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Gates Industrial Corp. Plc (GTES)

UBS Global Industrials and Transportation Virtual Conference

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Damian Karas
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MANAGEMENT DISCUSSION SECTION

Damian Karas
Analyst, UBS Securities LLC

Good afternoon, everyone. and thank you again for joining us as we round out Day 1 of the UBS Global Industrials and Transportation Conference. I'm Damian Karas, analyst on our electrical equipment and multi-industry research team.

We're pleased to welcome Gates Industrial Corporation for this fireside chat. Joining us from the Gates team, we have CEO, Ivo Jurek.

Now before we get into the Q&A session, let me first turn it over to Ivo to kick things off.

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

Thank you, Damian. Let me just briefly share with you why I believe this is such an exciting time at Gates. We have put a great deal of energy and investment into transforming Gates over the past few years building on the company's strong foundation. Throughout the challenging market environments of 2019 and 2020, we've continued to invest in revitalization of our product portfolio, our manufacturing footprint and our focused growth initiatives.

We are now starting to see these investments to pay off with a meaningful contribution and acceleration of growth momentum. Early in my tenure here at Gates, we set about rebuilding our innovation capabilities and tasked our teams with revitalizing our entire product portfolio.

This is well underway and not only opening up new opportunities, but also leading to improvements in sustainability for us as well as our customers. We are seeing our new product vitality pick up throughout the company and we are excited about the progress. The economic momentum is building across most of our end markets and we believe we are in the early state of industrial recovery. On top of this, our substantial above-market growth is supported by improving economic conditions and the success we are seeing with our innovation

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investments and growth initiatives. We believe the business is well-positioned to achieve our mid-term growth targets.

From a profitability perspective, we have a terrific set of organic opportunities across our segments and ongoing Gates Production System initiatives that support future margin expansion. We believe our recent investments in capacity, new products and restructuring, all provide runway for us to achieve our mid-term targets of 24% EBITDA margins.

Our cash flows have proven quite resilient and when combined with our improved profitability, we allowed ourselves to make significant progress to de-lever the business with our near-term goal of about 3 times net leverage and that's being squarely in our eye sights. This not only creates nice optionality for us to optimize capital allocation but also it gives us the opportunity to have a good runway for future prosperity of the company.

So, with that Damian, I'm happy to take some questions and move to Q&A.

Damian Karas
Analyst, UBS Securities LLC

Terrific. Thanks for that introduction, Ivo.

Just a note for those of you listening in, if you have any questions, you can submit them on the webcast and I'll go ahead and ask them.

QUESTION AND ANSWER SECTION

Damian Karas
Analyst, UBS Securities LLC

Q

So, Ivo, it's been quite the journey since the start of the COVID pandemic to today. I was wondering if you could maybe first reflect a bit, is there anything that you've learned about your business over the past year that you'd say really stands out. And secondly, as you kind of see things today, where would you say Gates has the most room for improvements or any issues that are really front and center for you?

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

A

I think it's a great question, Damian. So, look, 2020 was very tough obviously, but we've pivoted quickly to operate in a safe manner putting the safety of our employee first and foremost. I think it was critical throughout this pandemic. We also worked quite hard to ensure we were able to continue to support our customers, many of our customers which operate in essential industries. When we originally deployed our in-region/for-region manufacturing strategy, it was to shorten our supply chain and frankly operate in close proximity to our customers. But during the pandemic, this strategy allowed us to flex better and serve our customers well around the globe. So, in return, we believe this positions us well with customers today as well as it did over the last 12 to 16 months to frankly drive improvements to our market share position.

Now, maybe to the second part of the question, what – how we can improve the business better, what – how we have altered our portfolio. Maybe let me go back to that little bit and address that question a little more. Look, I almost have to go back to kind of 2018 when we went public first. We've talked about significant additional

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opportunity to rationalize our footprint, revitalize our product portfolio, improve the efficiency of our business and frankly improve the efficiency of our SG&A. And most importantly, we knew that we needed to improve the balance sheet that we were operating within. So, we really haven't changed the strategy even looking back to 2020 and 2019. It's been all about operating our business better. We've been focused on the longer term, which I think has been important for us and to drive innovation, execute on our targeted initiatives to deliver above-market growth.

So, when I look back at the challenges that we faced in 2019 and 2020, we continue to make those investments in product development and all of those growth initiatives and that's been helping us to reposition our business and frankly juiced up a little bit our growth rate. And I think we have been reporting some substantial growth certainly over the last couple of quarters.

During that time, we also dramatically reduced our automotive OEM business and so from that 2018 to 2020 we reduced that OEM business by nearly $100 million, which is a pretty substantial sum of revenue for a company of our size. And we had decided maybe in 2017-2018 timeframe that we will only focus on hybrid and ultimately electric applications and so we are doing that. And so, that offset, we've targeted the offset of automotive revenue with industrial investments. And frankly, we are seeing that with programs such as chain to belt, industrial fluid power initiatives. And that – I think that that's been paying nice dividend for our company.

Damian Karas
Analyst, UBS Securities LLC

Q

Great. Yeah. No, absolutely, you've been putting up some pretty impressive growth numbers in the last couple quarters. Really appreciate all that perspective. Maybe if we just honed in on the growth opportunity a little bit more, if I'm being honest, I think when most people see industrial belts and hoses, their initial response is less than exuberant. So, maybe you could just talk about what has you really the most excited about the future whether you're talking about specific products you've launched, commercial initiatives, some of the secular trends, maybe just kind of layout the growth case for Gates.

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

A

Damian, I think that one of the reasons that I'm most excited about it is because they don't quite understand that everything they do there is probably a Gates in an application that our folks are using in across maybe consumer all the way to industrial applications. But, well, really coming back to the fundamentals of that question, look, we believe that innovation is the foundation that's driving our growth.

Look, we are developing product that is differentiated, it is IP-protected technology and all of that is critical to driving future growth opportunities. So, this innovation frankly is opening doors to new markets and new applications that are frankly secular in nature such as e-commerce-driven logistics, food and beverage, pharma and chemical manufacturing, stationary manufacturing equipment, industrial automation, robotics, personal mobility. I can name many of those and as you start reflecting on these applications, you actually start realizing that, gee, maybe I didn't really think that a robot will have Gates belt in it, did I. And that's really kind of I think maybe the misnomer.

Now, the increasing focus on ESG in the industrial world is frankly accelerating the demand for our products. Why? Well, it's because our products are clean. They are more efficient. They increase uptime. They reduce the need for maintenance. And that is a dialogue that makes it much easier for us to approach customers with applications such as converting industrial chains to clean Gates manufactured differentiated belts. So – and we are seeing this in our results now. Markets have improved somewhat, our sales of Fluid Power as an example of

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the new products in Fluid Power in a most recent quarter were up 90%. Our mobility business grew 80%. And we saw a very significant lift in our industrial chain to belt business as well. Those are huge markets and we're in very, very early stages of penetrating those markets and driving the efficacy of these initiatives.

So, while we may not see this level of growth every quarter, Damian, we do see a very steady, long-term opportunities for our business. And that gives us confidence that we can deliver above-market growth rate that we have committed to our shareholders.

Damian Karas
Analyst, UBS Securities LLC

Q

Understood. I definitely want to ask you a little bit more about the chain conversion, but maybe just thinking a little bit about the market share gains that you're saying that you're achieving now that were in a growth cycle, obviously part of the growth that you're seeing is clearly macro driven. Was wondering if you could maybe share a tangible example or two of the evidence that you're seeing market share wins or a product success that you're having? If you can maybe kind of relate it to an example.

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

A

Sure. Look, I can reflect over the last couple of years, there has not been a quarter where we have not continuously talked about numerous design wins in very attractive end markets and applications. So, every quarter we come out and we delineate with both of our product segments how and where we are winning. Frankly, there hasn't been a quarter where we haven't seen number of very exciting wins across both of these product sub-segments, from chain to belt to industrial fluid power to mobility and others, right.

Most recently, we've talked about key design wins in healthcare, e-scooters, industrial automation, stationary manufacturing, ag, construction equipment, heavy-duty EV trucks to name a few. All we need to do is just reflect over the last couple of quarters and you see a true spectrum of very exciting design wins that now frankly are starting to turn into [ph] billable (00:13:40) revenue from our customers for our products. So, as I look at the revitalization of our product portfolio through this innovation, it is probably the least understood attribute that we have undertaken about the transformation that we have driven through this company. And frankly, that is differentiated our product performance and that is what is helping us penetrate this very diverse new set of applications, customers and frankly end markets.

Damian Karas
Analyst, UBS Securities LLC

Q

Great. So, one question that I do get, right, when they look at your business is fragmented market and high level of profitability. The question being kind of if there's some capital injection that comes in at some of your competitors, would they be able to kind of catch up to you quickly, what are your thoughts on that?

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

A

Yeah. Look, our advantage frankly the way that I think about our company is that we have two off-scale product platforms, okay, Power Transmission and Fluid Power. That in itself, Damian, drives incredible amount of focus and intimacy into applications and end markets. And frankly that's what differentiates Gates from others. And that level of understanding gives us the opportunity to drive innovation, to frankly drive applied material science into our product portfolio. I have spoken on numerous occasions about we are focused on building out an off-scale material science capability and we have made significant investments over several years into that and we have

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built development of our own industrial process technologies. And then, when you combine these two sub-segments, that's what's giving you an opportunity to drive that innovation.

Now, I respect our competitors, but I also believe that we are in stages where we will continue to drive generational product development progress in our platforms. We won't stop where we are today. We will continue to drive the innovation. And frankly, the – that vitality that we are driving into sales of our portfolio and I've spoken about the targets kind of over to mid-term of 20%-plus is what I believe is going to put us on a pedestal that we can remain. We can continue to drive higher levels of profitability. We can continue to drive growth of our company. And frankly, we can enable our customers to reach some of the new objectives that they are looking at, whether or not it is reducing the weight of their equipment, it is higher uptime, it is reduction of energy consumption and so on so forth. So, I feel actually quite good about where we sit competitively. And I believe that as our competitors at some point in time will catch up with us, we will have the next level of innovation that we'll be bringing into the marketplace.

Damian Karas
Analyst, UBS Securities LLC

Q

Great. So, I want to come back to the chain to belt conversion. Maybe for those investors that aren't as familiar with Gates, maybe you could just kind of begin by giving your perspective on the opportunity, what it means for you. And then, I would have a few follow-up questions on that.

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

A

Yeah. So, look, chain to belt is actually a very interesting opportunity for Gates. It's about approximately $8 billion market that is adjacent to what we do today, but it is presently served by industrial chain and Gates does not manufacture industrial chain. So, it is a opportunity that is secular in nature that we believe we are very differentiated from other competitors of ours. We will be – we are competing against non-traditional competitor which is a industrial chain. Look, we are seeing a real momentum that has built in that – in those conversions from a pretty strong foundation that they've built over the last three years. And now that that momentum is actually supported by increasing focus on ESG trends that are frankly front and center for manufacturers around the world. Our teams are very focused. They're really energized by the breadth and the momentum of design wins we are delivering. We're delivering them in end markets such as food and beverage, pharma, logistics, warehousing, industrial, automation to name a few.

And why is it happening? Well, it's happening because we are driving elimination of safety hazards in those facilities because you're not using lubrication, you don't have to shut down the equipment to lubricate those drive mechanisms, you reduce energy consumption because our belts, our drive mechanism is lighter and more efficient. And frankly, it gives you an opportunity to get most out of the industrial assets that are deployed. So, I think it's a really good value prop. And we are seeing that adaption by the way both at OEMs where we are trying to stay focused on converting design wins in machine design, but we're also seeing a momentum in end user operators where we are converting industrial chain in existing installations.

So, this is a business opportunity that is very secular in nature and we anticipate it will add to our growth for very many years to come because frankly we are very early in this opportunity. So, some – maybe borrowing a baseball analogy, we actually kind of feel like we're just putting our unis on, not even entering the playing field yet.

Damian Karas
Analyst, UBS Securities LLC

Q

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Wow. Okay. No. That's great. That was actually the next question I was going to ask you because you have been talking about I think chain to belt for a number of years since you've been public and you mentioned some good momentum now that you're seeing. But sounds like you think this is a really a multi-year, maybe even kind of a multi-decade type of cycle for this to play out?

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

A

Absolutely. Look, I would define the category of multi-decades. Again, look it's about an $8 billion market and from where I sit, why couldn't we have 25% penetration, 30% penetration of that market? I mean, can we get more? Yeah, we could. But, 30% of $8 billion market, that's a big opportunity. It will take time. And in 2019, I said look, we were kind of targeting $200 million of incremental revenue that we should be able to generate kind of by the 2023 timeframe and we are well on the way to be able to generate that level of revenue or more by that period of time. So, if you say, hey, look, these guys are probably going to get to $200 million, $250 million of revenue by 2023, the guy said it's $8 billion market size. That's why I feel that we are just pulling our unis on and we are seeing adoption to pick up. It's becoming much simpler to drive those conversions because people are starting to get it and they see the value and we feel quite confident that this is something that we can continue to drive for many years to come.

Damian Karas
Analyst, UBS Securities LLC

Q

That makes sense. Now you mentioned that you're seeing the conversions both on the first-fit new equipment as well as I guess some – aftermarket some retrofit if you will. Maybe if you could talk a little bit about – I mean obviously the aftermarket, the install base is a much larger portion of the market in a given year than the new equipment market. So, maybe you could give us a little bit your perspective on I mean kind of what is the difference in the adoption rate between those two markets and then thinking more about the aftermarket, the replacement market.

You guys are in a lot of different end markets' applications, what's the best way to think about the lifecycle for your product offering in the belts that – so as we think about how the adoption curve might move.

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

A

Yeah. So look the adoption curves varies, right? So let me give you a couple of different examples. And I'll try to cover – I think at the spectrum of the questions that you have you posed to me Damian with this. So, look, let me give a really easy example. Easy example and OEM adaption personal mobility, right? You go in, you're not going to convert E-bike or an E-scooter or a motorcycle or from a chain to belt unless you convert it at the design with the OEM. So there you go and you target the OEM, you go in and you replace the drive mechanism. And whatever they commit to do they'll do. So, if they commit to a belt they're going to drive a belt adoption. You can take a look at Harley Davidson, if you have Harley Davidson you will only get it with a Gates straps as an example, right? And so it'll be a really good example on OEM design adoption.

Now, let me remind you that the belt – although the belt will not break, the belt will wear. And at some point in time you will actually get to replace that belt and it just depends on your duty cycle. So, how often do you ride a motorcycle, do you ride it every day to work, do ride it for a pleasure, right. And that will predetermine how often you will replace that belt.

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Now, when I think about conversion, there's a huge infrastructure of industrial facilities that have been built out over the last 50, 100 years, right? And in those facilities, just about every apparatus has a drive and the drive generally speaking as an industrial chain. And so, what we are targeting is, we have built a small organization of folks that are targeting very specific industries and going from certain target industries to go and convert manufacturers.

So most recently, and I believe I have spoken about that on my Q1 earnings call, we have converted a very large manufacturer of food products in one of their facility and one of the reasons that they have done it is frankly because they grew frustrated by the amount of lubrication they needed to do to their [indiscernible] (00:25:50) looking for an opportunity to improve their uptime of operating that equipment. And so we went in and we've converted that one facility. They have 85 facilities in the United States and we will convert every one of those 85 facilities. And it's a food manufacturer that's manufacturing products that anybody that's got kids is probably using their products.

And how many of those facilities are out there. So that was one of their specific food product types. And so we see that resonates with our customers, uptime, efficiency, energy conservation. They are all important. And by the way, once we install it depending upon your up-cycle you, will still replace those belts, but instead of shutting your facility once a week – twice per week delivery to lubricate, you may replace the once a year. And so the value prop is quite substantial.

Damian Karas
Analyst, UBS Securities LLC

Q

Makes total sense. Really appreciate all that color. Maybe we can move on to, I guess, kind of thinking about electric vehicles and the opportunity there. It's something that you've characterized as being favorable long-term to Gates and that you'll – I think you've estimated kind of about 20% or more content on EV as opposed to an ICE vehicle. But I guess help us think a little bit about since you primarily play in the aftermarket rather than the first fit market for EV, what that means for your business, given that I think a lot of your product under the hood is sort of on maybe a 7 to 12 year kind of replacement cycle if you will. So, should we be thinking that kind of EV is maybe in a decade is where it's really becomes a robust opportunity for you. But maybe just help us walk through the thinking on that.

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

A

Yeah. Clearly, Damian, I think that you are thinking about it the right way. Look, we are in very early stages of the adoption of EVs as we all know it is very exciting. But I think we all agree we are very early here yet. So, we are developing new products and we are expanding our product cap coverage to continue our leadership position in the automotive replacement market around the world in particular. And so as you said, Damian, the replacement channel business, where our primary focus resides generally targets vehicles that are 7 to 12 years out. And so, we still have quite a bit of time before those markets fully developed.

So, that being said, we are seeing significantly larger content opportunity on the electric vehicles with an emphasis on thermal management system. And as we all probably understand thermal management is critical, because you don't want to have a thermal runaway event with batteries or inverters and molds. It'd just be a bad, very bad thing. So, we are very selectively participating today on the OEM side of the business in line with our long-term strategy. We will participate but only in line with how we are thinking about the need for our participation there. And while we are very excited about the future opportunity for Gates here, we believe it will take some time to materialize as the adoption curves evolve. So maybe 10 to 15 years down the road we ought to be realizing some really nice growth from electric vehicles.

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Damian Karas
Analyst, UBS Securities LLC

Q

Interesting. So you're strategically being very selective in where you play in the OE market for EVs?

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

A

Absolutely.

Damian Karas
Analyst, UBS Securities LLC

Q

So, where you're playing in thermal management, how do you feel like you're performing? Are you sort of gaining? What you're kind of market share that you're catching in this very small market right now?

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

A

Look, we are very much focused on-highway industrial applications. We've talked about couple of reasonably good sized design wins there. We anticipate those will start ramping up pretty quickly in production. We have good presence on the leading EV manufacturer today. So we have nice products and nice presence there. We just try to make sure that we don't overcommit ourselves, Damian. And, again, we want to protect our long-term aftermarket revenue stream, which we believe is critical. And, frankly, that's where we are most comfortable to operate within.

Damian Karas
Analyst, UBS Securities LLC

Q

Okay. No, that makes sense. So let me kind of switch over to the margins in the business and you alluded to earlier sort of this medium-term target of 24% EBITDA margins. I guess just kind of looking where you're at today, right. If you compared it to 2018 prior peak in the business looks like this year kind of you're projected to sort of be at the same level of sales and it looks like kind of a similar level of margin. Just wondering kind of why is that you're sort of kind of flat margin over the three years. Anything that stands out and help us to think about, right, how are you going to get to those 24% sort of medium-term target, is it all about volume or is there other stuff in the mix there that you kind of have in the harper [ph] harper (00:32:17) as well?

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

A

Yeah. So, look, although I think we all would like to put COVID-19 completely behind us, let's remind ourselves, we are still managing through impediments that are driven by it, whether or not it is labor shortages, it's material disruption. Frankly, let's also remind ourselves of geographic [ph] spots (00:32:42) and still here front and center certainly in 2021. And we anticipated that there is something that we're going to continue to deal with. If you recall back our Q1 earnings call, we have various guidance for 2021. And we feel very positively about how the year is developing.

Now kind of coming back to how and where we will get to that 24%-plus EBITDA margins. We are fully committed to the mid-term target. And we believe that we set the target in 2019. And we believe that we can deliver to that target And we believe that we can deliver it to that target within the same set period of time, which is frankly remarkable taking into account that we have gone through trade war induced, recession followed by a pandemic. So, we feel quite well where we're sitting. But, how do we get there? Look, the healthier end markets are going to

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help vis-à-vis volume, our Gates Production System improvements are driving incremental margin performance and our recent investment in capacity and new products as well as restructuring is how you should think about getting to that 24%-plus in EBITDA margins.

So, we feel good about 2021. We do feel that there are still impediments we need to manage through. And frankly we feel quite good about being able to get to that 24% target that we have committed to our shareholders in 2019.

Damian Karas
Analyst, UBS Securities LLC

Q

Right. Yeah. I wanted to ask you what your expectation is for level of investment from here. I mean is it you kind of have to sustain your current level of investment or even increase it or do you have an opportunity to kind of put the brakes on that a little bit given you have been investing quite robustly the last several years and now a lot of that product is coming commercial to market and the restructuring and other operational initiatives you've taken?

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

A

Yeah. I will say that look the transformation that we were talking about is more or less behind us. We are now entering the phase of kind of continuous improvements and driving growth. And that being said, from a CapEx requirement, our business is starting to stabilize kind of at 3% of sales. And we believe that that's kind of a good CapEx investment. We believe that most of our large restructuring is behind us. We have the capacity in place that we believe it's going to be supportive of driving organic growth and driving above market growth rate. And, frankly, that is how we are thinking about the timeframe that we have entered kind of into the next two to three years.

Now, 3% of sales of CapEx. This is still good amount of capital that you can deploy. And when you take into an account that about 1% of CapEx is required for maintenance, we still have 2% that we are guiding that we will be spending on organic initiatives. Frankly, those are really good, high ROIC projects and we believe that those are also projects that are the lowest risk projects. And so we feel that we are in a good place. Again, as you said, most of the significant investment behind us, we are well positioned to deliver the results that we have outlined that we can visualize.

Damian Karas
Analyst, UBS Securities LLC

Q

Got it. Got it. How about the supply chain issues? Maybe you can just kind of give us an update there. I think it sounded like first quarter you've been managing them fairly well without a lot of hiccups. Just wondering if things have gotten any better, any worse. Has your visibility changed at all around that? And also maybe just where you feel like you are being able to manage some of these inflationary pressures, which is that increasing investor concern right now?

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

A

Yeah. I mean, clearly, I can understand that sentiment. Look as I said Mike, you want to call, I am very proud of our supply chain team and [indiscernible] (00:37:26) and operating teams have respondent to these global challenges we were seeing with the supply chain shortages frankly on number of fronts. It wasn't one issue, only it was a multiple of issues whether or not it was chemistry saw steel, precision steel, aluminum and so on so forth. Our team managed quite well and frankly we continued to manage through these various supply chain disruptions in a reasonably good shape.

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We feel that the chemistry and the steel [ph] inputs (00:38:02) are improving, but we certainly don't believe that they're going to go away until maybe the latter part of second half. We believe that these things are going to remain. I think that what most folks don't quite understand is the impact that a Texas winter storm in February had on disruption in chemicals manufacturing and I think that we're all kind of living through that. When you combine that with the labor shortages and [indiscernible] (00:38:37) issues that the spectrum of manufacturers are dealing with, yeah, I think that it's probably likely that that's not going to work itself out certainly until the end of this year. It's been very challenging, of course, for our team I'm sure for our competitors and our customers, but they are managing through these impediments as well as is expected. And we anticipate that we should put it behind us as we exit 2021.

Now, in respect to inflation, look, I think we are all dealing with elevated levels of inflation, we do have over 60% of our revenue that comes through distribution channel. We have an ability to reasonably, rapidly put price increases in place. We have taken pretty proactive stance at the beginning of the year in various prices. We are now seeing those prices hold true. We have been raising prices to OEMs. We have a number of contracts that have escalation clauses. So we have enacted those. But, frankly, we are going to our customers that don't have the escalated clauses as well and those are never easy conversations, but those are conversations that are very important to be had and we believe that as we exit Q2, we'll be in a reasonably good shape to deal with frankly the escalation in inflation that we all are seeing so. On Q1 earnings call, I said that we believe that we will offset inflation, not just material inflation, but also logistics inflation, dollar-for-dollar and we believe that that remains to be the case.

Damian Karas
Analyst, UBS Securities LLC

Q

That's all very helpful. So, we've got a few minutes left here. I do want to ask you about capital allocation. You're going to be in a position here kind of for the first time since you've been public where you're de-levering naturally pretty quickly and I think you're going to kind of get down to certainly under 3 times maybe about 2.5 times leverage by the end of the year. So, could you give us a sense what's capital allocation, what's the Gates acquisition going to look like? Have you been nurturing a pipeline in the last few years or you just kind of starting to build that out today? Educate us on capital allocation.

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

A

Awesome. Look, first and foremost, our primary priority remains to de-lever the balance sheet. Honestly, as you can imagine in a company like Gates that came in, slightly higher elevated leverage into the public markets. That was an important parameter. We are going to get below 3 times. We're going to get there pretty quickly. And as you said, we should be in a reasonably good shape exiting 2021.

You know that being said, it does clearly open new avenues with additional optionality going forward. We have significant organic growth opportunities that we continue to fund. First and foremost, we are not short on organic growth opportunities, but clearly M&A becomes another option for us to drive this growth. But we're going to be very disciplined in our approach. We have a small team of people that we've put in place some time ago. You know it is not a new team. That team has been cultivating a pipeline of opportunities, let's remind ourselves that we participate in a very large, very fragmented markets. And so, we have a good pipeline of opportunities out there, but I think that what is extremely important for us is, we are going to remain disciplined. We do not need to jump in and overreact to M&A, because our balance sheet is improving. We have more than adequate amount of organic opportunities. And when we find the right opportunity to go and acquire and acquire it at a fair valuation, we will do that to ensure that we drive the returns that we anticipate from those type of activities.

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Damian Karas
Analyst, UBS Securities LLC

Q

That's really helpful. And I think we have time for one last question here. So, when I think about a lot of multi industrial investors, thinking what their – what's important to them, free cash flow, free cash flow conversion is something that gets asked about quite a bit. Now, you're free cash flow conversion has had a tendency to whip around a bit so far in the early years. I'm wondering is that just kind of a byproduct of the nature of your business or do you feel like there's things you can do to maybe drive more consistent free cash flow over time?

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

A

Yeah. So, look, let me start with the fact that we have built a strategy that we believe was built around investment and repositioning the business. And the strategy was enacted the way before we went public and then necessitated significantly enlarging our operational footprint and giving ourselves an opportunity to become more efficient and ultimately drive that efficiency through to earnings. And I believe that we are demonstrating that.

So, you're right. We were consuming a little more cash that we were generating. In the first couple of years those public exit – or entrance. 2021, our guidance for cash conversion is at least 80%, but that takes into account a very robust growth that we are seeing across our business and we are supporting the growth with working capital. I think that is necessary and we are generating receivable and there's receivable, we are ultimately turn into cash flow. That being said, we do see an opportunity to continue to improve our working capital efficiency over the mid-term and we're focused on that. We think we can do better. So typically our business has delivered at or above 100% free cash flow conversion and frankly there is the appropriate way to think about our business.

Damian Karas
Analyst, UBS Securities LLC

Okay. Great. Well, I think, we have to leave it there. Unfortunately, we're short on time. But, Ivo, I want to thank you again for taking the time to talk with us today. And thanks to all those who tuned into the meeting. Have a great day everybody.

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

Thank you.

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