Jamie: All right. So next up we have with us Gates Industrial, we have Dave Naemura, who's the chief financial officer. And so thank you very much for being here.

Dave N.: Glad to be here.

Jamie: I think we'll use the same format in terms of, it will just be informal Q&A. Because I'm up here, if you have a question just raise your hand and in the back they have a mic that they can bring over to you guys. So I guess first I think about is when you guys first went public, and you talked about your total addressable market of being about a $60 billion market versus, I think your sales this year will end up being... Or I'm sorry, your sales in '19 we'll end at about 3 billion or so. I guess, can you just talk about any changes in your view or how you view your total addressable market versus you went public, and where do you think the biggest opportunities for market outgrowth for Gates or content? Just giving you are a smaller piece of a much bigger pie, I guess.

Dave N.: Okay. I think our total addressable markets, which we see is about, probably is about 30 billion.

Jamie: 30? Okay.

Dave N.: Well 60 combined with the two pieces.

Jamie: Yeah, that's what I meant, 60 [crosstalk 00:01:06] with the two.

Dave N.: I think it's about roughly the same size. We measured that back towards the end of 2017. And I think obviously we saw significant expansion in 2018, particularly on the industrial side, primarily driven by hydraulic applications. But I think we've seen a lot of that growth come back this year with the downturn, particularly in mobile equipment. You know, we play in very large, very fragmented global markets with a number of competitors where we have different competitors by application, different competitors by region. And we only have a few real global players on the hydraulic side, people like us, Parker Hannifin and the Eaton hydraulic segment, hydraulic segment within Eaton, a number of power transmission players, some European-based folks.

We're the largest North American based team. And then you've got some Japanese players. But in any event, those global players tend to not make up more than maybe 30 or 40% of any given market, so they're very highly fragmented global markets. I think the biggest opportunities in our opinion remain expanding our addressable market in hydraulics, where historically we really only play in premium applications, but there's a broader range of premium applications that we can service. And by introducing new products, which we're introducing now, we believe we can increase our addressable market by a couple billion dollars. And on the power transmission side, what we've really targeted is alternative technologies. So we make part transmission belts, right? And you can use more than a belt to transmit mechanical power between two devices, you can use cables, you can use industrial chain.

And we think particularly industrial chain is an opportunity where in many of the applications you would use industrial chain, actually a belt is a better application. It's cleaner, weighs less, more energy efficient, and more environmentally safe. So we have a specific initiative that we call chain to belt, which is to use our material science, our material science capabilities, which allows us to build belts with unique capabilities that we believe for many applications can compete with industrial chain. And probably the best example that everyone gets is a bike chain. I mean a bike chain is a very small industrial chain that has bushings and bearings. It has all the dynamics of a typical chain. It rusts, it gets derailed, it needs to be maintained. And that's an application that we've replaced with a belt and are targeting a number of personal mobility applications, particularly electric applications where there typically tend to be high torque applications.

So eBikes, eScooters in emerging markets, those are very good applications for a Gates belt. And in many of those cases we use one of our more sophisticated belts, something that's not reinforced with metal or with a textile, but rather, reinforced with carbon fiber, which is something many people do. But I think we're known for doing it the most and probably the best.

Jamie: Okay. I guess, just a another question as we think about your strategy longer term. Some of the peers that you talked about, in particular Parker Hannifin, maybe even Eaton to a lesser degree, but they've sort of shifted their strategy over the past couple years focusing more on end markets which are viewed as more stable, or product lines which are more highly engineered. Shifting I guess less on the traditional sort of mobile equipment type market. So I'm just trying to understand how you think about your strategy in that context. I mean, understanding you have more of an aftermarket recurring earning stream versus first fit versus yours. But I'm wondering if you think about markets or products differently to reduce the overall cyclicality? Or does their lack of focus in those markets present a greater opportunity for you in terms of market share growth?

Dave N.: Sure. So obviously, I can't speak to their businesses-

Jamie: Right, you can speak to-

Dave N.: But I'll speak to ours. We are happy to be the specialists in what we do. We think we are the premium provider of fluid power products and power transmission products globally. And the end markets that we address provides opportunity for diversification. So we sell a lot into mobile hydraulics, because frankly that's a lot, or to mobile equipment, because that's a lot of where premium hydraulics go today. But a number of our initiatives are targeted towards stationary applications. And on the power transmission side on more MRO and end markets such as material handling, where precision movement and a synchronized belt, small synchronized belts are very good for positioning products. And stationary hydraulics in manufacturing applications as well, machine builders, lift applications, those sorts of things. So we're happy to be the specialist, but we're very focused on continuing to diversify the end markets that we address.

Jamie: Okay. Any questions in the audience? No. Okay, I'll keep going. What was I going to say? I guess, another thing, just again getting back to when you guys first went public in some of your longer term targets, let's take 2020 out of this because we all know it's going to be a difficult year. But I think when you guys first came public you talked about, I think, longer term, 5% organic top line growth, or that you could grow 150 to 200 basis points above industrial production or demand. I think you also talked about longer term targeting, 10% EBITDA growth. I'm just wondering if based on what you see, if those are still the correct longer term targets for Gates?

Dave N.: Yeah, fair question. That is our longterm target, we haven't updated that. And the one thing I would say, Jamie, is that our longterm target didn't contemplate what we ended up experiencing in 2019. I mean, being in mostly virtually all short cycle business with no backlog, and really we don't get much of a forecast either. We tend to fulfill many orders within 48 hours of receiving it. You know, again, 65% of our revenues are through aftermarket and the order comes or the order doesn't come. And so we've been dramatically impacted kind of on the front end of the recession. I think we led into the recession. I think history would say we tend to be a little faster out on the backside as well.

But I would say, we came in thinking the year would be up mid single digits, and we're coming out of a 2018 environment where, frankly, we were struggling to keep all of our customers happy, particularly on the fluid power side and hydraulics where it was kind of globally a constrained environment. Particularly at the most premium end of applications into a year where we saw obviously significant de-stocking and reduction of end user demand.

So when we talked about in February of 2019, when we came out with our first investor day following our IPO the year prior, we introduced our longterm targets but we hadn't contemplated this year. And the midpoint of our guidance for the year is negative 6% core growth, which would be the second largest decline in the history of the business. We don't think there's market share loss, we think it's just a function of where we play in the industrial downturn. And it's been compounded by some of the known automotive first fit issues that we see in China, that we've also seen from the emission standards uncertainty in Europe. We're starting to round trip those downturns and we think, you know, we haven't taken a position on when this industrial downturn will roundtrip. Historically these things have been kind of five to eight quarters in nature. Looking back at our business, I think this is different times given some of the extraneous concerns around trade and other matters.

So we are taking it month by month and trying to determine what will happen as we get into 2020. But long way of saying, yeah we didn't anticipate this kind of year-

Jamie: A longer term. Like let's take that 2020 outside, you know? Off the table in 2019. Longer term, is that still the right way, or will we at some point rethink those? Because again, they're longer term targets and they don't assume.

Dave N.: I think it is. And you've properly framed it. We've kind of stated our view of our model as global industrial production, plus a few points. That's how we've historically said it.

And we think that holds true. We think that the initiatives we have around emerging market growth, around expanding our addressable market and the new products we're bringing to market, position us to compete well in the places that we play, and outperform industrial production.

Jamie: Any questions in the audience? Yes. Andre, just wait for the mic.

Andre: Thank you. It's Andre from Credit Suisse. I just wanted to pick up on your point on de-stocking an inventory cycle. What are you seeing on that kind of from that month to month cadence? Have we gone to the maximum point of de-stock? Has there had been any kind of restock or end of de-stocking?

Dave N.: So as a-

Jamie: And, sorry. Besides auto, which it sounds like you feel like you're closer to the end. Are things getting better? Like, are there other markets that are, I guess, getting worse or better?

Dave N.: So separate automotive aftermarket, which we think is a far different dynamic than really the big issue going on, which is industrial distribution. And we saw further deceleration in the end market activity and further de-stocking through the third quarter. I think you asked the right question, which is, how far can it go? And the answer is, we're not sure. I will tell you, I personally been a little surprised by the level of de-stocking we've seen. And I think there is some prior precedent to say we're going to see things snap back a little bit too hard.

And that's probably our biggest worry, that too much inventory comes out of the channel, and then we have to put inefficient stress on our production environment to help our customers satisfy the demand when it does come back. So we're trying to work with those folks. But specifically to your question, we did see continued de-stocking. It varies by region. But particularly in North America we saw continued de-stocking in the third quarter. That's kind of as far as we've gone relative to our public statements. And when will it end, or is it at a rational point? I would only say that I've been surprised by the level of de-stocking.

Andre: And if I may. Is that general kind of industrial distribution, the guys who stock everything that have been de-stocking? Or is there a particular kind of verticals that you can identify within that?

Dave N.: I'm speaking of general, general industrial distribution. But I think we've seen it there and in some specialty applications like oil and gas, but for the most part where it's most notable is in kind of general industrial distribution.

Andre: Thank you. And last, just on pricing trends. How do you see that developing? Does pricing tend to be generally pro cyclical for you, or do you think even in 202 when maybe demand is kind of down H1, flat up H2, what do you think price can do in that kind of environment?

Dave N.: We'll see what happens with the pricing of raw material inputs, but historically we've done a very good job of we've... I believe we've probably led the market up in pricing. And with 65% of our revenues into independent distribution, we were well positioned to price, that combined with our strong brand, particularly in developed markets but in emerging markets as well is positioned as well to price. In 2019 we'll be priced cost favorable for the full year, but we are round tripping a lot of the price that we took over the course of 2018, so that begins to anniversary.

When we think about 2020, we tend to go into a year of thinking about it being kind of price cost neutral. And we'll see how it develops. I don't think it'll be nearly as robust of a pricing environment as we saw in 2018, or even the second half of 2017. But we'll see how the year develops. And we've demonstrated historically that we'll respond pretty proactively to the market environments.

Jamie: Go ahead. Okay, hold on, just wait for the mic there. Because I think [inaudible 00:13:36] broadcast.

Speaker 4: Thanks. In that same sort of longterm context of mid single digit revenue growth, how do you think about optimal capital structure for net debt to EBITDA? What do you think normalized levels of trade working capital are, and normalized CapEx to sales for the business? Thanks.

Dave N.: Sure. So maybe I'll take those in reverse order. So from a CapEx perspective, the business has historically run kind of 3% of sales plus or minus. With that being kind of half maintenance, CapEx and half growth CapEx. And we have elevated the level of CapEx spend through 2017 and 2018 as we've built additional fluid power capacity primarily at our large manufacturing campuses and emerging markets, namely Mexico and Poland. We have always said that we would normalize that back towards historical rates, and I think you see us coming back there this year. And we would anticipate in the next few years being still around that 3%, plus or minus.

From a working capital perspective, the business has been operated recently at a reasonably inflated working capital level that we would anticipate coming back into kind of normal bounds. We tend to run at a higher working capital level anyway, given the nature of some of our customer base, plus the finished goods inventory that we need to carry to satisfy the service level agreements that we have with our customers. That tends to run as a percent of sales around mid 20s, it's kind of been running closer to the higher 20s recently. And we would anticipate working back towards the mid 20s over the next few years.

And then from a leverage perspective, our stated objective is to de-lever to three times. We had entered the year thinking that exiting 2019 we would be close to that. Given that we didn't come close to our EBITDA objectives we'll exit the year at a higher leverage ratio than that. Look, we started as an LBO five years ago at a significantly higher leverage level, and post IPO proceeds we were below four times. And currently at the end of the third quarter on an LTM basis we were below four times as well. So our trip to three times has been slowed, but we still see that as kind of an intermediate term objective depending on if and when or what we do from acquisition standpoint. We've

done a few deals in the past, we're always looking at deals. And from a capital allocation perspective, we always say we will do what's in the longterm best interest of the business, which may include doing a deal which would impact the timing of de-leveraging. But we'll do what's in the longterm best interest while also being mindful of leverage.

Jamie: I guess I'll go. So a lot of industrial companies in the third quarter, or maybe even before the second quarter, have talked about streamlining their cost structure. So can you talk about some of the actions that you've already taken and whether you're contemplating incremental actions, and how we think about the cost cutting actions that are more variable versus structural, I guess is what I would say, and how that impacts your cost structure longer term.

Dave N.: So as we think about, maybe just stopping at gross margin for a minute. Is we think about our manufacturing capabilities, the challenge this year has been first getting our variable cost structure right. And as we said on our third quarter release we think we've exited the third quarter more or less right size to the near term volume environment. You know, beginning in the middle of the second quarter, really kind of mid May, we saw pretty good deceleration of our end markets, saw a lot of inventory coming out of the channel in a real step function down. We think because of our high level of aftermarket, because of our lack of backlog being mostly, if not all, short cycle, we tended to see these impacts a little earlier than others. And as a result we've been trying to get our variable cost right sized, and it really all of May and through the end of September to get that right. That doesn't address our fixed cost structure.

And that's something that we were already looking to do beginning now where we've done a few smaller things and introduced or announced our first plant closure. But we've actually are accelerating some of the things we had in mind. Not to necessarily take manufacturing capacity offline, but to take advantage of some of the new, more efficient production capacity that we've built. And also to take advantage of some of the productivity we've driven into our existing footprint, which should allow us to consolidate some sub-scale sites. So we have announced a program that'll more impact 2020 and 2021 which includes addressing a number of larger sites.

But look, we have 50 plants globally, and we're probably looking at four or five, the consolidation of four or five of those sites. And I would also say that we still have some opportunity below the gross margin line. You know, the business hasn't benefited from things like shared service centers and some other efficiencies that we will continue to build over the next few years that allow us to drive more money out of kind of traditional G&A spend, and invest those dollars into R&D or feet on the street, things that'll drive growth for the business.

Jamie: I guess just a longer term industry. I've covered this space for way too long, almost 20 years now. And I remember when, I don't need mean to bring Parker Hannifin up again, but I remember when Don Washkewicz would put up this slide of the motion control industry and how big it was and how fragmented it was. And that there should be... Which you play in a part of that, right?

Dave N.: Right.

Jamie: But that there should be broader consolidation, you know what I mean? Throughout the market. Which never really seems to materialize to some degree in the markets that you participate in. So can you talk to whether you think there's benefits to broader consolidation within your market, and why or why it hasn't happened? Or do you think that's perhaps an inopportunity in the downturn for the broader industry?

Dave N.: I can say that these are incredibly large, incredibly fragmented markets. And why there hasn't been more consolidation, I can't really speak to. But I do think there's opportunity for some players. I mean, we all have targeted, you know, specifically addressable markets in what is a very large Tam. And I think there is opportunity for bolt-on and even transformational type things for a number of businesses out there. Beyond that, I don't know. But I think these are markets that, given the fragmentation, are right for some level of consolidation. But given the geographical disparity and given the number of local players, it's tough to see.I wouldn't imagine there's going to be consolidation on a grand scale, but I think there's room for consolidation personally. How that develops, I don't know.

Jamie: Okay. Any questions in the audience? Okay, I'll keep going. So I guess, you know, I think what's implied in your guidance for the fourth quarter, I think similar to other industrial companies the fourth quarter margins are implied worse versus the third quarter is everyone's looking to right size, cut production, get inventory adjusted. So is that the right way to think? I'm just trying to... How do we think about the fourth quarter, recognizing you haven't guided yet for 2020?

Dave N.: Sure.

Jamie: But in that context, how should we think about the different variables besides volume, positives and negatives that would... You know what I mean? Impact your margin and we shouldn't use fourth quarter I guess as the run rate into 2020, is that the right way to think about it?

Dave N.: I think that's the right way to think about it. You know it's a little complicated, and we start analyzing the quarters in detail and looking at there's things in the comp year over year, and we really tried to give some insights to this on our third quarter call. Ultimately you back away from the noise, and I'll talk about the noise in a minute. But when you back away, I think the fourth quarter we're operating at a run rate that represents us being reasonably right-sized. The least efficient quarter for the year that we will have had is the third quarter, where we were kind of still seeing a significant amount of deceleration. We were in the process of getting our variable cost structure right. Those inefficiencies get capitalized in inventory and really kind of roll out in the fourth, so those from a P&L standpoint impact the fourth.

We try to strip away the timing and look at our absolute performance, and we think we've got things about right sized in the forth. You start looking at incrementals, or decrementals, rather, on a year over year basis. You know, the fourth quarter of '18 we

actually had incredible incrementals, and it was based on just the timing of some onetime things that from a decremental standpoint come back and hurt us this year. But again, when you strip away some of that timing stuff or onetime stuff, I think at the end of the day we're performing at a pretty good jumping off point level heading into the year. I think we'll exit the year plus or minus with inventories in pretty good shape. Our variable cost structure in pretty good shape, and some pretty good plans around reducing our fixed cost footprint.

Jamie: Okay. I guess I'll keep, but not to bring Parker Hannifin up again. Sorry. But they guided for 2020, so it's a good way to get you to talk about things. I think when they guided, you know in their June fiscal year end, but people were surprised by the organic growth guide of down 6% relative to what potentially other multi industries will talk about in terms of how they're thinking about organic growth. And I guess why it matters for your business if you think they're right. I think their North American guide was down 6%, aerospace was up four, 4.5. But international industrial, I think with the implied guide, was down like 11.5%. So how do you think about that in the context of what they're saying about industrial organic sales declines in 2020?

Dave N.: Obviously I can't comment on their [crosstalk 00:24:03] business. And I'll tell you, look, 2020's a developing situation. I can't speak for how others are thinking about it, but we're very much taking it month by month, and we're going to get into our Q4 release and get a few more months of data to see what we think it means. I think, again, not being a backlog business and probably leading our way into the downturn, our timing might be different than others out there. But these things tend to be kind of probably more or less, again, five to eight quarter type industrial recessions. And how far in is debatable, but I think there's a reasonable case for being four quarters into the current industrial downturn.

How long it'll last, I think, as I said earlier, I think there's some uncertainty too given some of the extraneous events and being in an election year and some of the other things that could impact the timing of the downturn. And I think it's a dynamic environment with enough uncertainty that it's very difficult to make the call right now, so we're watching it day by day. I guess that's the best I can say.

Jamie: Okay. Any other questions that are out there? All right, I guess... Let's see, what do we have?

I guess on the...

Speaker 5: [inaudible 00:25:29] David, on that point.

Jamie: Yeah, I think we need the mic.

Speaker 5: David, you mentioned the five day quarters, industrial pause, whatnot, dynamic environment and election year. Can you just give us an insight into your boardroom? Is is that backdrop killing you from doing something that's a little bit more forward leaning as you go into 2020?

Dave N.: Yeah, great question. The answer is, no. And I think one of the things we have really prioritized is continuing to invest in the business and prioritize the strategic spend. And to the extent we've drawn back investment dollars, not doing it in the areas where it might hamper some of our, what we think are large strategic opportunities. We believe the business is poised to exit this downturn stronger than any other downturn we've seen, from the new product pipeline, the work we've done on VAVE as well as manufacturing processes, and the manufacturing capacity and capability of the business. We think the business is in as good a shape as it's been. Unfortunately, some of these things we've been hampered by the industrial end markets where we've targeted a lot of our growth initiatives, but we're continuing to position ourselves from when the markets do come back. We think we'll be in a position to compete well, and we've continued to prioritize that spend both from an OPEX perspective, but also from a capital perspective.

Thanks. That's a good question.

Speaker 6: Hi. So I'm not looking for any insights into what Blackstone is currently thinking today about their ownership stake in you, but I was wondering if you could provide a bit of historical context and color about high level. What were some of the business characteristics that drew them to take a position in your company, whenever that started? And what was it that they liked about just the bone structure of what you do on a day-to-day basis?

Dave N.: Sure. Obviously I don't speak for Blackstone, but I can-

Speaker 6: In your opinion.

Dave N.: ... hypothesize for my opinion. You know, Gates is a great American company. It's been around since 1911, end users know the brand, it's synonymous with quality. It's a global brand. We're continually surprised as we go around the world, even in emerging markets where you wouldn't expect people to know the brand as well as they do. We're continually surprised by the brand affinity that Gates has with end users. Gates went from family ownership for up through I think 1996 it was owned by a British conglomerate for awhile. That conglomerate went through around a private equity ownership, which I might characterize, I wasn't here, but I might characterize it as maybe kind of more of a financial engineering type of ownership.

And Gates was isolated, and I think it was considered generally the crown jewel of that process. And I think what I believe there was a good operating play to be had. And given the dynamics of Gates with the global brand recognition, the good profitability, the strong cash flow generation and the large diversified end markets with high after market exposure, were all very, very, very attractive I would suspect. And that with the opportunity to maybe add a team of industrial operators led by our CEO, Evo Yurik, and a lot of the team that he's been able to put together. I think most people would look at it and say that's probably a pretty good opportunity.

Jamie: I guess and just last, if no one else has another question. I mean, is there anything else as you sit here and you've been the CFO of Gates that you think the market, and you look at the multiple of your stock what market under appreciates about Gates as we get through this short... I'm an optimistic always, so I'll assume a short term downturn, but a shorter downturn versus normal.

Dave N.: Well I think the point I made earlier-

Jamie: Or pushback you get from investors that we might under appreciate.

Dave N.: I think the thing that's under appreciated is, I think everybody sees the downturn. Which I think obviously we need to focus on things that are within our control. And as I talk about having the business well positioned exiting the downturn, I think those are the things we're focused on. Aside from just the industrial downturn there's other compounding events, like I talked about a few of the automotive end markets. Automotive first fit isn't a big part of our business, it's about 15% in total, and it's very important to the aftermarket franchise. And so in China and in Europe, that's kind of compounded the top line impact we've seen recently. But when you strip it away, I think we're performing very well competitively in the markets that we serve.

And again, we're positioned well to exit the downturn. So I think we continue to focus on those things that are within our control, and we continue to invest in those areas that are important to the business. And for everything you read in the news, we're still very bullish on China. And we've talked recently about starting to see more of a bottom in China. We have an automotive aftermarket business in China that is growing at kind of mid teens level, in what's a developing after market environment, and will be the largest aged car park in the world in five or something years. And we believe we have a leadership position there, so we're continuing to focus on important initiatives like that. And when the markets turned, and the markets will turn, we think we're well positioned.

Jamie: Sorry, go ahead Andre. Just wait for the mic.

Andre: [inaudible 00:31:42].

Jamie: What? No, you can. Go ahead.

Andre: Thank you. I just want to come back to more big picture stuff. And maybe at risk of opening a big can of worms. When we think about the industrials and the big things that are going on is things like electrification of everything. So all the motion is becoming electric rather than combustion or hydraulic. Then digital, everything's getting connected. You don't have to run it better, hence you use less parts. And then everything is a service. So across these three things can kind of see a few risks for Gates here, but probably there are also opportunities. Just wanted to take your view on how we can run through this and kind of weigh the map, and what are you doing as a company to position yourself in that context?

Dave N.: Yeah, it's a good question. So I think as propulsion technologies change over time, I think it results in different opportunities. So the classic example is automobiles. Automobiles today use a lot of mechanical power, transmission products. Electric vehicles in the future will use more fluid power, heating and cooling, batteries need to be heated, batteries need to be cooled. Electric water pumps on an electric car. I talked a little bit about personal mobility and how high torque electric applications like eBikes and eScooters are very well suited for the belt products and technology that we have.

Verticalization of people moving to cities and lift applications, and distribution of products and precision movement and warehousing and distribution. So I think the opportunities change, but I think we see plenty of opportunities given the major trends that we see towards urbanization, mechanization and even if you... I know Deere was in here earlier, but there's a lot of farm equipment that's going AI. And look, there's going to be a lot of belt-driven applications on those machines as well.

So it's incumbent upon us to stay ahead of the times. But given the investment and the advancements we're making on the R&D side, we think we're well positioned to be on the forefront of these things. In the near term, if you went back to last summer, maybe about a year ago, we had an announcement of a bunch of new products. And you see as targeting things like hybrid applications and automotive, those are complex applications, start/stop applications. Those are belt-driven applications that are more complex than historical application. So we see more content for Gates on a hybrid car than we do a traditional ICE engine. And there's industrial examples of that as well. So I think the opportunities change, to your point, but I think there'll be plenty of opportunities.

Andre: Thank you.

Jamie: Great.

Dave N.: Your welcome.

Jamie: And with that we're probably all set unless someone has a last or final question. No? Great. Thank you very much.

Dave N.: Thank you. I appreciate your guys' time.