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Gates Industrial Corp. Plc (GTES)

Citi Global Industrials Conference

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MANAGEMENT DISCUSSION SECTION

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

We'll start filing in still. But we're really excited to have Gates with us today. I think Ivo obviously is probably about a year almost since you went public, we're getting up to that anniversary here. So Ivo Jurek joined the Gates Corporation in May 2015. He spent the entire career in the industrial area both U.S. and internationally. David Naemura has served as CFO since March of 2015. Prior to Gates, Dave was at Danaher which I know none of you guys have ever heard of Skin Danaher if you're listening. So anyway we're really happy to have you guys here today.

QUESTION AND ANSWER SECTION

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

I'll just start off with kind of a softball for you guys. You get 3.5% growth in the quarter in Q4 which was a little slower than it's been, still pretty good obviously. But you know we know you have a pretty strong industrial business, very solid auto replacement business. So just kind of go over some of the trends that you saw, like a kind of update and then maybe has anything changed here? I mean you just reported. So I'm sure not much has changed, but any sort of update that you'd give on the markets.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. So we like the softball. So I'm not going to be...

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

They're not obviously softballs either.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

I'm going to be using the baseball analogy in here. But so look 3.5% core growth in Q4, very strong industrial performance still, high-single digits growth in Q4 but impacted by our first-fit presence in automotive markets particularly in Europe and in China. And it was kind of a tale of two stories there if you would. One is that in

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Europe we have anticipated some declines in our performance because we simply haven't – we've decided that we will not renew some of these programs that we were on historically, and as we said during the IPO, we really don't feel that we need to be a large market, full market participant in automotive first-fit business in the industrial world to continue to drive actually our presence for it in the automotive replacement market. And so we have consciously decided to take fewer programs in Europe.

But we were impacted by about 50% greater decline, primarily driven by that change of the emission laws in Europe and so that impact was little bigger than what we'd anticipated in Q4 and it was frankly a little bit longer lasting than I think all of us anticipated. And then you know in Q3, you know when I go back to that earnings call that we had at that time, we said hey, look, China we've had some really heavy numbers in China in automotive first-fit and so we thought that we're going to see some comparative declines to growth rates, but China came in a little bit worse than what we've anticipated and frankly it was a little bit broader than just the automotive first-fit business in China.

I think we have seen some declines in sales, particularly to export oriented machine builders and so that came in a little bit worse, but all-in it was a pretty solid performance taking into an account the level of exposure that we've had in the other first-fit business in those two buckets.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

So you guiding 3% to 5% growth for the year for 2019. I think the question I get is how much contingency have you factored in to your guide for Europe continuing to sort of be, especially in the auto first-fit market, weak for at least first half of the year. The issues you mentioned in China whether it's first-fit auto or whether it's the exporters. How much cushion do you have if those businesses get worse while all the other businesses are okay?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. So Andy, let me start maybe with answering that question a little bit differently and then I'll try to come back to your specific set of questions. But look when we think about how Gates should perform, Gates has a very high degree of correlation to global industrial production. And so when we were thinking about our guidance, we said, hey look, we don't anticipate that the markets are going to be as good as they were in 2018 and they're still reasonably good. But we didn't think that they're going to be as good as in 2018. So we started with the assumption that those markets are going to be a little bit weaker. But when you come back to Gates, so we say, hey look Gates kind of performs global industrial production plus 2% to 3% incrementally of growth driven by some of the large initiatives that we have for the company.

So now coming back to your specific question about 2019, so we said, hey, look global industrial production is going to be probably down slightly from 2018. So we were pretty pragmatic about where we felt the markets are going to be and how much help we're going to get from the markets. We assumed that we're going to have some help from pricing. I mean, we've had very strong performance in price material economics in 2018 and so we have number of carry-through of pricing initiatives going into 2019 and we have installed new capacity globally in fluid power.

We have launched a whole bunch of new products, highly innovative, highly differentiated. It's just the beginning of what we're going to continue to do through 2019 and beyond. So, we feel reasonably positive that we have a good opportunity to deliver that midpoint of our guidance taking into an account what's going to happen in the markets. And by the way, we have counted on the auto first-fit business to be kind of down for the year not really

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forecasting any significant recovering. And of course, back half of the year is going to get a little easier from the comps.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

So, this is the thing that I don't think some investors get is that I just want to clarify what you just said. It seems like what you're saying is that market outgrowth, call it 2% to 3%, plus pricing call it 1% to 2% is basically your whole forecast of you know – and again you're assuming basically flat or no global industrial production growth, you think you can do 3% to 5% in that environment. Is that fair?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc
A

It's fair. Look, and again I think that the markets are opaque right. So it's hard to predict what's going to happen tomorrow obviously but we feel we feel reasonably constructive that we can outgrow the market to the degree that we have forecasted.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

And then maybe you can talk about this outgrowth a little more, right. So when you and I first met, you talked about you wanting to make it more material science when you came in and it does seem like this new product revolution has continued to increase. So maybe the first question is, is 2019 a bigger new product year than 2018 and is 2020 still a bigger product year than 2019, you get that question. And then the other side of the question is around capacity, right. You've basically added China, Mexico, Poland now. By the second half of this year, basically you're all up and running in these places and how much extra growth do you get just from the capacity additions, assuming you feel them at least somewhat.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc
A

So lots of questions in there.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Yes. Well we have lots of time, so.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc
A

Hopefully, I can hit them all, but starting with the capacity first. So in terms of capacity as you said we have three new plants that came online and you know I'll brag a little bit in here for a second, right. You know industrial companies, generally speaking, have a difficulty ramping up one new capacity project at a time. We have done three in second half of last year in three different geographies and we have done that really well. And so when you think about the capacity additions more specifically, we have fully capacitized our existing plant in China and so that plant is up and running from about August of last year.

We have added capacity in our campus in Mexico. That capacity has started to ramp up in Q4 and should be in a very nice run rate trajectory in Q1. And our Polish plant started commercial shipments in Q4 and our expectation is that as we progress through 2019, we're going to be at a steady state run rate from that capacity addition.

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What we have done is with the exception of China we have capacitized only about half of those two new facilities. So we have more runway to further increase capacity if we see fit to do that. And if you think about how much capacity we added, we've kind of added, if we sold it all out and you know although it would be a nice problem to have, we hope that we don't sell it out in the first year or two years, we've added about $150 million to $200 million of incremental revenue that capacity. So that's kind of on that last question first.

You know coming back to that innovation cycle, look when we came to Gates, Dave and I in 2015, we had the opportunity to walk straight into an industrial recession that it seems like we all kind of forget about. And so when we started to manage this business, started to get our arms around it and we're experiencing this recession, we said hey look, we need to do something differently to be able to get this business back on the trajectory and the model that we have had. And so we started with driving productivity improvements across our factories. And we say, hey, we start with productivity improvements. Then we're going to be focus on VAVE, and then the third piece or third leg of that story would be the innovation.

And so, it kind of played out the way that we've anticipated. The VAVE jumpstarted our innovation and that's when we start saying, hey look we got lots of opportunity on material science side. We got lots of opportunity frankly on dramatically changing the industrial processes that are used to build these products and that will not only help us to build better products, but also it's going to help us to create the next layer of competitive mode around the products that we manufacture for our customers.

And then the third leg was using lever on material science and developing kind of the physics based technologies and those started to launch in middle of our second half of 2018. And frankly, our anticipation is that over the next three to five years we'll completely turn our portfolio through innovation around and start mixing the portfolio towards a better mix of profitability as well as so much more highly competitive that will allow us to enter new markets particularly on the fluid power side. And we've represented that those are multibillion dollar opportunities that we have through the innovation that we anticipate to launch and that we have started to launch in late 2018.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

So Ivo, when I hear you know that Mexico and Poland are half utilized, I want to think about margin dilution. But then I look at your Q4 and you add 50% incrementals in fluid power with a bunch of startup costs. So maybe this is how to get Dave involved. Like you know, talk about the margin potential first of all why did you – your guidance was pretty conservative for Q4 around margin. I thought you did a really good job versus it you know in what was supposed to be your higher cost quarter. So how did you sort of persevere through that?

And then as you go into 2019 here, if your two bigger factors are sitting half utilized, is it that there're just so much more efficient and so you know you had mentioned sort of shutting down a Turkish facility, like is that part of this that even though you've got incremental capacity you just have much more efficient production when it comes down to it.

David Naemura
Chief Financial Officer, Gates Industrial Corp. Plc

A

So Andy for Q4, this tends to run in kind of the 30%-ish to low-30s incrementals on a core basis. What you saw on a core basis in Q4 was 50%. So if you kind of did the math, we would have anticipated kind of more high-30%s in the environment we've been running because we've been reasonably priced cost favorable and that's been kind of mixing up the incrementals. So if you will that there's 15 points of difference in there, it's $4 million, $5 million. And that is really driven by just frankly a few things going better than we thought at year-end. So it's a little bit the

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law of small numbers, but I think what we saw was some of those costs that we continue to field around start up and another kind of footprint optimizations, all of the product optimization moves we're making and frankly some continued inefficiencies running at full capacity that were offset by some other things that kind of went our way or weren't as worse – weren't as bad as we would have thought.

As we look into the year, we will get some improvement from relief against some of those costs we've been incurring over the course of particularly the second half of this year, and that'll help next year. But the plans – what we do is, we build the building, right. We don't fit out the whole building with equipment. We're very judicious about being at 40% or 50% of that and it gives us room to expand as we go. So I think we'll still continue to incur some startup costs through the first half of the year. There's equipment still hitting the ground. We're not fully absorbing all of the overhead that we put in place, but we're talking – yeah, Ivo talked about this new capacity being $200 million of revenue. So we're talking now 8% of total revenue of which a portion of which we're under-absorbing. There's plenty of other factors around VAVE projects coming online as well as other efficiencies around footprint and other things we continue to drive this should offset that.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

And Dave you reminded me. You did have a bunch of, call it, I won't say transportation costs, but costs in terms of being at full capacity in fluid power...

David Naemura
Chief Financial Officer, Gates Industrial Corp. Plc
A

Yeah.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

...or over full capacity in power. So those costs, are they more than the incremental savings or incremental headwind that you have from underutilization, you see what I'm saying? So, like If I look at the first half of the year, it seems like your incremental should actually be a little better because you are lapping the bad stuff from the fully utilized even though you've got a little bit of underutilization in your new factories. I think that makes sense maybe...

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc
A

I think so. The compare against those costs of running a full utilization...

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Yeah. That's what I mean.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc
A

...will be favorable in the second half of the year to some degree. In the first half of this year, we'll continue to have some startup costs that frankly are a little more in 2019 than they would have been in the first half of 2018 and then I think we get a little bit of a favorable compare in the back half of the year until the next thing happens, so...

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Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Got. And you did allude to pricing right – and favorable pricing. So again, I mean Gates is known as a premium brand in most of what you do, right. So maybe you can talk a little bit more about your ability to sort of stay ahead of the game. I think you guys were kind of early in the sort of raising prices and price cost conundrum that we all saw. So if we don't go to a 25% tariffs does price cost become more of a tailwind as you go out over the next few quarters?

David Naemura
Chief Financial Officer, Gates Industrial Corp. Plc

A

I don't think more of a tailwind. It was a good tailwind for us in 2018. We saw raw material inflation and we were able to price for it. We were price-cost favorable. We think that normalizes a little bit as we head into 2019. We'll still have some price. We'll have some amount of raw material inflation, but in our business, we think about our business as we're going to incur raw material inflation charge up the price for it. Combination of our brand and our aftermarket presence positions as well to do that, that's kind of how we think of pricing. I think we're successful in 2018 and in a very fair way probably you know probably accomplished, had good accomplishment on the pricing side, price-cost side.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

And then because we're all analysts, we want to know what's next before it happens. Maybe you can talk about the March Analyst Day just in the sense and that like you've talked about this, taking out this higher cost Turkey facility and you mentioned sort of the one, the two footprint rationalizations that you could do per year. Is that a topic that will come up more of this Analyst Day or is it just sort of this is what we can do with our existing footprint? Like, how much should we think about cost out as another leg for you guys over the next couple of years?

David Naemura
Chief Financial Officer, Gates Industrial Corp. Plc

A

Well, we didn't anticipate kind of rolling out the broader vision, if you will at the Analyst Day in a week. I think in a quarter or so you'll see us come back with a broader plan. But I guess the one highlight I'd make is that in early days, we got a lot of feedback that said this company has been through for private ownership, all the cost is torn out and it's just not the case. I mean there's a lot of rooftop consolidation opportunities and things that people may have assumed has happened, but has not yet happened.

We've been really focused to-date on driving productivity into the footprint that we have and now as we move out of that stage, we'll be looking to more optimize that existing footprint based on not just the new capacity we've brought online, but also the productivity we've added to our existing capacity which provides us some opportunity to not take capacity offline, but rather to deliver similar capacity within a smaller footprint. So you know more to come. I think party is in the venue for us to announce new actions, but we think there's a good runway of opportunities to continue to optimize over the next few years.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And one more from me before I open up to audience. So in China, again it's a mixed market for you guys right because you've got order replacement, it's pretty strong. Industrial replacement actually has been pretty

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strong and that offset some of the just industrial OE business and the auto first-fit business. So how should we think about that balancing act in the current environment looking at this year and maybe next year? Are the businesses big enough in auto and industrial replacement to offset if the OE businesses continue to sort of slow down a little bit.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Look, I think that you know our auto first-fit business in China is the largest component of our business today. But the way that we think about China, first and foremost, China is the largest industrial economy in the world. It's not the largest economy, but largest industrial economy in the world. And so, we feel that we have a tremendous amount of opportunity to expand our presence in the industrial space. We see a terrific set of positive dynamics in the automotive replacement business. That business is growing 2x to 3x the rate of any other business that we have in China. And so, whether or not we're going to see more bumps short-term from a quarter-to-quarter, we do believe that the long-term trajectory for our business in China is very strong. And frankly, we anticipate that we're going to deliver positive core growth in China in 2019.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Any questions from the audience?

Q

Hey, guys.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Hi.

Q

Ivo, back to your comments on industrial and the strength you saw – I think you called out ag, construction and general industrial as all being strong. But could you disaggregate those a little bit for us, maybe where are you seeing the most strength, is it – or is it just pretty equal across those buckets and what do you – what gives you kind of confidence in the sustainability of those particular markets?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. So, I think on the call, we said that we have seen reasonably good amount of strength frankly globally. It was better in North America than maybe elsewhere. But in general, the industrial growth was reasonably good globally across the applications that we service.

Q

Any commentary on those kind of different end markets?

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Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

My sense – I don't want to put myself out there on the record. But my sense is that 2018 was a really good year in these markets, right. And generally speaking, it feels like our end customers and end users feel still reasonably positive. I think everybody is forecasting that they see a reasonably good demand for their products. My sense is that you're going to start seeing a normalization of the run rates of growth. But I don't anticipate that you're going to see a negative core growth or negative growth in the end user machine equipment build-out rates.

Q

Thank you.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

And just to follow up on that, within – specifically within the Fluid Power business, the largest player in that market put up flat to down orders in their second, so the calendar fourth quarter. So, I'm just curious what – is there a mix differential as you think about how your portfolio lines up versus Parker's and then just – or maybe they're too conservative in their outlook. So, maybe just kind of contrast your kind of geographic or product footprint and how it may differ.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. So, look, I'm not necessarily going to compare myself to – or Gates to Parker. What I try to remind folks is that Parker is a really large company that's got a very significant number of different product lines, maybe hundreds of product lines. Gates got two product lines, and so I think that we are a little more nimble, a little more focused on the end applications and markets and customers.

We also have about 70% of our Fluid Power revenue that comes from the aftermarkets, and I think that that's a little richer aftermarket mix component versus some of the other competitors like Parker and some of the other guys. And so, I think that that bodes better for us. We have an ability to drive revenue and maybe take a little more market share more effectively, I would say. And then, I would say that we also are very, very focused on innovation, and I think that the new innovative products that are coming to the marketplace are going to continue to differentiate us from some of the larger, more general participants in the market, if that makes sense.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Ivo, I wanted to sort of dig in a little bit on the global auto aftermarket business, because it's so important for you guys. And the resiliency in places like China has been very strong. So, we understand the penetration business there that you have. But maybe give us a little more color on why it's been so strong for you guys, who you're taking share from and sort of what is the longevity of the growth that you see.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

So, that's a really interesting dynamic. And look, China, what we call the sweet spot of our applications is kind of that 7 to 12-year old car fleet. The China 7 to 12-year old car fleet has been growing very dramatically over the last many years, right. It's been a unprecedented registration growth in China of new vehicles and that's filtering

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through. So, by kind of 2020, that car fleet is going to become the largest car fleet in the world. So, that's really the good news, right. Where we have spent quite a bit of time, money and resources over the last four, five years is on building out our product portfolio coverage.

So, today, we have what we represent as the leading portfolio coverage of the Chinese car parc. We have about 90%-plus of portfolio coverage for the entire car fleet that's present in the Chinese marketplace today. Where it becomes interesting is that China unlike United States or Europe does not have a very well-developed channel. And so, not only have we been developing the product portfolio coverage over the last five years or so, we have also been spending quite a bit of time and money on developing our channel presence, and frankly, our presence within the various markets that China offers. That investment has translated into frankly high double-digit growth rates that we expect that we will see for a pretty reasonable amount of time because of the dynamics of that age car parc.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

So, we know about your share in the U.S. auto replacement market, but why haven't any Western – why hasn't any Western competition tried to compete with you in China as well?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. Look, I think that many Western companies make a little bit of a miscalculation, right, when they go in, and you're supposed to make an investment. You look and say, well, let me wait until that market develops and then I'm going to invest. Our philosophy at Gates has been quite different. We felt that we want to drive the development of the marketplace, because that entrenches us and that gives us the opportunity to have a frankly unfair competitive advantage for the long-term.

And that's what you really see in North America, where we have a very, very little automotive first-fit presence, but we are absolutely by far the largest market shareholder in the automotive aftermarket business. And so, we view the same thing in China. And I think that by the time that the market is going to develop into a very large numbers, it maybe a little too late to start building out that coverage of products, which takes a significant amount of time. And secondarily, once you have the products, you have to have that regional – China regional presence, which is not easy to do when you don't have a mature distribution footprint that has developed in that country.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

And then just finally on auto replacement like would you highlight any sort of recent trends in U.S. auto replacement, because it's – continue to be a very solid market for you?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

A lot of it we know is from the car parcs sort of maturing after the 2009 recession. But anything else that's continued to lead to the solid results that you've had there?

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Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Well, I think that the big issue, Andy, is what you just said, right. We are seeing finally the negative turning to a positive. So, the 2009, 2010 car registrations have turned finally into positive tailwind. And then look, the economy is really good. We all drive more than we have maybe driven 15 years ago. Gasoline is cheap and the economy is doing really well. So, that's a mix of attributes that are very positive towards folks feeling good and wanting to repair their automobiles and wanting to get a job and driving to their job or driving to school, what have you. So, the dynamics in the developed markets are positive due to these factors. And of course, we talked about the dynamics in the emerging economies, which are very, very strong as well.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Dave, let me ask you about cash flow. Your long-term target is 100%. You want to do 80%-plus in 2019. But obviously, cash conversion was lower. We asked you all those questions on the call in 2018. So, maybe we could sort of go over it again in terms of we know you had to fund the 10% growth in working capital. We know you had to spend significant CapEx for these plants that you are putting online. But maybe talk about the conviction in 80% or more cash conversion in 2019, because I do think it's a pivotal year for you to generate cash?

David Naemura
Chief Financial Officer, Gates Industrial Corp. Plc

A

Yeah, thanks. Andy, I think – well, our conviction is high and I think our historical business model in essence reflects that level of performance. So, I think 2018 was the anomaly. We're getting back to really the kind of the structural nature of the business. We're talking about a 3% to 5% core growth rate as opposed to the 10% actual growth rate total all up that we delivered last year, albeit, only roughly 6% core. So, at roughly 25% of sales, we had to provide a lot of working capital associated with that. And then, we hit a bit of an all-time high from a CapEx standpoint as we built out the new capacity.

We think the capacity will come – or excuse me, the CapEx will come down from about $180 million to about $150 million. We need to drive more efficiency in working capital. So, we tend to target 50 basis points a year, and we think we'll target that again this year. And I think on the lower growth rate, I think if you did all that math, you'd be somewhere over 80% and us returning back towards our historical cash conversion levels as a percentage of our adjusted net income.

From a CapEx perspective, we've always said that about 3% is about where this business should run. We kind of under-invested in 2016 or didn't -as we were working out our strategy. Then, you saw us gain traction in 2017 and 2018, and 2018 being the high as a percent of sales. And you'll see us work back down towards that 3% level over the course of 2019 and 2020, bringing cash flow well back in line. And then, the math on leverage should be that if we're successful in doing this, we have a lot of conviction on our line of sight to be at 3 times leverage – net debt at a leverage ratio of 3 times EBITDA by year-end or better frankly below 3 times.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

And Dave, what's the right level, is it sort of that 2, 2.5 times that you want to target or what was it?

David Naemura
Chief Financial Officer, Gates Industrial Corp. Plc

A

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It's tough to say. One of the things about our markets is they're highly fragmented. They're good markets to compete in. They're also very good markets to acquire in. So, we've answered a lot of questions around M&A over the course of the last few years, and I think we see M&A as an opportunity that, as we continue to reduce leverage, becomes more of an opportunity for us. So, I don't want to say we're heading all the way to 2 times, because we might get below 3 times and decide to do a deal or two. So, it's tough to say. But we do see 3 times as an important demarcation point. We've always said we had a lot of conviction around achieving that level sooner than later and I think this is the year.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

And Dave or Ivo, is it more likely that you do an industrial acquisition than an auto acquisition? Do you care?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

I think that you can probably bet on more of an industrial acquisition than an auto acquisition.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And let me ask you about cyclicality in general, right. A lot of us like if we go back and look at your 2009 performance, it actually was reasonably good versus some of the other industrial companies that we cover. And you've continued to sort of add to the portfolio over time. You obviously have 60% of the business in aftermarket. So, how do you think you'd perform in the next recession and why or in the next slowdown?

David Naemura
Chief Financial Officer, Gates Industrial Corp. Plc

A

Going back to 2008, 2009 and 2010, what we saw was a couple of things. One, very V-shaped recovery for Gates. I think down big in 2019 driven by our OE markets, both industrial and automotive, and then a larger recovery on a core basis in 2010. But in that 2009 downturn, our automotive aftermarket, which is the steadier part of our business, was actually flat or maybe even up 50 basis points. So, that helped us work our way through what were more volatile times.

I think that was the extreme. In 2015, again, we saw some volatility on the industrial side significantly in a lot of commodity-based end markets like oil and gas and some others, where we offset some of that roughness with that kind of automotive aftermarket once again. So, I guess it depends on the nature of the downturn. But I think what we're seeing is our larger concentration of automotive aftermarket offsetting some of the volatility that we will see come through particularly in that 35% of the business that's more OE focused.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Okay. So, no Gates presentation would be the same without asking about chain-to-belt. So, I've got to ask about chain-to-belt, like it still seems like the early days. But at the same time, you've been talking about it for a while. We know it's a huge opportunity. So, you've given more examples of growth aspects. But when does it become a needle-mover you think for you guys in terms of revenue? Is it as early as next year, 2021, like when do you think it really will move the needle?

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Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

So, Andy, let me start with the fact that we today already generate around $200 million from what we call the chain-to-belt market opportunities. So, we already have a really nice baseline of the business, and we have a very nice strong pipeline of future opportunities that we are working on to continue to add to that revenue base. We try to stay away from characterizing how much more revenue we're going to generate. But when we think about this opportunity, it's about an $8 billion total available market for Gates. We would not – or we don't compete generally speaking with anybody that's in our space. Our traditional belt-type competitors can't touch that. We compete with a competing technology, the roller chain.

And when we think about this opportunity, this $8 billion market, we say, hey look, we kind of think about it in three streams. One is kind of a industrial set of applications, so heavy-duty industrial applications such as lumber mills and grain silos and aggregate manufacturing facilities as examples. There is a stream that we are focused on which we call personal mobility. So, anything from bicycles to motorcycles and scooters and electric scooters and so on and so forth, which is a pretty large opportunity, about $1 billion in size for us, and we have a very nice presence there and continue to drive our revenue in that space annually.

And the third piece is something that we call the light industrial automation [ph] and think conveyance or (00:37:07) moving goods on conveyor systems and light industrial distribution, warehousing type facilities as an example. And it's not the belt that's actually moving the packages, so the product itself. It is that apparatus, that motor that's powering that set of rollers that will move that package or that – whatever that content is on that belt. And so, that's a huge opportunity for us with a business that we have in our portfolio that is manufacturing products out of thermoplastic urethane and from urethane materials. We have about a $40 million, $50 million business there, and we anticipate that we can tap into that $1 billion opportunity very nicely.

So, we feel that we have a much stronger conviction I think today, Andy, than we had a year ago. We have a nice base of products on which we can build off. As we discussed earlier, we have an incredible amount of innovation that we are directing into this opportunity in particular, and our anticipation is that it's going to be quite meaningful addition of revenue over the next kind of one to three years' timeframe.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Is it the most exciting thing in the portfolio now or is there something else that you point to and say bigger growth prospects?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Look, I think that the chain-to-belt is a prospect for the company for the next 100 years. That's kind of highly secular very important piece that we have to execute and something that's going to solidify our presence in the marketplace for a long time. But we are also very excited about the opportunities that we have with the technology we're launching on an initiative that we call belt-to-belt. So, that's basically going after our competitors with differentiated technology, which is quite exciting. And then, we are very excited and continue to be very excited about Fluid Power and hydraulics.

We have a ton of new products that are going to be launched, and I think there will be bunch of new press releases that we're going to be issuing over the next couple of weeks with some new innovations we are putting into the marketplace. And as we do that, we continue to broader the market opportunity for the products that we

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manufacture. And again, at the end of the day, we want to be the premium player across all markets and many of the markets the company has not participated historically, because we simply did not have the portfolio. So, I'm quite excited about prospects – long-term prospects for the company across those two product lines that we have in our portfolio today.

Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

And that's a good note to end on. Thank you, Ivo. Thank you, Dave. Appreciate it.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you.

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