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Gates Industrial Corp. Plc (GTES)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Gates Q4 2021 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]

Thank you. Bill Waelke, Head of Investor Relations, you may begin.

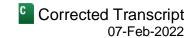
Bill Waelke

Vice President-Investor Relations, Gates Industrial Corp. Plc

Thank you for joining us this morning on our fourth quarter 2021 earnings call. I'll briefly cover our non-GAAP and forward-looking language before passing the call over to our CEO, Ivo Jurek, who will be followed by Brooks Mallard, our CFO.

Before the market opened today, we published our fourth quarter and full-year results. A copy of the release is available on our website at investors.gates.com. Our call this morning 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.

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

With that, I'll turn things over to Ivo.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you, Bill. Good morning, everyone, and thank you for joining our call today. I'll begin with the overview outlined on slide 3 of the presentation. The fourth quarter marked the conclusion of an excellent year for Gates. Our global teams delivered strong revenue growth, benefiting from solid execution of our strategy to reposition the company's business exposure to higher growth end markets. The investments we are making in materials science, innovation, targeted incremental capacity and our unwavering commitment to service our customers, positioned the company to grow by winning new business while managing demand during these challenging times.

Our proactive approach to pricing, particularly early in the year, enabled us to remain price/cost neutral for the year. We delivered incremental margins of nearly 35% despite the rapid rise in inflation we experienced in the second half of the year. Free cash flow generation was also strong, enabling us to significantly reduce our net leverage from 2020 levels.

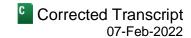
In the fourth quarter specifically, the supportive, underlying demand and order trends continued in both of our segments. Despite our focused execution, we were not able to satisfy all customer demand. Channel inventories remained relatively lean. Our book-to-bill in the quarter was well above 1 and our backlog is at record levels. Global order rates are strong with North America, in particular, seeing the highest monthly order rate in the company's history in January.

From an operational perspective, we navigated ongoing material and logistics availability issues, as well as greater-than-expected COVID disruptions that significantly impacted our production efficiency. These temporary external challenges, notwithstanding, we delivered results in line with the guidance we provided and maintained a supportive market outlook for 2022.

While many of the operating environments challenges persist as we work through Q1 2022, we anticipate these issues will start to abate in Q2. While we are taking a pragmatic view of the operating environment, we expect to deliver another strong performance in 2022.

With that, let's move into more of the detail on the quarter's results on slide 4. Total revenue of \$816 million, including core growth of over 3%, put us at the top end of the range we provided. Our teams executed well in light of the operating environment and delivered another quarter of growth as compared to a record Q4 2020. From a channel perspective, replacement outperformed our OEM business. Our focused growth initiatives in Mobility & Recreation and Diversified Industrial end markets once again delivered the most significant growth, offsetting the decline in sales to other OEMs.

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Our sales to automotive replacement customers performed well, delivering modest growth on a very strong performance in Q4 2020. Our fourth quarter adjusted EBITDA was \$140 million for an adjusted EBITDA margin of 17.1%. As expected, this included a margin headwind of approximately 200 basis points specifically related to price/cost, which is being addressed with additional pricing that went into effect early this quarter and will progressively ramp up.

Despite incremental operational challenges in a quarter, our profitability was in line with the midpoint of the guidance we provided. Although we expect most of these operational challenges to continue, there are signs that some of the most critical material availability issues are beginning to improve. Our adjusted earnings per share were \$0.31 in the quarter, representing an increase of 55% compared to the prior year period, and included some favorable tax items that came through in the quarter.

Moving now to slide 5 and the highlights in our segments, which both saw exceptional core growth in 2021. Our Power Transmission segment had core growth of over 20% for the year, led by a high-20s growth in industrial end markets. Additionally, we saw over 90% growth in Mobility & Recreation. The strong industrial end market growth in the quarter offset the decline in automotive OEM. Our long-term strategy to reposition our portfolio of business continues to progress well.

Beyond key industrial chain to belt wins in semiconductor processing equipment, warehouse automation and robotics, in Q4, we announced entry into an exclusive strategic relationship with Gogoro, a rising electric scooter manufacturer in Asia. This partner is pioneering a smart rechargeable battery exchange ecosystem to enable growth in sustainable micromobility and utilizes the quiet, maintenance-free operation of Gates Carbon Drive Belts in its drive system. We also secured an additional key win with a leading electric vehicle manufacturer on a new platform, further reinforcing our solid position as these end markets move towards electrification.

Overall, in Power Transmission, our pipeline of opportunities is growing, conversion and order rates are increasing and backlog has continued to build. Our Fluid Power segment saw core growth of 24% in 2021, led by strong performance in Diversified Industrial and Off-Highway end markets. In the fourth quarter, our revenue grew approximately 8% year-over-year, led again by Diversified Industrial end market and included notable acceleration in the Energy end market.

We continue to build our order book securing key wins with our new products in Stationary Hydraulics, Forklift and Construction Applications in particular. We are also making nice progress with respect to innovation and recently launched a further expansion of our differentiated hydraulic product line, opening up additional new market opportunities for the company.

With respect to profitability, we delivered solid margin expansion in both segments for the full year. In the fourth quarter, margins in both segments were impacted by operational challenges I mentioned during my opening remarks. The Power Transmission segment was further impacted by investments we are making in additional production capacity in support of the book of business our teams are delivering through successful execution on our strategic business growth initiatives.

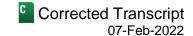
With that, I will turn the call over to Brooks for additional color on our results. Brooks?

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc



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Thank you, Ivo. Moving now to slide 6 and the regional breakdown of our core revenue performance. Our diversified and global business delivered strong full year performance, including record revenues in Q4 of 2021. In Europe, we saw over 30% growth in industrial end markets, which more than offset the decline in auto OEM and was led by the Diversified Industrial and Off-Highway end markets. Replacement channels continue to perform well with both industrial and automotive end markets delivering solid growth.

Moving to North America, we saw a high-single-digit growth in the industrial end markets in Q4, led by Mobility & Recreation, Energy and Diversified Industrial. Our total sales into replacement channels also performed well, offsetting the decline in auto OEM. China performs broadly in line with our expectations in the quarter. We saw low double-digit growth in our industrial replacement channel, which was offset by first-fit declines primarily in the construction, automotive and on-highway end markets. Despite the near-term slowdown, we remain bullish on our business in China, particularly the investments we've made in the replacement channels over the past several years.

Finally, our businesses in South America and East Asia and India had varied performance in the quarter. South America saw solid growth across all end markets, led by Diversified Industrial and Ag. In East Asia and India, strong growth in the industrial ends markets was largely offset by the decline in auto OEM.

Moving now to slide 7 and some details on key balance sheet and cash flow items. We generated strong free cash flow in the quarter with conversion on adjusted net income of approximately 160% and year-over-year growth in LTM free cash flow of over 20%. Our full year

free cash flow conversion was negatively impacted by discrete tax items which increased adjusted net income without providing a corresponding cash benefit in the period. Without this effect, our full year free cash flow conversion was above the 80% guidance we provided.

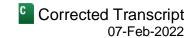
Net leverage improved to 2.6 times, well within our targeted mid-term range of 2 to 3 times, further increasing capital allocation flexibility. Our return on invested capital remain strong at 22.4%, representing a year-over-year increase of 720 basis points.

Moving now to slide 8 and our outlook. We are introducing our expectation for the full year core revenue growth in the range of 5% to 9%. We anticipate the majority of our end markets and regions will remain supportive but are taking a measured view and still anticipating some level of continued material and labor constraints through the first half of the year.

Our outlook for adjusted EBITDA is between \$755 million and \$805 million, taking into account the ongoing uncertainty in the operating environment, as well as price/cost headwinds in the first half of the year. On our last earnings call, we mentioned the transition to adjusted earnings per share guidance and accordingly are providing our expectation of \$1.20 to \$1.30 earnings per share for the year. The midpoint of this guidance reflects a \$0.15 operating increase, offset by a \$0.27 decrease made up of tax and other primarily as a result of the discrete tax items in 2021.

We expect the first quarter to have the most significant impact from operational inefficiencies with moderate sales growth from Q4 driven by normal seasonality in pricing and modest sequential margin expansion. Since our last call, we have implemented multiple price increases in line with our current view of inflation, and we'll continue to take further pricing actions as necessary.

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With respect to cash flow, we expect full year CapEx to be in the range of \$100 million to \$120 million and free cash flow conversion greater than 90%.

With that, I will turn it back over to Ivo for some final thoughts.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you, Brooks. Moving now to the summary on slide 9 and a few key takeaways. I would like to begin the wrap up by thanking our Gates associates around the world whose effort and perseverance drove outstanding full-year performance. Their commitment and execution during these challenging times was truly remarkable.

Our investment in materials science, innovation and our business growth initiatives demonstrated solid progress. We are accelerating the transition of our revenue towards higher growth end markets, particularly in applications with clear secular tailwinds.

As a result, we delivered solid financial performance and have entered 2022 well-positioned to deliver another year of profitable growth and value for all of our stakeholders. With a stronger balance sheet, capital allocation optionality is high as we continue to evaluate opportunities to supplement our growth and return capital to shareholders. Although we anticipate challenges ahead, our business is on a strong footing, and we believe the investments we have made provide a foundation for substantial opportunity moving forward.

Operator: Thank you. [Operator Instructions] Our first question is from Deane Dray with RBC Capital Markets.

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

QUESTION AND ANSWER SECTION

rour line is open.	
Deane Dray Analyst, RBC Capital Markets LLC	Q
Thank you. Good morning, everyone.	
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. Plc	A
Good morning, Deane.	
L. Brooks Mallard Chief Financial Officer, Gates Industrial Corp. Plc	A
Good morning, Deane.	
Deane Dray Analyst, RBC Capital Markets LLC	Q
Hey, congrats on hitting your deleveraging target. I know that was an important milestone for you all and a	

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Analyst, RBC Capital Markets LLC

Corrected Transcript
07-Feb-2022

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

А

Thank you.

Deane Dray

Q

Hey, just so we're calibrated, you said that you were not able to satisfy all the demand in the fourth quarter. We're hearing that from so many companies. Are you able to size what it was either dollar amount or a percent of organic? And did that all go into backlog? Has it been any cancellations out of backlog? Anything meaningful there?

Ivo Jurek

A

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Yeah. Thanks, Deane. It's a great question. Look, I mean, the way that we would size it is that we – kind of midsingle digit for the quarter was the impact of what we felt we were not able to deliver. And as I said in my prepared remarks, the business remains very strong. Our bookings rate is very strong. January was quite solid.

And so, we have been in a mode where demand is being greater than our ability to supply, but I also mentioned that we are making good progress on adding incremental capacity for some of the most constrained products that we have. And we would expect that if capacity is going to be coming online sometime early in Q2 and we certainly anticipated we should be getting – we should start making some progress on eating into the backlog. And as you know, we are book and ship business, so we don't like to have a highly elevated backlog.

Coming back to the question about backlog cancellation, we really have not seen any backlog cancellation at this point in time. And frankly, all the conversations that I am having with the customers are some more associated with we would like to get more products, not we are anticipating to cancel our order. So, we're doing everything that is possible. And certainly, our teams globally are performing at a remarkable level, taking into account this environment to satisfy the demand.

Deane Dray

Analyst, RBC Capital Markets LLC

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That's all good to hear. And just as second question would be on how you are transitioning to include adjusted EPS guidance, just what you said you would do last quarter. You're doing it now here. That's fine for us, the maturity of the company, visibility. So, it begs the question, I don't know for you, Ivo or Brooks, can you talk about the cadence – expected cadence of earnings throughout the year or especially just with regard to seasonality? And maybe you can start with comments on the fourth quarter, just puts and takes. Your comment about the tax items that are not repeating. That'd be a great place to start. Thanks.

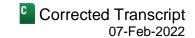
L. Brooks Mallard



Chief Financial Officer, Gates Industrial Corp. Plc

So, let me try to – there's a few things to unpack there. So, let me start with we expect the seasonality, I think of the business – we really haven't had normal seasonality for a couple of years in a row, right. You had COVID and then you had last – then you had in 2021. So, we expect the seasonality. Normally, we're kind of 51/49 first half versus second half. We expect that to be a little bit more weighted to the second half as we work through some of these external headwinds in the first half. So, we do expect it to be maybe more 50/50 or 49/51 first half versus second half of the year.

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I think secondarily on the – if you think about some of the one-off items related to tax, we expect that to be much more normalized. In general, when you think about the tax planning we've done and you also think about the improvement in earnings, that's just created some estimate changes and changes in how we look at deferred taxes and valuation allowances. We're hopeful we've got a lot of that behind us. So, that tax rate is really more normalized in that low-20s. And so, you won't see as much noise there.

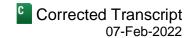
And then I think the third thing on the cadence. Again, on the profitability side, the first half is going to be tougher as we work through the labor-related or the Omicron-related, COVID-related labor issues in the first part of the year, as well as getting really fully ramped back up on some of the material issues that we have in Q4. I mean, we're seeing those get a little bit better, but we still have some work to do to get fully – to get all that material fully into the system

and get output from it. So, we definitely expect to see the second half a little bit better than the first half or better than the first half from a profitability perspective.

Deane Dray Analyst, RBC Capital Markets LLC	Q
That's real helpful.	
L. Brooks Mallard Chief Financial Officer, Gates Industrial Corp. Plc	A
Did I get all your question? Okay.	
Deane Dray Analyst, RBC Capital Markets LLC	Q
Yeah. You did. Really appreciate it and look forward to seeing you all on I	March 8.
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. PIc	A
Thank you.	
Operator: Our next question is from Nigel Coe with Wolfe Research. Yo	ur line is open.
Nigel Coe Analyst, Wolfe Research LLC	Q
Thanks. Good morning, everyone.	
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. PIc	A
Good morning.	
Nigel Coe Analyst, Wolfe Research LLC	Q

So, I think price/cost, I think you mentioned the 200 basis points of dilution to the margin in 4Q. Just wondering how you see that in 1Q and really are we seeing peak inflationary pressures right now or have we seen it? And then, just curious as well how much the 5% to 9% organic embeds price increases?

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L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

Well, let me handle the price question first. So, what we had said on price/cost, if you think about 2021, right, it was a headwind on margins of about 200 bps in Q4 and for the full year of about 50 bps. And we don't really talk about how much of our total volume is price versus – I mean, our total core growth is price versus volume. We've always been – we always haven't talked about that. What we talk about more is the margin impact.

If you think about, as we move forward into 2022, we certainly expect to be price/cost positive from a dollars perspective. And our goal is definitely to be margin neutral from a price/cost perspective. So, I'll leave at that on the price/cost side

And in the first part of your question, remind me what that was again.

Nigel Coe

Analyst, Wolfe Research LLC

There's a price/cost dynamic, 200 basis points of division, how has that look in 1Q? And do we get to neutrality in 2Q?

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

Well, I think it's kind of back to what I said before, right. Price/cost in the first half of the year will be better than we were in Q4. But then that will ramp into the second half of the year, and that's really part of the profitability question as well. Some of it's going to be the production headwinds that we see in the first half of the year that should abate as we move through. And then some of it's going to be the price/cost dynamic. As we get all the price layered in the first half, we really almost looked at price on a quarterly price increase basis as you've seen inflation ramp. And so, we feel good about the pricing we've got laid in. Q1 will be the toughest quarter from a price/cost perspective, and it will get sequentially better each quarter as we move through.

Nigel Coe

Analyst, Wolfe Research LLC

Great.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

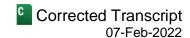
Nigel, maybe additional color on pricing. So, look, I mean, we've priced several times last year as the inflation ramped up quite significantly, particularly in the Q4. On last call we've discussed that we are announcing additional pricing steps. We saw that we wanted to work through with channel partners to ensure that we don't – frankly, we don't create chaos and repricing the price book. And so, we have that layered in. Pricing is rolling in from the beginning of this quarter and we will be taking additional steps if needed. But we feel that we are reasonably shape to be able to deliver price/cost and margin neutrality for 2022.

Nigel Coe

Analyst, Wolfe Research LLC

Great. Thanks, Ivo. My follow-on, a quick follow-on is now your own EPS guidance basis, the share count matters a bit more. How much of your \$10 million buyback do you have dialed into that guidance range?

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L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

We don't really consider that, I mean, because we've got so much opportunity with capital allocation that we really haven't dialed anything in so far.

Nigel Coe

Analyst, Wolfe Research LLC

Okay. That's very clear. Thanks.

Operator: Our next question is from Josh Pokrzywinski with Morgan Stanley. Your line is open.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Hi. Good morning, guys.

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

<A>: Good morning.

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

Good morning, Josh.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC

Brooks, if you don't mind, help us out a little bit on the sequentials into 1Q, especially adjusted EBITDA margins? I mean, I think historically, we can look back and I don't know if there's a necessarily pure cadence. You mentioned you haven't had a normal year in a while, but they usually look like they're down 4Q to 1Q. How do you see that trending this year?

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

Well, if you go back to what I said in the opening comments, right, we expect modest as we move from Q4 to Q1 improvement. There's still a lot of uncertainty in the market or in the external operating environment. When you think about the Omicron impact on our labor availability and being able to get stuff out the door. And so, that's what we're being a little bit cautious on how the year's going to start out.

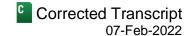
We do expect that to moderate as we move through Q1 and into Q2. And we expect to be back to a more normalized production cadence sometime in the first half. And again, we're going to be cautious in terms of getting out over our skis when that happens because some of it's just unknown. And then we expect the second half to be to be significantly better and to be back to more normalized operating cadence. So hopefully that helps frame it up.

Joshua C. Pokrzywinski

Analyst, Morgan Stanley & Co. LLC



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Yeah. That's helpful. I must have missed that in the opening remark as well, so I appreciate that. And then just second question on some of these consumer kind of recreational verticals. You talked about where you guys have seen some strength. How big is that as a percentage of the business today? It seems like it has been pretty healthy, but what's your visibility like into those channels. Any observations you'd make around kind of inventories or overall kind of customer health there would be would be useful. Thanks.

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

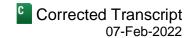
Yeah. Thank you, Josh. As we've discussed, this has been a strategic initiative of ours, particularly as you look at the market continuing to evolve very nicely. And we continue to invest not only in product line coverage and expanding our product line coverage to have a full range of applications from kind of the mainstream bikes to high-end motorcycles getting electrified where our products play really quite nicely with quiet and efficient and reliable belt drives.

We believe that we are kind of at the early adoption of these products and electrification of these, as you said, more consumer-based applications. We believe that it's got a very long trajectory. I think that during our secondary offering, we have outlined that there's about 100 million bicycle, e-bikes and motorcycles that are built annually and we anticipated over a period of time, kind of for the next eight or nine years, about 30% of that populace should get electrified. And that represents a very strong set of opportunities for us, particularly, as we have quite a substantial content on these. And so, we are quite excited. It's grown very strongly. It's around 4% of total revenue. So, as you well pointed out, Josh, it was nearly nil in 2017 and it's nearly 4% of revenue in 2021.

And so, we anticipate that is going to continue well into the future. And look, our teams are executing very well on this initiative and this is also one of those areas where we have seen a significant constraint of our capacity. So, coming back to your inventory question, we really don't have any inventory [ph] in the channel (00:32:37). We see people demanding more of our products and, frankly, we are somewhat struggling keeping up with the demand, but they are very well-positioned, incremental capacity is coming on stream. And we are very excited about this opportunity well into the future.

Joshua C. Pokrzywinski Analyst, Morgan Stanley & Co. LLC	Q
Great. Appreciate the color. Nice work, guys.	
Operator: Our next question is from Mike Halloran with Baird. Your li	ne is open.
Michael Patrick Halloran Analyst, Robert W. Baird & Co., Inc.	Q
Hey, good morning, everyone.	
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. Plc	A
Good morning, Mike.	
Michael Patrick Halloran Analyst, Robert W. Baird & Co., Inc.	Q

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So, on the backlog just could you help give some context here, how long is that stretching out at this point versus what does that look like historically? And then, as you think about backlog starting to normalize, what level of normalization is embedded in the guidance at this point?

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

А

So, Mike, really great question. And I remind everybody we are not a backlog business. Obviously, we are a book and ship business. So, any time that you have backlog, it means frankly that you're having difficulty keeping up with demand. And the backlog has reached record levels. We've just not been able to meet all of the demands, and we're doing everything that is possible to be able to do that.

As Brooks outlined in his comments, we've been hit pretty hard by raw material supply that frankly is exacerbating the issues that we are dealing with. So, it's really not completely driven by our installed capacity. It has really been exacerbated by polymers, chemical additives, some steel and aluminum from various baselines.

And so, that backlog has increased by about \$70 million in the second half of the year. And we've really not embedded a lot of it in our guidance, particularly as we're being reasonably cautious on when we believe we're going to kind of see the breakthrough from our suppliers, their ability to supply to our underlying demand, the raw materials that are required. And then frankly, although we believe that the raw material supply situation is getting a little bit better and we're getting maybe slightly better visibility.

The biggest issue that we are dealing with in Q1 is obviously Omicron that has been hitting factories quite hard and the level of absenteeism has been pretty tough to overcome. So, in a long-winded way, the backlog is high, very little embedded in our guide of being worked through. And we are very optimistic that things will – get a little bit better. And when they do, we will be able to catch up to demand.

Michael Patrick Halloran

Analyst, Robert W. Baird & Co., Inc.

Thanks for that. And I know the first-fit market has some different end market characteristics, but that's a market you highlighted is maybe a little softer, but feel optimistic about. What's the reason for the optimism and maybe just give us an outlook on how you think those markets track as we move forward here.

Ivo Jurek

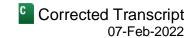
Chief Executive Officer & Director, Gates Industrial Corp. Plc

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So, we said that the – our weakness in the OEM markets has been particularly driven through the weakness of the automotive OEMs. I'm not going to go into the litany of issues that they are facing. We have been reasonably realistic about that business recovering. We didn't really believe that it's going to recover in second half and it really didn't and it got a little bit worse. And what I would say is that we are going back to those automotive OEM accounts as well and telling them we really can't supply you even at that reduced the level of demand predominantly driven by the polymer supply issues in this highly precision, engineered valves that go into that end market.

And so, there was a probably more impactful headwind for us in Q4. And we are being reasonably realistic about what we believe is

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going to happen with the other OEM end market in 2022. We certainly don't believe that it's going to be as rosy as maybe some of those forecasts that are coming out and we are not planning on substantial recovery. So, we I think that we are being realistic about what's going to happen with the OEM end market.

Now, conversely, on the industrial side, we see a good amount of strength. Again, we've discussed, lots of the personal mobility and a good amount of obviously, of the hydraulics business is going through the industrial first-fit end market, and that remains quite strong. And our customers are quite bullish, and they certainly believe that they see a prolonged cycle with the demand for their products and, ultimately, that [ph] filters in (00:38:24) demand for our products.

Michael Patrick Halloran Analyst, Robert W. Baird & Co., Inc.	Q
Appreciate that, Ivo. Thank you.	
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. Plc	A
Thank you.	
Operator: Our next question is from Jerry Revich with Goldman Sachs	s. Your line is open.
Jerry Revich Analyst, Goldman Sachs & Co. LLC	Q
Yes. Hi, good morning, everyone.	
L. Brooks Mallard Chief Financial Officer, Gates Industrial Corp. Plc	A
Hey, good morning.	
Jerry Revich Analyst, Goldman Sachs & Co. LLC	Q

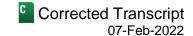
Hi. I'm wondering if you could just expand on the cadence conversation that we've had over the course of this call. It looks like we have really good supply in the early part of 2021. So, correct me if I'm wrong, but I believe your comments about Omicron implied year-over-year revenue is down year-over-year to start the year, Ivo, and then which would certainly imply double-digit organic growth exit rate in the fourth quarter just the way the makeup of the guidance appears. Is that right of my understanding your Omicron comments and the comps comments correctly? Can you just talk about the revenue cadence that you're expecting on a year-over-year basis? I know we spoke first half versus second half on a year-over-year basis? Thanks.

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

Yeah. So, if you go back to my comments in the prepared remarks, what I said was modest profitability, sequential improvement and then moderate top line improvement sequentially as we move from Q4 to Q1. So, we were impacted in Q4 by material shortages. At the end of the quarter, Omicron started to – COVID started to be more of an issue.

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I think as we move through Q1, we think some of the material issues will start to improve, but we still got to work through these COVID-related absenteeism, particularly in North America where it's moving through our factories and impacting our ability to produce. As I said, we expect the first half of the year to be a little bit less than the second half, which is a little bit of a reversal from normal seasonality. Again, I use normal in quotation marks because it has not been a normal kind of two-year run here. But really that's the cadence that we're expecting right now based on what we know.

Now, if things get better, maybe they get better. If not, we're taking a cautious view. Hopefully, we've got that sized right. But that's really the cadence that we're looking at right now, and that's kind of our best visibility to it at this point in time.

Jerry Revich

Analyst, Goldman Sachs & Co. LLC

Okay. I appreciate the color. And then separately, you mentioned the new EV manufacture win this quarter, Ivo. I wondering if you could just talk about since it's the last Analyst Day what's been the cadence of new awards versus your expectations and is it possible to have a similar conversation sizing the revenue opportunity for you, folks, for the electric vehicle business the same way you stepped through on the consumer side.

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

Yeah. Absolutely, Jerry. If you bear with us, we'll unveil the – all of our thoughts, the opportunity, the size of the opportunity on March 8 at the Analyst Day. We certainly view that as a very sizable opportunity for our business. We'll be talking about some of the directional changes that we have been making. I'm actually quite pleased with the amount of design wins and business awards we have been awarded. I mean, I think if you go back maybe throughout 2021, I don't think that a quarter has passed that we haven't gotten a nice new design win or a

business award in electrification. Look, we like our auto business. We have been molding that portfolio around where we believe our technology serves the most to our customers.

And we believe that over the mid-term and the long term, we have even more substantial opportunity as electrification takes hold. And we are spending quite a bit of our R&D resources to be not only ready but to maintain our leadership position, particularly in automotive replacement channel. And we certainly believe that that will be the case as the years pass on. And these car fleets get bigger, the electrified car fleets get bigger and they age and get to a point where we frankly like to operate, which is that 7- to 11-year age car fleet. But more to come during our Analyst Shareholder Day in early March.

Jerry Revich	
Analyst, Goldman Sachs & Co. LLC	6

Looking forward to it. Thanks.

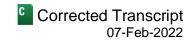
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you.

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



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Julian Mitchell

Analyst, Barclays Capital, Inc.

Hi. Good morning. Maybe just wanted to understand a couple of things around sort of inventories and cash conversion. So, many industrial companies this earnings season have been telling us that their own inventories are sky high, but all their customers' inventories are rock bottom. So, just wondered about your perspectives on that and how plausible do you think such a bifurcation really is.

And then when you look at Gates' own inventories, you're guiding for a big step-up in cash flow conversion in 2022, even with CapEx up substantially. Just maybe talk through the cadence around that working capital liquidation over the balance of the year.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Sounds good. Good morning, Julian. It's a great question. Let me start, and then I'll pass it on to Brooks, because this – I think there's quite a bit to unpack in that question as well. But look, when we assess the inventory levels, particularly as we generally speak, we have – we are focused on the replacement channel. And so, as we are looking at the replacement channel inventories, they remain – I would term it reasonably lean.

All of our customers want to buy more. I think I said it earlier in the call, Julian, the calls that I'm getting from our customers from the CEOs or chief purchasing officers, are not, hey, look, we are worried about the demand. We need more of your products because you are preventing us from building our devices. And so, we are very much kind of in front and center of helping them to get their products into the marketplace.

So, based on kind of the point-of-sale data that we see and that we track very carefully, the indicator saw that the inventory levels are not overinflated. Again, I think I addressed the OEM part of it. And so, our sense is that we are in a reasonably good shape. From our side, I would point out that we are trying to secure some of the key raw materials that we can get are – that we can get our hands on, to be honest with you.

So, whether or not it is the highly engineered compounded resins that have been a real issue, some of them have been impacted by the Defense Act that was enacted last year that saw, of course, being removed very late last quarter. So, we are seeing a little ease of some of those critical resins [ph] and others (00:46:35) to our manufacturing processes easing off. We have quite a bit of in-transit inventories due to some of the logistics inefficiencies that you see out there. And I would say that that's probably kind of the at the higher level, what we see vis-à-vis inventories in the channel and some of the – some with kind of more global inventory items that we hold.

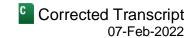
I'll pass it on to Brooks for some additional color as well, though.

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

Yeah. So, from a cash conversion perspective I think we had some headwinds in 2021, certainly, I think relative to the cash taxes versus the GAAP taxes that we saw that won't repeat. And then, I think on the AR side, clearly, with a lot of the pricing that's going in, you're going to see some higher accounts receivable as you move through the year. But the real opportunity for us is inventory. We have been holding higher inventories as we tried to procure certain strategic materials as well as our, really elevated in-transit materials as transit times have, in many cases, more than doubled.

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And so, not only are you – do you have more material on the water, but then, you're trying to procure more material because you've got more material on the water. So, you're trying to get more material in to have on-hand because you're not sure about, the transit times. So, we think net-net, that we have more of an opportunity with inventory that'll help us drive down working capital. From a cost perspective the payables and the increase in the material cost sort of wash out. And then, that's how we get to our improved cash conversion number.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Thank you. And then, just my follow up question on trends in China. Gates has a very good perspective on that market and a large presence. And your sales there, I think, were down mid-teens in Q4, having been down low-single digit in Q3. So maybe tell us how you see the first quarter starting out in China year-on-year and any expectations for the full year? Maybe relative to that 6% top 9% firm-wide core growth guidance?

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

Yeah. I think, it's a great point, Julian. Well, let me start with the bigger picture, right? We anticipate in .

2022 a growth, a positive for growth in China, and we certainly are maintaining our positive long-term outlook. We anticipate – again, we are being realistic. You are seeing all the news flow that's coming out vis-à-vis Omicron and the shutdowns that they have in China. Some of our business is frankly consumer business, particularly in the AR channel, people are driving a little bit less. But that being said – Olympics is also not helping out.

But that being said, we anticipate that in 2022, our growth in China is going to go back up to kind of the mid-single-digit level, again, driven by our design wins and activity in mobility and Diversified Industrials in particular, in addition, starting to see a little – a little more of the automotive replacement business strengthening again after maybe two quarters of uncertainty there in China.

And so, we are – over the long term, we are very bullish on China. We are very bullish with what we have done in terms of building our presence and tapping into some of the growth trends that I have talked about for the company. Those growth trends are associated with opportunities in China as well and we did see some choppiness in Q4. But for the year, we believe it's going to be more kind of mixed single-digit growth.

Julian Mitchell
Analyst, Barclays Capital, Inc.

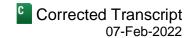
Great. Thank you.

Operator: Our next question is from David Raso with Evercore. Your line is open.

David Raso
Analyst, Evercore Group LLC

Hi. Thank you very much. I'm trying to get a sense in the guide if there's any volume growth baked in. Because when I see the margins as flat year-over-year implied, but the revenue up 5% to 7%, maybe a little negative on currency, but call it 6% to 7%, you would have thought maybe price/cost is a drag on the margin, but you're saying price/cost is neutral to the margin. So, maybe what it is most of the revenue is top – the top line is mostly pricing and there's no operating leverage. It's solely margin neutral, which would explain it. But then I'm trying to think about some of the comments about some supply opportunities getting a little better and so forth. So, I'm just

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trying to figure out, do we have any volume growth built into the guide for this year? And thus you would think you'd have a little operating leverage on that better volume?

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

Yeah. So, let me start with kind of the financial part of it, and then I'll let Ivo talk about the commercial part of it. Like I said, we've been – we've never really split out between volume and price. There is volume baked into our guide. So, I'll say that and leave it at that.

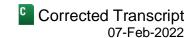
I think on the operating leverage side, what you have to think of is we're still working through some pretty significant issues around Omicron and around operating headwinds and things of that nature. And while our target is to be margin neutral on the price/cost side, we've got some work to do to get there.

Having said that, the comps in the first half of the year of 2022 versus 2021 are tough, right. I mean, we had two of the best quarters in the company's history in the first part of 2021. And so, we'll – as we work through the operating headwinds operating headwinds, as work to the operating headwinds in the first half of the year and we get to the second half of the year, I think the incrementals and the overall kind of operating margin fall through will get better as we progress through the year.

But we've just got to work through these operational headwinds in the first half of the year because they're significant, right. I mean, when you're dealing with this level of absenteeism, that's a cost headwind as well as a production kind of volume headwind. And so, we'll work through that. And we'll still deliver solid incrementals, just not what we think our long-term incrementals are going to be, which are still intact. We still think as we work through these price/cost issues and some of these operational headwinds, we feel really confident in our 35% to 40% incrementals.

David Raso Analyst, Evercore Group LLC	Q
But not	
[indiscernible] (00:54:06)	
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. Plc	A
And, David, maybe	
David Raso Analyst, Evercore Group LLC	Q
making sure. Just basically they're	
L. Brooks Mallard Chief Financial Officer, Gates Industrial Corp. Plc	A
Yeah.	
David Raso Analyst. Evercore Group LLC	Q

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...yeah, I appreciate that. I'm sorry. Go ahead.

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

Yeah. For all those reasons I listed, right, price/cost, which from a margin percent [indiscernible] (00:54:16) So from an EBITDA margin perspective, it's a little bit lower than our normal incrementals. But then also from an operating efficiency headwind, those are things we're going to have to work through in the first half as well.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

So, David, maybe let me let me kind of just add a couple more things to what Brooks said, right, and come back to – look, again, the underlying demand and the order flow activity is very strong. We have been in the mode of demanding significantly greater than our demand. Now, when you compound that with the significant material freight and labor availability issues, we're just being realistic about what we are seeing in Q1. We certainly expect that for the year, volume is going to be up as the first half weakness gets better with – and some of the incremental capacity investments that I've mentioned start kicking in as well.

So, we also all-in expect that we will be getting healthier operationally from material and labor perspective. And we anticipated we should be in a position to start converting some of the backlog and start catching up to the underlying strength that we see with our orders. But this is probably the most challenging operating environment that I have ever seen. And I'm certainly very proud of how our associates around the globe have been able to step up and support our customers to the best of our abilities.

David Raso

Analyst, Evercore Group LLC

I appreciate that. My follow-up on the pricing actions that we discussed at length last quarter thing, let's not do it right toward the year end. Let's start January 1 and it'll be a bit of a substantial increase. What has been the feedback in the sense of getting that pricing at the timing that you expected and the magnitude when it comes to they're accepting it and, obviously, if you have any visibility into the point of sale, how the end customers handling it? But particularly the timing of what you expected to get and the magnitude.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Look, I mean, we have done exactly what we said on that call on the Q3 earnings release. We worked with our channel partners. We've brought in the increases that we have discussed on that call. Look, nobody is scratching their heads and say, why are you doing that? Certainly pretty substantial level of inflation that they see across everything that they purchase. We have gone across the globe. We have not touched any region or any customer. And these are ramping through to the quarter. Many of them have been effective January 1, and we are just – we are being very realistic about what happens with inflation. And if inflation continues the trajectory that it was on Q4, we will take more price if needed. Presently, we believe that we have scope, inflation and pricing in such a way that we anticipate for the year to be margin not diluted, but it will be a situation that has to get worked through as the year progresses.

David Raso

Analyst, Evercore Group LLC

Great color. Thanks.

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L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

And let me add to – let me just add to what Ivo said. We've got really, I think, strong value-added pricing teams in place. They do a good job working with our commercial teams. And so, we're, in addition, as we work through making sure that we cover inflation, we're also constantly making sure that we value pricing all the products that we make and everything that we bring to the market. And we're using this opportunity to go back and look at profitability by product line and, quite frankly, make sure that we're getting the right pricing level for the value we bring to the table.

And so, it's a tough effort. There has been a lot of work that's going on, but our value-added pricing teams do a great job. They do a great job working with our commercial team, and they're very upfront in communities and with the customers on all those fronts.

with the customers on all those nonts.		
David Raso Analyst, Evercore Group LLC	Q	
I forgot one quick clarification, sorry. Tax rate, you mentioned getting back to the low-20s in a normalized level. What is the tax rate we should be modeling within your guidance for the year?		
L. Brooks Mallard Chief Financial Officer, Gates Industrial Corp. Plc	A	
21% to 23%.		
David Raso Analyst, Evercore Group LLC	Q	
And that's sort of the cadence, just 21% a quarter makes sense or something unique a	t the moment?	
L. Brooks Mallard Chief Financial Officer, Gates Industrial Corp. Plc	A	
Yes.		
David Raso Analyst, Evercore Group LLC	Q	
Okay. Terrific.		
L. Brooks Mallard Chief Financial Officer, Gates Industrial Corp. Plc	A	
That's correct.		
David Raso Analyst, Evercore Group LLC	Q	
Thanks so much for the time. I appreciate it.		
lvo Jurek	Д	
Chief Executive Officer & Director, Gates Industrial Corp. Plc Thank you.	/ \	
Haik you.		

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Operator: Our	next question is	from Andy	Kaplowitz with	Citigroup.	Your line is open.
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Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

Hey. Good morning, guys.

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

Good morning.

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

Good morning, Andy.

Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

Ivo, last year this time, you talked about Gates being positioned to deliver mid-single-digit market outperformance, and I think you're positioning toward high-growth industrial markets and your new product vitality index [ph] have seemed to (00:59:52) accelerate. You've got chain to belt, these new products and fluid power that you introduced over the last couple of years. So, how do you think about market outgrowth in the context of the 5% to 9% organic growth guidance you gave for 2022?

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Andy, if I take into account what was the underlying demand, we would be in a position to be a lot more constructive in the market outgrowth. I just think that we are being very realistic associated with what we are seeing in terms of the raw material shortages, particularly in the resins that we use as well as the Omicron situation. But the underlying demand again, is positioning us to deliver very robust market outgrowth once we worked through the issues associated with labor and raw material shortfall.

Andrew Kaplowitz

Analyst, Citigroup Global Markets, Inc.

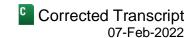
Got it. And, Ivo, you could give us some more color on how to think about auto replacement and auto markets and what's baked into your 2022 guidance. I know you said, low double-digit auto replacement growth in Q4, more than offset a pretty big decline auto OE, which I think was more China-based, but I know you said you're more skeptical around auto OE, coming back quickly in 2022. But as the global car park continues to get older, given production so slow, could we see an extended replacement cycle for you guys?

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Yeah. Look, the auto replacement business has been absolutely terrific for us over the last six quarters and we've continued to deliver a very nice growth in Q4 as well off and absolutely terrific comps in Q1 2020. We believe that auto replacement is going to continue to grow kind of low- to mid-single digits in 2022. But just like everything

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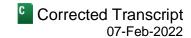
else, it is also impacted by raw material supply and labor challenges that we deal with across that entire enterprise.

So, the more we work those through, I think the more we capitalize on the market, the underlying strength in the market. And you very well pointed out, Andy, that we believe that the life cycle on vehicle life is extending and if you extend that life, you need to repair, you need to take better care of those vehicles.

So, we believe that the underlying trend is very positive in AR, vis-à-vis automotive OEMs. We are more skeptical about the OEM's ability to ramp up production. We have been very skeptical in 2021. I think that we were being viewed as overly negative. I think that Q4 got a little bit worse than what we have anticipated. And our view is that auto OEM business may kind of be flat lining in 2022. I get it that that puts us as an outlier, but I need to see the recovery before we become more constructive on the global carmakers' ability to ramp up production and keep with their underlying demand.

Andrew Kaplowitz Analyst, Citigroup Global Markets, Inc.	Q
And Ivo, just to clarify, is auto OE flat? Is that kind of what's in your guide for 2022?	
Ivo Jurek	А
Chief Executive Officer & Director, Gates Industrial Corp. Plc It's maybe very low-single digits up, Andy,	<i>"</i>
L. Brooks Mallard Chief Financial Officer, Gates Industrial Corp. Plc	А
Yeah.	
Andrew Kaplowitz Analyst, Citigroup Global Markets, Inc.	Q
Thank you.	
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. Pic	А
Thank you.	
Operator: Our next question is from Jeff Hammond with KeyBanc Capital Markets. Your line is ope	n.
Jeffrey D. Hammond Analyst, KeyBanc Capital Markets, Inc.	Q
Hey. Morning, guys.	
Ivo Jurek Chief Executive Officer & Director, Gates Industrial Corp. Plc	А
Good morning, Jeff.	

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Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Just on – I guess what we've been hearing is maybe a little bit better price and availability on some inputs like steel and resin, but it seems like you're still seeing acute inflation in availability. Can you just made me speak to where those challenges are most acute still?

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Yeah. So, I would say that – I mean, we are starting to see some green shoots on raw material availability as well, Jeff. I would say that raw material availability was – I will say, they peaked in Q4. That was really tough. We are starting to see more available material for our consumption pretty much across the board. There are still some that are highly constrained that may not break through certainly in Q1 or Q2, but the number of resins or additives in – the polymer additives that we are being highly constrained on is significantly reduced in the amount of the types of additives. So also, I would say, maybe getting a little bit better.

The biggest issue really is Omicron for us in Q1. We have operating facilities that have reasonably low vaccination rates, production facilities and those facilities are impacted quite significantly. And so, I would say that the way to think about Q1 and maybe the beginning of Q2, but I'm hoping really Q1, is that as Omicron works through, we will be in much better situation. And certainly with – combined with additions in incremental capacity, we should be a little more constructive as we get into the second half.

L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

I would add on the inflation question. You remember, even though people have been raising prices throughout 2021, there's still the beginning of the year price increases that rolled through. It drove a lot of suppliers. And so, even though you see an elevated inflation, there's still more that you're going to have to price in as you move through 2022.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Okay. And then just on order because I'm struggling a little bit versus like the supply constraints versus any kind of underlying order slowing. Is China kind of the only market where you're seeing maybe some true deceleration versus what has been a pretty healthy overall order environment?

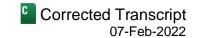
Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Yes, Jeff. I would say that China has been the only region, frankly, where we have seen weakness in Q4, where we anticipate still a degree of weakness in Q1, but predominantly driven by some of the external issues associated with the Olympics and Chinese New Year and little bit of the restrictions that the government is placing on Omicron cases that they see there, but we're also seeing that that should improve as we exit second quarter.

And you also start seeing more – more manageable comps. And as I said, I think to Julian's question, we anticipated we will be for the year mid-single-digit positive on core in China. So, we certainly see some positive outcome on China as well in 2022.

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L. Brooks Mallard

Chief Financial Officer, Gates Industrial Corp. Plc

А

I would say just that. Okay.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Okay. Thanks, guys.

Operator: This concludes our question-and-answer session. I'll turn the call back over to Bill Waelke for any closing remarks.

Bill Waelke

Vice President-Investor Relations, Gates Industrial Corp. Plc

Thanks, Chris. Before we disconnect, just wanted to briefly mention our upcoming Investor Day, which is planned now for the afternoon of March 8 in New York. If you've not received any information or interested in attending in person, please contact us at investorrelations@gates.com. Thank you for your interest in Gates and have a good rest of the day.

Operator: Ladies and gentlemen, this concludes today's conference call and webcast. Thank you for participating. You may now disconnect.

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