we experienced some temporary operating inefficiencies at our Shanghai plant which is currently operating at full capacity. We have installed a new furnace at this plant and will install a second one later this fiscal year. This additional capacity will allow us to continue to expand our production of automotive oil coolers which has been so instrumental to our recent growth in Asia.

Adjusted operating income in Asia segment increased $900,000 or 47% in the fourth quarter compared to the prior year, primarily due to higher sales volumes.

As we look to fiscal 2018, we expect the growth trends to continue in Asia and -- with the China automotive market up 3% and driven by ongoing improvement in the construction markets across the region. We also expect both the automotive and commercial vehicle markets in India to grow by 5%, which is great news for our high-performing India operations.

Overall, we expect revenue growth in our Asia segment to driven by -- equally by market growth and maturing volumes from automotive oil cooler launches. In addition, we'll be launching a heavy-duty powertrain cooling module with JAC, a major commercial vehicle customer in China, this year. We expect similar growth in earnings in the region with the benefit of higher volumes partially offset by higher raw material cost. I am very pleased with the growth in this segment over the past 2 years, and it's great to see that the investments we made to diversify our sales have led to a level of sustained profitability for this segment.

Please turn to Page 9. Sales for our Building HVAC segment were up 2% compared with the prior year on a constant currency basis. Higher sales of air conditioning products in the U.K. were partially offset by lower sales of heating and ventilation products in North America. Our gross margin improved by 60 basis points to 27.5%, and SG&A expense was lower by $900,000 or a decrease of 10% due to planned cost reductions. This resulted in a $700,000 improvement in adjusted operating income from the prior year.

As expected, we are continuing to see improvements in this segment resulting from the actions taken earlier this year. We had a particularly weak heating season in North America again this year, but we are seeing volume and operational improvements in the U.K.

For fiscal '18, we're expecting to see further improvements in our markets. We expect the North American heating market to be flat to up 2%, the air-conditioning market in Europe to be up 4% and the commercial ventilation markets of both North America and the U.K. to be up 2%. We expect our sales growth to be in line with the market or slightly above as we continue to grow market share and to see continued improvement in earnings and margins.

With the challenges in the U.K. during the past several years now behind us, our new leadership team is focused on operational performance, efficiencies and long-term growth. In North America, we have been crossing the country with our Innovation Tour, demonstrating our products and solutions to our customers and distributors. As a result, we have a strong order book in place, particularly with school products and rooftop ventilation units.

Please turn to Page 10. It has been nearly 6 months since our acquisition of Luvata HTS, and I'm very pleased with the progress we have made in bringing our 2 companies together. From a business perspective, Modine CIS is a leader in a majority of the markets we serve. Our strategy of being fast and flexible in response to customer requests allows the CIS team to respond quickly to discrete customer orders that make up the majority of CIS sales. The capability of the CIS business units to provide a large and diverse set of customers with highly effective and competitive thermal management solutions is why we decided to add this business to our portfolio.

This was the first full quarter since we made the acquisition, and the CIS segment reported $143 million in sales. Gross profit was $21.6 million which resulted in a gross margin of 15.1%. As a reminder, there's $3.2 million in depreciation amortization expense recorded as a result of purchase accounting. The segment reported operating income of $7.8 million, which is above the estimate we've provided last quarter. We expect the markets served by the CIS segment will be up 2% for fiscal 2018 other than precision cooling, which we expect to be up 3%.

Our integration efforts are continuing, and we remain committed to delivering synergies in excess of our goal of $15 million annual savings over the next 3 or 4 years.

With that, I'd like to turn it over to Mick for an overview of our consolidated financial results. And Mick will also provide us our revenue and earnings guidance for fiscal 2018.

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Thanks, Tom. Please turn to Slide 12. We are pleased with the results this quarter, especially given the contribution from CIS in its first full quarter with Modine. As expected, sales challenges remained in some areas of our base business. Also, aluminum and copper increased significantly in the quarter.

Beginning with the top line. Our fourth quarter sales increased $150 million on a constant currency basis, including $143 million of sales from our new CIS segment. Excluding CIS, constant currency sales were up $7 million or 2% year-over-year.

Reported gross profit of $84.9 million was up $23 million. This includes $21.6 million from CIS. The reported gross margin was negatively impacted by $1.4 million from the inventory step-up related to purchase accounting. We backed this out for our adjusted operating income, and this is the last time we'll need to do that. Excluding CIS and this adjustment, gross margin on the base business improved 70 basis points over the prior year to 18.8%.

SG&A of $60.6 million includes 2 significant items worth noting. First, we incurred fees of $3.2 million on integration-related cost. These are again added back for our adjusted operating results. Second, the CIS segment added $13.8 million of SG&A. Excluding these items, SG&A was up only $2 million or 5% from the prior year.

During the quarter, we recorded $4.9 million of restructuring expenses. These relate to European severance of $3.2 million and $1.7 million of equipment transfers and plant consolidation cost for the Washington, Iowa closure. We also added back $4.6 million of acquisition-related items, which are comprised of the inventory step-up and various integration cost.

I'd like to note that we sold our McHenry, Illinois and Washington, Iowa facilities during the quarter. These asset sales gains were excluded from our adjusted operating income.

Fourth quarter adjusted operating income was $29.2 million was up $5.5 million or 23%, and our adjusted earnings per share was $0.35, down $0.01 compared to last year. Our EPS was negatively impacted by more shares outstanding and incremental interest due to the Luvata HTS acquisition.

As a reminder, our U.S. GAAP income statement is included in the appendix to this presentation and in our earnings release. This includes a full reconciliation between our reported results and adjusted operating results.

Turning to Slide 13. In the quarter, adjusted free cash flow was a negative $900,000, which is down from last quarter but better than the prior year by $7.8 million. Full year operating cash flow was temporarily impacted by cash restructuring and acquisition-related payments.

Adjusted free cash flow for the full year was $9.9 million. The year-over-year decline was due to the combination of several items, including lower cash earnings, higher levels of working capital and slightly increased capital expenditures.

The free cash flow adjustments of $32.7 million include restructuring payments of $18 million, which are related to plant consolidation and severance, with the remaining items related to acquisition and integration activities.

Finally, our debt leverage ratio is currently 2.9. This is well below the covenant requirement of 3.75, as shown in the table on the upper right.

Looking ahead to fiscal '18, we are anticipating a much improved adjusted free cash flow. We're focused on paying down our debt and getting our leverage ratio back below 2.5 by the end of the fiscal year.

Now let's turn to our fiscal 2018 full year guidance on Slide 14. I'm pleased to report that we're expecting strong sales and earnings growth in the new fiscal year, which includes the full year impact of the Luvata HTS acquisition. As Tom discussed the segment slide -- on the segments slide, we anticipate good growth in Asia and Building HVAC with less in the Americas and Europe.

We've made some key assumptions on our guidance, and I want to review those with you since any one of them could cause some change in our outlook. First, we have summarized our major end market assumptions on the previous slide. Next, we anticipate that copper and aluminum will hold at current levels. Our current outlook includes approximately $15 million to $20 million of temporary cost increases as we absorb the higher metals cost during the customary lag period. Third, we expect the U.S. dollar will hold at current levels versus most major currencies. And last, we assume interest rate expense of approximately $26 million and an effective tax rate in the 15% range.

So to summarize. We project sales to be up 25% to 30% from the prior year. We expect adjusted operating income to be in the range of $100 million to $110 million. Our SDG cost-savings initiatives will offset the impact to commercial pricing agreements, normal economic cost increases and the higher metals. The full year impact of CIS will be a big driver of operating income in fiscal 2018.

Please note that we are including adjusted EBITDA in our guidance this year to help assess the impact from CIS and the complexities of purchase accounting. We expect adjusted EBITDA to be in the range of $175 million to $185 million which equates to an increase of more than 40% over the prior year. Finally, we expect our adjusted EPS to be between $1.20 and $1.35, which is up significantly from $0.78 in fiscal '17.

In addition to the pretax earnings improvement, we are assuming a tax credit associated with the plant expansion in Hungary. This is a onetime tax benefit that is expected to lower our adjusted tax expense to the 15% range in fiscal 2018.

We've made great progress in fiscal 2017, and we've set the stage for a strong fiscal '18. It appears the market headwinds are lessening for our vehicular business. And we're glad to have CIS onboard. Integration is proceeding as expected, and we're excited about the opportunities in front of us.

With that, Tom, I'll turn it back to you.

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

Thanks, Mick. This has been a remarkable year for Modine. In addition to celebrating our 100th anniversary, we completed the largest acquisition in our company's history. In doing so, we achieved our goal of diversifying our end markets and customer base with 40% of our revenues now stemming from industrial applications. Meanwhile, we remain focused on our core competency, that is, solving thermal management challenges for our customers.

Our priorities for the year ahead include continuing the integration of the CIS business and capturing the synergies to which we committed. In some cases, it takes cash up front to achieve synergies, so we are balancing these needs with our desire to pay down the debt we took on to finance the acquisition as quickly as possible. As Mick mentioned, we expect to get down to our target leverage range by the end of this fiscal year. We will therefore be very disciplined with our capital allocation strategy, balancing our need to invest for both synergies and growth with debt repayment.

As I have previously mentioned, for the past year, we have been working on becoming a more global organization. For fiscal 2018, we will continue to manage and report results for our vehicular business under the 3 existing regional segments, but plan to combine them into 1 segment in fiscal 2019 which we will call Vehicular Thermal Solutions, or VTS. The advantage of combining these vehicular segments is to have a more global approach to our business, including how we interact with our customers, manage our operations and develop our products.

With our transformation into the 3 business units: VTS, CIS and Building HVAC, we are in a much better position to make strategic decisions and allocate capital more efficiently. We can better assess the markets we serve and consolidate the relative strength of our competitive positions.

The common and an unwavering commitment among our businesses is our proven leadership in providing thermal management solutions. Leveraging this core competency across our various markets will drive greater value by minimizing the risk of market cyclicality and by providing greater scale to better withstand the competitive forces we will continue to face. This is a big change for our company, but we have the right team in place to continue our focus on growth and diversification by leveraging our position as a global leader in thermal management solutions.

I am very excited about the year ahead of us. As Mick outlined in his overview of our guidance for fiscal 2018, we're expecting a year of significant sales and earnings growth driven by the addition of the CIS business. Through the execution of our SDG strategy, we have clearly met our goal of transforming Modine into a more diversified thermal management leader.

And with that, we will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from the line of David Leiker with Robert W. Baird.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

This is Joe Vruwink for David. I wanted to start in and try to maybe get at the growth for Modine coming from things like new business, content, market share. So if I just look at your fiscal '17 results, I think the base business maybe declined 1% organically. Can you quantify it? You have some CV programs rolling up, you had some BMW business rolling off, all of that was planned, so that's a headwind. The end markets were obviously negative. It just seems like if I try to get at kind of the Modine growth not related to those other things, you're doing a pretty nice rate of growth. And I'm wondering what that number is exactly.

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Yes, Joe, difficult to quantify, but what I can tell you is in the areas where we've targeted our growth and have really built that strong global product platform, we're growing -- we've been growing, in some cases, double-digits top line. I would say longer term, it's been growing in the mid-single digits. And then what you've seen offset that has been the wind-down of certain programs which you've named that we knew about. And then candidly, we've also, in the last, really, 18, 24 months, have been battling some market declines on the overall heavy-duty side or off-highway side as well. Tom, do you have anything to add?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

No. You hit it.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Is there a point in time where some of those negative items -- I know end markets, you can't really predict quarters in advance or years in advance. But is there a point in time where the planned program exits subside and Modine will more clearly be a mid- to high-single digit grower in the reported results?

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Yes. From my side, I think we're getting to that, really to that point now where we're starting to turn the corner on some of the major headwinds we've had on the wind-downs. I think this is -- we're through the BMW wind-down. Most of the issues we've been through in the last year or 2. Restructuring in the Americas is behind us. We're seeing stability in Brazil and then gaining share, winning our programs in Brazil. So that seems to be stable. Asia is stable. I think the only remaining issue that we need to manage in the next year is the wind-down of some commercial vehicle programs in Europe. Other than that and in the magnitude, that's not huge on a $1 billion, $2 billion, $3 billion vehicular business. That would be the last item I see. Tom?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

Yes, no, I agree. I think the focus on the portfolio on the product side, the vehicular business, is we've got it in excellent position on platform bases located in the right places, namely low-cost country. The big trends in industry from a standpoint of fuel efficiency, electrification and so on are -- we're positioned very well. So I feel very good about how we worked to get the portfolio right and the cost structure right. Again, Mick mentioned the challenges or the headwinds of the off-highway market which has been a significant drag on revenue. We continue to be very satisfied with our relationships with customers, our win rate in that market, in specifically heavy-duty, especially related in the mining side. As that comes back, we will fare very well. And in ag as well.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Okay, great. If I shift to the cost side, so obviously, a tremendous amount has been done to generate better incremental profits going forward. If I just look at Q4 and I did my math right, it's about a $2.5 million gross profit improvement on a $6.8 million revenue improvement for the base business, so pretty healthy contribution margins. Is that the right incremental to think about, not factoring in materials, obviously, but given the work you've done on incremental volume? In the near term, we can be expecting that type of performance?

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Joe, I'd say I think we still hold to 25% to 30% conversion on volume, which I think is what we should expect to see and would be good. And then you pointed out the other thing, it's just at least in the next 6 months as we start to pass through materials, we've got a pretty big headwind this

year, $15 million to $20 million on the copper, aluminum side. But absent anything on the metals side, I would say 25% to 30%. In some cases, we can do a little bit better, but that would be the average.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Is that an EBIT contribution?

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Well, great question. It should be close. We've got -- we've really gotten our SG&A down to pretty lean and where we need it from the SDG program, so most of our SG&A moves will frankly just be with general economics. So I would say gross profit, 25% to 30% conversion, less any kind of general economics on SG&A.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

And then my last question, on free cash flow. So to do what you've done to the vehicle business, obviously, that consumed cash. It sounds like you're in the later innings, so probably tailwinds for free cash from the vehicle business. What would be your expectation in fiscal '18 for free cash flow? And then maybe a blue sky scenario for what's the vehicle business and Luvata ultimately could do, free cash flow generation.

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Yes. I think in fiscal '18, Joe, we'd expect free cash flow to be up in line with the increase in EBITDA. I don't really expect a big change in working capital and only CapEx should be within $5 million or so of what we spent this year. So we should see a really nice move next year of free cash flow, up with the EBITDA. Up -- it's going to be up about $50 million to $60 million. And then longer term, I think the company has the ability to generate, for sure, $75 million to $100 million type of free cash flow with top line growth.

Operator

Our next question will come from the line of Matthew Paige with Gabelli and Company.

Matthew T. Paige - *G. Research, LLC - Research Analyst*

You noted $15 million in synergies over the next 3 to 4 years. Could you put any of that into buckets for us?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

Yes. I think you said $15 million? Or did you say...

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

$15 million.

Matthew T. Paige - *G. Research, LLC - Research Analyst*

$15 million, yes.

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

$15 million is the -- yes, okay. I thought maybe you said $50 million for a second there...

Matthew T. Paige - *G. Research, LLC - Research Analyst*

One could hope.

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

Yes. No, clearly, we are looking at all the traditional elements of synergy opportunities, as we've reported with the planning of the acquisition to close, we stood up integration management office, an executive oversight, dedicated team, work stream leaders on both sides of -- in both companies as we came together. And we've generated many ideas. So you can think of all the traditional operational, procurement, back office opportunities that are in place to make sure we drive that. So I feel very good about when I -- when we say meet or exceed that commitment of being very much achievable. So breaking that up right now will be a little premature, but you can take away that we're -- every opportunity is being looked at and every major value stream is going to be -- is being impacted as far as looking for opportunity.

Matthew T. Paige - *G. Research, LLC - Research Analyst*

Great. And as you noted, Asia growth was particularly strong. Could you talk about some of the potential drivers, such as regulation enforcement, there? As well as how you're faring on domestic versus JV platforms?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

Sure. No. We are very excited. We invested early with the right product platforms in Asia, anticipating the regulatory changes on emission controls similar to the rest of Europe and North America. Those -- that strategy is paying off now with the right product mix that customers need, both multinationals and domestics, as I mentioned. One example, a major win with JAC, a major truck player in China. But we're seeing the same clearly with automotive drive, with oil coolers as the need for higher-efficiency performing vehicles in the China region are demanding the product that we, quite frankly, are a leader in providing solutions to and all the adjacent opportunities that those bring, things like charge air coolers and transmission oil coolers and other devices that are very important to balance out the engine powertrain performance of these higher-performing cars. So the mix is right. Again, China very specifically. But India right there with it as well, so I feel very positive that we're set up well for those trends in regulatory changes to meet the needs of that region.

Matthew T. Paige - *G. Research, LLC - Research Analyst*

Great. That's very helpful. And last question from me is you spoke to improvement, particularly in the off-highway segment. Could you just touch on what regions primarily are seeing this? And any cadence throughout the quarter that you saw?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

Yes. Well, clearly, we mentioned Asia. We're seeing construction infrastructure gains really kicking off. The excavator business up a little bit, which is very much a target focus for us in Asia. So that's one. We're also seeing off-highway mining-related opportunities that are developing from the low base in North America. So those are both very encouraging demands. There's some indication of ag business, off-highway on the ag side coming back, Brazil showing some signs, but also indications coming from some of our larger customers. So all in all, as Mick pointed out, we're anticipating some tailwinds this year, which is great coming from a very important segment -- or set of segments of our business portfolio.

Operator

Our next question will come from the line of Mike Shlisky from Seaport Global.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director of Machinery and Trucks and Senior Industrials Analyst*

I want to turn to your -- back to your slide for North America. So you're saying that you're seeing a flat outlook for Class 8 for fiscal '18, but the big forecasting services, like ACT, they're now saying up double digits. I'd say similarly in medium-duty, I think you're saying flat to up 5%, while the big survey forecasters are saying up double digits there as well for Class 5 to 7 trucks. So I'm just kind of confused why you're saying flat, maybe up slightly, when you've got double digit outlook for the big forecasters. And I've never known you guys to deviate much from what those guys have been saying. Could you help bridge the gap there?

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Yes. Mike, we talked a lot about that this week. It seems like in the last set of earnings announcements, there's been some more positive news on the truck side. We are really basing it off of what we're seeing on some of our order intakes on the short-term order intakes and directions from the customer. I guess I would say we've been reading this week the same news that you've been doing, and I hope that would be a tailwind for us. So we've primarily built it on our specific programs and what we're hearing in particular from our customers and our plants. Tom, anything?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

No. That's exactly right. So we've -- we hope that comes through, but basically right now, what we're seeing is kind of numbers that hold to those projections we gave. That's feedback from -- customer feedback.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director of Machinery and Trucks and Senior Industrials Analyst*

Got it. Quick follow-up there. Have any truck makers kind of thrown a wrench in their production plans, I mean, for the coming quarter here because of some suppliers elsewhere that are having problems shipping, so they're not ordering all the other components from you or anybody else? I guess, are there any big wrenches in the production process right now?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

I'm not aware of anything, Mike.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director of Machinery and Trucks and Senior Industrials Analyst*

Okay. I'll say, I guess, kind of similarly in off-highway, I mean, you just saw Deere just raise their outlook to positive 13% and CAT's looking at an up year as well. I imagine those are 2 of your bigger customers there. And yet, you're flat. I guess I was kind of wondering, again, for North America at least, I mean, is -- does your outlook for flat based upon what you're seeing from your main customers? Or again, is there a potential for a hopeful better back half of the year here?

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Yes. Mike, I think we're as hopeful as everybody else. It's just after the last 2 years of really, we'd like to see more. Clearly, we had a very strong Q4 and strong month of March, and a lot of that came from the off-highway, heavy equipment people. So we are hearing a lot of favorable news for

the first time in a while, a lot of green shoots, I guess. So I wouldn't disagree with you. We just would like to see more than 1 or 2 months before we change the full year outlook. Hopefully, we -- as I said on my concluding thoughts, for once, it feels like here, we have potentially more tailwind than headwind coming at us.

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

And Mike, we forecast on released [EDI], right, that comes from our customers. So right now, we hear the optimism, they talk about the optimism and that sort of stuff. But we convert forecast when we see that released into our EDI .

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director of Machinery and Trucks and Senior Industrials Analyst*

Okay, got it. And then turning to the CIS segment, I guess I was kind of wondering, do your previously released sort of financials and outlook for that segment, back when you first did the deal, I guess do those still hold going forward for the most part? Do we take that, just maybe add 2% to it based on what was in the slide? Give us a sense as to how that's progressing as far as all the numbers, holistically, for you.

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Yes. So one of the things we try to do, Mike, is there was clearly a lot of questions around the impact of purchase accounting. I would say it's absolutely in line with what we've modeled and did on the due diligence side. It's -- that business, depending on the exchange rate, has been in the $500 million to $550 million range. When you add in the purchase accounting, the $13 million-ish of increased amortization, depreciation, it's about a -- temporarily here, a 200 to 300 basis point decline in margins that we will work back as we continue to push through synergies. So as we look ahead, I think it's going to be in that $500 million, $550 million revenue range with an operating margin of 5.5%, 6.5% range, which again, is down a little bit from historical. But you got to back out -- you have to back out the purchase accounting. For example, in the last quarter here, absent the purchase accounting, their operating margin was about 7.75%. So as you look forward, just to kind of maybe be clear here, I think operating margin in the 5.5% to 6.5% with all-in GAAP reporting going forward. Hope that answers your question.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director of Machinery and Trucks and Senior Industrials Analyst*

Yes, that helps tremendously. Maybe I can squeeze in one last one here on the cost of metals. Did you say that cost savings initiatives will fully offset any of the high materials costs? Will it -- might be a headwind in the first half and a tailwind in the back half? Give us a sense as to what that -- might transpire there over the course of the year.

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Yes. We're -- we'll offset during the year. And primarily, we've committed to and we've got in our plans, we've got the $20 million of the remaining SDG savings. But what partially offsetting all those savings is the $15 million to $20 million of materials. The metals really ran in -- beginning around January through March, so it'll be -- we'll be hardest hit in our first quarter, second quarter. And then it'll start to catch up, Mike, in Q3 and Q4.

Michael Shlisky - *Seaport Global Securities LLC, Research Division - Director of Machinery and Trucks and Senior Industrials Analyst*

Okay. But there aren't any, like, new initiatives being done to offset these costs specifically, so it's the general SDG...

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

No. Yes, SDG. And that work's done, behind us, so we're capturing those benefits. Just us getting the full benefit of those will be a lag until we really can push through contractually our metals increases.

Operator

Our next question will come from the line of [Douglas D.C. with D.C. Capital].

Unidentified Analyst

Could you elaborate a little bit on Asia? And what -- kind of 3 years out, what you might see there in revenues and kind of a target operating income, maybe percentage or margin? And do you have the footprint there now to get there?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

I'll start and let Mick come through on margins discussion. Clearly, a big, huge jump this year on revenue top line, which we've been really -- we're really glad to see that come through as our strategy of the automotive investment to get our oil cooler and LC product line over there to support that growing opportunity. Obviously, we see growth continuing, not at that pace, okay? But probably in the mid-teen range for the next few years. Capacity-wise, as I've pointed out, we've kind of hit the first level of capacity constraint, that we've added essentially 2 additional furnaces that will be in place by the end of this year that will manage the near-term growth needs. But clearly, we have a nice leverage in our capacity in place now with the projections going forward. We don't have plans for additional brick-and-mortar expansion this time, but as we see that going forward, we will look at it. But we plan to leverage every opportunity as we see these growing trends of our product portfolio set up that we put in place, which includes commercial truck, off-highway and automotive balance on the vehicular side, as well as supporting the CIS growing opportunities over there that Mike mentioned, that they have with their 2 operations. So from a overall perspective, I'm very pleased with the leadership guidance in Asia that were in place to really capture that upside. From a margin perspective, Mick, do you want to add your comments?

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

Yes. We finished '17 here just a little bit north of $100 million and a 7% operating margin. The next few years, with the growth we've got booked, that business can be $150 million several years out. And it's capacitized, so we'd like to see it get to $200 million, longer term. And operating margins probably in the 8% to 9% range.

Operator

Our next question will come from the line of David Leiker with Robert W. Baird.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

I wanted to follow-up on maybe a high-level discussion on electrification. You're clearly well positioned in automotive. I don't think there's any debate that, as you bring in bigger batteries, the thermal contents really needs to rise to facilitate that. Electric trucks are becoming an increasingly big piece of the conversation on the heavy-duty side of the equation. Are you seeing customers' quotes for those types of programs, engage you in discussions? And how would you do your competitive positioning in that potential opportunity as it develops?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

So I'm going to take those in order. The answer is yes. We are seeing truck development opportunities, engagements with some of those names that are out there that you are familiar with. I will say that the pace across the board on EV automotive programs is picking up. We are currently awarded programs with 5 different OEs right now, okay, with multiple opportunities or programs per OE, but we're probably working with another 2 dozen companies as well. I mean, it's really a -- been a real acceleration along these lines. So again, I'm very, very excited about the opportunity and we've got both feet on the ground, though, okay? I mean, it's making sure that we make the right -- get allocations on resource and capital

going forward. So -- but yes, this is one that's gone from something that is on the fringe to come into the core element across the vehicular business. As you mentioned, not just automotive business, which is the biggest push, but now things like truck as well.

Joseph D. Vruwink - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate*

Is it possible maybe to frame the incremental content? So you've outlined $300 in addressable content on an automotive EV. What would that number look like if it was a heavy-duty class 7, Class 8 truck?

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

A little early to give you a number there, Joe. Great question and something we can take away and think about as that matures as an opportunity. But clearly, there's a lot going on there, you're right, as far as content.

Michael B. Lucareli - *Modine Manufacturing Company - CFO, CAO and VP of Finance*

I'm guessing higher, but (inaudible) want to quantify it...

Thomas A. Burke - *Modine Manufacturing Company - CEO, President and Director*

Yes, guessing higher, but (inaudible), so...

Operator

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

Kathleen T. Powers - *Modine Manufacturing Company - VP of IR & Tax and Treasurer*

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

Operator

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