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# Gates Industrial Corp. Plc (GTES)

## Q4 2019 Earnings Call


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# CORPORATE PARTICIPANTS

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

**David M. Wisniewski**
*Chief Financial & Accounting Officer, Gates Industrial Corp. Plc*

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

# OTHER PARTICIPANTS

**Andrew Kaplowitz**
*Analyst, Citigroup Global Markets, Inc.*

**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC*

**Julian Mitchell**
*Analyst, Barclays Capital, Inc.*

# MANAGEMENT DISCUSSION SECTION

**Operator**: Good afternoon. My name is Shantel and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Gates Industrial Corporation Fourth Quarter 2019 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers remarks there will be a question-and-answer session. [Operator Instructions] Please limit your questions to one question and one follow up to allow other participants time for questions. Thank you.

Bill Waelke, Head of Investor Relations. You may begin your conference.

## Bill Waelke

*Vice President-Investor Relations, Gates Industrial Corp. Plc*

Thanks Shantel, and thanks to everyone for joining us on our fourth quarter 2019 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 our interim CFO today, David Naemura. After the market close, we published our fourth quarter and full year 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 the 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.


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We disclaim any obligation

to update these forward-looking statements which may not be updated until our next quarterly earnings call, if at all.

With that, I will turn the call over to Ivo.

## Ivo Jurek

*Chief Executive Officer & Director, Gates Industrial Corp. Plc*

Thank you, Bill. Good afternoon and thanks for joining us today. Let me start with a brief summary of the company's performance. We navigated a very challenging macro environment in 2019 while our global teams stay focused on the long-term growth, profitability and cash generation. We actively manage our cost structure to the prevailing demand conditions while advancing several key strategic initiatives across both bulk of our product segments. Balancing short-term cost containment with long-term strategic investments. The Q4 results are consistent with our expectations and our full year results are in line with the midpoint of the guidance we provided back in August. During Q4 we saw our China business return to growth and Europe notably improve its performance sequentially. The challenging and end market conditions in North America which entered a down cycle later than our other regions persisted. We continue to take actions to reduce our variable manufacturing cost structure which we believe will largely align our costs with the end market conditions exiting the year. We delivered strong free cash flow which contributed to our net leverage remaining flat to Q3 on a last 12-month basis. Although, the market backdrop in 2019 was undoubtedly challenging. We existed the year with a more efficient operating structure and believe we are positioned to capture enhance margins on higher volume coming out of this downturn.

Jumping right in a slide 3 of our presentation. Our revenue in a quarter declined 7.6% on a core basis compared to the prior year which was consistent with our expectations. Our sales into the auto end markets outperformed the industrial end markets in Q4. Industrial core revenue decelerated modestly from Q3 with the construction and heavy duty truck end markets seeing particular weakness.

Our automotive results were better in Q4 down low single digits globally. Core sales into the automotive first-fit channel were down mid-single digits, a sequential improvement from the decline we saw in Q3. The automotive replacement channel declined low single-digits a slight sequential improvement from the third quarter. Growth in Europe, China and South America offset a decline in North America that was primarily driven by lower hydraulic sales through the automotive replacement channel, as well as the timing of some of the backlog reduction in a prior year period.

On a regional basis, we delivered core revenue growth of nearly 6% in China, driven by the execution of our initiatives and reflecting what we believe is above market performance. While our automotive replacement business in China continued its trend of double-digit growth Our sales into the automotive first-fit and industrial end markets also returned to growth in the quarter.

In Europe, core revenue declined slightly on a year-over-year basis which was a meaningful improvement from the high single-digit decline we experienced in Q3. The sequential improvement was driven mostly by the auto end market where sales into our automotive replacement channel improved from mid-single digit decline in Q3 to mid-single digit growth in Q4. The Europe industrial end markets decelerated slightly primarily due to further softness in construction and heavy duty truck markets.


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In North America, our end markets remain challenging. Core revenue was down low teens on a year-over-year basis, primarily the result of weakness in the industrial end markets and more specifically mobile hydraulics. Within our industrial first-fit customer base, we saw some sequential deceleration in construction and heavy duty truck end markets relative to Q3. Our industrial replacement channel business while still weak on a year-over-year basis did improve sequentially from Q3 as we saw some normalization of destocking in the certain product lines.

Fourth quarter adjusted EBITDA was $135 million representing a margin of 18.6%, a decline of 490 basis points from the prior year period, in line with the expectations communicated on our mid-year earnings call and reaffirmed last quarter. The year-over-year volume declines as well as the resulting production inefficiencies compressed our gross margins and subsequently adjusted EBITDA margin. Our teams have made solid progress addressing compressible manufacturing costs across our footprint and our previously announced fixed cost restructuring initiatives are progressing well positioning the company for improvement in 2020. Our fourth quarter adjusted earnings per share of $0.19 is a decline from $0.36 in the prior year period driven primarily by the lower adjusted EBITDA. Our seasonally strong Q4 – Q4 free cash flow generation came in very well. Free cash flow of $179 million in Q4 represented an increase of 25% over the prior year period and a conversion rate of 317% of adjusted net income. Free cash flow for the full year ended at $266 million representing 95% conversion of the adjusted net income.

Let me move now to our segments on slide 4. Our Power Transmission segment core revenue declined 3.4% in a the quarter an improvement from 5.9% decline we experienced in Q3. Sales into industrial and markets remain weak on year-over-year basis led by the construction ag and general industrial end markets. Sales into our automotive end markets grew modestly in the quarter, a significant improvement from the high single digit decline in Q3.

From a regional perspective our Power Transmission business in China showed the largest improvement generating over 5% core growth in the quarter and improving over 10 percentage points sequentially driven by both automotive and industrial applications. Europe was down slightly on a year-over-year basis with core growth in all channels improving sequentially from Q3.

Our revenue in North America was down mid-single digits on a core basis. However we did see some initial signs of stabilization in the industrial replacement channel. Emerging markets returned to growth driven by China and South America and outperformed a mid-single digit core decline in developed markets.

Power Transmission adjusted EBITDA declined by approximately $17 million in the fourth quarter compared to the prior year period driven primarily by the impacts of lower production volumes with a resulting adjusted EBITDA margin of 20.7%. While the market backdrop is challenging we remain committed to funding our new product development and organic growth priorities. Our Chain-to-Belt initiative is advancing well with particular progress made in personal mobility, light industrial applications and lifestyle space.

In 2019 we build a large pipeline of opportunities globally across both the first-fit and replacement channels. We also are making good progress launching new products which we anticipate will further accelerate in 2020.

Going now to slide 5. Our Fluid Power segment Q4 2019 core revenue declined 14.5% compared to the prior year period, when we experienced a substantially elevated demand environment and the highest core growth quarter of that year. This segment and mobile hydraulics in particular is where we are seeing the most significant impact from the industrial end market headwinds. We experienced sequential deceleration in heavy duty truck and construction end markets somewhat offset by improvements in general industrial and oil and gas end markets.


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On a regional basis, our Fluid Power performance was similar to the trends we saw with our power transmission segment. China core revenue was up high single-digits compared to the prior year a significant sequential improvement from Q3, driven by our team's solid execution on initiatives. Europe, core revenues down slightly compared to the prior year also improved sequentially from Q3. North America core revenue was down high-teens on a year-over-year basis led by deceleration in the industrial channel. While the decline in the replacement channel business was somewhat consistent with what we saw in Q3. This performance is consistent with our OEM customers shutdown activity that we experienced in Q4 which was more pronounced than in the prior year Fluid Power adjusted EBITDA declined by approximately $33 million compared to Q4 2018. The decline in adjusted EBITDA and the resulting margin contraction were attributable to the substantially lower sales and production volumes as our large hydraulics product line is seeing the most impact from the downturn in the industrial end markets.

Despite the significant and market weakness, we launched a number of innovative new products throughout 2019. These new products differentiate us competitively and have resulted in a growing pipeline of opportunities, which we expect to benefit from – which we benefit from, at the end, as the markets improve throughout 2020 and beyond.

Now, turning to slide 6, which contains a summary of our core growth and the relative revenue size by region, in aggregate, in 2019, we experienced the impact of the market headwinds across the majority of our geographic footprint. However, as the year progressed, we began to see some green shoots in certain regions, primarily due to the execution of our company's initiatives and less negative market conditions.

Beginning with China, where our core growth turned negative in Q4 2018 and stayed negative through Q3 2019, sales into the automotive replacement channel grew nicely throughout the year, but it was the Q4 improvement in the rest of our business that returned to region as a whole to growth in the quarter. In Europe, our core growth in a quarter.

In Europe, our core growth also turned negative in Q4 of 2018 and begun to largely stabilize by Q4 2019. In North America, the downturn began with destocking in Q1 2019 for us and accelerated in Q2 with our industrial end markets turned negative. Given that the downturn in North America began later than China and Europe we expect it to continue through the first half of this year. Although top line performance was challenging in 2019 we are encouraged by the positive signs we saw in the fourth quarter.

In December, we announced the commencement of an executive search to replace our CFO who departed at the end of last month. While we are fortunate to have a deep bench of talent to carry us forward. Earlier today we filed a Form 8-K and related press release announcing the appointment of Brooks Mallard as our CFO beginning on February 24. Brooks has a wide range of experience in corporate and operational finance roles and will be a great asset to the team as we continue to drive Gates forward.

With that, I will now turn the call over to our Interim CFO, David Wisniewski whom I would also like to thank for capably serving in that role. He will add some additional details on financials before I provide outlook for 2020 and wrap up our prepared remarks. David?

## David M. Wisniewski

*Chief Financial & Accounting Officer, Gates Industrial Corp. Plc*

Thank you.


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Ivo. I will now cover our Q4 financial performance beginning on Slide 7. As Ivo noted, we experienced a core revenue decline of 7.6% in Q4, a sequential improvement from last quarter. Revenue in total declined 8.4% in Q4 including a negative 80 basis point impact from FX. Our revenue performance in the quarter reflects the continued challenging conditions in certain end markets, but also some underlying improvement in signs of stabilization in certain key areas.

Fourth quarter adjusted EBITDA of $135 million represented an adjusted EBITDA margin of 18.6% which is significantly lower than the prior year due to the lower sales volumes and resulting impact of production efficiencies. The impact on production efficiencies is made worse by the inventory reductions that we have driven with full year inventory coming down $63 million and Q4 inventory coming down $33 million. Our explicit actions to reduce inventory further reduced production volumes beyond the impact of the revenue decline.

As we noted on our previous earnings call, we generally believe that we have right sized our variable production costs to the current demand levels. I would also note that the prior year Q4 margin was exceptionally strong from an incrementals perspective creating a bit of a tough compare. We alluded to this dynamic on our previous earnings call. Importantly as we've made meaningful progress during the downturn to optimize our operating structure, we believe we are well-positioned to deliver higher incrementals as volume returns to the business compared to the decrementals we experienced in 2019.

Our fourth quarter adjusted earnings per share of $0.19 is a decline from $0.36 in the prior year period driven primarily by the lower adjusted EBITDA as well as a $6 million impact from higher interest expense due to accelerated amortization of deferred financing fees related to our bond refinancing, partially offset by a lower underlying effective tax rate.

Moving now to slide 8 which provides detail on cash flow items. Working capital in the fourth quarter remained stable as a percentage of sales, reflecting significant progress on reducing inventory levels in response to the top line dynamic. As I noted earlier our inventory reductions in both the fourth quarter and the full year were significant. As Ivo noted our seasonally high Q4 free cash flow was $179 million. This is a significant improvement over the prior year as we normalized CapEx back to historical levels and reduced inventory.

On a full year basis our free cash flow of $266 million or 95% conversion of adjusted net income also represented a significant improvement over the prior year again normalizing back towards historical levels. With respect to leverage we ended the year with net leverage of 3.8 times due to a lower level of adjusted EBITDA. Deleveraging the business remains a priority as we move forward in 2020

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

## Ivo Jurek

*Chief Executive Officer & Director, Gates Industrial Corp. Plc*

Thanks, David. Turning to slide 9 and our guidance for 2020. Based on the current and market environment our outlook for core revenue ranges from a decline of 1% to growth of 2%. We anticipate that the demand environment will improve in 2020 with core revenue remaining negative in the first half and returning to growth in the second half. More specifically, we expect that Q1 will be our most difficult quarter in 2020, with a core growth decline slightly improved from what we've experienced in Q4. We anticipate this improving in the second quarter to a low mid-single digit decline.

We believe that channel inventories are poised to normalize by the end of the first half, and that we will see more substantial underlying end market improvements and contributions from our growth initiatives in the second half of


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the year. This outlook is based on a combination of the improvements and progress we've begun to see in the fourth quarter as well as recovery patterns of past downturns.

We are mindful of the Corona virus outbreak situation that's developing in China and have taken into account a modest headwind from what impacts are known as of today. We have our teams ready to resume full operation -- operational activities in the region on February 10th as mandated by Chinese government.

At this point, we are not in a position to predict the ultimate impact should the situation develop more negatively. Our outlook for adjusted EBITDA is $610 million to $640 million which at the midpoint and absent further movements in Fx reflects incremental margins in excess of the decrement margin we saw in 2019. This is despite the fact that included in our EBITDA guide is a reset of certain variable compensation programs that did not achieve payout threshold in 2019. As to further detail on the progression of the upcoming year we expect margin pressure to continue in Q1 of this year, but I anticipate seeing quarterly sequential improvements as the year progresses a result of volume increasing from both growth initiatives and improving end market conditions and savings associated with our fixed cost restructuring actions kicking in. Capital expenditures for the year are expected to be approximately $100 million representing a typical level for the business at around 3% of sales. Similar to 2019 we expect 2020 free cash flow conversion to be greater than 80% of adjusted net income. So wrapping things up on slide 10 in summary during 2019 we managed through the most challenging end market environments since 2009. As the year progressed we've made significant progress on resizing our variable cost structure and initiated the execution of our initial manufacturing footprint optimization projects. The Gates teams are executing on our long-term growth initiatives as well as launching a significant number of new products, which we expect to facilitate above market growth rates over the mid-term. We enter 2020 with a solid pipeline of design wins and near-term opportunities across both of our product segments that we expect will help us exit this market downturn in a much stronger position while serving our customers with advanced products and solutions. We are well positioned with capacity to support our global and regional partners across new and legacy applications. We increased our financial flexibility by refinancing our bonds and delivering $266 million of free cash flow, a $135 million improvement over 2018. Although we anticipate the market conditions to remain challenging through the first half of 2020. We've begun to see some green shoots in key areas of our global business and expect this trend to continue throughout 2020. I would also like to take this opportunity to thank our global team of Gates Associates for their hard work and commitment in managing through the adverse conditions we saw in 2019 as their dedicated efforts have improved the underlying business and positioned us for success. We are excited about our future prospects and look forward to delivering strong results in 2020.

Thank you. And we will now turn the call back over to the operator to begin the Q&A.


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# QUESTION AND ANSWER SECTION

**Operator**: At this time, I would like to remind everyone [Operator Instructions] Please limit yourself to one question and one follow-up question to allow other participants time for questions. We'll pause for just a moment to compile the Q&A roster. Your first question comes from Andy Kaplowitz with Citi. Your line is open.

**Andrew Kaplowitz**
*Analyst, Citigroup Global Markets, Inc.*

Q

Hey. Good afternoon, guys.

A

Hi, Andy.

**Andrew Kaplowitz**
*Analyst, Citigroup Global Markets, Inc.*

Q

Ivo obviously China turning good was very good to see, but could you give us more color into your assumptions for China industrial and first-fit auto in 2020. I'm going to assume that auto replacement is going to stay strong for you in China, but you did mention minor potential impact from the corona virus, maybe you give us more color into what you're seeing on the ground at this point in China and what you're expecting regarding their own factories and in your supply chain here in the short term?

A

Yeah, Andy. Let me start with coronavirus first for a second, look I mean, you know this is very unfortunate obviously and we are taking this situation very seriously. And you know obviously we are in constant contact with our leaders there in China. Look our China plans will be close to February 9 in accordance with the local government instructions and we certainly anticipate and we are on a standby to be able to go back to work on February 10. The present guidance that we have put together contemplates the first half of February being kind of a wash and you know and it's taking that into an account. We certainly are monitoring the situation there and we are on standby to do to get some additional feedback from the local authorities, but that's kind of how we are thinking about that coronavirus impact at this point in time.

Look while you know coming back to the maybe the first part of your question about the markets we'll agree you know we don't really anticipate that we're going to get an incredible support from the end markets in China, so they you know they really don't – they don't expect that they're going to provide a significant support for us, but you know we do have a strong set of regional growth initiatives that we expect to largely drive forward. And you know we frankly anticipate similar results we experienced in Q4, again the Q1 may prove to be quite difficult in China taking into account what we have seen from the incremental corona virus situation, but you know January pointed out to very similar results that we have seen in China in Q4. So we are remaining reasonably optimistic in that as long as the Chinese government is going to get this wrapped up reasonably quickly. We anticipate that it's going to be very limited in scope for us in terms of impact on our China business in 2020.


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Q

Ivo, that's helpful. And then I want to ask you about restructuring progress. I think a couple of quarters ago you mentioned that $20 million a net restructuring savings that would hit in 2020. If I look at the midpoint of your new guide you're up $15 million on slightly positive growth. So could you give more color on sort of what you're seeing around restructuring or are you just sort of being conservative with your guide, are you're on target for the savings that you'd previously mentioned?

A

Look, I mean, our restructuring that we have announced previously is pretty much on track, so we are progressing quite well, not really having any concerns with being able to deliver to deliver on that. We'll see the incremental impact of the restructuring actions in the second half of 2020 in particular and into 2021. So we believe that from a restructuring perspective we are – you know we are pretty well on track. In terms of maybe some additional color there, I mean we did incur significant amount of inefficiencies in 2019 as a result of rightsizing our variable cost and frankly inventory levels with rightsizing the business to the prevailing business environment. We believe that that's behind us predominantly and we will not expect to see these inefficiencies of the variable cost take out into – you know into 2020. So but when you do some of the comparison we did have pretty solid Q1 of 2019 still and we kind of running against some tough, tough comps then we are basically planning on delivering progressively better performance as we exit through Q1 into the second half of the year.

Q

One more if I may, Bill like just following up on your comments on sort of inventory and destocking. You mentioned in the prepared remarks maybe some improvement in North American industrial destocking and that you were hopeful by the end of the first half of 2020 that that would be behind you. Maybe if you can talk about sort of any color from the customers on that point and then you know the confidence level that you're own inventory is pretty much where you want it so we don't see any destocking pressure on your margin here in 2020?

A

Yeah, Ann let me start with our internal inventory and we have taken you know a pretty substantial steps forward to take over $60 million out of our internal inventories in 2019. So we are pretty confident that we have right sized our internal inventories well in line with the underlying market demand. So we feel pretty – pretty positive about what we have done in 2019 from the internal perspective.

If I take a look at and maybe give you a color by kind of an end market you know from our perspective the automotive replacement channel and I've talked about a little bit in the past, we believe that the inventories – the inventory position in the automotive replacement end channel is more or less normalized. So we believe that you know, I mean you can – here and there you can see a little more or a little less that activity on incremental destocking, but we don't see that as a major headwind in the automotive replacement channel.

In the industrial replacement channel, we are still seeing destocking, but we also are seeing the distributor purchasing behavior to start showing signs of normalization in, you know, in some of our product lines particularly in the power transmission product line in Q4. And I would say that – that normalization has been has


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demonstrated itself primarily in North America and in Europe. We still see quite a significant level of destocking in the fluid power product segment. And we anticipated that's going to continue more or less in line with the end market that we still believe is going to remain weak at least through the first half of 2020, although it's you know it's quite difficult to predict. We do believe that the industrial replacement channel destocking is going to take care of itself kind of at the end of second quarter of this year And remember we've kind of seen destocking, we've been played a first company out there talking about a destocking. So we believe that we will annualize it pretty much in the first half of 2020 and that gives us much higher level of confidence that we should be through that level of destocking that we have seen in 2019.

Q

Thanks, Ivo appreciate all the color.

A

Thank you.

**Operator**: Your next question comes from Jeff Hammond with KeyBanc Capital Markets. Your line is open.

Q

Hey good afternoon, guys.

Q

Hey, Jeff. So what are your competitors talked about some pull forward into 4Q ahead of kind of this extended Chinese New Year. And I'm just wondering if you saw any of that – any of that would have helped the better China fourth quarter?

A

Jeff we didn't really see any pull forward and again as I said we have seen pretty solid performance to continue through January. We're reasonably confident about the level of initiatives that our original team in China is executing they have a great pipeline and they are executing quite well. So absent of some incremental coronavirus shock we feel quite good about what's happening in China for us.

Q

Okay great. And then the mobile hydraulics piece seemed to step down I think you said it a couple of times truck and construction. Can you just give us a sense of how you're thinking about that as you go through 2020 in terms of it persisting or starting to moderate?


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A

Yeah we believe that we're going to see continued weakness through the first half, although we believe that it's going to start abating as we exit kind of the second quarter. As I have indicated we also have seen you know a significant weakness with channel inventories of our partners and we anticipate to see that work itself through kind of the first half of 2020. We have terrific set of opportunities that we have developed over the last 18 months from products that we have launched over the last 18 months so we believe that that's going to be supportive in the second half of 2020 as we see some improvements in the end markets we also anticipate that our growth initiatives are going to give us an opportunity to outperform the market based upon those initiatives to be executing on.

Q

Okay. And just a couple of housekeeping can you give us the interest expense and what you think the tax rate is going to be for 2020? Thanks.

A

Sure. David is going you this answer here.

A

Yeah, so Jeff and I think we're looking at interest expense flat to slightly down from for where we've been in 2019 principally due to a non-reputed that at fourth quarter $6 million write-off of accelerated financing fees. As I think about effective interest tax rate, well I think we continue to guide to something in the low to mid-20s range is really the underlying effective tax rate that we should be thinking about.

Q

Okay. Thanks, guys.

A

Thanks, Jeff.

**Operator**: Your next question comes from Julian Mitchell with Barclays. Your line is open.

Q

Hi. Good afternoon.


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A

Hi. Hi, Julian.

Q

Maybe  just – hey. Maybe just a question around the cash flow, I guess that the cash conversion average over sort of 2018 to 2020 it's about 75% or so. You know, I just wondered sort of in the long run, what should we expect and whether we'll start to see some of those adjustments on slide 15 shrink over time. And related to that, the net leverage just on the four times, what's the outlook for de-levering?

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

A

Sure. So from a cash flow, I mean let me take that first. We anticipate that the cash flow should start normalizing above 80% of adjusted net income, Julian. That's our business model. I would remind you that over the last couple of years, we have been building quite a substantial amount of new capacity that we've brought online. So it was primarily impacted by this capacity that we stood up and this year is more normalized level of cash generation. So we anticipated that's how you should start thinking about that. This is how the company has operated in the past and this is how we anticipate to operate in the future. The net leverage kind of exiting 2020 should be approximately 3.5 times taking into account the midpoint of our guide.

**Julian Mitchell**
*Analyst, Barclays Capital, Inc.*

Q

That's helpful. Thank you, Ivo. And then just my second or follow-up question. You did have pretty severe year-on-year and sequential decrementals in Q4 firm wide. So just as we're thinking about the cadence of that recovery through 2020, is there any kind of first half, second half split you could give us on the EBITDA for example at the midpoint?

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

A

What I would say, Julian is that we still have a pretty tough comp and we still have a pretty tough time and tough comp in Q1 of 2020, but we expect 2020 to really be a tale of two halves. I know that you keep hearing it from everybody I believe, but look in the first two quarters we anticipate kind of a mid-single digit to low-single digit core revenue declines that frankly will moderate the year-over-year declines and that will ultimately followed by a return of increasing level of growth in the back half of the year, that's kind of how we are thinking about it and that's going to be impacting the deleverage and leverage that we that we deliver. And then if you think about our leverage on the incremental revenue at midpoint of our guidance, we anticipate that we're going to lever up at a much greater rate that we have de-levered last year. And that's a result of frankly the reduction of the various operating cost which I feel pretty good about how well our great Gates team has responded in the second half of the year and the reduction of the fixed overhead that we will start delivering on and ramp up as the year progresses, so that's kind of how we are thinking about the guide and that's kind of what we believe you will see in terms of not only the top line, but also the bottom line.

Q


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Thank you very much.

**Operator**: Your next question comes from Jerry Revich with Goldman Sachs. Your line is open.

**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC*

Q

Yes, hi. Good afternoon and good evening everyone.

A

Hi, Jay.

**Jerry Revich**
*Analyst, Goldman Sachs & Co. LLC*

Q

I'm wondering if you could – Hi, I'm wondering if you could talk about where you view your market share is across your end markets today compared to the cycle high of, call it, a year-and-a-half ago. Any areas that we should keep in mind, as we think about what recovery sales look like for your business today and maybe on that same note, I'll get you to comment, if you don't mind, the margin profile, so if you go back to prior cycle level of sales, given the cost structure changes we're talking about here, how should the margin profile compared to what we saw in 2018?

A

Sure. Let me let me try take on the first part first. Look, I'll stay away from declaring our market share. My sense, Jerry, is that taking into account how the markets have been behaving, we have picked up some business in certain regions on certain markets with certain customers. And I would say that we have lost some business debt. On one side, we walked away a little bit with. And on the other side, we have lost some in terms of our inability to supply in 2018 at the peak of the upcycle.

So, I'd say that on aggregate, we believe that we are probably picking a little bit of market share. But I wouldn't say that it is yet a dramatic level of market share gain. Now, that being said, we anticipate that the new products that we have launched are going to facilitate by far greater ability that our commercial teams have to compete and take market share away from the competitors that we compete with presently, so our anticipation is that, as the market recover, taking into account that we have added a good amount of capacity globally to be able to service our customers. And the fact that we have launched very innovative and highly differentiated products into the market space that gives us a high degree of confidence that we are positioned well to be able to take some market share as the markets start recovering.

Now in terms of the margin performance again our expectation is that in 2020 in particular we are going to lever up at by far greater rate than we have deleverage in 2019. Taking into account all of the restructuring albeit short-term and or the long-term fixed asset base restructuring that we are conducting. So we anticipate that our margins as we exit 2020 to 2021 should start to normalize and should start approaching the margins that we have delivered during the last up cycle taking into an account that we will see the revenue growth that we have seen during the last up cycle. So we feel pretty well-positioned Jay.


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Q

Okay, Thank you. And then in terms of the industrial and auto replacement markets you're already in the first quarter starting to come some easier time periods in terms of what the performance looked like in Europe and North America auto replacement can you just talk about. You spoke about what China that's look like through January. Can you talk about what your overall replacement markets globally have looked like through January and obviously we see all the production cuts on the OEM side. But I'm wondering are the comps starting to flatten out in the replacement market since obviously we saw the destock their first?

A

Yeah

A

Yeah. As I said we don't believe that we will see an easier comp until we kind of get to the mid-year. What we have seen in January Jerry is more or less in line with what we anticipate to deliver and what is contemplated within our guidance. So we feel reasonably comfortable today to speak about the guide that we have provided you. But I don't really have anything specific that I want to add towards the comp in Q1 – the comp in Q1 is going to be quite difficult. We still had a very strong performance. Yes some of the destocking started to occur but we did not really see the brunt of the revenue declines until kind of May, June of last year. So Q1 is still going to be a pretty tough comp for us.

Q

Okay. Thank you.

**Operator**: Your next question comes from Jamie Cook with Credit Suisse. Your line is open.

Q

Hi. Good evening. Sorry just another question on the comps your first half versus second half in particular fluid power obviously the margins declined pretty dramatically in the fourth quarter and were well-explained. I'm just trying to understand how to think about the margin cadence just given the base we came off of how we exit the year for fluid power specifically? And then as you think about the 2020 guide in total are – is there anything we should be aware of major changes 2020 versus 2019, whether its mix first-fit versus after-market things like price cost incentive comp any – any other variables we should be aware of? Thanks.

A

Hi, Jamie. So let me start with the with some of the easier ones. I would say that price maturity economics we are planning on basically a neutral price material economics. We believe that that is our business model and we believe that we will see price material economics neutral. We have variable comp that we have contemplated within our guide. We anticipate a refunding of that, of that variable compensation that we'll have to get back on the


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books. As I said in my prepared remarks, we did not meet the threshold, so that that had to be accounted for with the midpoint of the guidance that we have put out there. Let's see what were some of the some of the other items, a mix me anticipate to be similar to what we have seen kind of over the historical perspective, kind of that's 60% – 40%, 60% to 38%. I think that we had a little better than in 2019 than we have had historically, but we anticipate that the mix is not going to have a significant shift year-on-year. I think I hit it pretty much all. I think that I have already said earlier that again it's going to be, you know it's going to – I mean, you know we are not guiding by market segment. So we will kind of stay away from that a little bit, but you should think about DSP having a better margin improvements certainly in 2020 than PT given the declines that we have seen in 2019. I think I probably hit everything that you touched on Jamie.

Q

Thank you. That was helpful.

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

Q

Thank you. Good afternoon, everyone.

A

Hi, Deane.

Q

Hey, Ivo. This has come up several times on the call today about where you're comfortable having right size your cost structure both fixed and variable. But is there any sense that you have hampered your ability to flex back up when you do get a normalized in demand and so I mean how would you know whether you've got too much and when would you know it?

A

Deane we believe we have positioned the business well you know that was part of the build out of our capacity – we've put the capacity frankly in all regions, so we have the capability to serve our customers fully regionally. And we've also put the factories in the most significant amount of capacity in locations where we have by far greater flexibility to staff up and/or reduce our staffing as the business enters its cyclical, it's cyclical cycle. So we feel pretty well about our ability to be able to flex up and certainly also flex down as we enter the next phase of where we are here today – where we stand today. We also we also believe that we are quite focused on some of the early signals where we would be able to react to potential up cycle. Again the industries I think are firming up so we believe that you know we're all being very cautious about ensuring that we don't get behind the curve here with our ability to deliver to our customer requirements.


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Q

That's helpful. And Ivo I'd be really interested in hearing your comments on what are the implications for Gates with Eaton exiting hydraulics to set the sale to Danfoss. So I mean typically you'll see some disruptions where competitors like you should be able to benefit, but any early read on these implications or potential implications?

A

I mean, I think that you know there's a full range of what you can think through as you know, but look I mean we certainly don't expect the general competitive dynamic – dynamics of our Fluid Power business to materially change. We anticipate that there may be some disruption and of course we believe that our new products and our new capacity positions us well to capitalize on any potential temporary or permanent disruptions out there from this transaction. Look Eaton Hydraulics is a very good competitor and we expect that it's going to be a very good competitor after the transaction is completed and part of Danfoss. And we certainly if there is any positive we see the multiple as a positive indicator for the value of our Fluid Power franchise, so that's kind of how we are thinking about what has transpired with the transaction.

Q

That's helpful. Thanksk, Ivo.

A

Thank you, Deane.

**Operator**: There are no further questions at this time. I'll now turn the call back over to Bill Waelke for closing remarks.

### Bill Waelke

*Vice President-Investor Relations, Gates Industrial Corp. Plc*

Okay. Thank you for the thoughtful questions there and thank you to everyone else for the broader interest in Gates. As always we're available for follow-up questions. And other than that, we'll look forward to speaking with you again in May. Have a good evening.

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


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