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Allison Transmission Holdings, Inc. (ALSN)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. Thank you for standing by. Welcome to Allison Transmission's Second Quarter 2024 Earnings Conference Call. My name is Diego and I will be your conference call operator today.

At this time, all participants are in a listen-only mode. After prepared remarks, Allison Transmission executives will conduct a question-and-answer session and conference-call participants will be given instructions at that time. As a reminder, this conference call is being recorded. [Operator Instructions]

I would now like turn the conference call over to Jackie Bolles, Executive Director of Treasury and Investor Relations. Please go ahead, Jackie.

Jacalyn C. Bolles

Executive Director-Treasury & Investor Relations, Allison Transmission Holdings, Inc.

Thank you, Diego. Good afternoon and thank you for joining us for our second quarter 2024 earnings conference call.

With me this afternoon are Dave Graziosi, our Chair and Chief Executive Officer; and Fred Bohley, our Chief Operating Officer, Chief Financial Officer and Treasurer.

As a reminder, this conference call, webcast and this afternoon's presentation are available on the Investor Relations section of allisontransmission.com. A replay of this call will be available through August 8.

As noted on slide 2 of the presentation, many of our remarks today contain forward-looking statements based on current expectations. These forward-looking statements are subject to known and unknown risks, including those set forth in our second quarter 2024 earnings press release, our Annual Report on Form 10-K for the year ended December 31, 2023, and other general economic factors. Should one or more of these risks or uncertainties materialize, or should underlying assumptions or estimates prove incorrect, actual results may vary materially from those we express today.

In addition, as noted on slide 3 of the presentation, some of our remarks today contain non-GAAP financial measures as defined by the SEC. You can find reconciliations of the non-GAAP financial measures to the most comparable GAAP measures attached as an appendix to the presentation and to our second quarter 2024 earnings press release.

Today's call is set to end at 5:45 PM Eastern Time. In order to maximize participation opportunities on the call, we'll take just one question from each analyst. Please turn to slide 4 of the presentation for the call agenda.

During today's call, Fred Bohley will review our second quarter 2024 financial performance and review updates to our full-year 2024 guidance. Dave will close with an update on recent announcements across our business prior to commencing the Q&A.

Now I'll turn the call over to Fred.

G. Frederick Bohley

Chief Operating Officer, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

Thank you, Jackie. Good afternoon and thank you for joining us.

Closing out the first half of the year, we are pleased to report record revenue of \$816 million for the second quarter of 2024. Demand for Class 8 vocational vehicles intensified during the quarter, leading to record quarterly revenue of \$456 million in our North American On-Highway end market. Year-over-year top line results were also improved by increases in our Defense and Outside North American On-Highway end markets as we continue to execute on our growth objectives.

Please turn to slide 5 of the presentation for the Q2 2024 performance summary.

Year-over-year net sales increased 4% from the same period in 2023 to a record of \$816 million. The increase in year-over-year results was led by 15% increase in the North American On-Highway end market, principally driven by strength in demand for Class 8 vocational vehicles and medium-duty trucks and price increases on certain products. Year-over-year net sales were further improved by a 30% increase in our Defense end market. The increase was principally driven by increased demand for tracked vehicle applications.

Finally, year-over-year results were improved by a record second quarter in our Outside North America On-Highway end market. The increase in net sales in the Outside North America On-Highway end market was principally driven by higher demand in Asia and price increases on certain products, partially offset by lower demand in Europe.

Gross profit for the quarter was \$394 million, an increase of \$13 million from \$381 million for the same period in 2023. The increase in gross profit was principally driven by price increases on certain products and increased net sales, partially offset by higher manufacturing expense.

Net income for the quarter was \$187 million, an increase of \$12 million from the same period in 2023. The increase was principally driven by higher gross profit, lower selling general and administrative expenses, and lower interest expense net partially offset by a non-cash defined benefit pension plan settlement charge incurred in the second quarter of 2024, and unrealized mark-to-market adjustments from marketable securities.

Our adjusted EBITDA for the quarter was \$301 million compared to \$288 million for the same period in 2023. The increase in adjusted EBITDA was principally driven by higher gross profit. Diluted earnings per share increased 11% from the same period in 2023. Second quarter EPS of \$2.13 was driven by higher net income and lower total shares outstanding. A detailed overview of our net sales by end market and Q2 2024 financial performance can be found on slides 6 and 7 of the presentation.

Please turn to slide 8 of the presentation for the Q2 2024 cash flow performance summary. Adjusted free cash flow for the quarter was \$150 million compared to \$122 million for the same period in 2023. The increase was principally driven by lower cash income taxes and higher gross profit, partially offset by higher net working capital funding requirement.

During the second quarter, we paid a dividend of \$0.25 per share and repurchased over \$31 million of our common stock. We ended the quarter with a net leverage ratio of 1.6 times, \$648 million of cash and \$745 million of available revolving credit facility commitments. In addition, we continue to maintain a flexible, long-dated and covenant-light debt structure.

Please turn to slide 9 of the presentation for the update to our 2024 guidance. As a result of the ongoing strength in our North America On-Highway end-market, we are raising our full-year guidance for revenue, earnings, and cash flow. Allison expects net sales to be in the range of \$3.090 billion to \$3.170 billion. In addition to Allison's 2024 net sales guidance, we anticipate net income in the range of \$650 million to \$700 million; adjusted EBITDA in the range of \$1.085 billion to \$1.145 billion; net cash provided by operating activities in the range of \$715 million to \$775 million; capital expenditures in the range of \$125 million to \$135 million; and adjusted free cash flow in the range of \$590 million to \$640 million.

Thank you. And I'll now turn the call over to Dave for an update on recent announcements.

David S. Graziosi

Chair & Chief Executive Officer, Allison Transmission Holdings, Inc.

Thank you, Fred.

Please join me in congratulating Fred on his new role and responsibilities at Allison. In early June, Fred was appointed to the newly created position of Chief Operating Officer. Over the course of his 30-year career at Allison, Fred has demonstrated exceptional leadership and a deep understanding of our company and our end markets. We are excited for Fred to step into this new position, enhancing our ability to meet the opportunities ahead and continue our tradition of innovation and excellence. Allison has begun an extensive search for a new CFO, with Fred continuing to serve in his current roles in order to ensure a smooth transition.

Before moving on to other recent announcements, I would like to take a moment to discuss the current environment in our North America On-Highway end market. Funding and spending for infrastructure projects has

led to extraordinary demand for Class 8 vocational vehicles in North America. With Allison's share in 2023 at roughly 80% in these vocational vehicles, we are seeing unprecedented demand for our 3000 Series and 4000 Series On-Highway products. In order to meet this elevated demand, we have made investments in our supply chain and operations to not only manage capacity, but also improve manufacturing throughput.

With that being said, increasing production at the rate and scale demanded by the market has not been without challenges. Allison remains committed to meeting near-term opportunities while diligently evaluating investments to position the company for long-term growth.

Moving on to other announcements during the second quarter. In the middle of May, we announced a commitment to invest \$10 million in EnerTech Capital through our recently announced venture capital arm, Allison Ventures.

EnerTech Capital is a venture capital firm focused on the development of emerging technologies and business models in the mobility space. Through this partnership, we will gain access to EnerTech's large network of high-tech companies that are advancing technologies in the electrification, connectivity, autonomy and digitization sectors. We are eager to collaborate with like-minded organizations and investors while accelerating our efforts to increase our innovation pipeline across commercial mobility and work solutions.

Last year, as export opportunities increased and the addressable market expanded, we announced the resizing of our wide-body mining dump opportunity to \$100 million of incremental annual revenue opportunity.

We are excited to expand our product offering in this vocation as we recently announced our strategic partnership with LGMG, a prominent Chinese mining equipment manufacturer. Through this partnership, Allison will provide our new 6625 Wide Body Dump Series transmissions for use in LGMG's 136-ton wide-body mining dump trucks. This collaboration notes the first time an Allison fully automatic transmission has been integrated into a larger 136-ton crossover vehicle, with field tests currently ongoing in South America and Southeast Asia.

The strategic partnership between Allison and LGMG is rooted in a shared commitment to quality and expanding our global presence. We are pleased to form a new strategic partnership to support our continued collaboration.

Also in our Outside North America On-Highway market, last week we highlighted significant milestone and growth opportunity in South Korea, with the delivery of our 10,000 Hyundai Mighty truck equipment, 1000 Series fully automatic transmission. The Hyundai Mighty is South Korea's top selling light-duty truck experiencing quick adoption and market share gains since its launch in 2020. Over the past four years, Allison has grown its shares in the Hyundai Mighty to nearly 50%.

We are delighted by the tremendous success of the Allison-equipped Hyundai Mighty vehicles and look forward to further growth in our Outside North America On-Highway end market through collaboration and partnerships with our OEM customers.

For our Defense end market, we maintain our outlook and target for realization of \$100 million of annual (sic) [incremental annual] (00:12:26) revenue, as we capitalize on the defense upcycle, both internationally and through increased defense investments globally, amid geopolitical uncertainties and domestically through opportunities with United States modernization programs, as well as increased international sales through the US Department of Defense.

In addition to our \$100-million incremental annual revenue opportunity in the near term, we look forward to further growth in our Defense business with the expansion of our product portfolio and introduction of the new Allison 4040 MX medium weight cross-drive transmission. The 4040 MX is an upgraded variant of the proven 3040 MX, which was selected for the US Army's M10 Booker program last year.

Last week we announced the signing of a contract with BAE Systems' Hägglunds, one of Europe's most successful producers of track combat vehicles to provide our new 4040 MX propulsion solution for the ongoing CV90 infantry fighting vehicle, or IFV programs, with production expected to begin in 2028. BAE Systems' Hägglunds has recently won the IFV contracts in Slovakia and the Czech Republic for approximately 400 new CV90 Mark 4 vehicles. Currently, nearly 1,000 CV90s are operated by various countries in Europe, utilizing the Allison X300 propulsion solution.

This agreement between Allison and BAE Systems' Hägglunds assures long-term support for the existing CV90 fleet, while Allison pursues opportunities for further growth in other IFV programs globally.

We are excited to deliver a new product uniquely designed for the CV90 Mark 4 vehicle while supporting numerous nations who trust this vehicle to execute their toughest missions. The introduction of the 4040 MX enhances Allison's portfolio and present further opportunities for international expansion in our Defense end market.

Finally, as our markets evolve, we remain committed to offering a portfolio of products designed to meet the needs of customers. Just this week, we announced our partnership with Cummins to test and validate their X15N 15-liter natural gas engine, paired with our 4000 Series transmission. Sandman, a bulk cement hauling fleet based in California has already successfully completed over 50,000 miles of vehicle testing with the X15 engine and 4000 Series transmission. Sandman has reported significant improvements in fuel efficiency and performance.

Allison fully automatic transmissions are fuel agnostic, meaning they compare with multiple energy sources, including diesel and natural gas, hydrogen, electric hybrid and fuel cell and battery electric. As the industry continues to adapt, more customers are adopting alternative fuel engines as an immediate solution to increasing emission stringencies.

We look forward to further partnering with Cummins and leading OEMs to help fleets reduce their carbon footprint without sacrificing productivity and efficiency.

In summary, Allison's second quarter results demonstrate not only the current strong performance of our business, but the notable growth opportunities to come. We continue to invest in our business in order to achieve our growth ambitions, while returning capital to shareholders and delivering on our brand promise to improve the way the world works.

This concludes our prepared remarks. Diego, please open the call for question.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting our question-and-answer session. Please limit yourselves to one question. [Operator Instructions]

Our first question comes from Tim Thein with Raymond James. Please state your question.

Timothy W. Thein

Analyst, Raymond James

Q

Thank you. And hey, Fred, congrats on the announcement. Very well deserved.

G. Frederick Bohley

Chief Operating Officer, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Thank you.

Timothy W. Thein

Analyst, Raymond James

Q

Yeah. So, just thinking through like the question relates to kind of the guidance as you've laid out for the back half of the year. If you look at – so the incremental EBITDA flow-through in the second quarter was just under 40%. And as I look at the midpoint of the revenue and EBITDA guidance for the back half of the year, it would imply that EBITDA generation is essentially flat year-over-year.

So, is the – the question being, you know, is there some kind of a, maybe a mix benefit in the quarter, that doesn't persist, or you anticipate – just do costs and just inefficiencies arise as you need to stretch to meet the higher demand in the back half of the year in either of the above? Just maybe some color on how we should think about the framework for the back half of the year. Thank you.

G. Frederick Bohley

Chief Operating Officer, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Sure, Tim. This is Fred. You know, the – if you think about the back half of 2023, Q4 came in extremely strong. And as we have things modeled currently, it's modeled with more normal seasonality. So, we've got Q4, you know, a little lighter in the back half of the year. That's primarily what's driving the margin difference between first half and second half.

Timothy W. Thein

Analyst, Raymond James

Q

Thank you.

Operator: And our next question comes from Rob Wertheimer with Melius Research. Please state your question.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Yeah, hi. Thanks. Evening, everybody. There's a lot going on in North America On-Highway, and obviously your segments never saw the kind of peaks or excesses that the long-haul stuff did. But I'm curious about the kind of uptick in strength. Does that – you guys kind of know the pie chart, I guess, of vocational trucks a lot better than we do and what you sell to, but is that end-market driven? Is that maybe supply-chain constraints on getting, you know, dump bodies or whatever else built, loosening up? I mean, what kind of is leading to that? And, you know, how fundamental is the strength in North America On-Highway?

David S. Graziosi

Chair & Chief Executive Officer, Allison Transmission Holdings, Inc.

A

Hey, Rob, it's Dave. Thank you for that question. So, we've mentioned this on pretty near-term recent calls (sic) [prior near-term calls], but there are a number of factors to answer your question. Vocational, if you go back to COVID and the lack of production, probably suffered more than other areas. So, post-COVID, as the Infrastructure Bill was signed, and other funding was being provided, it was clear you were coming into an upcycle in terms of demand without the vehicles.

So, you're now working through – the industry is working through a very soft period of vehicle production in a period of very high demand. So, you have an aged fleet with very high underlying demand. At the same time, from a labor perspective, what you have seen is through COVID, as you know, a number of retirements where you've – the workforce has shed a number of more experienced workers, and specifically, drivers.

So, from an equipment perspective, whereas used to – some fleets could use with manuals per se, those drivers are now retired. So, you're looking at not only the shortage in vehicles coming in to a pretty significant uptick in overall vehicle demand, but also a change in the demographics of the driver base. So we're seeing the combination start to drive its way through, so to speak, the market.

The other fact is, with that demand, as you would expect, and I would, you know, certainly refer you to other comments that already have been made here recently by the vehicle OEMs in terms of results, but they're producing what the market demand is. And right now, with the softness, you could say, with the line haul business, they're going to do, I assume, as much as they can, to deliver the vehicles that people want. Thus, I think you're seeing this real emphasis to not only catch up and cover the gap that we had post COVID, but really start to address that backlog down to a more normalized level.

As we mentioned on the April call, we do not believe that there's been significant improvement necessarily in some of the other supply chain constrains for vocational, specifically around bodybuilders and such. So, lead times continue to be extended, and that's a labor issue to a degree as well. So, that will provide, I believe, a bit of a governor in terms of necessarily going much higher per se, because they just can't process the vehicles fast enough.

So, our expectation, and Fred's earlier comments, and we talked about again on the April call is a reasonably high level of demand here. As we work our way through the second half, we'll see what the balance of the year presents as we get late into it relative to 2025. I think the comments, at least the more recent public ones, by some of the OEMs, would indicate pretty stout order books for Q3, and at this point, a decent start on Q4 relative to vocational.

Operator: Thank you. And our next question comes from Ian Zaffino with Oppenheimer. Please state your question.

Ian Zaffino

Analyst, Oppenheimer & Co., Inc.



Hi. Great. Thank you very much. Good color. Question would be on some of the On-Highway contracts. I know you've been not necessarily taking price in a lot of those contracts and I think they're up for negotiation. But I believe, now, or we're kind of getting into that season, so maybe kind of give us a, maybe some color on what's going on there as far as how you feel being, or how you feel you're positioned going into that, and kind of what the environment is to maybe get those contracts marked to market. Thanks.

G. Frederick Bohley

Chief Operating Officer, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.



Hi, Ian, it's Fred. Yeah, as we mentioned on earlier earnings calls, there is a significant amount of our North American On-Highway business up for pricing in 2025. Over 60% is available to price. And as we look at the value that our product delivers, the value proposition is very high right now.

Obviously, the OEMs have increased the price of the vehicles, all the costs that, in effect, our transmission saves, maintenance costs, getting more productivity in a day, able to size fewer trucks, fewer drivers, all those costs have elevated. And that puts us in a situation where our products delivering a significant amount of value. And we've been under multiyear contracts predating the level of inflation we've seen the last couple of years. So, we do anticipate in 2025 pursuing price relative to the value that we're delivering.

It's still rather early for negotiations with OEMs. And I would suspect that most of the negotiations will go down to the wire. But we feel very well-positioned based on the value our product is delivering and the demand in the marketplace for our product to achieve meaningful price.

Operator: Thank you. Our next question comes from Angel Castillo with Morgan Stanley. Please state your question.

Angel O. Castillo

Analyst, Morgan Stanley & Co. LLC



Hi. Thanks for taking my question. And Fred, let me just join in congratulating you on the new role. Dave, just wanted to go back, you gave a lot of good color on the dynamics that you're seeing kind of on On-Highway and vocational, but just wanted to kind of take a step back and think about the second-half guide.

It sounds like, if I recall correctly, the assumptions baked into the kind of the full-year guide were for kind of a slowdown in the second half. And you mentioned some seasonality in the fourth quarter, but just given the dynamics of continued kind of pent-up demand and the supply chain trying to meet this vocational demand that you've talked about, it would seem, at least, high level, that you should be able to run kind of full-out just to try to continue to meet that.

So, maybe just if you could help kind of explain what would cause any kind of slowdown kind of in the second half, given that you're more exposed to vocational versus something like the line haul, or areas where we're hearing a little bit more weakness.

David S. Graziosi

Chair & Chief Executive Officer, Allison Transmission Holdings, Inc.



Hey Angel, thanks for that question. So, in terms of second half to build upon Fred's comment with seasonality, typical with the Allison business, just given the (sic) [that with] most businesses, but the holidays in the fourth quarter, calendar quarter, of course, you're looking at 5% – at least 5% less production days. So, that normally results in a softer, if you will, fourth quarter because of the lack of production days.

That was not necessarily the case in Q4 of last year, was unusual because I think, as you know, tracking the numbers, we started to really see a pickup in vocational into the second half of last year, really starting to elevate when you look at those fourth quarter results.

To your question, we now see and we talked about this on the last call a bit, is that we certainly expect a more normalized fourth quarter relative to that seasonality regardless of demand. It's just the fact in terms of the lack of production days. So, unless there's a significant change in schedules, if you will, we would expect some of that seasonality to be dealt with in the fourth quarter.

Other things that can certainly drive, I guess, attempt to drive more or less demand. As I mentioned, our understanding is order books for Q3 are pretty full at this stage, if not completely full, relative to vocational. So, when you think about Q4, I'm sure there's some to be filled in, but I think the reality is, you know, as we mentioned in the prepared remarks, we're doing everything we can as a team to meet that market demand.

I would also offer, you know, the market isn't perfectly supplied outside of Allison relative to components. So, that's the other part of the answer to your question is, we can continue to drive the supply into the market, but the market has to have all those other components to build these trucks. So, I would say it's less of an issue certainly than it was during COVID, but you do see sporadically some level of disruptions.

I think the OEMs that we're fortunate enough to work with, do their best to work through those constraints as they pop up. But it's – some of those are certainly unplanned and there's always the unplanned situations that are much broader in terms of displacing a particular supplier that has broad market share, that can always create some challenges.

But the short answer is, we expect a pretty robust level of vocational demand right through into fourth quarter, again, subject to the seasonality that I just talked to.

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Operator: Thank you. And our next question comes from Tami Zakaria with JPMorgan. Please state your question.

Tami Zakaria

Analyst, JPMorgan Securities LLC

Q

Hi. Thank you so much. Very impressive results. So, congrats to the team. I wanted to follow up on an earlier question about the guide. So, it seems like the midpoint of the guide assumes revenues still up, call it about 1% year-over-year in the back half, but EBITDA margin down of almost 160 basis points. And so, if I were modeling, I would have modeled EBITDA margin at least flat, if sales are – flat to up a bit.

So, is this margin guide just conservatism, or are you seeing any cost pressure or mix headwinds that makes you guide as such?

.....
G. Frederick Bohley

Chief Operating Officer, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Hi, Tami. It's Fred. When you look at really the movement that we made on guide, obviously we increased guide at a top line level. At the midpoint, \$30 million, \$15 million of that dropped through to EBITDA [ph] with further (00:30:17) EBITDA guide up \$15 million. So, you know, 50% drop-through guide to guide.

As we look out to the balance of the year, there's certainly puts and takes to what the second half will look like. You know, we've seen, you know, raw materials come off a little bit here this month. Does that continue to hold? We've talked about what the top line could look like. We've certainly modeled a more normal fourth quarter. Demand was more robust. Certainly the incremental drop-throughs would be favorable. Thanks.

Operator: Thank you. Our next question comes from Luke Junk with Baird. Please state your question.

Luke L. Junk

Analyst, Robert W. Baird & Co., Inc.

Q

Good evening, everyone. Fred, just hoping you could go through the updated guidance to the major segments on the top-line just at a high level, in terms of any variances versus the original segment guidance you gave in the fourth quarter beyond North America vocational especially. I guess I'm thinking about Defense in terms of the supply chain and how much growth it could allow you into the back half of the year. And then also maybe puts and takes in Outside North America On-Highway, given the dynamic sort of growth in Asia, but maybe some headwinds in Europe. Thank you.

G. Frederick Bohley

Chief Operating Officer, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.

A

Thanks. Thanks, Luke. And this is Fred. The – we obviously guide and provide that end market detail when we published the initial guide. So, I'm not going to get down to specifics, but it's safe to say that looking back to when we came out with those numbers in February, that the demand in North America On-Highway, is stronger. And then when you look across to Outside North America, fewer vehicles being produced.

We are – and continue to have very good traction in Asia and that's what's been driving the performance year-to-date outside North America. But even that performance is light of our initial full-year guide where we had suggested we'd be up 14% Outside North America On-Highway. I expect at this point with the challenges in Europe that that'll be a real challenge for the team to meet.

From a supply chain, I think [that's] the piece that we continue to work through, will have significant demand in the – on the Defense side and continuing to work through getting parts in, getting the throughput through our manufacturing facilities. So, we'll see how we run for the balance. But certainly the – it's a challenge to ramp up at the pace in which we currently have demand.

From a Service Parts standpoint, we knew the first half was going to be a difficult comp with the records that we ran in the first half. But as we look at it, we do see second half looking a lot like first half from a Service Parts, Support Equipment, and Other end market.

Operator: Thank you. And our next question comes from Jerry Revich with Goldman Sachs. Please state your question.

Jerry Revich

Analyst, Goldman Sachs & Co. LLC

Q

Yes, hi. Good afternoon, and, Fred, congratulations.

G. Frederick Bohley*Chief Operating Officer, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.*

Thanks, Jerry.

A

Jerry Revich*Analyst, Goldman Sachs & Co. LLC*

So, Fred, can we just talk about the cost comment that you made a moment ago? You spoke about some material costs are starting to decline. Are we at a point where we could maybe see a tailwind from material costs? And if you wouldn't mind, just bridge the year-over-year margin performance in the quarter between pricing costs and absorption. Just so we understand the moving pieces relative to the back-half guide.

Q

G. Frederick Bohley*Chief Operating Officer, Chief Financial Officer & Treasurer, Allison Transmission Holdings, Inc.*

So, Jerry, it's interesting, from a material cost, we were neutral in the quarter and it's been a while since we saw that. We took some increases from a value-add to our supply chain, but that was offset with the lower commodity cost. From a price/cost standpoint, we got a little over \$20 million in price in the quarter. So, 260 basis points. Manufacturing cost was up \$12 million and material cost was flat. So, when you pull that through, sort of a – kind of a normal type drop-through for Allison, high 40%.

A

I think there's going to be – continue for I think for all industrial companies, pressure with the value-add from suppliers, just driven by the labor comments that Dave made earlier on the call. I mean, it's still a challenge to recruit and attract skilled manufacturing employees.

From a raw materials standpoint, I think a lot of things can move that. Obviously, we see softening in the economy. We could potentially see that continue to roll off, but it's moved quite a bit throughout the quarter. So as we're looking at it and modeling it, we're modeling it kind of at current commodity prices for the balance of the year.

Operator: Thank you. And our next question comes from Kyle Menges with Citigroup. Please state your question.

Kyle Menges*Analyst, Citigroup Global Markets, Inc.*

Thank you. I was curious, just given the robust demand you're seeing for Class 8 vocational, are you entertaining the idea of there'll be more capacity and is there enough visibility to potentially do so? I suppose it sounds like there's other supply chain constraints that are outside of your control that could keep you from adding capacity. Just how are you thinking about that?

Q

David S. Graziosi*Chair & Chief Executive Officer, Allison Transmission Holdings, Inc.*

Kyle, thank you for the question. It's Dave. So, we mentioned briefly in the prepared comments, we are making investments in some of our On-Highway products to enhance capacity, if you will. We're not, I would say, if your question is building new plants or assembly lines, et cetera, the answer to that is no. It really comes down to breaking some constraints with our existing capital footprint. That goes for Allison Transmission as well as some of our suppliers.

A

So it's not only investments that we're making in our own footprint, if you will, from an operating perspective, but also within supply chain. Some of that, frankly, will get timed in here over the next call it 6 to 18 months, depending on the equipment. The other thing, though, that it really comes back to is labor availability, because you can certainly add portions of shifts or more shifts, if you will, but there are inefficiencies inherent in some of those operational strategies. So, we're looking at all of that to really come back to a, I would say, more efficient operation.

I would also offer with the supply base in certain cases running north of what we refer to as a lean capacity rate, you're generating very high supplemental costs to drive that additional capacity through. So, it gets back to the investments to break some of those constraints and get to a more, what I would – what we would consider to be a lean capacity type of rate. So, those are the investments that are being made very broadly both inside of Allison, as well as our supply base.

We're also looking at some further opportunities in terms of upgrading as we normally do, maintenance and sustainment capital. The team is implementing what we would refer to as best-of-breed in terms of operational performance excellence. So, the capital we continue to expend in terms of sustainment, it's also focused on improving actual output, so, units per hour, etcetera. So, scrap rates, you name it, but the team's very engaged in that and with our global footprint, we do have the capability to shift around to rebalance some of that production.

But, beyond that, it's really back to the comment Fred made terms of continuing to recruit, attract and retain some of these skills that our team members need, to produce the kind of quality products that our customers have come to expect from Allison.

Operator: Thank you. And our next question comes from Rob Wertheimer with Melius Research. Please state your question.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Hi. Thanks for squeezing me in for the follow up. Dave, in your response, you kind of mentioned an idea on the manual transmission fading that we think about a bit, but haven't asked you about a long time, and even with your high market share, that's still around 20% or 25% upside, I guess, if you eventually take the whole market. Question is, is AMT a material part of that part that you don't have? Is it mostly manual? And is AMT gaining traction? Fading? I'm just not sure where that balance lies, actually in a long, long time. Thank you,

David S. Graziosi

Chair & Chief Executive Officer, Allison Transmission Holdings, Inc.

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Robert, thank you for that question. So the – we do, as you stated, enjoy very high market share and I think the team has worked extremely diligently over decades to reach that point. The fully automatic transmission, as you know, has significant advantages over any power-interrupted transmission, which would be defined as a manual or an AMT. The manuals, as a percentage of the market, continue to shrink, at least within our addressable market which is (sic) [are] high shift density as well as severe duty vehicles such as vocational.

AMTs have, for a number of years, been very effective at displacing manuals, where you have duty cycles that do not feature heavy stop-start, or very rugged service applications. So, to your point, you know, we continue to look at ways – always looking at ways to grow our share position. But, I think the AMTs have done a very adequate job displacing manuals because to my earlier comment on drivers, you do not have the amount drivers trained for those manual gearboxes at this stage.

So, it's a natural attrition that you're seeing or market share gain for AMTs at the expense of manuals again in really non-Allison duty cycles and segments.

Operator: Thank you. And that concludes our question-and-answer portion of this call. I'll now turn the floor back over to David Graziosi for closing comments.

David S. Graziosi

Chair & Chief Executive Officer, Allison Transmission Holdings, Inc.

Thank you, Diego, and thank you for your continued interest in Allison and for participating on today's call. Enjoy your evening.

Operator: Thank you. And that concludes today's call. All parties may disconnect. Have a good day.

Editor's Note: Words in [] have been added at the request of the company, after the conclusion of the event, to provide clarity to the readers.

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