NASDAQ:NNBR Q3 2025 Earnings Call Transcript

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Operator | Conference Operator:

Good day and welcome to NN Inc third quarter 2025 earnings call, conference call. All participants will be in listen only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on a touch tone phone. To withdraw your question, please press star then two. Please note that this event is being recorded. I would now like to turn the conference over to Stephen Poe, Investor Relations. Please go ahead.

Stephen Poe | Investor Relations:

Thank you, Operator. Good morning, everyone, and thanks for joining us. I'm Stephen Poe with NNA's Investor Relations team, and I'd like to thank you for attending today's earnings call on Business Update. Last evening, we issued a press release announcing our financial results for the third quarter ended September 30, 2025, as well as a supplemental presentation, which has been posted on the Investor Relations section of our website. If anyone needs a copy of the press release and the supplemental presentation, you may contact Alpha IR Group at nnbr at alpha-ir.com. Joining us from NN Management today are Harold Vivas, President and Chief Executive Officer, Chris Sonner, Senior Vice President and Chief Financial Officer, and Tim French, our Senior Vice President and Chief Operating Officer. Please turn to slide two, where you'll find our forward-looking statements and disclosure information. Before we begin, I'd ask that you take note of the cautionary language regarding forward-looking statements contained in today's press release supplemental presentation in the risk factors section in the company's quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2025. The same language applies to comments made on today's conference call, including the Q&A session, as well as the live webcast. Our presentation today will contain forward-looking statements regarding sales, margins, inflation, supply chain constraints, foreign exchange rates, cash flow, tax rates, acquisitions and divestitures, synergies, cash and cost savings, feature operating results, performance of our worldwide markets, general economic conditions and economic conditions in the industrial sector, including the potential impact and ramification of tariffs, the impacts of pandemics and other public health crises and military conflicts on the company's financial condition, among other topics. These statements should be used with caution and are subject to various risks and uncertainties, many of which are outside of the company's control, which may cause actual results to be materially different from such forward-looking statements. The presentation also includes certain non-GAAP measures as defined by SEC rules. Reconciliation of such non-GAAP measures is contained in the tables in the final section of the press release in the supplemental presentation. Please turn to slide three, and I will now turn the call over to our CEO, Harold Dubas.

Harold Vivas | President & Chief Executive Officer:

Harold Dubas Thank you, Stephen, and good morning, everyone, for joining. I'd like to cover the highlights and some key metrics for the quarter and go through the main events in this quarter and going forward. Structured sales growth is a top priority for us and we own that. Our sales growth program to secure new business is working and we've secured over $180 million of new business, all of which is in varying stages of ramp up. We've had no cancellations of any of these new wins, just some push outs. With sales growth being our top job and having continued headwinds in our served markets, we added further resources in Q3 to upsize our business prospecting efforts, especially in electrical products, medical products, and defense

products. We've now grown our sales pipeline to over 850 million, and we're running a hit rate of closed opportunities at over 20%. And as far as quarterly sales momentum goes, we believe that we are now on the bottom of the bathtub curve for our serve markets and customers. We're making our own momentum by winning new business and we had key wins in both defense and in medical in the quarter. The foundational win in defense was with weapons components and it's the result of an 18-month development process. The foundational win in medical was with robotic surgery equipment consumables and also was a result of an 18-month development process. Each of these wins alone can be over $5 million per year individually and can lead to further penetration of brand new markets and brand new customers for NN. We're continuing to generate strong free cash flow with stronger adjusted operating earnings, as well as consistent improvement in working capital management. And we are combating very high inflation on precious metals and base metals. We are creating a stronger portfolio and we're completing our phase one, which involves creating a scalable core business. And the three of us will cover that in more detail as we go through today's update. Our strategic M&A program is underway, and we're currently evaluating multiple acquisition targets, big and small, to scale and accelerate growth. And we're committing to growing through M&A. And our preferred equity refinancing is formally underway and continuing. We've initiated discussions to refinance our preferred equity. And importantly, we're working with other parts of our capital structure, current stakeholders, and we're getting organized to look at refinancing both with and without acquisitions involved. So we're in the organizational stages there and gathering information and inputs from our main stakeholders, making progress. If we can turn to page four, I'd like to cover the key metrics for the quarter. Our sales were about 104 million, and the positives were that our power solutions growth and new launches were on track, and we had growth in our aerospace, defense, and electronics business areas. Negative headwinds came from mobile solutions and specifically automotive rationalization, as well as some of our customers being conservative with all the volatility in the serve markets. We're committed to forcing our way through that with new wins and growing the top line. We believe we're at the bottom of the curve right now. Our adjusted operating income improved nicely. It's about $4 million now, and it results in a margin of almost 4%. And that's another strong trend versus our historical results. Our adjusted EBITDA did go up. Um, it went up 7.9% year over year on a lower sales base. Part of that's due to the restructuring that we're doing and getting rid of business that didn't make money in the first place. Uh, our margin is up 170 basis points year over year, and we're on track for our long-term goals. And maybe we'll increase them as well, given our track record here is stronger than we expected. Our new wins were 11 million in the quarter. And I mentioned key wins in defense and medical were important to us, and we've been stalking them for quite a while. We're pretty happy to be awarded and nominated. And we're positioned to continue winning new business going into next year. And even this week with one of our top two customers, we were named a supplier of the year. We're in good shape with our customers and growing both with existing customers and new customers. Our adjusted gross margin was about 19%. It was impacted a little bit on a percentage basis by very high precious metal costs, specifically gold, running through our numbers. It's a pass-through item, but it impacts our percentages. But we have strong operating performance and efficiencies in our plants, as well as positive portfolio shifts. We're having a good mix shift. This is a 350 basis point improvement compared to Q1 of this year. And free cash flow was a good story for us. We generated $9 million of free cash flow. Actually, our cash flow from operations, if you look in the appendix material and reconciliations, was over $11 million. And we also funded CapEx in the quarter and netted $9 million of free cash flow. Our working capital program is delivering strong results in addition to improved operating income, and this is almost a $21 million improvement over the last two years, and it's continuing, and Tim's gonna cover it further in a couple slides. I just wanna point out it does not include any benefit from CARES Act proceeds. The IRS is in a furlough mode right now. The government shut down, and so we're on hold right now with regards to receiving our approved refund there. But at a high level, softness in the North American automotive market created an opportunity for us to go ahead and consolidate our last plant that loses money. And it's a negative drag on our business. And we're in the process of talking to customers right now and getting timing lined up. And then, of course, it'll be a Warnack notice, so we have a whole bunch of proper things to do in order here, so we're not at liberty to discuss the plan. But we're going to go ahead and pull that trigger so that it eliminates that last piece of unprofitable business. If you turn to page five, I'd just like to talk a little more fully about our served markets. And, you know, we have five primary ones. Automotive is 40% of our revenue. These percentages were

consistent over the last couple quarters. We check them. We round them to the closest five percentile, and it's been pretty steady for us. If you look at automotive, everyone knows that there's been a lot of changes with the elimination of BEV incentives, the elimination of forward emissions improvements, A lot of incentive declines. There's been a misjudgment by what types of vehicles consumers wanted, and the main OEs are shifting their investment approaches, mainly balancing back towards ICE. And that benefits us because our portfolio is bigger on ICE. And one reason our pipeline has grown significantly is that this market has turned back into our strength. So we're a very innovative situation, and we're involved with quite a few next-generation improvements. But base production is down, if you can follow that with public reporters. And so we've been down with them. It turns out that that's a good mix here for us, but it is impacting us this year. And we think we're at the bottom, and if you look at some of the forecasts, Going into next year, there's predictions that there's going to be a rebound because vehicle sales are actually higher than production. And so this inventory destocking is going to benefit supply chain participants like ourselves. The next biggest one is electric grid and electrical distribution. That's 20% of our business. That also has had some volatility. There's been a lot of cancellation of federal funding programs for infrastructure. And that has impacted electrical infrastructure in the U.S., electrical infrastructure spending. A bellwether reporter here is ITRON, also a customer of ours, and they report on this pretty concisely. And we've had one-on-one meetings with them. Tim's our executive sponsor at that account. And spending is down. And so we're down a little bit with it as the federal funds have declined in this area. not losing, we're actually gaining positions, but the base business has been slightly down versus it had been up. The quite different story is defense being at an all-time record high right now in the United States, and it's focused on modernization and next generation advancements. And there's a forecast for this to continue because of all the appropriations that are being approved, and it will grow to almost 500 billion by 2023 which makes it two and a half times bigger than the entire medical market. So it's a big thing for us, and we're fully paying attention to it, and it fits our capabilities quite nicely. The GDP types of products that we have, it's kind of our all other. The economy was down in the first quarter, came back in the second quarter. It's led by consumer spending. We're really tied to equipment. and mainly the biggest one in there is construction, and that's been a little bit down as well. Commercial vehicle, it's a smaller market for us, but it's been in the doldrums for a few years now. The bankruptcies are still rolling through the industry. I looked at some data in the last couple days that the bankruptcies in the third quarter were about the same rate as the second quarter, and there's now been over 800 bankruptcies of freight haulers which means less trucks are needed, and so that industry is going through recalibration also, but it's predicted to end in 26, so we can see forward supply chains and forecasts in our EDI portals improving. In medicals, the market that we entered is a decent-sized market. It fits us, and we had a good quarter with a foundational win, as I mentioned. So overall, markets are soft this year. We've taken the opportunity to take more cost out. We've taken the opportunity to take working capital out. We have increased our effort to get new wins to offset what the base market does. And in the third quarter, we did grow our profits and our cash flow on less sales. So that's kind of a quick overview, and we might get some questions later. But I'd like to turn it now over to Chris to walk through some of our financials.

Chris Sonner | Senior Vice President & Chief Financial Officer:

Thank you, Harold. Good morning, everyone. Today, as in prior quarters, I'll be presenting the GAAP information as well as pro forma information to provide transparency into our results. We've got the main item this year, the rationalized volume that we've been talking about the past couple of quarters. So I'll start on slide six, where we detail our financial results for the third quarter. This slide shows our as reported on the left and our non-adjusted numbers for On the left side, we again lined out the pro formas in the middle on our quarter results and with our pro formas on the right side of the table. The pro forma adjustments include last year's contribution for strategically rationalized sales volumes and the impacts of foreign currency translation. So on an as reported basis, the net sales for the quarter were 103.9 million, declining 9.7 million versus last year's third quarter. On a pro forma basis, accounting for those adjustments, Sales declined only 4.4% or $4.8 million. Our adjusted operating income for the third quarter was $4 million, marking a strong increase, as Harold noted, of $2.7 million compared to $1.3 million in the prior year third quarter. On an as-adjusted pro

forma basis, operating income increased $2 million or about 100% versus the prior year period. Adjusted EBITDA and pro forma results for the quarter were 12.4 million compared to 11.6 million in the prior year period, increasing 6.9% or 0.8 million compared to the prior year third quarter. And lastly, margins of 11.9% of net sales expanded to 170 basis points. on an as-reported basis and 130 basis points inclusive of pro forma adjustments. I'll now turn it over to Tim for a minute to discuss improvements in our adjusted EBITDA margins. Tim?

Tim French | Senior Vice President & Chief Operating Officer:

Thank you, Chris, and good morning, everyone. Turning to slide seven, I want to spend a few minutes walking us through the structural improvements A&M has made to its overall profitability profile. Key aspect of our transformational focus has been to expand our overall margin profile of the company to help drive growth. to our operating earnings and adjusted EBITDA. Q3 marked another consecutive quarter of success in this area. Our adjusted EBITDA margins have expanded 260 basis points since the launch of our transformational plan in early 23. Our consolidated performance continues to push us towards a long-term goal of 13% to 14%. Our adjusted gross margin also continues to show marked improvement. Year-to-date, our margins have expanded by 90 basis points to 18.4%. Our performance keeps us on track to achieve our goal of 20% gross margins. We've been able to expand our margin profile and profitability metrics to the adoption of a one-team culture across multiple facilities. We have also strategically rationalized low- to no-margin business, closing two underperforming facilities. One of the key drivers of our improvements is the right sizing of our SG&A workforce. We've reduced our overall headcount by more than 20%. more appropriately aligning our resources to the needs of the company. Our focus on margin expansion will continue. With that, I'll turn it back over to Chris.

Chris Sonner | Senior Vice President & Chief Financial Officer:

Thanks, Tim. I'll just provide a little more detail on our quarterly results by talking about our two segments, Power Solutions and mobile. Starting on slide eight, in our Power Solutions segment, where our business consists largely of stamp products, Net sales results for the quarter were 44.9 million, up 2 million compared to 42.9 million in the prior year period. This is mainly due to an increase in precious metals pass-through and the benefit of new launches that Harold mentioned in electrical and defense business, partially offset by lower volumes at one stamping customer. When compared on a pro forma basis, third quarter net sales results increased 1.9 million or 4.4%, noted in the charts on the right. Power Solutions adjusted EBITDA results, as reported, of 8.9 million, increased 2.5 million versus last year's third quarter of 6.4 million, driven by sales growth, the strengthening of our profitability through cost-out initiatives, and an overall improved sales mix. As a function of this improved adjusted EBITDA, we've seen stronger margin pull-through, with quarterly adjusted EBITDA margins representing 19.8% of net sales, up approximately 500 basis points versus the prior year period. Now turning to slide nine, our mobile solution segment, which covers our machine products business. Net sales for the third quarter were 59.1 million for the period compared to 70.7 million in last year's third quarter. Net sales comparisons were primarily impacted by the rationalization of underperforming business and plants and lower volume in North American customers. On a pro forma basis, net sales of 59.1 million were down 6.7 million, or 10.2%, compared to pro forma sales of 65.8 million in last year's third quarter. Our third quarter adjusted EBITDA in the mobile solutions segment was 6.7 million, down 2.1 million from last year's third quarter on an as-reported and pro forma basis. The weaker overall top line drove compression in our adjusted EBITDA margins, which declined to 11.4%, 120-point basis point decrease year over year. We continue to focus on cost-out actions and the ongoing reprofiling of our sales mix. Looking ahead, our new business momentum remains strong. Through three quarters, we have secured $34.5 million in new awards across a large number of individual programs, spanning high-value auto as well as in medical and defense markets. Our new business pipeline is strong for the segment and continues to reflect solid opportunities going forward. I'll now turn the call back over to Tim to review the company's cash flow performance and new business wins. Tim?

Tim French | Senior Vice President & Chief Operating Officer:

Thanks again, Chris. Turning to slide 10, you can see that we continue to make meaningful progress in reducing our operating working capital. Q3 marked a positive step in our free cash flow performance and demonstrates the impact of the focus we've had for several quarters. Networking capital ended the quarter at a low to what has been observed in recent years with improvements in both absolute dollars and as a percent of TTM sales. Working capital of under $80 million at the end of the quarter is down from $101 million in Q2-23, more than $20 million and almost 21% improvement. As a percent of TTM sales, we have seen a drop from 21.2% to 18.8%. On a run rate basis, this represents approximately a $10 million improvement. These improvements reflect the ongoing actions across all aspects of the working capital management. And when coupled with our stronger adjusted EBITDA and operating earnings, we'll continue to create a more predictable cash profile and a stronger foundation for free cash flow generation. Turning to slide 11, it highlights our success of our new business wind launch program and gives insight to our program launch sequence. In 2025, we anticipate launching over 100 programs, with more than 70 new programs already scheduled for 2026. These programs are forecasted to contribute approximately $26 million to our top line and an estimated $40 million when at full run rate. This year, we have increased our cumulative wins by $35 million, driving the total to approximately 182 million, well on our way to our long-term goal of 200 million. To support this growth, we've made significant capital investments globally. We've invested in dedicated equipment for medical, automotive, and A&D markets. Our pipeline remains robust and is being driven by our 40-person sales and engineering team. With that, I'll turn it back over to Harold.

Harold Vivas | President & Chief Executive Officer:

Thank you. Thank you, Tim. I wanted to talk a little bit about M&A, and I know we have some people interested in that as well as the refi. We have been working on this program for almost a year now and have looked at I don't know, maybe 40 or 50 companies and have it down to a small set of companies that look like they fit both what we want to do in terms of deleveraging and refinancing as well as scaling and getting scale at what we're doing, optimizing our cost structure and being more important to our suppliers and customers. We're getting ready to To embark upon that now, we have to be organized, obviously, in tandem with the refinancing. Obviously, we're not sitting on a big pile of cash, so any acquisition we do of any size at all requires a refinancing discussion. We've been very selective. We've put a lot of time on it, especially Tim and I, visiting a lot of plants, a lot of businesses, doing a lot of due diligence. We're getting there now. We don't have anything imminent. It would be material information anyway. I want you to know that it's a pipeline activity and we're getting down towards the throat of the pipeline here. We're very happy and very pleased with the opportunities that we've been able to dig up. We have a decent amount of people looking for us and helping us. I want you to know that it's real and it's an active activity for us organizationally. On the next page, I just want to cover our guidance real quick. We're pretty much reiterating it again with the exception of our sales. We're lowering them a bit. It's basically lowering our outlook for automotive and increasing our outlook. And so the net impact on gross margin dollars is minimal with that because our lower margin sales or the automotive ones are our highest margin sales or defense. So it's a good mix shift for us. So it preserves the EBITDA and the cash flow that would come from a lower amount of sales. New wins are on track to still hit our target here. And we say the pipeline's greater than 750. It's actually greater than 850. And it's balanced. The biggest part of our pipeline is electrical. And the biggest part of our pipeline is not automotive. So we're pretty happy. That's not by chance. We have a very structured approach here to targeting. And so we're on track. You know, the big thing about this year, year to date, and right now is the uncertainty in our core markets and with our core customers. So it makes us be uncertain because we're a supply chain supplier participant with them. But we're in good standing. We're winning positions. And we just see some near-term volume constraints, and so we've reflected that in our guidance. Pretty much the same expectations for our guidance as we had last time. So with that, I'd like to turn it over to the operator and open it up for questions.

Operator | Conference Operator:

Kim? We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed, and you would like to withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster. First question comes from Rob Brown with Lake Street Capital Markets. Go ahead, Rob.

Rob Brown | Analyst, Lake Street Capital Markets:

Good morning. First question is on the power segment. I think you mentioned electrical was a big part of the future programs you're working on. I guess to what degree is data center demand driving some of your growth there and the opportunity set? Data center is definitely driving the demand on the grid.

Harold Vivas | President & Chief Executive Officer:

The grid investment has been stalled this year with federal funding for infrastructure projects being stalled in many, many spots. And, you know, our bellwether person we listen to on that, Rob, is ITRON and Honeywell when they're talking about what's happening. And we've served both of them. And so that whole investment is going through a little bit of a bump. but the demand and the need for additional investment hasn't slowed down whatsoever. Our participation into it has to do with the connecting, disconnecting, and circuit breaking of the power. So we have a focused product strategy into the sector, and so our prospecting and hunting and bidding strategy And prototyping is about expanding our market share for the products that we offer, which are the hardware part of the grid. Mainly stamped products.

Rob Brown | Analyst, Lake Street Capital Markets:

Yeah. Okay, thank you. And then you talked about long-term goals of sort of 20% gross margins and 14% EBITDA. You've made good progress there, but sort of to get kind of the rest of the way there, do you need to do additional steps or sort of, you know, continue to do what you've been doing and let it play out over time or what sort of needs to happen from here on out?

Harold Vivas | President & Chief Executive Officer:

Well, on power, on stamping, which is where we have all of our gold and silver exposure, our percentages are being impacted by what's happening with the price of gold and silver. And so it's impacting our percentages somewhat sequentially through this year and year over year. And then the outlook right now, the outlooks for gold are to continue on this tear that they're on. So it's causing us to recalibrate what we say about percentages on the power side. But in terms of The mix, we're going to keep selling the same mix of products. The percentages are being impacted by the price of gold mainly. On the mobile side, we have the additional opportunity to get rid of business that's negative EBITDA. And so we're taking those final steps right now. So to get our percentages up in mobile, it's both doing the final chunk of underperforming business, getting it off of the books and eliminating that. And it's a few million dollars, so it's not going to be the day, so it impacts the percentages. And then the wins that we have are accretive to the business, obviously, that we're getting rid of. So it's twofold on the mobile side. And when we do the math, you know, on a constant metal basis, it works. The volatile thing right now, Rob, is the price of gold.

Rob Brown | Analyst, Lake Street Capital Markets:

I understand. Okay, thank you. I'll turn it over. Thank you.

Operator | Conference Operator:

Our next question comes from John Franz-Rabe from Sedodian Company.

John Franz-Rabe | Analyst, Sidoti & Company:

Good morning, guys, and thanks for taking the questions. I just want to go back to your adjustment to the revenue forecast. You kind of said it's lower order, higher defense. I'm curious if there's any impact of the acceleration of the facility rationalization that's also playing into that number.

Harold Vivas | President & Chief Executive Officer:

No, no, it's that, that'll mainly be a 2026 topic, John. So, you know, the order of events here with an industry term is PPAPing. So all of our parts are PPAP and customer approved. And so we have to get the customers on board with a transition plan, and then we build a bank. And so you have this weird honeymoon where all your numbers improve because you're producing at a really high rate. and then you disconnect the equipment that you need to move and move it and start it up again and then bleed down your inventory, all within the calendar year, but it will be a next year event. So in the fourth quarter of this year, that rationalization activity will have no impact on our sales, none.

John Franz-Rabe | Analyst, Sidoti & Company:

Okay, got it. Thank you. Just curious, what kind of capacity utilization rate are you running company-wise? We can break it down by segment.

Harold Vivas | President & Chief Executive Officer:

Yeah. Tim, you want to take that?

Tim French | Senior Vice President & Chief Operating Officer:

Sure. On the power side of it, stamping, we're running at, we don't run 24-7 in any of the facilities on stamping. So we have significant capacity available within the existing footprint. Our utilization is in that probably 60% range. So we have lots of room to grow on that range. And then it varies from facility to facility on the mobile side of things. We have some facilities that are pushing up into the 75, 80s, and some that are still down in the 60s to 70%. So it is a wide range, but there is significant capacity available across the company.

John Franz-Rabe | Analyst, Sidoti & Company:

Understood. Okay. And Harold, maybe you can walk us through your thought process here about M&A being more active in the M&A market versus taking out the preferred entirely. What are the puts and takes that's going through your minds and can you share with us?

Harold Vivas | President & Chief Executive Officer:

Yeah, sure. In terms of goals, we have a goal to eliminate the preferred stock. We don't foresee being able to do it in one fell swoop. Then you get into the come down the pyramid a little bit and then you get into do you try to do it as a standalone refinance or do you do it coupled with an acquisition? We haven't ruled anything out, John, and we're not onto one particular path. We're getting advice. We're not doing this in-house. We're not investment bankers or professional investors. We intend to rely upon the advice of investment bank experts in this area. And so when I refer to we're getting organized, that's what we're doing. We're trying to put together a team of advisors and existing stakeholders that are willing to help on an NDA kind of basis. So we're getting the team organized and listening, and we haven't ruled out you know, a refi with or without M&A. It's an active activity. We have good relationships with the current stakeholders. The preferred stocks held by Morgan Stanley. I think everyone knows that. And, of course, therefore, they're active in their point of view on what they want to happen and the timing. And so it's a positive, constructive activity. activity that's underway john i can't really say much more you know because it's private but um the management team is committed to making progress i know john you you follow the preferred stock and how it accretes each quarter and we talk about that um so we're trying to end that we're trying to end that era

John Franz-Rabe | Analyst, Sidoti & Company:

One last question, if I may. Can you just talk about the aerospace and defense market and how big you think that can get, I don't know, say three years down the line?

Harold Vivas | President & Chief Executive Officer:

Well, it's interesting how it kind of sneaked up on us because it started to show on our year-over-year customer charts. And at mid-year this year, half of our year-over-year sales growth, the biggest percentage of growth that we had were from, if you look at the top 10, five of them were in aerospace and electronics, and we're like, hey, wait a minute, let's pay attention here. We've been talking about medical, medical, medical, but this thing's happening naturally. Let's get behind it. And it's a really good mix for us because a lot of the products are gold-plated, and they go into the electronics modules inside of the equipment, both for launching missiles, missile guidance. We're heavily tied into electronic enclosures. So that's ubiquitous, but the gold plating aspect of it finds itself when the government's speccing. And so we're rapidly growing that business. And we have a lot of new customers. And the interim goal we have right now, John, is to double it, is to double that business. So that's a lot, because Tim referred to our capacity. That's one of the areas where we're running two shifts. So we have another shift we can do, but then we need to spend a little bit of money to expand our capacity for those kind of products. We're benefiting a little bit this year by, you know, we closed Awajiak, we closed Juarez, and we were able to redeploy a decent amount of the CapEx into Brazil, into North America, and avoid capital spending. We were able to substitute equipment that we needed with equipment that we had. And this last plant that we need to consolidate, we have that same opportunity again. We have good equipment that we can redeploy So the growing defenses and medical, we now see that we're going to be able to do that and be less capital intense because we've been successfully able to redeploy equipment that we have. So we're going to have an investor day, John, in December, and we're going to cover that topic more fully.

John Franz-Rabe | Analyst, Sidoti & Company:

Okay, great, Harold. Good luck on the venture.

Harold Vivas | President & Chief Executive Officer:

Thank you.

Operator | Conference Operator:

Our next question comes from Mike Crawford with B. Reilly Securities.

Mike Crawford | Analyst, B. Riley Securities:

Thanks. Can you just provide some more color on your operations in China, both wholly owned and with the Weifu JV?

Harold Vivas | President & Chief Executive Officer:

Yes. So the JV, Mike, If you know the JV test, you know, the asset test, so it's below 20% of our total assets, but it's getting close to 20. And when we look at our outlooks, it looks like it might even cross 20. If it does cross 20, we'll begin reporting, you know, including the financials of the JV as required. But it's a very successful JV. It's 130 million in sales. It's a little over 30 million in EBITDA. It's a net income generating business. It's been growing. It's dedicated to making fuel system components for Chinese manufacturers. The main customer of the JV is another JV with Bosch. Weifu, their biggest shareholder is Bosch. Our JV, we have a JV with Wayfu to make these components, and then the main customer of the JV is another Bosch entity. And the biggest customer of the JV is BYD, BYD. So the end of the story is that for BYD's internal combustion engine, passenger vehicles, cars and trucks, we're directly involved in that through our JV, and it's quite successful. It was set up 20 years ago by a team from Kentwood, Michigan, the AutoCam headquarters, if you will. And we set that JV up to make those products, and they're still making them 20 years later. And Tim and I are going to China in a few weeks, and we're going to celebrate their 20-year anniversary with them. That plant, which is about 130,000 square feet, is adjacent to and connected to our Wolfie plant. In the middle of the two plants is a shared cafeteria. And yet, you can guess they play ping pong against each other and have fun things like that. So it's good spirit. And on our side, the Holy Olm side, we have a different product focus. We're not going after fuel systems. We go after steering, braking, and powertrain components, which are agnostic to whether it's ICE or EV or hybrid or the ERIP. So we have slightly different types of equipment, different types of products that we make, and it also is 20 years old. Both of those businesses were formed 20 years ago by the former owner-founder of AutoCam, John Kennedy. And so the same man set them both up in this shared facility, and they're still doing well. Our China operation does over 70 million of sales and it's one of our most profitable businesses in terms of EBITDA, and it's free cash flow generative. They pay for their own growth and working capital, and we repatriate cash from there quarterly. From the JV, we get an annual dividend transfer, and from the Wolfie machining plant, Chris takes the cash regularly, like monthly. We also have a stamping plant in southern China And Foshan, which is near Shenzhen, which is near Hong Kong, it's wholly owned. And we make stamped products primarily for export, primarily for the medical market. The biggest customer is Becton Dickinson. And it has a clean room. It's set up for health care standards. And we recently put a big servo press in there. to be able to make certain products for the Chinese market. So we recently have entered the Chinese market for the stamping facility. The Wolfie and the JP Machining, they make their products in China, they buy their metal in China, they convert in China, and they sell in China. The stamping plant, we buy our metal in China and we export. It's also a very profitable business for us.

Mike Crawford | Analyst, B. Riley Securities:

Okay, thank you, Harold. You're welcome. Just one more from me. So your revised guidance implies in the fourth quarter you're going to have some $15 million or more of free cash flow, but that's including $12.7 million from CARES refund that you might not get if the IRS doesn't get back to work. That's right. So it could be just $2 or $3 million in free cash flow in the fourth quarter, which is fine. I mean, that's better than minus $2 million. But absent tax refund, given the footprint optimization work that you've been doing this year, how should we think about free cash flow next year?

Harold Vivas | President & Chief Executive Officer:

Yep, that's a good question. Our EBITDA, our cash flow from EBITDA in the second half of this year is a lot stronger than the first half. We went through a lot of severance and two plant closures at once. So our adjusted EBITDA was looking good, but our cash from EBITDA was not looking good, you know. And so our cash flow game plan was based, was working capital based. in the second half of this year, we've been benefiting from the adjusted EBITDA is pretty close to the EBITDA is pretty close to the cash. Going into next year, we're gonna have that again. So we're gonna have a benefit of that. And so we think that the cash flow is gonna continue strengthening. The working capital, you know, we did $9 million of working capital in the quarter, but if you look at 1231 to 930, our inventory went up a million and a half and our AR went up a million and a half. We offset that by having eight million of improvement in AP and our sales went down and our COGS went down, so you'd expect them to go down more strongly, inventory and AR, but they were propped up because of precious metals. So Tim has reset our game plans to be more aggressive with taking the unit volume of inventory down. And Chris is looking at our overdue to terms AR because to make improvements we want with precious metal basis costs going up, we have to be better than we were planning to be. So we're not going to back off of our cash from working capital plans for next year. and we're going to add to it a higher amount of EBITDA. So you're right with your math, Mike. I think that without the CARES Act this year, it's, you know, four or five, you know, and next year it should be around 10. One of the good things, though, that we haven't input into this is our cash interest. If you look at our attachments, our year-to-date cash interest is slightly less than last year, and rates are going down now. So when the Fed cuts rates, that helps us with our variable rate debt. And as I mentioned earlier, and everyone knows, you know, we're attempting a refi here. And of course, we're going after the rate we pay on the term loan. So it will be, I don't know, I don't know, Mike, probably two times, you know, but that's not a big number, right? So maybe 10, just for talking purposes. It's not going to be 20.

Chris Sonner | Senior Vice President & Chief Financial Officer:

Chris, would you comment on that? Yeah, no, I agree, Harold. And, again, you know, with rates going down, I think we have some opportunity for, you know, improvement to bring in a little more cash or pay a little less interest and bring in a little more cash flow. But we've got to balance that out with the investment needs of the business, the capital of the new business, as well as the, you know, the plant Harold talked about and restructuring. If you look at the free cash flow in the back of the earnings release, you'll see we've managed CapEx very tightly. We've always said that obviously the three of us look at every project, every opportunity. So we are managing those levers very tightly and in a controlled fashion, and we'll hope to improve free cash flow in next year.

Mike Crawford | Analyst, B. Riley Securities:

Great. Thank you very much.

Chris Sonner | Senior Vice President & Chief Financial Officer:

Thank you.

Mike Crawford | Analyst, B. Riley Securities:

Thank you, Mike.

Operator | Conference Operator:

Again, if you have a question, please press star, then one. Our next question comes from Barry Hames with Sage Asset Management.

Barry Hames | Portfolio Manager, Sage Asset Management:

Thanks so much for taking the questions. Appreciate all the color in the call so far. My question had to do with next year in terms of sort of broad talking points where we should be looking for change. It sounds like maybe you think automotive could at least be flat next year. Correct me if I'm wrong on that. You obviously have the new business wins that started this year that you get a full year next year. Are there any other just sort of directional comments you'd make as we start thinking about next year? Thank you.

Harold Vivas | President & Chief Executive Officer:

Yes. Thank you, Barry. So automotive for us is by region. So in China, we're growing rapidly. this year and will grow next year. We've been winning a lot of business in China and it's a creative margin rate to us. In Europe, we had a down year this year due to what happened to the Europe market but we had a big win that we won last year and it's ramping up now and actually we're gonna power through the market outlook in Europe because of that big win that we've had which will be made in our France plant And it's also a good margin for us. So Europe's looking up for us. South America has been flat. They're getting raided by BYD and people like that, and it's affecting the local production market that we're tied into. So not a lot of change in our Brazil plants, our three plants there that serve the South America auto market. North America, Um, the outlook for North American passenger vehicle production is to be up slightly versus down. And, um, there's a lot of, there's a lot of uncertainty to go through there, but, but that's the outlook right now for 26. And wall street seems to be pricing that in to auto parts suppliers like us. And, um, the big exogenous event, if you will, for us is that we're going to correct an underperforming plant we have. So we have a drag on our North America profits. And that's our last remaining drag. So we didn't have the cash. Tim likes to say that we've been correcting our footprint at the pace of our cash flow. So we just couldn't do everything at once. But we think we're in a position now to take care of the last one. And then we're done with that, and we won't talk about it anymore. that for next year um is going to be a non-sales benefit to the profits in north american auto on electrical um you know we've been at a couple of our customer meetings it looks like the demand is increasing but it's hard to tell on spending because of the federal fights over the budgets and federal funding into different states uh so we're we're expecting a flat base market, but improvement because of the wins that we've had. And as I mentioned, we had foundational wins in medical and a defense that are going to help that segment grow next year. So we see an inflection. You know, the big reporter for commercial vehicles is ACT Research, and the big bellwether filer is PACCAR. And PACCAR reported this week, so did Volvo Truck. And they've both been different shades of negative with regards to the rest of this year and the beginning of next year. But both them and ACT Research are saying that there will be a resurgence in the second half of next year and Cummins too, Cummins being tied into that. So we see an improvement in that business in the second half of next year. My initial comments when I said I think we're in the bathtub part of our base markets is we're not at an inflection point, boink, you know, doinking up. But I think we're in the bathtub right now, and

it's going to gradually improve. First auto is going to improve auto production and electrical, and in the second half of next year, commercial vehicle. But through this, if you did the math, Tim's math there, we have 170 programs that are in varying stages of launching. And some of them got pushed. The biggest one, with BYD, got pushed into Q1. So we have quite a bit of new wins that are going to be pushing into next year. We're not ready to give guidance, but it's a positive outlook compared to 25, Barry. Great. Thanks so much. Appreciate it. Lots of good luck. Thank you.

Operator | Conference Operator:

This concludes our question and answer session. I would like to turn the conference back over to Harold Beavis for any closing remarks.

Harold Vivas | President & Chief Executive Officer:

Thank you. We appreciate it. Probably between now and the next fourth quarter earnings call, we might have an 8K or two to keep everyone abreast of what we're doing that's material. We're pretty excited about our future. We're excited about the short-term opportunities we have as well, and thank you for your attention today, and we look forward to reporting our progress on these matters. And with that, we'll end the call. Thank you.

Operator | Conference Operator:

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.