

Q4 2017 Earnings Release

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Allison Transmission’s business is subject to numerous risks and uncertainties, which may cause future results of operations to vary significantly from those presented herein. Important factors that could cause actual results to differ materially are discussed in Allison Transmission’s Annual Report on Form 10-K for the year ended December 31, 2016.

Non-GAAP Financial Information

We use Adjusted EBITDA and Adjusted EBITDA margin to measure our operating profitability. We believe that Adjusted EBITDA and Adjusted EBITDA margin provide management, investors and creditors with useful measures of the operational results of our business and increase the period-to-period comparability of our operating profitability and comparability with other companies. Adjusted EBITDA margin is also used in the calculation of management's incentive compensation program. The most directly comparable U.S. generally accepted accounting principles ("GAAP") measure to Adjusted EBITDA is Net income. Adjusted EBITDA is calculated as the earnings before interest expense, income tax expense, amortization of intangible assets, depreciation of property, plant and equipment and other adjustments as defined by our debt agreement. Adjusted EBITDA margin is calculated as Adjusted EBITDA divided by net sales.

We use Adjusted free cash flow to evaluate the amount of cash generated by our business that, after the capital investment needed to maintain and grow our business and certain mandatory debt service requirements, can be used for repayment of debt, stockholder distributions and strategic opportunities, including investing in our business and strengthening our balance sheet. We believe that Adjusted free cash flow enhances the understanding of the cash flows of our business for management, investors and creditors. Adjusted free cash flow is also used in the calculation of management's incentive compensation program. The most directly comparable GAAP measure to Adjusted free cash flow is Net cash provided by operating activities.

Call Agenda

- **Q4 2017 Performance**
- **2018 Guidance**

Q4 2017 Performance Summary

(\$ in millions)	Q4 2017	Q4 2016	% Variance
Net Sales	\$588	\$469	25.4%
Gross Margin %	49.0%	46.4%	260 bps
Net Income	\$215	\$61	252.5%
Adjusted EBITDA ⁽¹⁾	\$210	\$158	32.9%
Adjusted Free Cash Flow ⁽¹⁾	\$115	\$145	(20.7%)

Commentary

Net Sales: increase was principally driven by higher demand in the North America On-Highway, Service Parts, Support Equipment & Other, North America Off-Highway and Outside North America On-Highway end markets.

Gross Margin: increase was principally driven by favorable net sales and price increases on certain products partially offset by \$9 million of cost in connection with the ratification of a six-year collective bargaining agreement with UAW Local 933 and unfavorable material cost.

Net Income: increase was principally driven by the enactment of the U.S. Tax Cuts and Jobs Act in December 2017 resulting in a one-time income tax benefit of \$155 million, increased gross profit and lower incentive compensation expense partially offset by a loss associated with the impairment of long-lived assets of \$32 million, increased technology-related investment expense, unfavorable product warranty adjustments, increased product initiatives spending, increased interest expense and increased commercial activities spending.

Adjusted EBITDA: increase was principally driven by increased net sales, price increases on certain products and lower incentive compensation expense partially offset by unfavorable product warranty adjustments, increased product initiatives spending, higher manufacturing expense commensurate with increased net sales, increased commercial activities spending and unfavorable material cost.

Adjusted Free Cash Flow: decrease was principally driven by increased cash interest expense, increased cash income taxes, increased pension funding, increased capital expenditures, unfavorable warranty adjustments, increased product initiatives spending and increased commercial activities spending partially offset by increased gross profit and lower incentive compensation expense.

(1) See Appendix for a reconciliation of Adjusted EBITDA and Adjusted Free Cash Flow.

Q4 2017 Sales Performance

(\$ in millions)

End Markets	Q4 2017	Q4 2016	% Variance	Commentary
North America On-Hwy	\$270	\$217	24%	Principally driven by higher demand for Rugged Duty Series models
North America Electric Hybrid-Propulsion Systems for Transit Bus	\$17	\$20	-15%	Principally driven by intra-year movement in the timing of orders
North America Off-Hwy	\$28	\$0	N/A	Principally driven by higher demand from hydraulic fracturing applications
Defense	\$25	\$37	-32%	Principally driven by the timing of Tracked Defense shipments
Outside North America On-Hwy	\$98	\$83	18%	Principally driven by higher demand in Asia, Europe and South America
Outside North America Off-Hwy	\$11	\$4	175%	Principally driven by higher demand in the mining sector
Service Parts, Support Equipment & Other	\$139	\$108	29%	Principally driven by higher demand for North America Off-Highway service parts and global support equipment
Total	\$588	\$469	25%	

Q4 2017 Financial Performance

(\$ in millions, except per share data)	Q4 2017	Q4 2016	\$ Var	% Var	Commentary
Net Sales	\$588	\$469	\$119	25.4%	Increase was principally driven by higher demand in the North America On-Highway, Service Parts, Support Equipment & Other, North America Off-Highway and Outside North America On-Highway end markets
Cost of Sales	\$300	\$251	(\$49)	(19.5%)	
Gross Profit	\$288	\$218	\$70	32.1%	Increase was principally driven by favorable net sales and price increases on certain products partially offset by \$9 million of cost in connection with the ratification of a six-year collective bargaining agreement with UAW Local 933, higher manufacturing expense commensurate with increased net sales and unfavorable material cost
Operating Expenses					
Selling, General and Administrative	\$97	\$84	(\$13)	(15.5%)	Increase was principally driven by unfavorable product warranty adjustments and increased commercial activities spending partially offset by lower incentive compensation expense
Engineering – Research and Development	\$31	\$24	(\$7)	(29.2%)	Increase was principally driven by increased product initiatives spending partially offset by lower incentive compensation expense
Loss associated with Impairment of Long-Lived Assets	\$32	\$0	(\$32)	N/A	Loss associated with impairment of certain long-lived assets related to the production of the TC10 transmission
Total Operating Expenses	\$160	\$108	(\$52)	(48.1%)	
Operating Income	\$128	\$110	\$18	16.4%	
Interest Expense, net	(\$25)	(\$17)	(\$8)	(47.1%)	Increase was principally driven by mark-to-market adjustments for interest rate derivatives and refinancing activities
Other (Expense) Income, net	(\$19)	\$1	(\$20)	(2000.0%)	Change was principally driven by increased technology-related investment expense and unfavorable vendor settlements
Income Before Income Taxes	\$84	\$94	(\$10)	(10.6%)	
Income Tax Benefit (Expense)	\$131	(\$33)	\$164	497.0%	Change was principally driven by a decrease in deferred tax liabilities partially offset by an increase in tax liabilities related to our accumulated foreign earnings and profits, both a as result of the U.S. Tax Cuts and Jobs Act enacted into law in December 2017
Net Income	\$215	\$61	\$154	252.5%	
Diluted Earnings Per Share	\$1.51	\$0.36	\$1.15	319.4%	Q4 2017: 142M shares; Q4 2016: 166M shares
Adjusted EBITDA⁽¹⁾	\$210	\$158	\$52	32.9%	
Adjusted EBITDA Margin⁽¹⁾	35.7%	33.8%	-	1.9%	

(1) See appendix for the reconciliation from Net Income.

Q4 2017 Cash Flow Performance

(\$ in millions)	Q4 2017	Q4 2016	\$ Variance	% Variance	Commentary
Net Cash Provided by Operating Activities	\$166	\$175	(\$9)	(5.1%)	Principally driven by increased cash interest expense, increased cash income taxes, increased pension funding, unfavorable warranty adjustments, increased product initiatives spending and increased commercial activities spending partially offset by increased gross profit and lower incentive compensation expense
CapEx	\$51	\$35	\$16	45.7%	Principally driven by increased productivity and replacement programs spending
Adjusted Free Cash Flow ⁽¹⁾	\$115	\$145	(\$30)	(20.7%)	Principally driven by decreased Cash Provided by Operating Activities and higher CapEx spending

(\$ in millions)	Q4 2017	Q4 2016	\$ Variance	% Variance	Commentary
Operating Working Capital ⁽²⁾ Percentage of LTM Sales	9.5%	10.6%	N/A	(110 Bps)	Principally driven by increased net sales
Cash Paid for Interest	\$53	\$14	\$39	278.6%	Principally driven by termination of interest rate derivatives and refinancing activities
Cash Paid for Income Taxes	\$31	\$3	\$28	933.3%	Principally driven by the 2016 exhaustion of U.S. net operating losses

(1) See Appendix for a reconciliation of Adjusted Free Cash Flow.

(2) Operating Working Capital = A/R + Inventory – A/P.

2018 Guidance – End Markets Net Sales Commentary

(\$ in millions)

End Market	2017 Net Sales	2018 Midpoint	Commentary
North America On-Hwy	\$1,106	7%	Principally driven by higher Class 8 straight and Class 6/7 truck production
North America Electric Hybrid-Propulsion Systems for Transit Bus	\$71	(6%)	Principally driven by timing of certain transit property orders
North America Off-Hwy	\$51	20%	Principally driven by increased demand in the energy sector
Defense	\$117	18%	Principally driven by Tracked Defense increased demand and timing of shipments
Outside North America On-Hwy	\$344	6%	Principally driven by increased commercial vehicle production and fully-automatic penetration
Outside North America Off-Hwy	\$41	5%	Principally driven by increased demand in the mining sector
Service Parts, Support Equipment & Other	\$532	(3%)	Principally driven by decreased demand for North America Off-Highway service parts

Allison expects first quarter net sales to be up from the same period in 2017 principally driven by increased demand in the North America On-Highway and North America Off-Highway end markets.

2018 Guidance - Summary

	Guidance	Commentary
Net Sales Change from 2017	3 to 7 percent	Guidance anticipates continued strength in the North American On-Highway end market. Allison's 2018 net sales outlook also assumes increased demand in the Outside North America On-Highway, Defense and North America Off-Highway end markets and price increases on certain products partially offset by decreased demand in the Service Parts, Support Equipment & Other end market.
Adjusted EBITDA Margin	37.5 to 39.5 percent	
Adjusted Free Cash Flow (\$ in millions)	\$550 to \$600	
CapEx (\$ in millions)	\$85 to \$95	Subject to timely completion of development and sourcing milestones
Cash Income Taxes (\$ in millions)	\$70 to \$80	

APPENDIX

Non-GAAP Financial Information

Non-GAAP Reconciliations (1 of 2)

Adjusted EBITDA reconciliation

\$ in millions, Unaudited	For the year ended December 31,					Three months ended December 31,	
	2013	2014	2015	2016	2017	2016	2017
Net income	\$165	\$229	\$182	\$215	\$504	\$61	\$215
plus:							
Interest expense, net	133	138	114	101	103	17	25
Income tax (benefit) expense	101	139	107	126	23	33	(131)
Technology-related investment expenses	5	2	—	1	16	—	13
Public offering expenses	2	1	—	—	—	—	—
Impairments	—	15	81	—	32	—	32
Environmental remediation	—	—	14	—	—	—	—
Amortization of intangible assets	105	99	97	92	90	23	23
Depreciation of property, plant and equipment	99	94	88	84	80	21	20
Loss on redemptions and repayments of long-term debt	1	1	1	—	—	—	—
Stockholder activism expenses	—	—	—	4	—	—	—
Dual power inverter module extended coverage	(2)	1	(2)	1	(2)	—	—
UAW Local 933 signing bonus	—	—	—	—	10	—	10
Unrealized (gain) loss on commodity hedge contracts	2	(1)	1	(2)	—	—	—
Unrealized loss (gain) on foreign exchange	2	5	1	1	—	—	(1)
Expenses related to long-term debt refinancing	—	—	25	12	—	—	—
Restructuring charges	1	1	—	—	—	—	—
Other, net ⁽¹⁾	13	15	11	9	12	3	4
Adjusted EBITDA	\$627	\$739	\$720	\$644	\$868	\$158	\$210
Net Sales	\$1,927	\$2,127	\$1,986	\$1,840	\$2,262	\$469	\$588
Adjusted EBITDA margin	32.5%	34.7%	36.2%	35.0%	38.4%	33.8%	35.7%

(1) Includes employee stock compensation expense

Non-GAAP Reconciliations (2 of 2)

Adjusted Free Cash Flow reconciliation

\$ in millions, Unaudited	For the year ended December 31,					Three months ended December 31,	
	2013	2014	2015	2016	2017	2016	2017
Net Cash Provided by Operating Activities	\$464	\$573	\$580	\$591	\$658	\$175	\$166
(Deductions) or Additions:							
Long-lived assets	(75)	(64)	(58)	(71)	(91)	(35)	(51)
Technology-related license expenses	6	6	—	—	—	—	—
Stockholder activism expenses	—	—	—	4	—	—	—
Excess tax benefit from stock-based compensation	14	25	8	6	—	5	—
Adjusted Free Cash Flow	\$409	\$540	\$530	\$530	\$567	\$145	\$115
Net Sales	\$1,927	\$2,127	\$1,986	\$1,840	\$2,262	\$469	\$588
Adjusted Free Cash Flow (%to Net Sales)	21.2%	25.4%	26.7%	28.8%	25.1%	31.1%	19.6%