Transcript

Lear Corporation

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MANAGEMENT DISCUSSION SECTION

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

... joining us for this session with Lear as part of Deutsche Bank's Global Automotive Conference. My name is Emmanuel Rosner and I'm the lead US auto and – auto technology analyst here at Deutsche Bank.

Lear is a global leader in the supply of automotive seating and electrical architecture and a fast-growing player in electronics, vehicle electrification and connectivity. The company has made a number of seating acquisitions while continuously working on repositioning its E-Systems segment for long-term growth. So, I'm extremely excited to talk about all these trends with the A-team from Lear. From Lear here, we have Ray Scott, who's President and CEO; Jason Cardew, who is SVP and CFO.

The format for today will be a fireside chat around some of my prepared questions, but also questions from all of you in the audience. We'll leave some time at the end. So, maybe just we'll start with mine. Thank you so much for being here.

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.

It's great being here. Thanks for having us.

QUESTION AND ANSWER SECTION

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.
Q

So maybe just to set the stage, how are things playing out for Lear so far in the second quarter from an industry perspective? What do you view as the biggest risk factors and opportunity for the sector in the second half and beyond?

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.
A

Well, why don't I start at the – first of all, thanks for having us and thanks for those attending here in person today. The – from a broader strategy perspective, we couldn't be more proud of what we've accomplished. I think in Seating, where we've talked about being the most vertically integrated seat company in the world, we've done a nice job of integrating Kongsberg and IGB, really setting us up for thermal comfort, modular system, and we're moving quickly with our customers across the board in that area, along with other areas of FlexAir that really uniquely define Lear as a different way of looking at seating as we move forward.

E-Systems, I couldn't be more proud of the team. We've had seven consecutive quarters of year-over-year improvement. The plan that we've put in place, the strategy we've put in place to really simplify the product portfolio is paying off and we're going to continue to make improvements in E-Systems. And the last leg of the strategy plan of this vertical integration within Industry 4.0 or what we just recently rolled out, IDEA by Lear, really takes in the digitalization. The technologies around automation within our manufacturing plant is really accelerating. So, I'm really proud of what we're doing strategically within Lear Corporation, and we're seeing each one of those areas move very positively.

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.
A

I'd say, from a financial perspective, the second quarter is playing out largely as we had anticipated, particularly on the things that we can control, the commercial negotiations or operating improvements. While we still have two and a half weeks to go, we have some work yet to close out between now and the end of the quarter. Everything on the performance side, operating income, operating margins is on track. And we are seeing revenues a little bit lower than we had anticipated in the second quarter. Some of those unusual things like the flood in South America that impacted the production in most of our plants, both in Seating and E-Systems [indiscernible] (00:03:10) lower revenue stream, $30 to $35 million.

We've seen some downtime, from select customers. We've seen slower ramp up on certain platforms. So, we had expected revenue to be up about 2.5% sequentially from the first quarter to the second quarter. We now think it's more likely to be flat in the quarter. But our performance improvement initiatives have largely offset by [indiscernible] (00:03:34) earnings are coming in where we had expected.

Thinking about the second half and the second part of your question, some of the risk and opportunities there. As we look out to the second half of the year, when we issued guidance on our first quarter earnings call, we had expected revenues to be flat from the first half to the second half of the year with the benefit of the backlog rolling on sort of offset by normal seasonality, particularly in Europe and North America, whether it's [indiscernible] (00:04:01) downtime. As we look at what's happened in the first five months of this year in terms of

Industry sales, particularly on electric vehicle platforms, we are starting to see as – and many are of course in the US disconnected to production levels and sales rates and inventory levels starting to increase, particularly on EVs.

You know, at this point, we are not going to update the full year guidance. We do expect revenues to be 1% or 2% lower second half of the year than the first half of the year, just based on what we've seen so far in terms of sales, industry sales in the US, Europe and China, our three largest markets.

In terms of our operating margins in the performance side of things we can control, we're more optimistic about our guidance for the full year there. One of the key drivers of that for first half to second half margin improvement in both segments was really that – what we refer to as net performance. And for us that $50 million to $60 million of operating improvements that we have a good line of sight on from the first half to second half falls into three buckets. The first is the launch cost and engineering costs, and the launch side is just the timing of programs ramping up. We expect launch costs to be a little lower in the second half. Expect engineering spending, net spending to be a little bit lower in the second half of the year.

The second bucket is really restructuring savings and the benefit of automation. Again, so we have already started to move production from Eastern Europe to North Africa with some benefits from that. Thagora, one of our acquisitions sort of impact our leather business [indiscernible] (00:05:44) but we have ramped up the deployment of that technology now in 60% of our plants. The other 40% are in process and will benefit us from the first half to second half. So these aren't speculative improvements. These are things that we've already implemented that we'll see sort of capture the benefits in the second half of the year.

And then the third component of that net performance, first half to second half is lower material costs. So it's purchasing negotiations with our supply base and CTO, or cost technology optimization. Product teams are working on with our customers to drive lower cost in the second half of the year. All those things taken together have a smaller drag on the operating side of the outlook.

Emmanuel Rosner Q

Analyst, Deutsche Bank Securities, Inc.

All right, that's extremely helpful. Just a quick point of clarification. So when you were talking about the second quarter, so far as you said revenues may be a bit softer than expected, some one-times, et cetera. But operating income still about in line with where you saw. Does that imply a decent sequential improvement in margin?

Jason M. Cardew A

Senior Vice President & Chief Financial Officer, Lear Corp.

Yes, particularly in Seating where we had expected for a flat margin in the first quarter, second quarter. We are seeing higher margins in the second quarter. Now, there are still some things we have to close out in the last two and a half weeks of the year, but – for the quarter, but we do see sequential margin improvement in Seating and could be as high as 7% in the second quarter from 6.6% in the first quarter. E-Systems, we're still sort of expecting flattish margins in the low-5s in the second quarter, despite the lower costs.

Emmanuel Rosner Q

Analyst, Deutsche Bank Securities, Inc.

And that upside would be driven by what?

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

A

It's mostly the operating improvement actions that I described that are benefiting in the second half are from the restructuring that we've done and the benefit of automation lowering our labor costs.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

For the benefit of people in the back of the room, there's a few seats in the front if you want to – or put your computer down on the table, the front table here. Thanks so much for this overview. So, you were mentioning in – initially, you recently announced this evolution of your strategy, IDEA by Lear, as well as the acquisition of the Industrial Automation. What role will automation and new technology play in your plan for expanding margins in real-time?

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.

A

It's going to play a big role. And I couldn't be more excited about what I'm seeing in our facilities. We've had a number of acquisitions, and we've always been focused on the operational [ph] ex (00:08:15). And now with our acquisitions of ASI, InTouch, Thagora, and most recently the WIP acquisition, which is centered around software and AI and algorithms that really change the dynamics of the invested capital on the floor and tying it to software that really brings to life ways to really create efficiencies. And so we talk internally about thinking differently, driving accountability, but most importantly, moving fast. And the changes that we're making in the organization are really centered around how we standardize these great technologies and capabilities that we have vertically integrated into Lear Corporation.

So, we don't need exterior players to come in and bring those type of capabilities into Lear. And so we are becoming really quickly an advanced manufacturer, integrator. And this role is very important. And we've talked about the product side of how we're moving to modularity and making sure that we're focused on really getting efficiency out of the product. But equally as important today with the technology that's coming out with automation, AI, the software development, master control panels that are standardized across all of our facilities, we're seeing the benefits.

And I think Jason alluded to how we're looking at our operations and how those are resulting in improvements quarter-over-quarter, but more importantly, year-over-year. I was just on our Gratiot facility last week, and I think it's important to point that out. There was a program that we took over from a competitor. There was the Jeep Wagoneer and the Grand Wagoneer. And walking through that facility where traditionally we would actually outsource 80% of the capital on the floor.

We source 75% of the capital internally to Lear. We manufactured the capital, and we did that through these acquisitions that we had in place. We saved 20% on the capital in that facility. And what was important is that we took that business over because the competitor that we took it over from couldn't get the throughput in place. They couldn't produce the parts in time for the customer.

We saw a significant improvement. We could not only – we only keep up with our customer, but we outpaced our customer. And we saw a 17% improvement in labor efficiency on the floor. And what's a great example when we talk about how we're reducing our capital cost by writing the software and building our own master control panels that are standardized across our facilities, a camera that would typically run within our facilities at $20,000; because of our software development programs, we got a camera at $500. We're seeing significant shifts and lower costs. And this is what we're talking about by IDEA by Lear is integrating all these standard processes from software development to digital capabilities to AI capabilities into the capital that's on the floor. And walking that plant and seeing what we're doing was amazing.

And I think what's uniquely different is the first time it was done in the industry. I've been in the business for – since 1988. I've never seen a company come in in 10 to 11 months and launch a program like that that was that much more efficient. And what's great about that, most programs take anywhere from 18 to 20 months to launch. Our customers want the acceleration of time in these facilities at a much faster pace. If you look at some of the Chinese domestic, when we're – we're doing a great job of winning business with the Chinese domestics, primarily because we can come in and accelerate the timeline.

We can accelerate the efficiency. And we offer them a differentiated product. And so when I think about Gratiot, Gratiot was somewhat limited because the design was baked. We have the ability to actually change the product itself to a modular design and change the components, the efficiency that we're building on the plant for. The savings are incredible. And so I think we're just scratching the surface. I think Gratiot was an example of what we can do. And we can combine that with a product. I think we can not only outpace the labor economics. But as labor economics starts to moderate with our increased automation, and we're studying that right now, we believe we can continue to expand margins within both business sets.

And so the whole organization has been put in place. I was – I had the great opportunity to move Carl Esposito into IDEA by Lear. His product, his design, his engineering experience is going to help us accelerate that area. And then continue – we're going to continue to improve our margins in E-Systems. But it's all about connecting it through wiring, trim covers, JIT facilities in our component business within Seating, within modular concepts that we have. And so it's definitely a way to differentiate us. It is differentiating us and it's actually driving our margins, and it's going to expand our margins into 2025.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

One additional topic on the environment and then we'll dive into your businesses. But the moderation of EV demand is having a large impact across the boards for OEMs, for suppliers. At the same time, we're seeing combustion engine programs having longer tails. How has this impacted your backlog and how is Lear adjusting to the changing environment?

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

A

We started to see this, as most did, about eight months ago and we adjusted backlog as we started this year, we lowered the electrification volume assumptions by about 20% of the backlog about $300 million lower. So we felt like we came into this year with conservative assumptions on [indiscernible] (00:14:02) now as we look again at inventory levels starting to build here in the US in particular, I still think there's some room for that number to drift down in the second half in the US.

Europe's holding up better. You had markets sort of shifting from luxury to [the] lower end of the market. So business that we have in high voltage wiring doing quite well with the volume holding up. Some of the luxury EV volumes are starting to moderate a little bit. And then in China, it's a totally different story. Things are holding up very well. And as Ray mentioned, we're doing a great job with the Chinese domestics like BYD which presents the most significant growth opportunity. It's really kind of a tale of three different markets.

In terms of the benefit of ICE platforms being extended, I don't think we've seen much of that yet, but as we look out to 2025 and 2026, I would fully expect we're going to start to see customers extending programs out that previously were scheduled to build out in 2025 and 2026. I don't have a number of examples to share with you yet, so that's [indiscernible] (00:15:18).

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Just one quick follow-up. I guess what had surprised me when you updated the 2024 backlog was that obviously the electrification piece would come under pressure, but obviously Seating as well to a certain extent, even though you essentially could sell the same seats on promotion and then on – and on EV, like it's essentially the same. So, is there sort of like eventually a one-for-one replacement in terms of if an EV doesn't get made, then you get the business on the ICE side? Or is it a function of in the end, every new vehicle that was going to launch was likely going to be an EV, and now these sort of like are being pushed out and you don't really see that being replaced?

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

A

I think over the next three years we will see a one-to-one tradeoff. But clearly seating is agnostic, so we're indifferent, whether it's on the ICE powertrain or the EV powertrain. But most of the new vehicles in the backlog were electric vehicles hence those volumes show signs of coming down and they have not been replaced with higher ICE volumes just based on [indiscernible] (00:16:18) of what we had on Seating backlog.

And there are some customer specific issues, Volvo with the ES90 [indiscernible] (00:16:26) will delay the launch. And that program is going to be kind of a slow ramp up in terms of that [indiscernible] (00:16:33).

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

So let's dive into your Seating business. What do you view as sustainable growth of the market for the mid-term? At your Seating Product Day last year, you introduced mid-term market share targets of 29% for jet, 32% for total seating, including components. What are the catalysts and how are the thermal comforts and the opportunities for complete seat modularity helping you achieve this target?

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

A

So first, let's just step back and look at the last five years. We've grown that business at four points above market through a combination of conquest wins with $2 billion or so of conquest business. That is the catalyst for that growth over market and market share gains that we've enjoyed so far. We did establish a target of [29%] market share by 2027. We're sort of now approaching 26%. So we're well on our way to meet that.

Thermal comfort is the key driver of that. It drives growth in our component sales as well. We have a little bit more than $2 billion a year in component sales that we sell to our competitors, and we see that business growing pretty rapidly as well. So, those are the key drivers for the long term. I think in the near term, growth is going to be a little choppy again because of what's happening in this transition from ICE to EV and some uncertainty around what our customers are going to build. It's a little harder to predict, but I think if you look out over five years, that's four points of growth of a market is very achievable in Seating.

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.

A

And just to add to that point, right now, we're working with just about every customer on these thermal comfort modules. And currently, we have – we're working in development programs on 22 different platforms, approximately 13 different OEMs. And we have what we consider to be Phase 2 with three different customers: Lucid, Volvo, and a German OEM. And what's important about that is this change to a modular design is revolutionary. And so even though you talk about the cost savings, the efficiency, the way you actually deliver the modular system and have savings within the JIT facility as far as your labor costs is a significant change.

And so these development programs are very important because it goes from the validation process. And there's a time element there. It is – we validate it internally. It's putting it in from the customer and getting it into production cases where you validate it. And so we're moving extremely quickly, I believe, given that the Kongsberg and IGB acquisitions just recently occurred. But that gave us a tremendous amount of credibility as we work with our customers.

And that – we just announced too, and it's a very important announcement that we have a fully integrated modular design with Ford Motor Company. And so a launch in late 2026, but what's important about that is that as we're going through the validation process, there's a number of elements we have to take that product through as far as the development goes, that gives us enormous amount of credibility with other customers. And so there is this kind of wait and see in some respects that once it gets into production, it's amazing how fast customers start to be more attracted to it.

And I think FlexAir is a great example. Jason talked about we're a small player in polyurethanes. It's a very dirty chemical that's used to really produce foam. And we have a revolutionary design around FlexAir that changes the composite, and actually it's recyclable, it reduces CO_2 emissions by 50%. And Hyundai was the first OE that introduced it in production. And now, they're looking at all kinds of different applications within the seating area to mass produce it in volume across different vehicles.

Now, that went from a push, we're talking to our customers, to now it's a pull. I was just down in a facility where we're working on the advanced manufacturing of FlexAir. It's lower capital. The cost is just about the same. We did great returns on the FlexAir, and now our customers are pulling in all different areas to get it into production so they can use – have their use cases to take that across multiple seating applications. So, those are the examples that we have, but there is a time element as we're getting those into production.

So, I couldn't be more proud of what we've done, where we're at. I think as we've worked with Ford on this – the ultimate design of integrating the components into the trim covers outside the JIT facility and then having the spoke and hub concept where you can flex, and you have the ability to flex across multiple platforms. That's what we're looking for. These programs are getting smaller in scale as far as volume. They have a number of different platforms across different types of propulsion systems. And so being able to flex the modular designs is the solution. And I think offering that to our customers is a solution that they're looking for. They are looking for ways that you can drive a modular component into – interceding in other areas within the vehicle. And so we're moving fast. There's no question about it. But there's an element of the development process that takes a little bit more time.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Your large seating competitor recently complained about some insourcing of JIT seating by some OEMs in Europe. Have you seen this? Does it concern you? And how does thermal comfort along with your automation initiatives contribute to your margin potential in Seating?

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.

A

Yeah. It's – like I said, I've been in seating for a long time, and there's different customers that have different strategies. We – Volkswagen has an element where they have been – insourced seating in the past and BYD does a little bit of that today. Tesla has done it in the past. So, we're not unfamiliar with always looking at insourcing, but I think it's when they don't have a solution. And we're not seeing any different trends or any outliers. And we talk to our customers every single day, particularly around where they're at, what they're looking at, how they're setting up their strategy for seating moving forward. So, there's been no changes, I haven't seen, of anything that would raise a concern from our perspective.

But what I always boil it down to this, I mean, you have to be the most competitive supplier in the business. You have to continue to create a value proposition for your customers. And I think when you have solutions and you're vertically integrating these modular solutions, it's a very unique way to differentiate those. I mean, we are the only company in the world that has that capability. And offering that to our customers does create a very unique solution.

I think in addition too, what I just mentioned with Gratiot, that's an important element. When you're the lowest cost producer, when you look at your capital on the ground, when you look at how you're investing, how you're standardizing your processes, it is the solution that you can offer your customer. And so they can have business case where they look internally and they look at other competitors or they look at you, and you have to be the most competitive. And I think that's the position we've put ourselves into. And so the examples that I have when I talk about us taking over conquest business from other competitors that are in mid-cycle, which is unheard of, is the example of offering a value proposition to our customers.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Let's talk about E-Systems and electrification. E-System had particularly strong Q1, equivalent to 10% growth over market, partly due to the Ford and GM platforms. Do you expect this strength to continue through the rest of the year? What kind of incremental margins can we expect from this segment going forward?

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

A

Yeah. So, we had an especially strong growth over market quarter in Q1 in E-Systems, and it was driven by both our backlog, and as you've mentioned in the question, certain platform volumes that were higher really had sort of an easy comparison year-over-year on some of our really important platforms like the Ford Escape, the Ford Super Duty and the GM Colorado Canyon. And so that really benefited the growth over market. So 10 points is a little bit of a anomaly as we look at the full year or prior guidance of 5 points of growth over market. So we do expect that to moderate through the balance of the year.

In terms of incremental margins, as we talked about historically, the volume increase on existing platforms are 25% is what we would expect in terms of incremental margin, and the backlog between 10% and 15% depending on the product category.

Raymond Scott A
President, Chief Executive Officer & Director, Lear Corp.

And just to add to that too, we made an organizational announcement recently, and I think it's important to point that out. One, it was with the intent to accelerate IDEA by Lear Industry 4.0, all the great acquisitions that we have in place now, and really centralize those in a way that we can standardize those great capabilities throughout our plans. But equally as important, we're in a much better position in E-Systems, and bringing Nick Roelli over from Seating, he's an expert in manufacturing processes. He's great with the customer. He's really focused on driving efficiencies. So the timing was perfect for us really shift into IDEA by Lear, setting that organization up so we can accelerate much faster across the board with standard processes that we've learnt.

But equally important was a great time now to take the simplicity that we did in the private portfolio, the improvements we're seeing and accelerate the efficiency within the systems division because we're there. And so we – our vision continues to be improvements within E-Systems and accelerate their business.

Emmanuel Rosner Q
Analyst, Deutsche Bank Securities, Inc.

Can you remind us of the size of the electrification opportunity for Lear? What's in the backlog? What's being quoted? And what can revenue look down the line?

Jason M. Cardew A
Senior Vice President & Chief Financial Officer, Lear Corp.

Yeah. This has been an important component of our growth story in E-Systems. That business, the electrification businesses, is about $565 million of revenue in 2022. It grew to roughly $750 million last year. Our guidance for this year has it growing to $800 million. So growth moderated somewhat this year as the industry transition to EVs slowed down a bit. But it is an important component of growth for E-Systems. So, we talked about 6 points of growth over market being the target in that business. 3 points of that growth over market is coming through electrification. I think in the mid-term, that may moderate a little bit and more than 1 to 2 percentage points. But over the long term, I still think that's kind of the right target to think about in terms of E-Systems growth over market.

Emmanuel Rosner Q
Analyst, Deutsche Bank Securities, Inc.

What's the opportunity from hybrids specifically in your portfolio?

Jason M. Cardew A
Senior Vice President & Chief Financial Officer, Lear Corp.

Yeah. So in a full electric vehicle, you have about $700 of additional CPV compared to an ICE vehicle, and in certain cases like a full-sized truck, it could be well above that. In a plug-in hybrid, you capture about a third of that, about $250 of additional CPV. So, it's still meaningful. It's not as much as the incremental content in an electric vehicle, but is still a meaningful growth opportunity for us.

Emmanuel Rosner Q
Analyst, Deutsche Bank Securities, Inc.

Maybe capital allocation is the next question. What are your priorities for capital allocation in the current environment between CapEx, M&A, buybacks, regular dividend? And can you walk us through your M&A strategy?

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

A

Yeah. So, consistent with what we've said in the past, first and foremost, we're going to invest in the business and we've been running with CapEx just under 3% of sales. That seems to be the right level. It might go a little bit above that if we have particularly appealing opportunities in automation and they strip back down as we find further options through the acquisitions, allowing us to lower our capital spend as we alluded to, for example, on the WS, Wagoneer, Grand Wagoneer launch where we were able to reduce our capital spending pretty dramatically. We see that as a growing opportunity for us. We're continuing to expand our supply base on the capital side, too. Numerous opportunities both in E-Systems and Seating with new suppliers in China that have allowed us to lower our capital cost as well. So, that's our first focus.

From an M&A standpoint, we're focused on small tuck-in acquisitions, much like we've done in the last several years, particularly on the process side. So, sort of these $15 million to $25 million acquisitions. There's a number of other companies we're looking at in that space over the next couple of years. We'd like to do more there.

In terms of our dividend, we've kind of held the dividend flat until we get back to sort of pre-COVID level of earnings. We'll likely hold that flat and then look to grow it as earnings fully recover from that time period. So, we're really focused on returning excess cash to shareholders through share repurchases. We have ramped that back up last year about $313 million stock back, about 4% of our shares out. We expect to do the same this year. We'd like to do a little bit more, especially with the stock price where it's at. We bought back $30 million in the first quarter. I'm looking at about $50 million in the second quarter. So, we're gradually ramping that up as we generate free cash flow throughout the year. So, that's going to continue to be an important part of the value creation story for shareholders, I think, for Lear over the next number of years.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Right. I have one more question on margins and then we can open up, if there's any questions in the room. You were targeting 8% operating margins for both segments in the midterm. Coming out of the last earnings, you generated 6.6% in Seating, 5.1% in E-Systems. What do you need to see and do in order to get to the 8%?

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

A

Yes. So, if you look at last year in Seating, we're at 6.8%. Our guidance this year is 6.7% to 7%. So, I think it's – we sort of end up right around 7%, and just underneath that, this year got 100 basis points we have to go to get to our 8% target. Thermal comfort is a component of that bridge, that 100-point bridge. In the medium term, that's about 20 basis points, and that's 30 basis points over the next four years or so. And we've started to see that improvement in the thermal comfort business this year. It was – it lost a little bit more than $10 million last year. It's going to be profitable this year. It's a $20 million-plus improvement year-over-year, and we see that pace of improvement accelerating into next year as we've kind of moved our footprint from Eastern Europe to North Africa. That's had a significant impact on that business as well as the synergies of just integrating those assets more fully into the company.

In addition to that, we do expect to continue to generate margins of under 15% on the backlog. The backlog will be accretive. So, even if industry volumes aren't growing, we see backlog as a contributor to margin expansion in Seating. And then the last piece of it is net performance. So that's our ability to offset wage inflation through customer recoveries and the automation programs that Ray described earlier. So, those are the kind of the main baskets driving the improvement in Seating.

In E-Systems, it's a little larger step-up from sort of mid-sized is what we expect for this year. So, we do need a little bit of industry volume in order to get to that 8% level I think in E-Systems, and we've started to see some of that benefit this year. And then we also have some things that are sort of self-help measures. Our North America wire business is underperforming right now. We've made significant improvements over the last 12 months, but we have more work to do and we've got a great team in place and we're well on our way to generating the improvements that we're anticipating in the outlook for the year and beyond there. So, there's a kind of combination of backlog, performance and then some self-help measures in E-Systems driving that margin bridge.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. I think we have time for maybe one or two questions. Jim?

Q

Hey, good to see you, guys, again. I guess, Ray, my question follows up on your competitive position, low-cost, leading technology, full capability and you're winning share. My question for you is the subsector seating, the pricing dynamics versus OEMs and what we've seen in terms of some major miscues from your competitors in the last five years and more recently mid-cycle conquests, like is just unprecedented. Great for you. But in terms of the sector's pricing power versus that OEM unrelenting pressure, are you seeing, or are you concerned about your competition being a little bit more aggressive on trying to win business three years out or two years out, depending on the lead time? And is that a big variable for you when you're thinking about your three-year targets that Emmanuel just asked you about?

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.

A

Yeah. I don't think we're unfamiliar with the irrational players thinking about their backlog. And even not that long ago, there was one of our competitors, their compensation was paid just strictly on the backlog. So we saw a lot of irrational behavior during that particular time, and that was one of the times we were growing at the fastest pace. I think it's important, one, that, like I said before, you have the most efficient low cost and you can walk a customer through very clearly the importance of being able to produce more efficiently than your competitors.

I think our customers are much more sophisticated. They understand some of the ins and outs in a much more sophisticated level. And walking through the importance of quality, I think they have long-term memories too. So there's a number of examples, without using names, of some of our competitors that have come in under irrational pricing, taken the business, and then had to give it up, or got into a major commercial battle with the customer. So our customers do have those memories on what has previously happened.

So reminding them of this is what happened in the past with supplier ABC is part of the process. And so it's constantly putting your – pressure on yourself to be the low-cost producer executing. I mean, executing every single day and getting the results from a quality perspective, a delivery standpoint is key, but then also working with them and explaining. So, I don't see any major trends in that area because I think a lot of them have these longer-term memories when I talk about our competitors, too. But that doesn't mean that there won't be an irrational player just for the sake of backlog trying to go out, but...

Q

So, the takeaway for me would then be price downs historically 1% to 3%, 2% to 3% historically? Is that kind of the framework that is still on that two to four-year horizon in both Seating and new products?

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

A

It's a little less than that, more like 1%, 1.5%. Seating, a little higher than that on the E-Systems side.

Q

And that's holding pretty steady? You feel pretty good with that?

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.

A

Yeah. Yes. That's...

Q

Okay.

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.

A

...holding steady. I think what's important is the traditional OEs are really studying some of the competitors within China and understanding – trying to understand how are they delivering at a lower cost. And so it's – they are working – our customers are now working with us on solutions. Like I say, timing is everything. A modular solution or a way to integrate much more efficiently capital on the ground is important to them.

I think in the past, it was important, but not to the significance or the priority that they have in place now. So, modularity is a really important component of how we're looking at growth. FlexAir, these components that we have that differentiate us, customers are now much more willing to really look at those seriously around how we're going to deploy longer term. And so that has changed. We talk about CTO or VAB, those type of things. But how you look at a seat assembly or a harness or the components within the vehicle has changed. They're much more in tune to try and look at how that delivery model can change. And there's a lot of inefficiency. There's no question about it. We work with some of our domestics in China. They open up a lot more on specifications, how you change your product. So, I think that equation around directed suppliers is going to change over time. I do. We're seeing that right now.

When we talk about thermal comfort, when I talk about working on 20 different platforms, that is a change from a directed model to working with our customers on an in-source because we take responsibility, but we also have the responsibility to source ourselves. That's the dynamic. That's what we're seeing our customers think through a little bit more thoroughly than they have in the past.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

I think we're out of time. Ray and Jason, thank you so much for your time and insights.

Raymond Scott
President, Chief Executive Officer & Director, Lear Corp.

Yeah. Thanks, Emmanuel.

Jason M. Cardew
Senior Vice President & Chief Financial Officer, Lear Corp.

Yeah. Thank you.