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Gates Industrial Corp. Plc (GTES)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Gates Industrial Corporation Q3 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the conference over to your first speaker today, Mr. Bill Waelke. Please go ahead.

Bill Waelke

Vice President-Investor Relations, Gates Industrial Corp. Plc

Thanks, Amy, and thank you everyone for joining us today on our third quarter 2020 earnings call. I'll briefly cover our non-GAAP and forward-looking language before passing the call over to Ivo, who will be followed by Brooks Mallard, our CFO. Before the market opened today, we published our third quarter results. A copy of the release is available on our website at investors.gates.com. Today's call is being webcast and is accompanied by a slide presentation. On this call, we will refer to certain non-GAAP financial measures that we believe are useful in evaluating our performance. Reconciliations of historical non-GAAP financial measures are included in our earnings release and slide presentation, each of which is available in the Investor Relations section of our website.

Please refer now to slide 2 of the presentation, which provides a reminder that our remarks will include forward-looking statements within the meaning of the Private Securities Litigation Reform Act. These forward-looking statements are subject to risks that could cause actual results to be materially different from those expressed in or implied by such forward-looking statements. These risks include, among others, matters that we have described in our most recent annual report on Form 10-K and in other filings we make with the SEC, including our first quarter report on Form 10-Q filed in May of this year. We disclaim any obligation to update these forward-looking statements which may not be updated until our next quarterly earnings call, if at all.

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With that, I will hand things over to Ivo.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you, Bill. Good morning and thank you for joining us this morning on our third quarter earnings call. As we continue to deal with the COVID-19 pandemic, I hope you and your families are staying safe and healthy. And our thoughts are with those who have been affected. The safety of our employees and surrounding communities remains our top priority and continues to guide our operating strategy. We have also taken a pragmatic approach across our operating footprint to continue to support the demand from our global customer base and all of our facilities are operational today.

For this commitment to keeping each other safe while continuing to support our customers, I would like to take the opportunity and recognize our Gates associates and thank each one of our team members for the commitment and dedication during these challenges of the past several months. There has been the case in previous downturns we believe our replacement-oriented business is again demonstrating its resilience. The momentum we carried into the third quarter continued with performance coming in well above anticipated levels. The overall business activity across our diversified end markets continue to trend positively, resulting in demand improving throughout the quarter.

Although we have seen a broad-based improvement across geographies and end markets, this has been particularly evident in our automotive replacement channel which returned to growth on a global basis in Q3. In addition to the age of the car park, we believe this business is seeing some tailwinds related to increased vehicle ownership and a preference by the general public to elect personal mobility over public transport options. We anticipate this trend will continue over the midterm. We are seeing the benefits of actions we took in 2019 to right-size the business and the flexible posture we have maintained has served us well as we have been highly responsive to improvements in demand. Through productivity initiatives under the Gates Production System, our plants are operating more efficiently and the investments we've made over the past few years in our footprint have provided us greater access to lower cost and more flexible labor.

These factors contributed to our gross margin expansion during the quarter despite the lower revenue base. Innovation remains a high priority for us at Gates. And we see an increased contribution to revenues from the products we have launched over the past 18 months. Throughout the pandemic, we have been focused on what we can control in the short-term, while investing in the long-term interest of the business. We are well-positioned to continue to manage through the pandemic and to capitalize on a post-COVID recovery.

Now moving to slide 4 and an overview of our third quarter results. Total Q3 revenue of $712 million declined 4.6% year-over-year, including a negative currency impact of 100 basis points. Core revenue in the quarter declined by 3.6% year-over-year, better than the updated range we provided in September and representing 23% sequential improvement from Q2. We saw nice improvement across the business with revenues continuing to strengthen throughout the quarter. Similar to prior downturns, our replacement channel demonstrated its resiliency. Most notably, our automotive replacement channel performed quite well and delivered solid core growth in Europe, China and North America. Our sales into industrial end markets, although they improved throughout the quarter, are recovering at a more measured pace.

Third quarter adjusted EBITDA was $140 million representing year-over-year margin expansion of 30 basis points to 19.7%. The resulting decremental margin of 14% was primarily driven by 190 basis points of gross margin improvement year-on-year achieved largely through operational productivity. Our Q3 adjusted net earnings per share were $0.26, an increase of 18% compared to the prior year period with slightly lower operating income

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being offset by an income tax benefit resulting from changes in expectations regarding potential realization of certain tax carryforwards.

Now moving on to slide 5 where you see the geographic breakdown of revenues. As a reminder, we plan to provide this quarterly breakdown just for the remainder of 2020. Our global business generates over half of its revenue from international market. And in the third quarter, we saw demand for our products improve substantially across all of our regions. In China, which was our best performing region, the revenue growth we saw in Q2 accelerated in Q3, led by strong performance in the industrial first-fit and automotive replacement channels. We remain optimistic about market conditions there and our prospects to continue to grow.

Our business in Europe showed the greatest sequential acceleration, returning to core growth in the quarter. In Europe, our growth was driven by the automotive replacement and industrial first-fit channels. While the automotive first-fit business remained in negative core growth territory for the quarter, it did return to growth in the month of September.

Moving on to North America. Our revenues there continue to recover nicely, displaying significant sequential acceleration in Q3. The improvement was once again led by the growth in the automotive replacement channel. Our industrial end markets continued to recover throughout the quarter but at a slow rate. Lastly, let me comment on our business in East Asia and India. While we did see a significant sequential improvement in business activity, it is demonstrating the slowest rate of recovery year-over-year. This is predominantly driven by slower reopening of the economies there, although I would note that we saw a nice progressive acceleration throughout the quarter with September being the best month we have seen in a while.

Moving on to the segment on slide 6. Our power transmission business accelerated over 23% from Q2 and came in roughly flat on year-on-year basis in Q3. Overall, our power transmission segment is demonstrating a high level of resilience, a function of its broad global presence across a wide range of applications. Our total sales into replacement channels returned to year-over-year growth led by the automotive replacement channel where the increased end user demand is underpinned by favorable market dynamics. Total sales into industrial end markets which serve new production as well as large installed base of critical equipment also returned to year-over-year growth led by the agriculture and general industrial end markets.

Spending a little time on the initiative side, we continue to see nice progress in converting industrial chain drives to our belt drives as well as upgrading legacy belt drives. One recent example came at a major Southern United States airport where we are converting the drives on the baggage conveying systems from chains to belts in order to reduce maintenance cost and noise pollution while improving operational uptime. Once we are in a facility like this one, it is not unusual for us to find additional opportunities for our products to improve equipment efficiency. At this same site, we are leveraging the Gates energy efficiency calculators in our suite of proprietary design tools to show the expected savings in electricity costs by converting drives in the existing high capacity HVAC units to our patented carbon fiber reinforced synchronous belt.

Based on the number of air handling units, we estimate this airport will save over $200,000 per year in energy costs alone before taking into account the savings from reduced maintenance costs. We are using this recent win to reinforce the efficiency benefits of our belts at similar HVAC projects at a variety of end user operators such as airports, university, university hospitals, and office parks amongst other areas as part of our broader chain to belt initiative.

Now moving to slide 7. Our fluid power core revenue represented a decline of 9.3% year-over-year and sequential improvement of over 21% from Q2. Our new manufacturing plants are serving us well in the improved end market

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environment, operating more efficiently and allowing us to be more flexible in responding to the increases in demand we have seen. Similar to power transmission, our fluid power sales into the automotive replacement channel demonstrated their resilience and posted solid year-over-year growth in the quarter. Our sales into all industrial end markets also showed significant sequential improvement. This was most evident in the first-fit channel as OE customers increased production to meet end market demand. The sequential acceleration was most pronounced in the construction and general industrial end markets.

Now looking at our fluid power initiatives. We've made additional headway with sales in our – of our new products both in the US and internationally with September being our best month today in terms of new product revenues. A recent design win enabled by these new products was a large injection molding equipment OEM in Asia that was looking for hydraulic houses that are easier to route through tight spaces in machines. This is a fairly common requirement in stationary applications. So, our pipeline of opportunities for these new products in both segments continues to grow. We remain optimistic that this momentum will continue in particular in more favorable market environment.

I will now turn the call over to our CFO, Brooks Mallard, for some additional details on the financials. Brooks?

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

Thanks, Ivo. Moving now to slide 8, which provides the detail on key balance sheet and cash flow items. Trade working capital decreased by $56 million compared to the third quarter of 2019 with all three working capital components contributing to the reduction. On an LTM basis, our third quarter free cash flow of $261 million represented 128% of adjusted net income. Compared to the LTM period ended Q3 of 2019, free cash flow benefited from lower working capital and cash taxes partially offset by lower operating income. Our return on invested capital was approximately 14% in the quarter on an LTM basis compared to approximately 20% in the prior year period with the reduction driven primarily by lower operating income related to the significant downturn in the second quarter of this year.

On slide 9, we provide detail on our available liquidity, financial covenants, and debt maturities. We continue to maintain ample liquidity with over $1.1 billion at the end of the quarter, consisting of $672 million in cash and $432 million in revolver availability. Our credit facilities remain undrawn. We do not have any material debt maturities until 2024. And we continue to expect to generate substantial free cash flow. Net debt in the quarter remained flat to Q2 at 4.8 times adjusted EBITDA. As the recovery continues, we expect our adjusted EBITDA and cash generation will increase and progresses toward our goal of bringing net leverage below 3 times.

With that, I will now turn it back over to Ivo.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thanks, Brooks. Despite the uncertainty that exists, we expect our business to continue to improve in the fourth quarter and are updating our high level 2020 framework. Absent additional more restrictive stay-at-home orders that would negatively impact manufacturing activity, we expect the fourth quarter which is seasonally our lightest to show sequential improvement. We anticipate the year-over-year change in core revenue will range from down 3% to up 1%. Second half decremental margins are now expected to be in the range of 10% to 15%, reflecting an improvement from our prior expectation of approximately 30%. Full year capital spending remains unchanged with our expectations of approximately $70 million to support maintenance and key growth initiatives.

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Our business has rebounded quickly from the lows we saw last quarter, quicker in fact than we had previously anticipated. Due to the increases we have seen in volumes, we now expect to fund a higher level of working capital investment in the fourth quarter. Additionally, the non-cash tax items we had in Q3 will increase full year adjusted net income without a corresponding benefit to cash. As a result of these factors, we now expect our free cash flow this year will be greater than 80% of adjusted net income.

So let me wrap things up on slide 11. I'm pleased with the way our global teams executed in the third quarter, delivering a performance better than the updated expectations we provided in September. Despite the uncertain environment, overall, we are encouraged by the trajectory of the business and believe we are better positioned today than we have been exiting prior downturns. We have new capacity in place, revitalized products, and a focused set large organic growth initiatives. We are also squarely focused on our playbook in driving productivity and remaining diligent with respect to our discretionary costs. We maintain our expectations that these actions along with the operational efficiencies from our new plants and savings from our restructuring program will result in solid incremental margins as we return to growth. Although we know the potential for bumps in the road still exists, we are confident in a way the business is positioned through the sustainable improvements we have driven and our ongoing investments in revitalizing our product portfolio.

With that, I will now turn the call back over to Amy to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question today comes from the line of Vlad Bystricky with Citigroup. Please proceed with your question.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

Good morning, guys. How are you?

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

A

Hi, how are you?

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

Good. Thanks. So very strong margin performance across the business and you highlighted 190 bps of gross margin expansion in the Gates Production System. So can you talk about just your runway to further drive gross margin expansion as the recovery takes hold and then also what impact, if any, pricing had on gross margin in the quarter?

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

A

Well, sure, look, as to the gross margins, we had work done, significant work done over the last year to right-size the business and to drive our global production system initiative. And that's frankly what has driven the gross margin improvement on lower revenues. What I would add is that our new plants also are no longer a gross margin headwind and will allow us to respond to incremental volumes much more efficiently. And both of these

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facts are basically what we have been outlining over the last three or four quarters. So, as our volume improves in second half, we expect to continue to deliver gross margin expansion. And frankly, as a little bit of the incremental variable spend comes in, taking that into account, we still believe that not only are we going to be able to drive gross margins up, but also, we're going to be able to drive earnings or EBITDA margins up.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

Okay, that's helpful and great to hear. And I guess just switching over to the regions. You obviously gave good color on the regions. China, an obvious bright spot in the quarter, can you talk a little bit more about, I know you talked about auto there, but any other particular end markets in China that are driving growth and how are you thinking about sort of the sustainability of these recent trends in China? Is this really end market demand that we're seeing? Are you also seeing some restocking tailwinds there driving these numbers in China?

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

A

I wouldn't say that we are seeing any restocking. I mean we have been speaking about China as a big priority for Gates for a pretty significant amount of time. We believe that we have the best automotive replacement franchise for the products that we manufacture there and that continues to deliver good leverage and good growth for us during all of these challenging conditions, good and not great. But I will say that in Q3 specifically, the growth has been driven by our industrial first-fit, predominantly in addition to the automotive replacement channel. And within the industrial first-fit, the strongest performance we have seen came from construction, heavy-duty truck, and frankly also, general industrial type applications. So we've seen a pretty broad-based growth in China and we believe that we will continue to demonstrate the growth as we exit Q4 and we certainly don't lack opportunities to continue to grow there.

Vladimir Bystricky
Analyst, Citigroup Global Markets, Inc.

Q

All right. Thanks very much, Ivo. I'll hop back in the queue.

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

A

Thank you.

Operator: Your next question today comes from the line of Jeff Hammond with KeyBanc Capital Markets. Please proceed with your question.

Jeff Hammond

Q

Hey, good morning, everyone.

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

A

Good morning, Jeff.

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L. Brooks Mallard
Chief Financial Officer, Gates Industrial Corp. Plc

A

Good morning.

Jeff Hammond

Q

So just on auto aftermarket, can you just speak to what you think was kind of underlying demand versus any catch-up versus any restocking and just kind of trends into October, particularly North America?

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

A

The trend into October remained positive, Jeff. So we have seen the momentum that we have seen from exiting Q3 to continue. I would caution everybody that – I mean we certainly are entering a seasonally weaker quarter, number one. And number two, I think with all the cases rising during the pandemic, I think that we all are getting a little bit sensitized to what can happen in Q4. But that being said coming back to AR, AR performed really well across our biggest markets, North America, Europe, and China. And we have really not seen any fundamental restocking in any of these regions, Jeff. We believe that the underlying demand is driving the sales recovery. You see the preference that folks have over public transportation options and I think that is part of that move up. And I certainly believe that that's going to remain with us for some intermediate future as people kind of feel that they want to be more self-protected by driving in their own vehicle by using some personal mobility option versus public option.

Jeff Hammond

Q

Okay, great. And then you also called out outperformance in auto replacement. Where are you seeing that outperformance and how sustainable do you think it is as we go forward?

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

A

Well, the outperformance in auto replacement has been again very broad-based, right. As I said, it's particularly China, North America, and Europe. Those were three markets that I would say are notably strong for us. And again, we remain pretty constructive on being able to stay in – certainly embedded in the positive core growth territory as we move forward.

Jeff Hammond

Q

Okay then. Just a quick one on fluid power, we're seeing better orders from peers. Certainly, that business is lagging from a growth perspective to [ph] PPE (00:27:15). But just talk about the order trends as you move into 4Q on that business.

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

A

That order has – I mean the business has rebounded quite strongly and I think it's been driven predominantly by the industrial OE applications, Jeff. We certainly, [ph] since some of the reports comes from some of our key peers (00:27:38), and we believe that we continue to take a little bit of market share away from them. And I think

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that we are well-positioned with our new products to continue to outperform. But we do see continuation of the improvement as we existed Q4.

Jeff Hammond

Q

Thanks a lot.

Operator: Your next question today comes from the line of Jerry Revich with Goldman Sachs. Please proceed with your question.

Q

Hi, this [ph] Jeff Ramon (00:28:10) on for Jerry Revich. This quarter looks like productivity improvement added about 2 points to gross margins. As we think about volumes recovering in the coming quarters, should we think of margins improving by a sustained 2 points plus your normal volume leverage on top of it?

L. Brooks Mallard
Chief Financial Officer, Gates Industrial Corp. Plc

A

Hey, this is Brooks. So I think there's a couple things there, right. One is we're going to have the additional restructuring savings that are going to come in on top as we progress throughout 2021 and that's going to be a tailwind for us, right. And those will progressively build until we get to the end of 2021. And then we'll get a little bit heading into the first part of 2021. And then I think from a leverage perspective in the ongoing businesses, what you see is kind of some step function as you have to add costs, as volume goes up. So I think you'll see some pretty good improvement and then we'll have to add some costs and then you'll see some good improvement. So it'll be as volume ticks back up, we'll see that incremental favorable leverage tick back up along with volume. I certainly think as we move forward, our targeted gross margin is north of 40. There's no question about that. And when you think about the incrementals we've talked about in the short-term, that really supports that gross margin target north of 40. So I think you're thinking kind of in line with what we're thinking.

Q

Thanks. And electric and hydrogen truck product development efforts have really accelerated. Can you talk about your content opportunities on these vehicles?

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

A

Sure. So look, our content opportunities are predominantly in the fluid power side. We actually are working on a couple of those opportunities with a couple of the companies that are in process of developing a commercialized vehicle for applications using alternative propulsion technology. So we believe that those opportunities continue to exist and we're well-positioned to capitalize on those as these products enter operations and the active market.

Q

Thank you.

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Bill Waelke
Vice President-Investor Relations, Gates Industrial Corp. Plc
A

Amy, are you still with us by chance? Apologies for the delay everyone online. It appears we have lost the operator. We are working expeditiously here to get her back.

[Technical Difficulty] (00:32:24-00:33:19)

Operator: My apologies for the technical issues.

Bill Waelke
Vice President-Investor Relations, Gates Industrial Corp. Plc
A

Okay. Can we jump back into the Q&A?

Operator: Perfect. We can definitely do that. So your next question comes from Jerry Revich from Goldman Sachs. Your line is open. Oh, it looks like...

Q

Hi, this is [ph] Jeff Ramon (00:33:44) on for Jerry Revich. My answers have been addressed. Thanks.

Operator: [Operator Instructions] Your next question comes from Deane Dray from RBC Capital Markets. Your line is open.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Hey, thanks. Good morning, everyone, and thank you for moving the call up earlier in the day. I really appreciate that.

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

Good morning, Deane.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Hey, I know you in a prior answer said that there was no restocking impact for the quarter. But what's your sense of channel inventory as it stands today and would you and are you expecting a benefit from restocking in the next couple of quarters?

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

Yeah, look, I would actually say, Deane, that we, if anything, associate with channel inventories, we saw some level of destocking in Europe. And so when it comes to North America, the channel inventories remained very stable, if I use that word. So my sense is that when markets will continue to trend up and continue to improve, you will start seeing some level of inventory repositioning. But I would say that it's probably not going to occur until

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sometime in 2021. And that was my expectation from last quarter and I think that that is what I expect to take place presently as well.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Good. And you mentioned that the contribution from new products in the quarter, can you specify that? And then related, this whole belt to, from chain to belt conversion, that example that you gave regarding the airport, both the HVAC and the baggage belt, those look pretty impressive and my guess is that would invite and attract other customers to do similar conversions if you can show that efficiency especially on the energy side. So what's the funnel look like for those kind of opportunities? Thanks.

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

A

Thank you, Deane. I mean I think that it is another example of driving these conversions forward. We've always envisaged that these opportunities are plentiful. And as I've outlined in my prepared remarks, we believe that we have a very solid set of opportunities in other airports as well as across a number of these operators that are utilizing particularly the heavy-duty than HVACs. And those funnels are very, very robust for us. We see funnels increasing every quarter despite the fact that we have obviously not a great opportunity to go and directly talk with these customers. We have adapted virtual tools that are serving us reasonably well and we are still able to execute on some of these key projects. So, the funnels are growing both for power transmission and for chain to belt. Our funnel in personal mobility in particular has been the largest since we started to outline this set of initiatives. And in fluid power, we also continue to see a very nice increase in adoption of our new technologies. I am not going to go in and specify percentages of contribution of revenue, but it is now starting to become quite meaningful, and we're very excited about the prospects of converting a very significant amount of our production over the next 24 months and get to that mid-20s NPI vitality that we have been discussing over the last several calls.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Great. And just a public service announcement. It seems like the operator had cleared the queue for Q&A. So I got in by resetting star one. So if anyone else is waiting, hasn't reset star one, they probably should. Thank you.

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

A

Thank you, Deane.

Operator: Next question comes from Julian Mitchell with Barclays.

Q

Hey, good morning. This is [ph] Trish (00:38:41) on for Julian. So maybe just looking at the Q4 guide the low end of the revenue guide kind of implies similar decline to Q3. I know you mentioned trends have improved sequentially kind of throughout the quarter and as we exited. So maybe can you talk a little bit more about kind of what's baked in the low end of guidance. Is this more conservatism or are you seeing any signs of slowing or kind of any yellow flags out there?

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

A

[ph] Trish (00:39:06), I would say that when we exited the quarter and entered into October, everything looked quite okay and everything does look quite okay right now. I think we're just being a little more cautious associated with two things. Number one, with the additional incremental announcements that are coming out of Europe, and I think let's remind ourselves that we have a short cycle, short visibility business and this is just taking hold right now. But also, Q4 generally speaking is a seasonally weakest quarter. So it's the calendar that also comes to play. So, from a demand perspective, we have seen continuation of positive trends. But the other two items that we just want to make sure that we don't [indiscernible] (00:40:07) pointing out.

Q

Got it. That makes sense. Thank you. And then maybe just one more kind of on the free cash flow guidance now at over 80% conversion versus the prior over 100%. Can you talk more about the moving pieces there with Q3 maybe a little bit weaker than you'd initially expected and that it seems like it probably picks up in the fourth quarter to over 100% conversion to get to that kind of 80% full year number?

L. Brooks Mallard
Chief Financial Officer, Gates Industrial Corp. Plc

A

Yeah, so from a working capital perspective, I mean our revenues went up $135 plus million from Q2 to Q3, right. And so when your revenues go up that much, your investment on working capital is going to go along with it and so that's really directly tied to the better performance from a top line perspective and so that will equal out over time. The other thing is the tax impact. We had certain valuation allowances related to disallowed interest that we recognized in Q3 and that offset – that was a favorable tax benefit compared to the actual cash taxes we paid and so nothing really to do with the operational or the operations of the business, just more of a tax planning exercise. And as Ivo said, Q4 tends to be kind of the weakest from a seasonal perspective and then working capital tends to roll through in Q4 as well. So we do tend to generate more cash in Q4 to go back and look historically. So it tends to even out as you get to the end of the year.

Q

Perfect. Thanks.

Operator: [Operator Instructions] We have a question from Damian Karas with UBS.

Damian Karas
Analyst, UBS Securities LLC

Q

Hi. Good morning, everyone. Really nice quarter.

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

A

Thank you, Damian.

L. Brooks Mallard
Chief Financial Officer, Gates Industrial Corp. Plc

A

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Thanks.

Damian Karas
Analyst, UBS Securities LLC

Q

I have a follow-up question on margin. I know you guided to sort of the 10% to 15% decremental for the second-half. I think the decremental math starts getting a little funky when you're growing in some areas, declining elsewhere, maybe kind of have more flattish overall revenues. Was just hoping you might be able to further clarify on the fourth quarter here. Are you expecting the expansion in margins for both segments kind of on a year-over-year basis [ph] than (00:42:43) sequentially and maybe you could just quantify are we talking sort of the company overall gets back above 20% EBITDA margin in the quarter?

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

A

Yeah, Damian, so I would just remind everybody that if you can recall 2019, in 2019, we did not fund any variable compensation programs. And there was a impact from it in Q3 of last year, but the bulk of that impact was in Q4, which is obviously now a reasonably good headwind for us this year. So absent this impact of the variable comp, we would have expected that our margins would have been incrementally 100 basis points higher. So that's really what's driving that impact in Q4.

Damian Karas
Analyst, UBS Securities LLC

Q

Okay. That's helpful. And you had spoken earlier about this consumer shift more towards personal mobility. Was hoping you might be able to elaborate on that a little bit. Were you speaking mostly to the China market or were you talking at the global level and any way you could sort of quantify are we talking a double-digit opportunity here next year?

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

A

Look, I think that you see that pretty broadly around the world. If you take a look at some of the indicators that are out there be it the Apple Maps or Google Maps [indiscernible] (00:44:25) that you see, pretty significant rebound versus what you see folks going and using a public transportation option. I think that you see that with a very large rebound in used car sales and new vehicle sales. And I think that the underlying reasons for that folks that have never owned a vehicle are now going out and getting a vehicle for themselves and their family, so that they do not need to be forced towards the public option, public transportation option. So what does that represent in terms of an overall opportunity? I don't know. I think we are still seeing that play itself out, but certainly, it does represent a positive tailwind when combined with the fact that the overall car fleet or the overall car park continues to age and is one of the oldest in history so and then all of that bodes well for our automotive replacement business which as you know is one of the best franchises out there for the products that we manufacture.

Damian Karas
Analyst, UBS Securities LLC

Q

Makes sense. Appreciate it. Thanks for taking our questions.

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

A

Thank you, Damian.

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Operator: [Operator Instructions] And we do not have any telephone questions at this time. I will turn the call over to the presenters.

Bill Waelke

Vice President-Investor Relations, Gates Industrial Corp. Plc

Thanks, Amy. Thanks everyone on the call again for your interest in Gates and we look forward to our next update in February.

Operator: This concludes today's conference call. You may now disconnect.

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