Lear (LEA) Earnings Report: Q1 2016 Conference Call Transcript

The following Lear conference call took place on April 27, 2016, 09:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Mel Stephens; Lear Corporation; Investor Relations
- Jeff Vanneste; Lear Corporation; CFO
- Matt Simoncini; Lear Corporation; President and CEO
- Raymond Scott; Lear Corporation; EVP, President Seating
- Philip McLaughlin; Lear Corporation; Head of Global Tax
- Frank Orsini; Lear Corporation; President of Electrical

Other Participants

- Itay Michaeli; Citigroup; Analyst
- John Murphy; BoA Merrill Lynch; Analyst
- Joseph Spak; RBC Capital Markets; Analyst
- Rod Lache; Deutsche Bank; Analyst
- Brian Johnson; Barclays Capital; Analyst
- Brett Hoselton; KeyBanc Capital Markets; Analyst
- Matt Stover; Susquehanna Financial Group / SIG; Analyst
- Unidentified Participant; JPMorgan; Analyst
- Colin Langan; UBS; Analyst
- Patrick Archambault; Goldman Sachs; Analyst
- Adam Jonas; Morgan Stanley; Analyst
- Chris McNally; Evercore ISI; Analyst
- Richard Hilgert; Morningstar; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

At this time, I would like to welcome everyone to the Lear Corporation first-quarter 2016 earnings conference call.

(Operator Instructions)

I will now turn the call over to Mel Stephens, Vice President, Investor Relations. Please go ahead.

Mel Stephens (Investor Relations):

Good morning, everyone. Thank you for joining us for our first-quarter 2016 earnings call.

Our press release was filed earlier this morning with the Securities and Exchange Commission and the presentation for our call is now posted on our website, lear.com, at the investor relations link.

Today's presenters are Matt Simoncini, our President and CEO; and Jeff Vanneste, our Chief Financial Officer. Also participating on the call today are several other Lear executives, including Ray Scott, who is the President of our seating division, and Frank Orsini, the President of our electrical business.

Before we begin, I'd like to remind you all that during the call, we will be making forward-looking statements that are subject to risks and uncertainties. Some of the factors that could impact our future results are described in the slide, investor information, found at the beginning of this presentation and they are also included in our SEC filing.

We also will be referring to certain non-GAAP financial measures. Additional information regarding these measures can be found in the slides labeled non-GAAP financial information, which can be found at the end of this presentation.

Slide 3 shows the agenda for today's review, and following the formal presentation, we will be taking your questions.

Now, please join me, and turn to slide 5. I will turn the program over to Jeff Vanneste.

Jeff Vanneste (CFO):

Thanks, Mel.

Lear is off to a great start in 2016, with strong sales growth and record core operating earnings. These operating results are the outcome of the investments we've made over the last several years, as well as our industry-leading cost structure. We have expanded our product capabilities in seating with the acquisitions of Guilford Fabric and Eagle Ottawa Leather.

And in electrical, we've expanded are industry-leading capabilities with the recent acquisitions of Autonet Mobile and Arada Systems to enhance our ability to move data and signals to, from, and within the vehicle. Since 2010, we have added 29 new component operations in low-cost countries and now have over 80% of our component manufacturing capacity in low-cost countries. This provides us with the lowest cost structure in both of our business segments.

We have a long history of strong free cash flow generation, which has allowed us to continue to invest in our business and return cash to shareholders while maintaining a strong and flexible capital structure. In light of our first quarter performance and confidence in the outlook for our business, we are increasing our earnings in free cash flow outlook for 2016.

Slide 6 shows vehicle production in our key markets for the first quarter. In the quarter, 22.5 million vehicles were produced globally, up 1% from 2015, and in line with our expectations. Production increased in all of our major markets.

Slide 7 shows our reported financial results for the first quarter of 2016. Our reported sales in the quarter increased by 3% from a year ago to $4.7 billion. Excluding the impact of foreign exchange and commodity prices, sales increased by 8%.

Pretax income before equity income, interest, and other expense was $374 million, up $113 million from a year ago. Equity income increased by $4 million -- reflecting strong performance in our non-consolidated joint ventures in China.

Other expense was $9 million in the first quarter, down $22 million. The first quarter of 2015 was impacted by costs associated with our debt financing and higher foreign exchange impacts. Interest expense was $21 million, down $3 million, reflecting lower average debt in the first quarter of 2016 versus the first quarter of 2015. Net income attributable to Lear was $248 million, up $101 million.

Slide 8 shows the impact of non-operating items on our first-quarter results. During the first quarter, we incurred $12 million of restructuring costs, primarily related to salary census actions. Excluding the impact of non-operating items, we had core operating earnings of $387 million, up $93 million from 2015. The increase in earnings reflects increased production on key platforms, the benefit of new business, and favorable operating performance.

Adjusted for restructuring and special items, net income attributable to Lear in the first quarter was $256 million and diluted earnings per share was $3.40, up 49% from 2015. Slide 9 shows our adjusted margins in the first quarter.

Lear's adjusted margin was 8.3%, up 180 basis points from a year ago. In seating, sales of $3.6 billion increased 3% from last year with adjusted earnings of $299 million, up $80 million or 36%.

Excluding the impact of foreign exchange and commodity prices, sales increased by 8%, reflecting higher production on key platforms and the addition of new business. Adjusted seating margins were 8.3%, up 200 basis points from a year ago. The increase in margin reflects strong operating performance, sales growth, and the timing of price adjustments related to commodities.

In electrical, sales of $1.1 billion were up 2% from last year, with adjusted earnings of $154 million, up $16 million or 12%. Excluding the impact of foreign exchange and commodity prices, sales were up 8%, primarily reflecting the addition of new business and higher production on key platforms. Adjusted electrical margins improved to 14.5%, up 120 basis points from a year ago, reflecting the increase in sales and favorable operating performance.

As we have discussed many times in the past, the required margin profile in each business reflects the level investment and the need to have returns in excess of our cost of capital. Return on invested capital is one of our key financial measures and drives most, if not all, of our investment decisions. At present margins, Lear's ROIC is averaging in the mid-teens, with both business segments achieving returns well above our cost of capital.

Slide 10 provides a summary of free cash flow which was $201 million in the first quarter of 2016. Compared with a year ago, free cash flow was up $321 million, reflecting higher earnings and additional cash receipts this year due to the timing of our fiscal quarter end. Slide 11 provides an update on our share repurchase program. In February, Lear's Board of Directors increased our share repurchase authorization to $1 billion through December of 2017.

In the first quarter of 2016, we repurchased 1.4 million shares for a total of $155 million. Since initiating the share repurchase program in 2011, we have repurchased 36.7 million shares for a total of $2.6 billion. Including dividends, total cash returned to shareholders over the same period is $2.9 billion.

Our share repurchases represent a reduction of approximately 35% of our shares outstanding at the time we began the program. The average price paid to repurchase shares over the life of the program is about $70 per share. At the end of the first quarter, we had 74.2 million diluted shares outstanding, and a remaining share repurchase authorization of $845 million.

Slide 13 highlights the key assumptions in our 2016 outlook. Global industry production is forecasted to grow by 3% to 89.7 million units, consistent with our prior outlook. Our 2016 financial outlook is based on an average euro assumption of $1.10 per euro, which is unchanged from our prior outlook.

Slide 14 shows our financial outlook for 2016, which as I mentioned earlier, reflects an increase in earnings and free cash flow from our prior outlook. Our sales are projected to be in the range of $18.5 billion to $19 billion, consistent with our prior outlook. Core operating earnings are projected to be in the range of $1.4 billion to $1.45 billion, up $50 million from our prior outlook.

Interest expense is projected to be approximately $85 million, a decrease of $5 million from our prior outlook, reflecting our increased free cash flow. Net income is expected to be $900 million to $940 million, up from our prior outlook of $855 million to $895 million.

Free cash flow is expected to be approximately $850 million, up $50 million from our prior outlook. This reflects a free cash flow yield of approximately 10%, among the highest in the automotive sector and the highest among our direct competitors.

Now, I will turn it over to Matt for some final comments.

Matt Simoncini (President and CEO):

Thanks, Jeff. Great job.

Slide 16 shows our revenue growth for full year based on the midpoint of our outlook compared to 2015. Excluding the impact of foreign exchange and commodity prices, our sales are expected to increase by approximately 6% for both seating and electrical, which is well in excess of 3% production growth for the industry.

Lear continues to focus on profitable sales growth and return on invested capital. At the same time, we continue to gain market share in both business segments, reflecting our industry-leading cost structure product capabilities. In summary, we had another great quarter with above-industry sales growth, record earnings and margins and strong performances in both business segments.

Our unique component capabilities in seating allow us to differentiate are seats with unique designs and the highest level of quality and craftsmanship at the lowest possible cost. In electrical, we're well-positioned to capitalize on trends for increased content, alternate energy vehicles and connectivity.

Our recent acquisitions of Autonet and Arada have increased our capabilities to manage data and signals both within and outside the vehicle. Given our unique product capability, leading cost structure and experienced Management Team, I am extremely confident that our business will continue to perform well. In short, we are in the best competitive position in our history.

Now we'd be happy to take your questions.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Itay Michaeli, Citi.

Itay Michaeli (Analyst - Citigroup):

Great. Thanks. Good morning and congrats, everyone,

Matt Simoncini (President and CEO):

Thank you.

Itay Michaeli (Analyst - Citigroup):

So just a question I think just on the guidance, given the strong Q1 EBIT. I think historically the first quarter EBIT contribution typically is actually under 25% for the full year, which could actually make your full-year guidance now look a bit conservative. Was there any kind of one-time or nonrecurring benefits in the first quarter or do you think there is even potential upside now to your new 2016 outlook?

Matt Simoncini (President and CEO):

A little bit about, Itay. One, it's unusual for us to increase guidance four months into the year. Normally, we wait for mid-year point to kind of reassess where we're at in history. But the performance was strong in both segments. Seating benefited about, I want to say, 30 basis points for the timing of commodity adjustments, but the business is probably running in a high-7% to low-8% margins.

We would expect that kind of margin performance to continue in probably the high-7%s, if you will. Electrical, we're pretty confident that we can maintain that 14.5 price percentage range. That being said, it's still four months into the year. So there may be some conservatism built in. Quite frankly, if the production assumptions hold and the currencies stay relatively consistent with where we have them, as well as the commodity environment, we would expect to post numbers and the high-end range.

Itay Michaeli (Analyst - Citigroup):

That's very helpful. And if I could follow up with two quick ones. Matt, love to get a sense of what the booking environment has looked like year-to-date. And then maybe for Jeff, how much of the $800 million backlog this year, roughly how much did you launch or accrue in the first quarter?

Matt Simoncini (President and CEO):

I will start off before I hand it over to Jeff. The booking environment has been great for gaining share in both product segments. We're in some very interesting preproduction development that we hope will eventually turn into production contracts. For us, it's not building a backlog for the sake of building a backlog. It's building a profitable backlog.

And we are able to penetrate the market while we are growing the business profitably. I think you can take confidence based on our history that when we have a backlog number, that business is going to come out profitably. From our standpoint, we are gaining share in both segments, as evidenced by I think our unique capabilities in product segments. We focused on profitable growth and return on investment. With that, I'll turn it over to Jeff.

Jeff Vanneste (CFO):

On the backlog today, the cadence of the backlog, Itay, is relatively consistent by quarter. I would say that the first quarter was slightly lighter than what we will see in the forth-coming quarters, but not materially so. It's pretty radible throughout the year.

Itay Michaeli (Analyst - Citigroup):

That's all very helpful. Thanks so much, guys.

Operator:

John Murphy, Bank of America Merrill Lynch.

John Murphy (Analyst - BoA Merrill Lynch):

Good morning, guys.

Matt Simoncini (President and CEO):

Good morning, John.

John Murphy (Analyst - BoA Merrill Lynch):

Just the first question, if we look at the growth above market in the first quarter, it was 7%. You're talking about 3% for the full year ex-currency. And you've been kind of running in that range for a number of years right now.

When do you think you might change the narrative on the top-line growth to 5% above market? And is that something that you think could be sustainable given what you are seeing in your backlog? Because I think backlog is helpful, but the simple explanation of what you think your growth could be above market might be helpful.

Matt Simoncini (President and CEO):

It's probably a better way of saying it. I think we are saying that, that we have been growing 5% above market, if you will, as we penetrate to gain share in both segments. And also taking into consideration content growth in electrical. From our standpoint, maybe we need to do a better job of articulating it, but I think that is exactly what we're saying, John.

John Murphy (Analyst - BoA Merrill Lynch):

Okay. That's helpful. And then Jeff, to parse some of your words, I mean I think when you were talking about seating, you said, and I think it might have been electronics as well, that as new business was rolling on, it was helping margins. I'm just curious if the new business that you guys are writing and bringing on is coming on at higher margins than corporate average and that's a big part the upside in margins here?

Jeff Vanneste (CFO):

Yes, I think they are coming on at margins that certainly were better than years ago when the old business rolled off. I think they are pretty consistent with what we have seen in terms of results that we are posting. So it's profitable new business coming on.

John Murphy (Analyst - BoA Merrill Lynch):

Okay. And then just lastly, as we look at where the stock is right now and what you guys are doing as far as buybacks, is there anything you would think to do to maybe get even more aggressive on recapitalizing the business?

I mean obviously an LBO might be a bit stretchy at this point given the math and what is going on in the capital markets reserve and the credit markets. But is there anything that you guys have considered as far as getting even more aggressive on recapping the business that could set you up to return even more value to shareholders? Because with the current leverage, you're relatively low.

Matt Simoncini (President and CEO):

Right. First and foremost, our focus is on a balanced strategy of investing in the business and returning excess liquidity to the shareholders. And I think this Board has a history and a track record of being aggressive on the returns to shareholders, if you will.

We are looking first and foremost, John, to invest in the business organically or through acquisitions that would complement our growth and our product offerings and provide value down the road. I think, if we finished a year and to not put the resources to work, if you will, through acquisitions, then you would probably see a more aggressive stance on repurchase. As far as recapping the business to do that, I don't think that's a likely outcome. I'm not going to rule it out, but I don't think it's a likely outcome in the remainder of the year.

John Murphy (Analyst - BoA Merrill Lynch):

I'm sorry, and maybe just a follow-up to that and this is the last question, is on the acquisition front. Obviously, you've had some great success on a number of acquisitions. Is there anything of size that you're looking out there or that you think could come your way to help grow the business? Maybe even --

Matt Simoncini (President and CEO):

Nothing that would significantly change the profile of the business. We are seeing at things between the Guilford and Eagle Ottawa type range and just as a refresher, that's $250 million to $750 million in acquisition costs. It could be something in that range, John, but I don't think it's anything that completely changes the profile of our business. I don't see a major acquisition out there. I see nice little tuck-ins that would complement our existing business and increase our product capabilities.

John Murphy (Analyst - BoA Merrill Lynch):

Great, thanks. Great quarter, guys.

Matt Simoncini (President and CEO):

Thank you, John.

Operator:

Joseph Spak, RBC Capital Markets.

Joseph Spak (Analyst - RBC Capital Markets):

Good morning, everyone. Congrats on the quarter.

Matt Simoncini (President and CEO):

Thanks, Joe.

Joseph Spak (Analyst - RBC Capital Markets):

First question's for Jeff, just housekeeping. We their something unusual with the free cash flow timing? It was a big source. It looks like over the past couple of years, if anything, it was a little bit of a use. And if so, what quarter do you expect that reversal?

Jeff Vanneste (CFO):

Well, historically, we operate on a fiscal calendar, which has a way of changing the quarter end. For example, last year, the fiscal quarter ended on March 28, and this year, the fiscal quarter ended on April 2. And as a result of that, you get a couple of extra days and those days that were added this year happened to be where we got customer payment.

So there was some cash receipts that we had received in that time frame that was different than last year. So that was a big portion, coupled with the earnings growth that we saw in the first quarter leading to the $320 million-odd year-over-year variant.

I think what we will see this year versus maybe previous years is more of a leveling effect on free cash flow through the quarters because the cadence of the fiscal quarters will continue to be kind of overlapping the calendar quarter-end. So we should see a more even cadence of free cash flow this year by quarter's end than we have seen maybe historically.

Joseph Spak (Analyst - RBC Capital Markets):

Okay, that's helpful. And then can you just, with Adient coming to market, I guess, here later on in the year and the filing today, can you just remind us, Matt, of your competitive positioning in some of the different sub segments?

I think they are bigger in frames and mechanisms. You're obviously stronger in leather, but what about cut-and-sew and some of the other stuff? As well as you've been starting to mention more and more intelligent seats and I'd be curious to see how you think you stack up there versus the competition.

Matt Simoncini (President and CEO):

Well, I think overall, we're at a number two position on global seating pretty much in every market. As far as components, they're a little bit better on frames and mechanisms as far as size. They are a little bit bigger with their acquisition of [Hammersein and Kypa] a few years ago. We are more focused on surface materials and craftsmanship. And it's not just the leather, it's the fabric, it's the leather and it's combining it with our sewing operations, which we have been the industry leader of for many, many years.

And when you put it together with our knowledge of how a seat comes together with foam, that's where I think we are truly unique in our capabilities and craftsmanship and I think we are number one in that ability to provide that. I also think we are number one in intelligent seating.

And our knowledge in electrical and software and the thousand software engineers that we have around the world that help us write code is allowing us to develop some very unique capabilities in seating and what we're calling into seating, intelligent seating, and I don't think anyone else in the industry has the capabilities we have there and so by that, we're head and shoulders above anybody, including Adient.

Joseph Spak (Analyst - RBC Capital Markets):

And just to follow up on the intelligent seating, is that something that's beginning to creep into the backlog in the outer years or is it still sort of you showing your capabilities to the different auto makers?

Matt Simoncini (President and CEO):

I have Ray Scott here, the President of Seating, but it's not in the backlog per say and Ray can add more color on it, but we are in preproduction and development with numerous car (multiple speakers).

Raymond Scott (EVP, President Seating):

Right now, we're, there's at least three customers that we have development programs with. And so this is more of a development program that we see coming at us pretty quickly and the different features that we're going to be able to offer our customers are going to really allow them to differentiate their products in the marketplace. We're real excited about what is happening. And like Matt said, with the convergence, the electrical and seating, the two fit perfectly together in what we're giving to our customers.

Joseph Spak (Analyst - RBC Capital Markets):

Great. Thanks a lot, guys.

Matt Simoncini (President and CEO):

You are welcome.

Operator:

Rod Lache, Deutsche Bank.

Rod Lache (Analyst - Deutsche Bank):

Good morning, everybody.

Matt Simoncini (President and CEO):

Hello, Rod.

Rod Lache (Analyst - Deutsche Bank):

I was hoping just to get a little bit more color on the year-over-year earnings bridges. So if I look at seating and I take away the 5% impact from FX, your top-line grew by maybe $290 million and your EBIT ex this benefit from raw materials and FX probably grew by the mid-70s.

That looks like a 25% incremental margin, which is a bit better than what you have suggested in the past, even excluding this benefit from raws. And electrical looks like it's even better than that. It looks like, ex-FX, maybe $25 billion on the top-line and $17 million or so on the EBIT. Just a huge conversion. Is there something else unusual in that bridge that we should be aware of next.

Matt Simoncini (President and CEO):

Not really, Rod. The performance of the business has been very good in both segments. And the day-to-day, just operational excellence, if you will. Continuous improvement. Restructuring savings. We're continuing to get leaner in both our administrative and our manufacturing groups. It's just pure out execution. Now seating, I think there may be quarters when we post numbers that are in the low-8%s, but on average, the run rate on that business is in the high-7%s and we're pretty confident with that level.

Rod Lache (Analyst - Deutsche Bank):

And was there anything in the electrical business in terms of R&D spending this quarter or pricing that was, or commodity timing that was unusual?

Matt Simoncini (President and CEO):

No, it's a pretty clean quarter. I do think that as we continue to penetrate in the market, you will see us step up in development spending, engineering spending to support the backlog gains that we are seeing. And so that could, in a quarter, maybe impact it. But that business should run at about 14.5% pretty clean.

Rod Lache (Analyst - Deutsche Bank):

Okay, and then lastly, your commentary is placing a lot of emphasis on returns, which is terrific. And obviously, at the same time, the street is hearing from Adient that they've got a big win rate so far this year. How should we interpret that vis-a-vis Lear? Are you basically suggesting that you might sacrifice some growth to sustain margins and returns in the future?

Matt Simoncini (President and CEO):

They're not taking sales from Lear so I'm not sure where they are getting them from. We're not here to build a backlog so we can sell the business. We're here to build a backlog to profitable growth. There is a certain cost structure that allows you to do that and product capabilities that we are focused on. I'm not really sure where they are getting the sales from because they're not getting them from us.

Rod Lache (Analyst - Deutsche Bank):

Okay. But the message is you are prioritizing the returns on the business and the margins as opposed to (multiple speakers).

Matt Simoncini (President and CEO):

I think we're balancing. I don't know if prioritizing because that kind of signals the fact that we're going to substitute sales growth.

Rod Lache (Analyst - Deutsche Bank):

Okay.

Matt Simoncini (President and CEO):

The reality is we're doing both. We're getting the returns and we're growing the business and we're penetrating the market and gaining shares. So I've saw the comments to me as just to kind of supports side of business.

Rod Lache (Analyst - Deutsche Bank):

Great, thank you.

Matt Simoncini (President and CEO):

Thanks.

Operator:

Brian Johnson, Barclays.

Brian Johnson (Analyst - Barclays Capital):

Good morning, Matt and Team.

Matt Simoncini (President and CEO):

Good morning, Brian.

Brian Johnson (Analyst - Barclays Capital):

So far (multiple speakers) on a couple of prior questions where you talked about the different parts of seating and their relative positions. Can you give us a sense of the, just very roughly, the revenue mix between just-in-time seats, surfaces, and then other components that could help us better understand kind of, since we can assume different margins on each, the sustainability of these margins and how that can (multiple speakers).

Matt Simoncini (President and CEO):

We will. I will turn it over to Jeff in a second. The reality is a lot of our components, while at times directed it to other customers, really go through Lear instead of kind of roll-off under our JIT business. But that being said, Jeff can give you color (multiple speakers).

Jeff Vanneste (CFO):

Yes, so if you looked at it from a total standpoint, in other words, disregarding the inter-company nature, the JIT business is about two-thirds of the seating mix. Trim, including the impact of the Eagle Ottawa deal, is about 20% of the overall mix, and metals is about 10%, with the remaining portion being the foam business.

Brian Johnson (Analyst - Barclays Capital):

Okay. And when you look at the margin expansion, is it coming more from the mix amongst those or is it coming from margin expansion, for example, in JIT?

Matt Simoncini (President and CEO):

I think it's collectively within all of those product segment, the margin expansion is growing.

Brian Johnson (Analyst - Barclays Capital):

Okay.

Jeff Vanneste (CFO):

We benefited from the mix. The just-in-time facilities are going quite well. We're sorting all of our issues in North American structures that we have talked about in the past. Surface materials, which is a combination of fabric, leather and sewing, I think is scraping up. It's across the board, Brian.

Brian Johnson (Analyst - Barclays Capital):

Okay. And then are you seeing in terms of the production requests coming from your customers, a tilt towards higher-end option mixes that take more upscale fabrics, upscale motors, upscale structures, and is that helping the margin?

Matt Simoncini (President and CEO):

I think what we are seeing is a trend towards BUVs in China and in North America. Europe's mixed pretty consistent. In North America we're seeing a rotation towards more CUVs and that typically come at a higher content for one reason alone: they typically have more seats than a pass car. And that is helping us somewhat.

Brian Johnson (Analyst - Barclays Capital):

Okay, thanks.

Matt Simoncini (President and CEO):

You are welcome.

Operator:

Brett Hoselton, KeyBanc.

Brett Hoselton (Analyst - KeyBanc Capital Markets):

Good morning, everybody.

Matt Simoncini (President and CEO):

Good morning, Brett.

Brett Hoselton (Analyst - KeyBanc Capital Markets):

I was hoping you could maybe expand on your comments regarding the competitive landscape. Obviously, some of your major competitors are going through some significant changes here. I'm wondering, it doesn't sound as though you're seeing any significant changes in your win rates or pricing or anything along those lines at this point in time. I'm wondering, is my understanding correct?

And then secondly, do you see anything on the horizon that might cause some changes there? And I'm of course referring to the seating business specifically.

Matt Simoncini (President and CEO):

Not really. The rational pricing, or a competitor has irrational pricing in a segment is nothing new. We've seen that in the past. For us, we need to stay focused on winning profitable business, working on our footprint and product capabilities and quality standards because in the end, that's ultimately what wins in the marketplace on a sustainable basis.

Really don't anticipate any changes. I mean there have been ebs and flows over the years with different competitors kind of trying to penetrate and what have you. But I really don't. I think we need to stay focused on what we offer, which, again, is a unique product, outstanding craftsmanship and quality at a very low cost footprint. And so, for us, no, I don't really see a change in the dynamic at all, Brett.

Brett Hoselton (Analyst - KeyBanc Capital Markets):

And then can you speak to your margins? You set forth some mid-term margin targets, in the seating and electrical business and you are obviously exiting those. Your contribution margins are driving the margins for each of those segments higher. So things are performing very, very well.

And I'm kind of wondering what are you thinking in terms of you're mid-term margin targets at this point in time? And what, if they are still in the same range that they've been in for the past year or so, what drives your margins back down to those levels?

Matt Simoncini (President and CEO):

Well, one would be engineering costs associated with the backlog gains that we are seeing and anticipating. It could be mixed as well. We talked a little bit about the positive mix on CUVs if that changed. But right now, we are comfortable with seating in that the mid-7% to 8% range. Let's just pick a number in the middle and say 7.7%.

In electrical, 14.5%, I think the business overall will run. We are increasing our infrastructure in some of the emerging markets, specifically China and Asia, which will drive a little bit more administrative expense. But all in all, we're pretty comfortable with where we are running.

Brett Hoselton (Analyst - KeyBanc Capital Markets):

Okay. Thank you very much, Matt. Great quarter.

Matt Simoncini6 Thank you.

Operator:

Matt Stover, SIG.

Matt Stover (Analyst - Susquehanna Financial Group / SIG):

Thank you very much. I have two questions. Number one was on the RD&E this year versus last, how would that compare?

Matt Simoncini (President and CEO):

Jeff?

Jeff Vanneste (CFO):

I think as you look at it, the R&D in the first quarter was pretty consistent on a year-over-year basis. I think, as Matt alluded to, with respect to some new programs that are coming on board, the engineering rate may elevate slightly in the back half as that backlog starts to come on board and we start engineering. But in the first quarter, it was relatively flat.

Matt Stover (Analyst - Susquehanna Financial Group / SIG):

So if we look at those year-to-year compares, there were no recoveries in there?

Jeff Vanneste (CFO):

Well there is always recoveries, but nothing significantly different.

Matt Simoncini (President and CEO):

I don't really see a significant change in the run rates. It could be half a point here and there, but it's pretty consistent. And it's really driven, Matt, more than anything -- the time of recovery has been consistent, but I would tell you that it's driven by the cadence of the backlog. But I don't see a material change that could move it 10, 20 basis points in a particular quarter. But I don't really see a whole scale change on it.

Matt Stover (Analyst - Susquehanna Financial Group / SIG):

This is the other question was on the CPV there. There might be something that's impacting this comp, but given the mix of production in North America, I was a bit surprised to see your calculated CPV go down 8% from 459 to 422. Is there something sort of odd happening in the quarter there in North America that distorts that?

Matt Simoncini (President and CEO):

Well again, it was the mix. Again, we don't sell necessarily to the industry. We sell to specific car lines and the industry in North America was up by 5%. But some of the programs that, our larger programs, weren't up that much, or in some cases were down, like the Focus, the Mustang, the Spinata programs were down year-over-year.

Matt Stover (Analyst - Susquehanna Financial Group / SIG):

So but if you were to look in region, in North America, as an example and you looked at the key platforms, you generally had higher content on those things, and therefore, that was one of the favorable contributors to improve profitability in that region.

Matt Simoncini (President and CEO):

Right. I mean, what you are calculating -- where we are disclosing, though, Matt, is a theoretical mix.

Matt Stover (Analyst - Susquehanna Financial Group / SIG):

Yes.

Matt Simoncini (President and CEO):

So from our standpoint, what we saw in the programs run versus where we thought we would be, our products are running well. There are, obviously, certain things are up and other things are down. And Jeff mentioned a couple of our car lines that are down. But overall, I thought the mix actually benefited us.

Matt Stover (Analyst - Susquehanna Financial Group / SIG):

Okay. Yes. Thanks very much, guys. Great quarter.

Matt Simoncini (President and CEO):

You're welcome.

Operator:

Ryan Brinkman, JPMorgan.

Unidentified Participant (Analyst - JPMorgan):

Good morning. This is [Samick] on behalf of Ryan. Just firstly wanted to get your views on China. I know you have a big presence there through your consolidated operations and also through your joint ventures.

Maybe you can share your thoughts about what are you seeing there in terms of industries and speed of [advertisement demand] but what drives your confidence in that [plus six plus end number] in terms of growth that you're using for the year and what are you seeing there in that market?

Matt Simoncini (President and CEO):

We are seeing growth pretty consistent with our assumptions. There is a rotation there. You are seeing more CUVs, crossover vehicles, penetrate there. I think the domestic brands are growing faster than the partners, or the foreign partner brands, if you will. There's obviously a push for alternative energy vehicles.

All these trends benefit Lear. We have great relationships both with the foreign partners as well as the domestic auto makers, and we have great capabilities, as well, in alternate energy vehicles. And so from that standpoint, I think it sets up pretty well. We are seeing growth both in our consolidated business, which is over $2.1 billion, and our non-consolidated business, which is growing as well, which is about $2 billion.

So overall, I think we are positioned well and we are seeing growth pretty consistent with what our expectations are. I think we are set up very well for continued penetration in that market.

Unidentified Participant (Analyst - JPMorgan):

All right. And just a follow-up there. You said domestic auto makers are doing better than before in CUVs. Is there a difference in [meet your contemper] vehicle on those sort of two segments and maybe just remind me what your relative exposure to each of those look like in China.

Matt Simoncini (President and CEO):

Right now, the domestic partnerships, or the foreign partnerships, are still more significant as far as sales in the marketplace, although those comments I made signals that we are seeing a growth in the domestic brand share. Typically, the domestic brands are a little bit lower in content, typically, then their foreign partner brands that come at a higher content.

For Lear, our business is roughly 65%, 35%, with the 65% being with the foreign partner brands and about 35% being with domestic brands. But as the domestic brands gain, we'd expect to gain share as well.

Unidentified Participant (Analyst - JPMorgan):

Got it. And just more on the housekeeping side. Are you seeing any OEMs pull back on production schedules in 2Q here because of the impact from the earthquake in Japan?

Matt Simoncini (President and CEO):

It hadn't hit us in a meaningful way. There is some adjustments because of some commodity tightening coming out of imports. It has not impacted Lear in a meaningful way. And if it did, it would be short-term because if they're selling the vehicles, they'd make the production up on the back half of the year. I don't anticipate a meaningful impact to Lear Corporation at all.

Unidentified Participant (Analyst - JPMorgan):

Got it. Great. Thank you. Thanks for taking the question.

Operator:

Colin Langan, UBS.

Colin Langan (Analyst - UBS):

Great, thanks for taking my questions. Can you just remind me, I don't know if I missed it, the impact of the commodity help sustaining margins in the quarter? Is there a dollar number there or a percent?

Jeff Vanneste (CFO):

Yes, we said about 30 basis points in seating, 30, 40 basis point, Colin.

Colin Langan (Analyst - UBS):

Okay. Got it. And any color, just a couple maintenance questions. Most of mine have been answered at this point. Any color on NOLs? I think there's about $900 million left. How many year of a tax benefit does that give you? And what is the tax? Is it like a 10% tax savings versus your cap rate?

Matt Simoncini (President and CEO):

Well I've got the tax expert sitting here at the table. Phil McLaughlin, our Head of Global Tax can take you through where we're at with that. Philip?

Philip McLaughlin (Head of Global Tax):

We have about $900 million worth of tax affected attributes globally, about two-thirds of those are in the US. And because they all are around the world, they will last for differing periods of time, but I think it's safe to say that we will still have attributes in the next five years in our long-range planning period, and we continue to see a cash tax rate below 20%.

Colin Langan (Analyst - UBS):

Got it. Very helpful. And just last question, I think last time I was out at your R&D center, you highlighted some of the technology you are adding around connectivity. Is there any movement there? Any opportunities that have opened up since that space is becoming more and more important? Any large ones there or anything notable?

Matt Simoncini (President and CEO):

There's huge opportunities in that space. Where we're focusing on, our gateway is one product that allows us to participate in that segment. And Frank Orsini, our President of our electrical division that heads up our connectivity efforts. Frank, can you give them some color on what we are doing there?

Frank Orsini (President of Electrical):

Yes, absolutely. As Matt mentioned, we do have a lot of activity in the area of connectivity. It's a really hot trend right now. And we are actively pursuing this with all of our customers on a global basis. But, to get specific, there is a development program that we're working on right now which essentially will be a connected gateway system that will provide 4G LTE over-the-air software upgradable modules for a premium OEM company in Europe.

So it's a development award that we are working on right now. The production quoting will follow as we go through the process. But Lear was single-sourced that development from all of our competition in the industry. So we're really happy how the software acquisitions that we made have really augmented the gateway business and wireless capabilities that we have, as Matt mentioned earlier. A lot of traction in this ares. It's a very hot topic for us work.

Colin Langan (Analyst - UBS):

Yes. Sounds very interesting. Congrats on a good quarter. Thanks for taking my questions.

Matt Simoncini (President and CEO):

Thank you, appreciate it.

Operator:

Patrick Archambault, Goldman Sachs.

Patrick Archambault (Analyst - Goldman Sachs):

All right. Thank you. Most of my questions have been answered, but one technology one as well. Can you remind us, 48-volt, how relevant is that for your portfolio? How big of an opportunity is it? And to the extent you have any color on the ability of it to maybe even display some EV penetration? Would be curious for your thoughts there too as well.

Matt Simoncini (President and CEO):

Well that's a great question. Once again, I'm going to go to our President of Electrical Division, Frank Orsini.

Frank Orsini (President of Electrical):

48 volts is another real hot topic for us in the industry right now. It's really all about adding power to the electrical architecture so our customers can add content for their consumers, and ultimately even add vehicle efficiency systems such as start/stop, as you referenced, hybrid levels, and ultimately, give lower-cost solutions for electrification.

For Lear, it's right in our wheelhouse of all of our product lines. Our wire business, our terminals connectors business and our electronics business will all benefit from this trend. We have scalable technology from 12-volt to 48-volt all the way on upwards to 400-volt in all these areas. So for us, it's very exciting. We see it as a major trend and we're very excited to be a part of it.

We have three production intent awards that we're working on right now with three different customers, two in Europe, one in Asia, that are slated for production in late 2018 and mid-2019. These are actual development projects that have been slated for production. So we are excited about that and we have many other active projects on 48-volt with other customers around the world. For us, it's a real trend and we're obviously deeply involved with it and excited about it.

Patrick Archambault (Analyst - Goldman Sachs):

That's great color. Just one other one is some people have suggested that the efficiency that you get is so good that it could actually maybe even push back some EV penetration. Is that -- just your views on that, if this is something that -- if you would agree with that characteristic of its capability?

Matt Simoncini (President and CEO):

It could. I don't think it will. Because EV is driven by a lot of different things, everything from fuel economy and efficiencies to CO2 emissions and what have you. But there's also the cost of the system, the relative cost of the system and you have to balance it out. I don't think it'll really change the dynamic of alternative energy vehicles. I think it will be more of the content that's going into traditional systems.

Patrick Archambault (Analyst - Goldman Sachs):

Got it. All right. Thanks, guys and congrats on the quarter.

Matt Simoncini (President and CEO):

Thank you.

Operator:

Adam Jonas, Morgan Stanley.

Adam Jonas (Analyst - Morgan Stanley):

Hello, Matt and Jeff.

Matt Simoncini (President and CEO):

Hello, Adam.

Adam Jonas (Analyst - Morgan Stanley):

There's just one question. Hello. Just one quick one. There's been a lot of talk recently of these new types of nontraditional companies looking at manufacturing cars and consumer electronics firms and tech firms that might view the car as basically an iPhone on wheels which, of course, would need seats and an electric component, thankfully.

But I'm just curious, even at a preliminary level from your perspective, and not mentioning any names, of course, is Lear beginning to engage with such nontraditional players on maybe early design and engineering efforts at any level at all or is it still just smoke, but no fire yet?

Matt Simoncini (President and CEO):

No, I think we're in conversations with pretty much all of the players that you would expect us to be that have interest in developing autonomous vehicles or to enter the space. I think what is great about where we are at is that we can help them execute their plans in an efficient manner. So, no, we're out there and we don't publicize it a whole lot, but we have got a presence out west and we have conversations on a regular basis and we are ready to step in.

I personally think, and you've heard me say this before, Adam, it's the most exciting time ever to be in the auto industry because of the convergence of these type of companies in our space, which creates all kind of opportunities, whether you believe in a full rolling smart device on wheels to some level of adaptive safety, it is a great time to be there. And I think we're well-positioned to take advantage of that trend.

Adam Jonas (Analyst - Morgan Stanley):

Great. Thanks for that.

Matt Simoncini (President and CEO):

Your welcome, Adam.

Operator:

Chris McNally, Evercore ISI.

Chris McNally (Analyst - Evercore ISI):

Thanks, guys. Just one more seating margin question, if you don't mind. I want to come at it from a regional contribution basis. Just curious if your Europe, you raised the outlook. I know you've taken a lot of costs out of the regionals over the last couple of years.

Could you just discussed, has that been a big benefit to margins? Just looking at the margin expansion, we're all trying to figure out what's the largest contributor and Europe has been on my radar screen for a while. Just curious how European margins come into the mix.

Matt Simoncini (President and CEO):

Well, we improved both in North America, we improved in North America, Europe, Asia stayed pretty consistent, but consistent at a high clip. Europe has contributed, as we expected it would. We're seeing a recovery in that marketplace, but more importantly, our efficiencies are improving and the restructuring actions that we have taken are starting to pay dividends. But, we pretty much improved in every major segment, save for South America, where we're just kind of continuing to hold serve. We are losing there.

We don't expect that to turn around in the near-term, but we're kind of holding our losses, if you will. But I have to say that we've pretty much improved in every market, including North America. But Europe was a big contributor. And Europe, historically, has been below, slightly below target margins for that segment. But they are fast closing the gap, if you will.

Chris McNally (Analyst - Evercore ISI):

That's great and just a follow-on for European mix. You discussed some of the larger platforms like the Focus and Mustang in North America. Maybe a slightly drag on the revenue mix, but made up by the fact that maybe some trucks have a larger EBIT mix. Could you maybe discussed that dynamic in Europe?

Matt Simoncini (President and CEO):

Yes, in Europe, our business is great in that it's very well-balanced by auto maker, but also by type of vehicle and platform. We have a nice blend of A, B, C platforms. But we also have a nice blend of luxury and cars that are available for export like the Mercedes C Class, the 3 Series BMW, Jag Land Rover, as well as Fiat and Peugeot and Citroen.

So I mean from our standpoint, we're pretty reflective of the market overall. The Audis are actually doing well. Although, Volkswagen, maybe not so much. But overall, our business is pretty balanced and as the segment grows, we'll grow equal to the gains that we are seeing overall in that region.

Chris McNally (Analyst - Evercore ISI):

Okay. Great color, guys. Thanks.

Operator:

Richard Hilgert, Morningstar.

Richard Hilgert (Analyst - Morningstar):

Thanks for taking my questions this morning, guys, and congrats on the quarter.

Matt Simoncini (President and CEO):

Thanks, Richard.

Richard Hilgert (Analyst - Morningstar):

Yes. Great margin expansion. Historically, going back years, the first quarter has always been the quarter where the price-downs hit, and the consolidated COGS is always higher, relative to the rest of the year.

I know you commented during the call here about the margin, but when I am looking back over time, that spread can be anywhere between 0.5 to 1.5 percentage points for the first quarter being higher cost of sales than the average the rest of the year. And again, the primary reasoning in the past has always been price-downs. Can you comment a little bit why that's not going to be the kind of relationship versus the rest of the year this time around?

Matt Simoncini (President and CEO):

Yes, you're right. The first quarter is typically a weak quarter compared to quarters two and quarters four, historically, because of the reason that you mentioned. I would say, Richard, what's a little bit different about this year, besides the commodity impact of 30 or 40 basis points that we talked about earlier in the call, is the mix is strong in the quarter.

And we expect it not to be as strong in the back half of the year, as well as the fact that we anticipate higher R&D spending to support the backlog growth that we're seeing. If the production assumptions hold, we would expect this business to post towards the higher end of the guidance range, however.

Richard Hilgert (Analyst - Morningstar):

Okay, great. The other question was, you had the slide in the deck that showed the growth rates being roughly 6% for both seating and electrical full-year revenue. As we progress over the next five years, with all of the electronic stuff coming out from the auto makers, the way that we should think about the growth rates, long-term growth rates, for these two different segments -- luxury vehicles where you tend to do better than your competitors has grown at a faster pace than the overall mass market on a global basis.

So thinking in terms of the differences between these two, are we going to see these kinds of growth rates being the same for both sectors over the long run? Or does electrical kind of overtake seating and the sitting growth rate kind of stays the same? What is your thinking longer-term there on these growth rates for the two sectors?

Matt Simoncini (President and CEO):

I think they both stay about the same as where they are at right now. I think we continue to win business and penetrate and the reason why is, yes, you are correct that electrical content is going to grow with the complexity of the vehicles and the trend and the penetration of alternate energy vehicle. But the seat is also becoming much more complex.

And I think the offerings that we're providing through intelligent seating and some of the craftsmanship initiatives, as well as the feature growth as seats become more power and safer, will provide ample content growth in that segment as well. Plus the fact that we are consolidating business in that segment. So I think the growth rates will be consistent with what we've seen, and I think it will be consistent between the two segments for that reason.

Richard Hilgert (Analyst - Morningstar):

Okay. Great. Thanks again, guys.

Matt Simoncini (President and CEO):

You are welcome.

Operator:

This concludes the Q&A portion of the call. I will turn it back to the Company.

Matt Simoncini (President and CEO):

Well, great. Thanks. By this time, probably the folks remaining on the call are the Lear employees and I have a message for you. First off, thank you. Because these results just don't happen. They happen through hard work and dedication.

I want to thank all of you for the work that you performed to help us achieve these results. I also want to remind everybody that we need to continue to reach for greatness and perform and drive these results. So thank you for all of your hard work for the past, and thank you for the hard work in the future. Have a good day. Bye, bye.

Operator:

Ladies and gentlemen, this concludes today's conference call.