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Gates Industrial Corp. Plc (GTES)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day. My name is Savannah, and I will be your conference operator for today. At this time, I would like to welcome everyone to the Gates Industrial Corporation Q1 2022 Earnings Call. Today's call is being recorded. All lines have been placed on mute to prevent any background noise. And after the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

And I would now like to turn the conference over to Bill Waelke. Please go ahead.

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

Thank you for joining us this morning on our first quarter 2022 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 first quarter 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.

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

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statements are subject to risks that could cause actual results to be materially different from those expressed in or implied by such forward-looking statements. These risks include, among others, matters that we have described in our most recent annual report on Form 10-K and in other filings we make with the SEC. We disclaim any obligation to update these forward-looking statements, which may not be updated until our next quarterly earnings call, if at all.

With that, I'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 us on our call today. I'll begin on slide 3 of the presentation. We delivered a solid start to the year with our first quarter results slightly ahead of the expectations we communicated on our last earnings call. While we anticipated a number of impediments as we entered the year, we managed through incremental challenges related to COVID, supply chain and inflation in the quarter.

From a top line perspective, we largely saw a continuation of the positive underlying demand for our products and associated order trends, and we delivered a record amount of revenue for Q1. Our focus on executing our initiatives in higher-growth end markets with exposure to secular tailwinds allowed us to substantially offset the additional challenges we encountered.

The COVID-related disruptions in our facilities early in the quarter in North America and Europe, and then in China in March, continue to weigh on our ability to meet the level of customer demand for our products. As a result, our backlog continued to grow and we exited the quarter once again with book-to-bill well above 1.

With respect to profitability, we delivered sequential margin improvement in line with the commentary we provided on our last earnings call. Our ongoing pricing actions offset the dollar impact of increased inflationary pressure across commodities and logistics costs. Based on our progress to date with pricing actions across the enterprise, we fully expect to achieve our goal of Adjusted EBITDA margin neutrality by the end of the year.

During the quarter, we continued to manage through significant inefficiencies created by COVID disruptions in our manufacturing facilities and supply chains. While the raw material availability improved in general, it still remains dynamic. Our sourcing and material science teams are working on a number of opportunities to continue to improve the flexibility of our supply options, which should contribute to lower level of disruptions in the second half of the year.

Finally, we repurchased $175 million of our shares in the first quarter under the authorization that was approved in November of last year. We are confident in the demonstrated cash generation capabilities of our business and plan to continue to be opportunistic with capital deployment options.

Moving now to slide 4. Our total revenue was $893 million, with core growth of over 4% on what was a previous record Q1 last year. The demand for our products remained solid, especially in our replacement channels where core growth remained in the high single-digit range and more than offset a modest decline in our first-fit business.

Our focused growth initiatives in the Mobility and Diversified Industrial end markets once again showed solid traction, delivering low double-digit core growth on a combined basis. I will note that our revenue generation in these end markets was impacted by some specific capacity limitations, which we are in the process of addressing to support expected customer demand and future growth.

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Finally, in the Energy and Resource end market with exposure to oil and gas, mining and renewables had another strong quarter of mid-teens growth on the increased level of activity in the field. Our first quarter Adjusted EBITDA was $157 million or a margin of 17.6%, in line with our expectations of modest sequential improvement from the fourth quarter despite what turned out to be more challenging operating conditions.

On balance, we executed well in the quarter. The significant operational inefficiencies, stemming from COVID disruptions in the first part of the quarter, were offset by a solid performance in Americas, particularly as we exited the quarter. Adjusted earnings per share of $0.26 in the quarter came in slightly better than we anticipated due to higher Adjusted EBITDA and lower income tax expense.

Moving now to slide 5, which covers our segment-level results. Our Power Transmission segment had revenue of $556 million in the quarter, including core growth of 3% and negative FX impact of 4%. We saw high single-digit growth in our industrial end markets, led by the Mobility, Diversified Industrial and Off-Highway applications.

Our replacement channels performed well with mid-single-digit growth more than offsetting the slight decline in first-fit channels. Our first-fit performance was particularly impacted by the continued weakness in production rates at European, Japanese and Korean automotive OEMs, driven by the meaningful supply chain issues specific to those customers.

On our last earnings call, we mentioned targeted capacity investments to support growth in the Mobility and Diversified Industrial end markets. These capacity investments are underway. We expect them to ramp up throughout the second quarter and be in place to support the incremental demand we see in these end markets in the second half of the year. Furthermore, our design wins across these growth initiatives remain quite robust.

Our Fluid Power segment had revenue of $338 million in the quarter, including core growth of 6% and negative FX impact of 1%. Growth was led by the Energy, Agriculture and On-Highway end markets. We have continued to see strong progress with our new products and key wins in stationary hydraulics, agriculture, mining and construction applications. Additionally, we are making good progress in market share gains with key distributors, particularly in North America and Europe. Our investments in innovations are also paying dividends and continue to enhance our competitive market position.

With respect to profitability, both segments were impacted by the operational disruptions I mentioned during my opening remarks, but based on the focused effort and dedication of our global teams, we came in better than what we originally expected. The Power Transmission segment was also somewhat impacted by the targeted investments in additional production capacity, which we expect will begin to deliver benefits in the second half of this year.

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

L. Brooks Mallard

Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

Thank you, Ivo. Moving now to slide 6 and the regional breakdown of our core revenue performance. The global diversification of our business helped us deliver core growth in the quarter, as pricing and volume growth in some regions offset COVID and supply chain headwinds in others. In Europe, we saw strong performance across the business outside of automotive first-fit. Our sales into Industrial end markets grew by nearly 20%, led by the Mobility, Energy and Off-Highway end markets. The replacement channels continued to perform well, with both Industrial and Automotive end markets delivering strong growth.

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Moving to North America, where we saw growth in the high single-digit range in Industrial end markets led by Mobility, Energy and On-Highway. From a channel perspective, we saw the largest growth in sales to OEM customers, particularly those serving the Industrial end markets. I would note that we saw a solid performance in North America with significantly lower impact of raw material and COVID disruptions as we exited the quarter.

Our business in China was on a nice trajectory of improvement in the first two months of the quarter before being significantly impacted in March by COVID and the disruptions resulting from broad lockdowns and tight restrictions in the movement of people and goods. Despite the near-term COVID headwinds, we continue to execute on our growth initiatives and believe we are well positioned for long-term growth in China.

Finally, our businesses in South America and East Asia and India had varied performance in the quarter. South America had a record quarter with strong growth across all end markets, led by On-Highway, Diversified Industrial and Off-Highway. In East Asia and India, demand overall remained strong. We saw solid growth in our replacement channel business, which was offset by a decline in first-fit shipments, driven largely by COVID shutdowns and supply chain constraints. Overall, the situation remains dynamic, and we are focused on managing through the short-term issues while investing for longer-term operational flexibility.

Moving now to slide 7 and some details on key balance sheet and cash flow items. Consistent with normal seasonality, we had a cash outflow in the first quarter, with higher sequential sales driving higher investment in working capital in addition to typical first quarter cash payments. We continue to tactically invest in inventory to help offset the disruptions caused by raw material availability and logistics timeliness. We believe this will moderate as we continue to improve our flexibility of supply and see decreasing COVID impacts in the second half of the year.

Our net leverage at the end of the quarter was 3.2 times, representing an improvement from 3.8 times in the prior year. Compared to year-end, net leverage was higher by 0.6 times, driven by share repurchases of approximately $175 million and normal seasonal cash outflow. We had a solid 19.2% return on invested capital, representing a year-over-year increase of 220 basis points.

Moving now to slide 8 and our full year guidance, which we are maintaining. There is clearly an elevated level of uncertainty in the global economy, and we believe we've taken a realistic approach to the balance of the year based on what we know today.

Embedded in our full year outlook is approximately 300 basis points of revenue headwind from the impact of full compliance with all sanctions against Russia and Belarus as well as our current view of the likely impact of the COVID lockdowns in China. However, we believe continued strong execution on both our growth initiatives and pricing will allow us to offset these headwinds.

Demand trends remain encouraging, and we have targeted capacity coming online to support specific end markets where we continue to see strong growth opportunities. We continue to drive additional pricing actions in all regions across all channels and believe we are making good progress towards our goal of Adjusted EBITDA margin neutrality by year-end.

In combination with pricing, we expect substantial margin improvement from a more stable operating environment in the second half as COVID disruptions and raw material challenges likely moderate. For the second quarter, we anticipate continued challenges from COVID disruptions in China and the availability of certain raw materials as well as the aforementioned Russia impact. The impact of these revenue headwinds in Q2 is expected to be 500 to 600 basis points sequentially compared to Q1.

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We expect improved pricing, combined with continued strength in the Americas and our growth initiatives to offset these headwinds and result in low single-digit sequential revenue growth. Improved price/cost and productivity are anticipated to drive sequential Adjusted EBITDA margin expansion in the range of 125 to 175 basis points.

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. So moving now to the summary on slide 9 and a few key takeaways. I would like to begin the wrap up by thanking our business associates around the world whose efforts and perseverance drove our solid performance. We are pleased with how Q1 shaped up and our team's ability to execute in an extremely difficult operating environment. While we remain realistic about the challenges ahead of us, we continue to focus on execution and managing what is within our control.

Throughout the past several years, we stayed committed to investing in innovation in our growth initiatives, which are contributing to the strong order flows we are now seeing. We expect our pricing momentum to continue and believe operating conditions will improve in the second half, giving us the confidence to maintain our guidance.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from Damian Karas with UBS. Please go ahead.

Damian Karas
Analyst, UBS Securities LLC

Q

Hi. Good morning, everyone.

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

A

Good morning.

Damian Karas
Analyst, UBS Securities LLC

Q

So I know you mentioned that you're expecting margin neutrality by the end of the year. But just thinking about the 5% to 9% sales growth that you reaffirmed, are you sort of expecting that the supply chain headwinds ease such that you're fully able to kind of meet your demand by year-end and are playing catch-up? Or are you still assuming that there's kind of bottlenecks through the rest of the year? And also, it sounds like you've taken down your China outlook. So just curious what you have baked in compared to the prior modest growth expectation.

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

A

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Yeah. Good morning, Damian. We anticipate – first of all, we have seen a nice improvement in the availability of raw materials sequentially, so from 4Q last year to Q1. Last year, we were dealing with maybe dozens of raw material issues kind of on weekly basis. And as we entered the year, we've seen maybe half a dozen of those issues and now we are dealing with just a few day-to-day issues. I mean, they're still reasonably significant, but we are seeing a very, very substantial improvement.

And as I said in my prepared remarks, I mean we are working very feverishly to give ourselves more optionality to reduce our dependency on some of the most constrained of materials that we are still dealing with. And we think that as we exit Q2, we're going to be in a very solid position to, hopefully, not be talking about raw material supply issues.

So we are reasonably confident that we got that under control. And as we enter kind of the second half, we will be in a solid position to start producing at a much better rate and a rate that hopefully start actually taking a backlog down and keep up with the order flow. That being said, obviously, there's still lots of challenges that they are dealing with on weekly basis, daily basis that you haven't really forecasted. And that is what we see right now.

When you take a look at the second part of your question on China, we've been pretty realistic on China for Q2. And we anticipate that in China, we will see a negative core growth kind of in the mid-single digit, plus or minus rate, for the full year. So Q2 is going to be pretty tough, obviously, for the reasons that we're all experiencing when we operate there or what you read about when you read your news. It's tough there and we're just being reasonably realistic about it.

Damian Karas
Analyst, UBS Securities LLC

Q

Understood. And related to that capacity expansion you have underway, could you quantify how much additional capacity we're talking? And geographically, where is that located?

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

A

Yeah. So the specific capacity in particular that we are talking about is associated with our ability to convert the book of orders that we have with change to build predominantly in the Industrial and the Mobility side of our business. And the capacity is getting added in North America and in Europe in particular. It is not in your rooftop, it's just an incremental machine capacity within existing facilities. And we've positioned it in those two areas where we believe we have a very substantial backlog that we've built up over the last 12 months or so, so Mobility and Diversified Industrial.

Damian Karas
Analyst, UBS Securities LLC

Q

Very helpful. Thank you. I'll pass it along.

Operator: And our next question will come from Deane Dray with RBC Capital Markets. Please go ahead.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning, everyone.

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

A

Good morning.

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

Good morning.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Hey. How are you feeling about seasonality now? And I'm almost embarrassed to ask that given all the different headwinds that you're facing that just sort of distort what might be a normal cadence, but this has been a more back-end weighted year. I see we were thinking like [ph] 49/51 (00:23:53). How does that – how are you expecting to see the back half play out now?

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

Hey, Deane. So yeah, that's a great question. I think a couple of things, right? One is the capacity comments that Ivo just made is going to allow us to work our backlog down in the second half. And so we're feeling that even absent some additional order flow, we're going to be able to get some additional sales as we work through some of that backlog. Having said that, the order flow for those businesses, certain – the businesses he mentioned certainly support the extra capacity.

And in addition, you have to think about last year. We were significantly impacted starting in Q3 and then really through Q4 with really significant supply chain and material disruptions, which was – really made it more pronounced in the back half of last year in terms of the seasonality. So we've built our normal seasonality into the equation.

And then we've added in the new capacity, and then we've added in kind of a onetime knock-on effects that we experienced last year in the back half. And so we feel pretty confident that we're going to get some additional volume in the second half over and above our normal seasonality that goes down. And we've got the capacity, we've got the orders, we've got the backlogs to deliver it.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's great to hear...

[indiscernible] (00:25:24)

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

A

What I would add, Deane, I think as people think about seasonality predominantly driven by order flow, I would suggest that also you take into account that the businesses and the orders that we are seeing remain very, very strong. But you got to take into account the operational inefficiencies that we have even seen in Q1 that have kind of topped off the amount of revenue that you could realize. So you almost need to think about it that the first half

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of 2022 is going to be a little bit more stunted, not because of business, but because of your ability to produce your goods.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Of course. And then just as a follow-up question, I'm not sure I caught it but what – did you size what the growth investments in capacity is? And then any comment on the contribution from new products in the quarter?

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

A

So yeah, we did not size up what we anticipate to deliver. But we are installing the incremental capacity that should give us the ability to be in a very solid state for the next couple of years and also give ourselves an opportunity to launch the Generation 2 and Generation 3 products that we are bringing into the marketplace into Mobility and Diversified Industrial. So it's kind of a combination of incremental capacity to deal with the backlog and the order flow that we see as well as launching these new products.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

New products in the quarter?

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

A

We have not quantified that, but it's approximately an increase of additional mid-single digits.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's great. Thank you.

Operator: And our next question will come from David Raso with Evercore ISI.

David Raso
Analyst, Evercore ISI

Q

Hi...

Operator: Please go ahead.

David Raso
Analyst, Evercore ISI

Q

I just wanted to make sure, first, just one clarification. The organic sales for the year, the midpoint [ph] 7 (00:27:48), a currency number we should use is about a 1.5% drag, something like that, 2%? Is that the way to think about it?

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

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Yeah, I would go a little bit higher than 1%. I would think 2% because we have seen a little bit of weakening in the euro and that's the primary driver for us.

David Raso
Analyst, Evercore ISI

Q

Okay. And I do appreciate a lot of unique things happened since the last call, to say the least. But just so I can level-set the back half that's being implied after the 2Q commentary, the 2Q, you said basically sales sort of up sequentially low single and EBITDA margins up around 150 bps. Was that – did I hear that correctly?

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

Yeah. At the midpoint, that's correct.

David Raso
Analyst, Evercore ISI

Q

Okay. So the second half of the year, and I understand price/cost should swing to helping margins, not just neutral because the full year, you expect price/cost to be neutral to margins. It looks like the back half of the year, the EBITDA margins probably need to be above 24% to kind of hit the midpoints. I just wanted to make sure I was doing that math correctly. And just given maybe what you see in your backlog, and I know some costs can move around, but how much confidence do you have in that kind of margin level when it comes to what's already in the backlog and what you know is already being kind of booked on cost? And then I know you mentioned some of the new capacity could bring some operational efficiencies, but I just want to make sure I had those numbers generally correct.

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

Yeah. I think you may be a little rich there, probably kind of lower 20s, but in the ballpark, but maybe a little rich in terms of what we need to deliver in the second half. And the way you need to think about it is, look, our assumptions are, you're going to see an easier operating environment in the second half, right? The material and supply chain issues that we've slowly started to see abate through Q1 will continue to get better. And then in the second half, you'll have much easier comps, both to the first half of the year and to the back half of 2021.

And then you add to that the additional capacity we're putting in place, and then you add to that the pricing momentum that we're going to have in the second half of the year. And so, you have all three of those things accreting in the second half of the year. And so, if we can put the COVID disruptions, the supply chain disruptions behind us and we have these capacity and pricing momentum in the second half, you got a second half that, quite frankly, looks a lot more like the first half of 2021. And that's the way we're thinking about it.

David Raso
Analyst, Evercore ISI

Q

Yeah...

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

Because the demand is – yeah, the demand is there. So...

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David Raso
Analyst, Evercore ISI

Q

[indiscernible] (00:30:39) issue. I mean, if you look, like right now, I mean, if the margin is the exact 19.1% in 2Q and the revenue is up a little bit sequentially, it does mean that the first half of the year, the EBITDA margins are only about 18%. So to get to 21%-and change for the year, it does imply a little bigger EBITDA margin in the second half of the year. But knowing that you have a big backlog, executing on it efficiently with better price/cost can get it done. I was just trying to get a little more clarity of like, what's really in the backlog, price versus some costs that are maybe somewhat already locked in, just to get that comfort level? But it sounds like some of the operational efficiencies are a big part of it as well. It's really not just a price/cost story by any means.

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

A

Absolutely. I mean, I think that it is really underappreciated how much of a headwind you also take when you can't produce, obviously, your goods, so you don't have your materials and you have people either standing in and being ready to produce or, on the other hand, you don't have people and you have materials, right? And we've dealt with all of that. I mean, every industrial company is dealing with all of these type of impediments.

And look, good news, a little bit, right? We have seen those headwinds get smaller, particularly in North America as we exited Q1. So we are cautiously optimistic that COVID hopefully is quite behind us. So at least, we will not be dealing with the level of impact that we have dealt with in the kind of the Q4, Q1 2022.

And again, as I said, raw material availability becomes a little bit better, more green shoots than they were in Q4. And you get your operational efficiency to a level where it is more aligned with the level of demand that you have out there. And you really don't need to do an incredible amount of work to start delivering much better leverage on that revenue that you have.

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

Yeah. And the one thing I'd add just to that, on the backlog side. The replacement business tends to be fairly real-time in terms of backlog and cost. And so, we don't carry as much backlog there as we do on the OEM side. On the OEM side, typically, for the most part, we tend to price based on when the price increase effective date is. And so there's not as much disconnect between the cost and the price that's embedded in backlog versus when you actually ship it.

David Raso
Analyst, Evercore ISI

Q

That's helpful. And my one last quickie on the operational improvement. Thinking sequentially by business segment, I know it's hard to predict lockdown timing in China as well, but even woven into that, this comment about sequential margin improvement by division. Like PT obviously has a little more China exposure than FP. But can you give us some sense of where we should see the biggest sequential margin improvement, given that first quarter, we kind of see the margins were equal in the divisions?

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

A

Yeah. I think that – look, you are thinking about it correctly. We don't – frankly, we don't guide by segment, and so I'll stay away from it a little bit. But you're thinking about it correctly. I mean, China has got significantly more PT than FP. So we'll have to see that filter through the results.

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But I think that as the raw material inefficiencies filter out, they have been predominantly impacting our Power Transmission side of the business. That's why you've seen the margins performance the way it was. But that's also the primary opportunity for us and the second half of that business is a very solid business for us.

David Raso
Analyst, Evercore ISI

Q

Thank you for the time. I appreciate it.

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

A

Thank you.

Operator: Our next question will come from Jeffrey Hammond with KeyBanc. Please go ahead.

David Tarantino
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Good morning, guys. This is David Tarantino on for Jeff.

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

A

Good morning.

David Tarantino
Analyst, KeyBanc Capital Markets, Inc.

Q

So could you just give us a little more color on the size of the COVID impact on margins between segments and kind of maybe where that stands today? And then on that, like if these issues roll off, could that imply a fairly meaningful sequential improvement for margins?

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

Yeah. So it gets a little bit difficult to parse it between COVID and supply chain impacts. So you're kind of dealing with all these impacts. But if you think of it from a year-over-year perspective and you size the dilution of margins and the impact, I mean, I would say it's probably 100 bps impact in terms of kind of the overall COVID impact in Q1. And then that doesn't take into account the lost sales, which you generate as well because we really don't quantify.

We have an idea of what we could have gotten out the door. But given the number of different headwinds, we're not assuming that that would have gotten out. But I would say it's about at least 100 bps in Q1, dilution, that's from a year-over-year perspective.

David Tarantino
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Great. And then can we just dig into the reiterated sales guidance a little bit and kind of what the puts and takes are between PT and FP, just given the evolving macro backdrop?

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

A

Look, again, we don't guide by PT and FP. But again, I would reiterate that, look, we took China down from roughly positive mid-single-digit-plus growth for the year to down mid-single digits, taking into account what you experienced there. That business is predominantly PT business. So you'll see that that's going to probably filter through quite substantially.

And then the second item that I would have made is that in the first half, we anticipate that the biggest material shortages that we have experienced are predominantly impacting our Power Transmission business and that should start working itself out, as I've indicated, in the second half of the year. So the PT business is more impacted by China and material shortages than FP business. So I would just let you work through your model with that outline. We can probably help you out after the call if you need.

Q

Great. Thank you.

Operator: And our next question will come from Jamie Cook with Credit Suisse. Please go ahead.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Good morning. I guess just a couple of questions. One, I mean, you sound fairly positive. Just wondering if you could talk more specifically what you're seeing in Europe, if there's any knock-on effects of what's happening with Russia and Ukraine? Any cancels or – cancellations or commentary by country?

And then my second question, again, sorry, back on the top line. It sounds like everyone has been pretty aggressive passing through price increases. So I'm just trying to understand what your assumptions are on volume versus price for the year. Thank you.

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

A

Good morning, Jamie. Look, I'm going to take the first part, and I'll pass the second question on the price increases to Brooks. But in terms of European demand, we have not seen any order cancellations at this point in time on our business. Obviously, we are in full compliance with the sanctions in Russia, and we have taken the impact of those into account. And as we have highlighted in our prepared remarks, between China and Russia, and Russia restrictions, we anticipate about a 3% headwind to what we have originally guided to.

So that was the impediment that we anticipate to make up through better performance in top line on industrial, personal mobility and the rest of the kind of the business flow in oil and gas and mining and renewables, in particular. So we think that we can close that gap, but so far no real impact to orders.

I'd probably say that maybe the order flow is actually a little more robust than what I would have expected, knowing what's happening. But I would also state that we've positioned the company quite well. We have no reliance on raw material supply that's coming out of Russia, and that's also giving us an opportunity to potentially be a little more – maybe a better position to support our customers, particularly on the industrial side in FP specifically.

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And I'll pass it on to Brooks on the pricing.

L. Brooks Mallard
Executive Vice President & Chief Financial Officer, Gates Industrial Corp. Plc

A

Yeah. So the way I would think about it is, look, we've got some solid core growth that's happening with our growth initiatives, but a lot of that's being offset. And when I say core growth, I should probably say volume core growth, but a lot of that's being offset by the headwinds we expect to see in Russia and also the headwinds from the ongoing lockdowns for the year in China. So when you think about the split volume versus price, you should – I would expect slight, slight overall volume growth for the year as part of that core growth number with, again, the growth initiatives offset by the headwinds we've seen in Russia and China.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Operator: And our final question will come from Mike Halloran with Baird. Please go ahead.

Q

Hey. Good morning, everybody. It's [ph] Pez (00:41:14) on for Mike today.

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

A

Good morning.

Q

[ph] Got (00:41:16) question for you. I know when we had the log jam going on at the [ph] Port of LA and (00:41:23) Long Beach, I know that that caused significant disruption. Can we maybe dig in a little bit more specifically on the transportation freight logistics side of things with what we're seeing in Shanghai and some of the shutdowns in China?

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

A

Well, sure. I mean, I think that you can probably look it up in terms of how many boats awaiting or ships awaiting in the Port of Shanghai, so that's pretty significant there. From our vantage point, your transportation issues in China, probably almost more dramatic just in the domestic transportation on being able to drive goods in between provinces in China. And so that's a really big issue in movement of goods even within the country.

And then it clearly is going to filter out over the next couple of quarters what the impact is going to be on people's ability to secure goods. So it's going to be a challenge. I think that everybody is managing through the challenge, but the situation in China is very fluid and very complex presently.

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Q

Thanks. That's really helpful. And then secondly, I believe in the prepared remarks, it was mentioned about potential share gains in Fluid Power. Can you maybe, at a high level, talk to us? Is that primarily from the internal initiatives that you're driving? Are you seeing any benefits from the relatively significant acquisition one of your primary distributors completed earlier this year? Can you maybe provide a little bit more color on some of those share gains?

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. Sure. So look, I mean, we have been speaking over the last several years about how we are revitalizing our portfolio of Fluid Power products, and we've put that portfolio in very competitive market position. We obviously feel very good where we sit vis-à-vis competitive positioning. In prepared remarks, I said that we are gaining position with North America and European distributors and that's part of it.

I would say that we also are somewhat cautiously optimistic about our ability to continue to supply products, particularly in Europe as well as in North America on shorter lead times in Fluid Power because we have a significantly lower dependency on some of the highly constrained critical raw materials that are flowing out of Russia and Ukraine. We don't buy any of those products. We have substituted them already as we were revitalizing our product portfolio.

So we believe that we are taking market share based upon what we have done with innovation in Fluid Power. And obviously, we are benefiting from some of the market movements across the globe as well with our customers.

Q

Thank you. I'll pass it on.

Operator: And that will conclude the question-and-answer question. I would now like to turn the call back over to Bill Waelke for closing remarks.

Bill Waelke

Vice President-Investor Relations, Gates Industrial Corp. Plc

Thanks, everyone, for your interest in Gates. As always, the team here is available for any follow-up questions, and we look forward to speaking after Q2. Have a good day.

Operator: This will conclude today's conference. Thank you for your participation and you may now disconnect.

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