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Gates Industrial Corp. Plc (GTES)

Q4 2024 Earnings Call

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CORPORATE PARTICIPANTS

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

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

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

OTHER PARTICIPANTS

Julian Mitchell
Analyst, Barclays Capital, Inc.

Deane Dray
Analyst, RBC Capital Markets LLC

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

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

Stephen Volkmann
Analyst, Jefferies LLC

Nigel Coe
Analyst, Wolfe Research LLC

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

David Raso
Analyst, Evercore ISI

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Gates Industrial Corporation's Fourth Quarter and Full Year 2024 Earnings Call. All participants are in a listen-only mode. After the speakers' remarks, we will have a question and answer session. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the call over to Rich Kwas, Vice President, Investor Relations. Thank you. Please go ahead.

Rich Kwas

Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

Greetings and thank you for joining us on our fourth quarter and full year 2024 earnings call. I'll briefly cover our non-GAAP and forward-looking language before passing the call over to our CEO, Ivo Jurek. He'll be followed by Brooks Mallard, our CFO.

Before the market opened today, we published our fourth quarter and full year 2024 financial 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 include forward-looking statements within the meaning of the Private Securities Litigation Reform Act. These forward-looking statements are subject to risks that could cause actual results to be materially different from those expressed in or implied by such forward-looking statements. These risks include, among others, matters that we have described in our most recent Annual Report on Form 10-K and in other filings we make with the SEC. We disclaim any obligation to update these forward-looking statements.

We will be attending several investor conferences during February and March. We look forward to meeting with many of you. And before we start, please note all comparisons are against the prior-year period unless stated otherwise.

Now, I'll turn it over to Ivo.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you, Rich. Good morning, everyone, and we appreciate you joining us today. Let's begin on slide 3 of the presentation and review what we've accomplished in 2024. The Gates team globally made significant progress in 2024. We grew adjusted EBITDA margins by 140 basis points, significantly exceeding our initial forecast while encountering a more challenging demand environment than we've expected at the outset of the year. Our teams executed well on our enterprise initiatives and our focus enabled us to deliver strong gross margin expansion relative to 2023. Our profit improvement helped us to generate record adjusted earnings per share and adjusted EBITDA dollars in 2024.

Further, we successfully refinanced our debt stack, lowered our financing costs and reduced our net leverage ratio. Lastly, we supported Blackstone's sell down during the year by repurchasing $175 million of our stock, ultimately facilitating their exit prior to year end. Fundamentally, we believe our business operations are positioned to capitalize on a potential industrial demand recovery during 2025, and we've made strong headway towards achieving our mid-term targets. Brooks and I will provide more color on the current state of our journey later in the presentation.

On slide 4, we summarize the key movements in our 2024 adjusted EPS. We delivered earnings per share growth led by operating income contribution augmented by lower interest expense and share count, which more than offset a higher tax rate and lower contribution from other items. We believe 2024 was indicative of our organization's operational strength and improved financial flexibility.

On slide 5, I will review fourth quarter results. Core revenue performance was consistent with our expectations while the strengthening of the US dollar during the quarter negatively impacted reported revenues. Our replacement channel posted growth supported by a mid-single-digit increase in auto replacement. Our OEM sales decreased, primarily affected by volume reductions in the agriculture and construction end markets. Encouragingly, personal mobility core growth increased for the first time in seven quarters and expanded approximately 20%.

Our book to bill remained above 1 at the end of the year. Our profitability performance was solid as adjusted EBITDA margin expanded 30 basis points to 21.8%. The increase was driven by a 130 basis points increase in gross margin to 40.4%, a record gross margin performance for a fourth quarter. Gross margin primarily benefited from ongoing contributions from our various enterprise initiatives, which supported the improved operating performance and price realization as well as favorable channel mix. The lower volume was a drag.

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Our free cash flow conversion during the quarter was 168%, which brought the full year to 74%. We believe we are at or near trough demand levels in some of our end markets and are seeing green shoots in others and have maintained our inventory levels to ensure that we fully capitalize on an expected cycle inflection. Additionally, we have positioned inventory and invested CapEx to support our continued footprint optimization plans, which launched in earnest during the second half of 2024.

Our net leverage ratio declined to 2.2 times from 2.3 times at yearend 2023. We allocated $175 million of cash to share repurchases during the year, resources that would have reduced our net leverage ratio further. We believe that we are in a strong position to hit our 2026 target net leverage ratio of 1 times to 2 times.

Please turn to slide 6. Fourth quarter total revenue were $829 million, which represented a 2.6% decrease on a core basis and was slightly better than our expectations. Total revenues were down just under 4%, inclusive of unfavorable foreign currency effects that incrementally worsened through the quarter. Automotive grew low-single-digits on a core basis. This was offset by mid-single-declines in industrial end markets, primarily driven by North America and Europe. Our Asian business continues to see signs of industrial recovery. Replacement sales grew modestly as we continue to see constructive demand in the automotive replacement business. OEM sales decreased in line with expectations as auto OEM builds were flat and agriculture and construction industry inventories remained elevated.

Adjusted EBITDA was $181 million and yielded a margin of 21.8%, an increase of 30 basis points. The expansion was led by a solid 130 basis point improvement in gross margins. Benefits from our enterprise initiatives more than offset the adjusted EBITDA impact from lower core sales. Adjusted earnings per share was $0.36, which was down 3% versus the prior year. Operating income was approximately $0.02 headwind, driven by lower sales volume and partially offset by initiative savings. Our lower share count contributed $0.01.

On slide 7, we will review our segment highlights. In the Power Transmission segment, we generated revenues of $520 million in the quarter, which translated to approximate 1% decrease on a core basis. The replacement channel was up year over year, supported by modest growth in automotive replacement and some stabilization in industrial replacement. OEM demand was under pressure with both industrial and automotive posting declines. Notably, personal mobility returned to growth in the quarter with a double-digit increase that lessened the overall magnitude of the OEM channel decline. Our transmission's adjusted EBITDA margin declined 30 basis points, impacted by the lower top line.

In the Fluid Power segment, our sales were $309 million. On a core basis, sales decreased approximately 5%. The replacement business remained stable, supported by automotive replacement, which grew high-single-digits. This was slightly offset by softness in industrial replacement, which declined mid-single digits. Industrial OEM sales declined high teens on a core basis driven by continued demand pressure in agriculture and construction. Fluid Power segment EBITDA margins expanded 120 basis points, benefiting from our enterprise initiatives and a higher replacement sales mix, which more than offset the volume declines.

I will now pass the call over to Brooks for further comments on our results.

Lawrence Brooks Mallard

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

Thank you, Ivo. I'll begin on slide 8 and review our core sales performance by region. China and East Asia performed well in the quarter, delivering modest growth. This was more than offset by broad macro weakness in Europe and soft industrial activity in the Americas. In North America, core sales declined approximately 3% and

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were primarily affected by lower OEM demand. Industrial OEM channel sales decreased double digits with the agriculture and construction end markets most impactful to our performance.

North American replacement channel sales expanded mid-single digits with high-single-digit growth in auto replacement and a slight increase in industrial replacement. In EMEA, core sales fell just over 6%. OEM sales decreased double-digits with automotive experiencing significant weakness. Industrial OEM sales were down low-single digits. Replacement sales were mixed with automotive replacement core growth in the low-single digits and industrial replacement down in the low-teens.

At the end market level, agriculture and energy were headwinds while personal mobility returned to growth. China core sales grew modestly and benefited from strength in the replacement channel. Industrial replacement grew mid-teens, supported by demand strength in the diversified industrial end market. Automotive replacement expanded high-single digits. The growth was slightly offset by a low-single-digit decline in OEM sales, driven by automotive softness.

East Asia and India posted 3.5% growth in core sales. Automotive OEM sales declined low-single digits, which was more than offset by growth in the automotive replacement channel and industrial end markets. South America core sales declined mid to high single digits, primarily impacted by logistic disruptions in Brazil.

On slide 9, we display the key components of our year-over-year change in adjusted earnings per share. Lower volume was a $0.06 per share headwind to adjusted earnings per share but was largely mitigated by contributions from our enterprise initiatives. Other items and a lower share count contributed $0.01.

Slide 10 has an update on our cash flow performance and balance sheet trends at year end. Our free cash flow for the fourth quarter was $158 million, which represented 168% conversion to adjusted net income. As previously mentioned, we are keeping healthy inventory levels to help strengthen our ability to fully capitalize on an anticipated demand inflection. Also, we pulled forward some CapEx investments to accelerate the timing of certain footprint optimization projects and deployed capital to certain systems enhancement programs.

Our net leverage ratio was 2.2 times at the end of the year, down slightly from 2.3 times at the end of 2023. We made good progress with our balance sheet in 2024. Specifically, we lowered our gross debt by over $100 million and executed a successful refinancing of our full debt stack during the middle of the year. In the fourth quarter, we delivered a 50 basis point reduction on our term loan spreads, which will lower our interest expense for 2025. We believe that we are in a strong position to realize our 2026 net leverage target of 1 times to 2 times.

Our trailing 12-month return on invested capital finished at 24%, a 100 basis point increase compared to year end 2023. We continue to deploy capital to support enterprise initiatives and system enhancements. These internal projects are typically our highest return opportunities.

On slide 11, we introduce our full-year 2025 guidance and our expectations for the first quarter. For 2025, we have initiated guidance for core revenues to be in the range of down 0.5% to up 3.5% relative to 2024. Importantly, at the midpoint of 1.5% growth, we have assumed end market contribution as a slight headwind on a weighted average basis. We anticipate year-over-year core growth will improve as the year progresses. We are budgeting about a 3% headwind from foreign exchange for the year with greater impact expected in the first half of the year.

Our initial 2025 adjusted EBITDA guidance is in the range of $735 million to $795 million. At the midpoint, our guidance represents a 50 basis point year-over-year increase in adjusted EBITDA margin. Our adjusted earnings

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per share guidance is in the range of $1.36 per share to $1.52 per share. We are spending more on capital expenditures in 2025 to support high-return projects. We anticipate our free cash flow to exceed 90% of our adjusted net income in 2025.

For the first quarter, we estimate total revenues to be in the range of $805 million to $835 million and core revenues to be down approximately 1% at the midpoint. For the first quarter, we expect our adjusted EBITDA margin to decrease in the range of 40 basis points to 80 basis points compared to Q1 2024.

On Slide 12, we show a walk that helps explain the moving pieces in our Q1 adjusted EBITDA margin. Starting from the left, our Q1 2024 adjusted EBITDA margin benefited 70 basis points from the realization of insurance proceeds. Excluding these non-recurring proceeds, our Q1 2024 adjusted EBITDA margin was approximately 22%. At the midpoint of our Q1 guidance, we expect a 1% core sales decrease, which we estimate impacts adjusted EBITDA margin by about 40 basis points. We expect to more than offset the lower sales with contributions from our enterprise initiatives and improved mix. As such, we would be generating a 22.6% adjusted EBITDA margin in the quarter without an estimated 50 basis point headwind from unfavorable foreign exchange rates.

On slide 13, we provide a walk through our 2025 adjusted EBITDA at the midpoint. We expect operational items to add a little over $50 million to our profitability with contributions from our enterprise initiatives and footprint optimization. FX is estimated to be about a $34 million headwind to profitability based on about a $100 million reduction year over year to our top line. We also had some favorable items in 2024 that we don't expect to repeat in 2025 such as the insurance proceeds I just noted as well as a gain from the sale of real estate. An important point on this slide is the profit headwind incurred from foreign exchange. The $34 million headwind is more than the difference between the consensus 2025 adjusted EBITDA and the midpoint of our guidance.

On slide 14, we display an adjusted earnings per share walk for 2025. From left to right, we project about a $0.12 benefit from operational items. Foreign exchange represents a $0.10 headwind to adjusted earnings per share compared to the prior-year period. Non-recurring and below-the-line items net to a $0.03 per share improvement.

On slide 15, we provide some more color and background on our CapEx plans and our margin progress. On the left, you see we intend to spend above our depreciation expense in 2025 and 2026 to support our footprint optimization projects and enhance our system capabilities. In the middle, you see our march to 24.5% adjusted EBITDA margin by 2026. Our 2025 adjusted EBITDA margin guidance of 22.8% includes a 40-basis-point headwind from unfavorable FX and system investments. Importantly, our margin progress to date has been achieved with no volume support and our footprint optimization savings are yet to be realized. As such, we believe we are in good position to deliver our 2026 adjusted EBITDA margin target.

I will now turn it back over to Ivo.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thanks, Brooks. Slide 16 provides a refresher on our 2026 gross margin target, which we introduced last year at our Capital Markets Day. As you can see, we generated approximately 40% gross margin for full year 2024, which puts us a little over 200 basis points away from our full-year 2026 target. We expanded gross margin almost 200 basis points last year despite a decline in our core sales. We have made good progress with our material cost reduction initiative and additional savings opportunities remains in front of us.

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To date, although we have not realized significant benefits from our operational excellence initiatives, we anticipate those savings to pick up steam as our volumes recover. We also expect to realize initial savings from our footprint optimization initiative in 2025. As a reminder, our footprint optimization initiative is estimated to yield over 100 basis points of margin improvement at maturity. Further, we believe there is a volume recovery ahead of us which should result in a solid core operating leverage. With the progress made to date, we believe we are in a good position to achieve the gross margin target we outlined for 2026.

Turning to slide 17, we highlight some of the key secular growth opportunities in front of us. Our mobility business continues to see strong design win activity, and we have developed applications for new segments such as e-mountain bikes and our incremental reducing the cost of our systems to penetrate lower priced, higher volume areas of e-bike and e-scooter applications. We expect our mobility business to generate solid growth in 2025.

In data centers, we are deep in the specification process across variety of customers, including webhosting services providers and hyperscalers as well as server and rack manufacturers and cooling system integrators. We offer fluid conveyance products that support the major form of liquid cooling systems, including direct-to-chip, immersion and rear-door heat exchangers. We believe that we have a good opportunity to capture a meaningful portion of the total addressable market for liquid cooling applications over the mid to long term through differentiated product performance, and we are expanding our capabilities to fully capitalize on that opportunity.

The auto replacement market globally continues to offer multiple avenues for us to grow. We added a major new channel partner in North America during the second half of 2024, which we expect to be a nice contributor to our revenue base in 2025. We have opportunities to capture business with both new and existing channel partners in North America and EMEA. In addition, we are expanding our product coverage in various emerging markets and intend to be well-positioned to support demand as their carpark ages.

Moving to Slide 18, I'll offer some final thoughts before we take your questions. First, our global team executed well in 2024, driving a margin increase in a softer than expected demand environment. We are highly focused on serving our customers and increased our service levels to best in class in 2024. We also grew our design wins nicely and are deploying our material science and process capabilities to new markets that possess secular growth drivers.

Second, we believe our business is well-positioned for the potential industrial recovery. As I mentioned earlier, our margin expansion journey is ahead of schedule. Within our framework, we are making investments to improve the business for the mid to long term. As Brooks referenced earlier, we are making investments in our systems to improve our organizational efficiencies and increasing our responsiveness to the evolving needs of our customers. In addition, we are adding commercial resources selectively to take advantage of secular growth opportunities available to us. Our balance sheet continues to improve, which should help widen our capital deployment aperture over the next few years.

Before taking your questions, I want to extend my gratitude to the more than 14,000 global Gates associates for their commitment and perseverance applied towards fulfilling our strategic goals and meeting our customer needs.

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

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Julian Mitchell from Barclays. Please go ahead. Your line is open.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. Maybe just the first question around the margin levels, as you've given very good revenue and end market color. So, looking at those slides on the margins, I guess, for example, slide 12, you've got the margin up around 50 bps, 60 bps year-on-year in the first quarter underlying aside from FX and the insurance. The full year guide, I suppose, stripping those out, is up about maybe 70 bps or something. So, it doesn't look like you're embedding a big EBITDA margin improvement after Q1 even though I think volumes on the top line are meant to improve. So, maybe just help us understand. Is that conservatism? Is there anything else moving around within the EBITDA? What's the phasing of efficiency savings for example? Any color on that, please?

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

A

[ph] You go ahead (00:40:22).

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

A

Yeah, Julian. So, I think, look, if you look at slide 13, I think that kind of lays out really the margin walk. We've got significant margin upside mostly coming from our enterprise initiatives and it continues to be very material-oriented. The big headwind is FX. And so, FX is really a pretty significant headwind as we've guided model today based on the year-end rates, right. We don't try to predict FX rates. We just model it based on the current going rate. So, we – the levers haven't changed dramatically. We have not embedded an inflection in terms of the market recovery in our numbers. And we still continue to drive the enterprise initiatives within the four walls of Gates that are going to drive margin improvement year over year. So, I think – does that answer your question?

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Yeah, I think that's mostly – I guess what I was just trying to get to is, is there any sort of phasing difference of efficiency or footprint first half, second half, but perhaps it seems pretty steady?

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

A

Well, yeah, I think the FX impact is definitely going to hit us harder in the first half and then definitely the phasing on like some of the footprint optimization savings and it's going to hit in the second half. And so, that's kind of the phasing first half versus second half. The material savings is fairly linear as you move through the year.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

That's helpful. And then just a follow-up topic. In terms of kind of your exposures on, say, COGS, I don't know if you're willing to give any color around the sort of Mexico, Canada, China grouping of how much of your sort of

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total buy represents imports into the US from those three or any broader commentary you can make around the tariff backdrop?

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

Yeah. Julian, good morning. I would say that China and Canada are kind of de minimis. That's not really a lots of exposure. I mean, obviously, we have a reasonably large footprint in Mexico. I would also say that we have a good presence of assets in the United States that we would sweat more and flex up and down as needed. But we've gone through this process before. We have tools in place that would give us the opportunity to manage tariffs once we actually know what the actual situation would be vis-à-vis tariffs. We would very likely use price to offset any impact that we cannot rebalance to production in between Mexico and US assets. But China and Canada, that's not really much of a concern for us.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Great. Thank you.

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc
A

Thanks, Julian.

Operator: Our next question comes from Deane Dray from RBC Capital Markets. Please go ahead. Your 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.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Hey, since we've been waiting seven quarters for personal mobility to have an uptick, I feel it should get a little bit of spotlight here. So, is this a turn or is it easy comps and where and how do – what are kind of key indicators that you're looking at?

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

Yeah, good morning, Deane. I would say that, yes, all of the above. I mean, obviously, the comp became much easier. But that being said, we have seen a very strong performance, primarily driven by EMEA and Asia broadly. So, very constructive Q4. We've also seen very constructive January. So, we are now starting to see very positive trend line on the recovery in personal mobility. The inventories at manufacturers have very steadily declined since the peak in June of 2023. So, at this point in time, the inventories are more or less at normalized levels. Activity – core activities are very, very strong. We've talked in the past about the design wins that we've gotten. So, I would

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say that easier comp, business inflecting, pretty broad strength in personal mobility and we believe that we will deliver very nice growth that we have also embedded in our guidance for 2025.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

All right. I really appreciate that. Now, Ivo, you teased us at the very beginning to say that there were signs of green shoots and maybe part of personal mobility accounted to that. But if you just kind of step back, look at your verticals, you're very short cycle, so at the margin, any sort of activity can certainly show up as a green shoot. So, if you were kind of to frame for us or prioritize, which are the green shoots that you are referring to and how meaningful are those embedded in terms of trajectory in your 2025 guidance?

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

A

Yeah. Sure. Thank you for the question, Deane. Look, let me kind of start with more of the purview of our customers. Our customers are very optimistic that things are going to get better for them. But that being said, we're not really in a business of forecasting recoveries based upon how folks feel, but it certainly is a good thing. We manage what's in front of us. We manage from the data points that we have. And as you know, we look at very significant amount of forward looking indicators to give us a little bit of a better sense of what we think is going to happen.

But that being given, industrial activity has been suppressed for over two years. And certainly, it would appear that inflection on industrials is much closer than probably not. We were very encouraged by the January PMI [ph] reading gain (00:47:16) for first time in a very long time, [ph] somewhat about 50 (00:47:21). Last month's new order component of the PMI and that is December component of the PMI started to inflect nicely above 50. We are starting to see a good behavior in the industrial base of customers in Asia. We have seen pretty nice core growth in Q4. So, that certainly is giving us a degree of data points that things should start inflecting.

Look, mobility, as we discussed, has definitely been a very strong green shoot. Ag and construction activity is not. I mean, that's really very dislocated. Our automotive replacement business is doing very strongly, and we believe that that's got the green shoots remain, I would say, not they just show up. So, it's a mixed bag, but we are starting to see more green flashing on our screens than red. And we have done a really good job in 2024 offsetting a couple of very, very negative end markets. I think we have delivered very strong results. We've managed what is under control. We have improved profitability. We have done that through just grit and improving our gross margins. So, we are very optimistic that at a time that inflection may occur, and again, we have not embedded any inflection in our forward guidance, that we will see a very strong performance for the underlying business.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

That's all really helpful, Ivo. Thank you.

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

A

Thanks, Deane.

Operator: Our next question comes from Andy Kaplowitz from Citigroup. Please go ahead. Your line is open.

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Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Hey, good morning, everyone.

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

A

Hey, Andy.

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

A

Good morning.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Ivo, you're obviously sticking to your gross margin and adjusted EBITDA margin targets for 2026 despite the continued slower organic growth and pretty big FX headwinds. And you said you haven't really experienced big savings from operational excellence and footprint optimization yet, so it seems like material cost reduction has been much bigger than you thought. Maybe you can comment on that. And can you reach that 24.5% adjusted EBITDA margin without resuming 3% to 5% organic growth in 2026?

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

A

Yeah. Thank you for the question. We definitely believe that we can get certainly very close to that 24.5% adjusted EBITDA without the 3% to 5% organic growth. What we did say is that we need to see the organic volume declines to stop, but we don't necessarily need to see a significant rebound of growth for us to deliver on that commitment.

Coming back to the first part of your question, definitely the material cost out has been executed really well. Our teams are doing fantastic job. We believe that we have a terrific runway to continue on a trajectory of further improving our efficiency vis-à-vis raw materials. We did state that we believe that we have about 100 basis points of margin improvement coming from our restructuring activities that will be run rated by the end of next year. So, all in, we believe that we are in a position to be able to deliver on our mid-term commitment that we have made to our shareholders at the Capitals Market update last year without necessarily significant rebound.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Very helpful. And then, Ivo, I think one of big drags on the business that you just mentioned has been construction, ag. I think in the presentation, you mentioned energy a little bit of a drag in Q4 too, but maybe you can talk about what you're baking in for expectations on those businesses in 2025. Do they stop going down in 2025? You still have them going down in the first half of the year for instance. And can you talk about inventory in the channel that you're seeing in those markets? Does inventory – is it bottomed out here? Do you have any more confidence that a turn is imminent in these businesses?

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

A

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Ag and construction, they have been super negative, right. I mean, I think that you have seen CNH and ATCO reporting over the last few days. So, those numbers are pretty staggering, right. I mean, they just had a really dislocated market. And we've managed through that really well. Our business is down significantly less than anything that you see coming out of those two verticals.

My sense, Andy, is that the end market, the ag and commercial construction end market is going to be less bad in 2025 than it was in 2024. But we still believe that it will be down kind of mid-single digit versus prior year. So, it's still no good. I mean, I think that first half is going to be significantly dislocated for those customers still. There are still reasonably higher levels of dealer inventories with the equipment that has been put on the dealer lot. I think that it's going to still take some time to work through. I would say that perhaps by the end of Q1 of this year, the dealer inventory should be in much healthier position. And so, we anticipate that that's going to be still pretty tough market, but it should start getting less bad in second half of 2025.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Appreciate all the color.

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

A

Thanks, Andy.

Operator: Our next question comes from Jeff Hammond from KeyBanc Capital Markets. Please go ahead. Your line is open.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Good morning, guys. Maybe just to start on this FX dynamic. So, you called out, I think, $100 million topline and $34 million EBITDA. So, I just want to understand the drop through there, just seems very high. So, I don't know if there's translation and transaction. Just walk me through why such a high drop through on the bottom line.

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

A

No, you hit it on the head. It's a combination of translation and transactional that doesn't repeat, that we don't have modeled in repeating in 2025. So, that's exactly what it is.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. And then maybe just speak to where you think inventories are, particularly in auto replacement, industrial replacement and just auto aftermarket seems like it's been a bright spot. And the OE side obviously has some challenges. But just wondering if you're seeing any cracks or if it's just simply as people extend the life, that aftermarket holds up?

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

A

Yeah. Look, the aftermarket is doing really terrific for us. And that's really kind of how evolve this and envisage that our portfolio is going to perform, have a little more stability through these different cycles. The inventories in

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the channel are not out of line for the automotive replacement side of the business. So, my sense is that that's going to continue at kind of that GDP plus growth for the baseline of that business. And obviously, we're taking market share and adding new customers and broadening our presence globally with existing and new accounts. So, we are very bullish on what is happening in the automotive replacement side of our business.

The industrial businesses, we've been talking about feeling that the destocking is going to be done. I think that we are approaching that destination. Again, I always hate to state that we are there, but my sense is that if we are not there, we are very near to bottom and we should start seeing a little better performance as we move through progressively through 2025.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Thanks a lot.

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

A

Thanks, Jeff.

Operator: Our next question comes from Mike Halloran from Baird. Please go ahead. Your line is open.

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

Q

Hey, good morning, everyone.

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

A

Hey. Good morning.

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

Q

So, how do you think about the – with the customers saying, in answer to earlier question, there's more optimism in the channel with your customers. Is there anything different that they're basing their optimism on relative to what you referenced earlier, Ivo? And what do you think it takes for that, from their perspective, that optimism turn into actual purchasing and accelerating the demand curves?

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

A

Yeah, Mike. I think that I will say that, in general, we take customer feelings under account. But we try to take a look at the hard data because sentiment and optimism doesn't always go hand in hand with kind of what's happening in the end market. But I think that the folks are enthusiastic about some of the industrial policy that may come their way, maybe some tax certainty, an ability to actually put money to work, invest in CapEx, get some of these bigger projects off the books that have been in planning stages for a while. We certainly see that the activities in places like data centers remain quite robust.

So, I think that people start getting a little more optimistic. And it's been hard 28 months, 29 months of looking at the deceleration in the manufacturing PMIs. So, I think that folks are just ready to feel better. But again, as I said,

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we just want to make sure that we see hard evidence of things turning. And the things that I am looking at certainly would give you an indication that things should improve. But again, we are not embedding improvements into how we think about our guidance for 2025. I think that we are in a position to wait and see, when it turns, we will let everybody know.

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

Q

Thanks for that. And then just on the capital deployment side, any shift in the thought process, willingness to continue to be a little more aggressive on the buyback side with where leverage is and just thoughts on the M&A cycle?

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

A

Let me take the first part and I'll let Ivo hit big M&A part. So, look, we've been pretty evenly distributed in capital deployment between stock buybacks and debt pay-down. We still have $125 million of authorization for stock repurchases. We still think that returning capital to shareholders via that route is a very good return for us. So, we'll continue to look at that. We've continued to work on our balance sheet from a debt perspective. We refinanced our debt stack so we've got no maturities until, I think, 2029. And we got – we shaved about 50 bps off of our term loan in Q4. So, we continue to do work there.

Having said that, we've committed to getting our gross debt below $2 billion. So, that's something we're going to continue to work on. And then, we've got great investments internally, you can see that our capital spending is going to be up over the next couple of years. Well, that's the highest return on invested capital money we can spend [indiscernible] (01:00:08), so we're going to continue to work on that for footprint optimization and some of the other things we talked about. So, all three of those capital deployment options are very, very good for our shareholders. So, we're going to continue to go down that path.

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

Q

Great. Thanks. Appreciate it.

Operator: Our next question comes from Stephen Volkmann from Jefferies. Please go ahead. Your line is open.

Stephen Volkmann
Analyst, Jefferies LLC

Q

Great. Thanks for fitting me in. Just one quick follow-up. I'm just curious, historically, do your distributors tend to restock inventory when they start feeling better about the world or is it more just kind of a quick pass through for them?

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

A

Stephen, I think it's a more quick pass through. I mean, our service levels have gotten so good, we service at extremely high fill rates. And so, as everybody is looking at optimizing their working capital, they know that they don't have to be restocking significantly in advance of end market recovery. So, my sense is that, it's much shorter fuse, so to speak, as to the restocking. And again, like I said, our performance is just terrific vis-à-vis fulfillment. So, my sense is that they'll want to see the turn before they'll start acquiring more inventory.

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Stephen Volkmann
Analyst, Jefferies LLC

Q

Super. Thank you. Good luck.

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

A

Thanks, Stephen.

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

A

Thanks.

Operator: Our next question comes from Nigel Coe from Wolfe Research. Please go ahead. Your line is open.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning. I just have a couple of clear-ups here. So, auto aftermarket was actually really strong in the fourth quarter, up in the mid-single digits. Did you have any benefit from this retail conversion that you talked about? I don't think – I think it's meant to be more kind of 1Q and beyond, but any benefit there? And can you just remind us how much the tailwinds you expect from this in 2025?

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

A

Yeah. So, good morning, Nigel. Yes, we did have some benefit. I mean, we spoke about accelerating the fulfillment into Q4. So, we have seen some of that benefit. I mean, it wasn't massive, but it was good to see that we started to convert couple of the DCs for that account and we will start seeing more significant ramp-up in Q1. By end of Q1, we should be fully ramped up with the business that was allocated. And then we go into straight line just replenishment model from second quarter on. And we anticipate that that was – I think we said it's about 100 basis points to 150 basis points of incremental growth on the company. So, that's the scope of that design win.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. Thanks, Ivo. And then my second question is around the liquid cooling commentary in the slides, but maybe could we just clarify that FX margin comment? Was that a prior year gain, so therefore we're lapping that gain? Just – I didn't quite understand that. But the question is really around you talk about becoming specified with customers. So, I'm just wondering if you just maybe add a bit more color in terms of where we are in the process of getting specified and whether 2025 has any benefit from DC ramp?

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

A

Yeah. So, to your first question on the FX, yeah, that's exactly right. We had some favorable transactional things. And then the way the hedges all worked out in 2024 kind of we lap that in addition to the translational part, the $100 million and fall through on the EBITDA on that in 2025. As we do we also model the kind of the hedging activity as we look out into 2025.

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

A

Let me take the data center part of your question, Nigel. Look, we have significantly ramped up our engagement with a pretty broad based set of customers from server manufacturers, system integrators, all the way to data center operators. And we are in a very varied stages of design and testing across the full spectrum of these customers. We have projects that are under process from validation testing that's being completed by potential customers to getting pre-specified by number of server guys to working on negotiations with business awards that are in very latent stages. So, it's a full spectrum of effort here. And we certainly believe that we are very well-positioned to take advantage on the available applications. And we will advise you when we are in a position of the awards. We've certainly seen revenue start trickling in, in 2024 nicely. But we believe that we will be in a position to make some announcements of much bigger awards as we progress through 2025. And I'm hoping that that's not going to be too far in the future.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Thanks, Ivo.

Operator: Our next question comes from Jerry Revich from Goldman Sachs. Please go ahead. Your line is open.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Hi. Good morning, everyone. Brooks, I'm wondering if you could just talk about the efficiency gains as you ramp up over the course of the year. It looks like the margin tailwind from the green bar is higher for the full year than the first quarter. Can you just talk about how much of that is margin improvement versus operating leverage, if you could flesh that out for us so we can gauge the momentum into 2026?

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

A

Yeah. I'd say the way to think about is, like I said, I talked about FX a little bit and that's a bigger number this year, being bigger in the first half versus the second half. The efficiency is pretty linear because it's mostly coming from material savings. And then, I would say kind of a little bit of improvement is getting some operating leverage. We – Q1 is still a little bit down in our guidance from an organic growth perspective, largely on OEMs just not cycling up to their normal seasonality. And typically, you'll see them build a little bit faster in Q1. But we talked about industrial OEM being down in construction and ag. So, as we kind of lap the comps and as we start to get some additional shipping for the [ph] AR (01:07:18) customer that we got for the balance of the year, we continue to see mobility improve, that little bit of volume uptick would get us a little bit of operating leverage as we move through the year.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Super. And, Ivo, can I ask you another question on the data center side? You've laid out the TAM at $1.5 billion for your range of products. Can you just talk to us about how you're thinking about it in terms of dollar per megawatt given the evolving range of estimates on the magnitude of the build out? And in terms of the competitive positioning, you folks versus [indiscernible] (01:07:55) versus Parker. Anything that you'd point out on the Gates offering versus your major competitors?

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

A

Yeah, sure. Look, I don't think that our thinking has changed on the size of the TAM at this point in time. What we actually see is that there is a commitment to liquid cooling, remains pretty firm out there. For us, look, we have interesting technologies both on kind of the just the normalized liquid cooling or cooling all the way to immersion liquid cooling across the spectrum of the products. So, we have launched late last year a fluid conveyance hose that can be used in both of these applications that's data center specific. And we are starting to see good amount of enthusiasm building around that from our customer base.

We are definitely demonstrating then our industrial pumps that we have designed in conjunction with [indiscernible] (01:09:04) are presently probably best in class in terms of power per cubic inch of space. So, that's highly differentiated. And we are in specification process with dozens – frankly, dozens of people that are in that space from servers to the back door cooling folks. And we are working on our own coupling. Presently, we are working with a partner on a coupling for liquid cooling applications. But we are also working on a highly differentiated, unique design that we believe we will be able to bring to the marketplace sometime latter part of this year. So, we are well-positioned, but it's all within our wheelhouse of what we believe we have a right to play from pumps to that conveyor in data applications.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Our next question comes from Chris Snyder from Morgan Stanley. Please go ahead. Your line is open.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Just first one quick on China. You guys said modest growth in Q4. It seems like that was led by replacement. But any just color on specific end markets that are driving the growth in China?

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

A

Yeah, look, I think that we are pretty proud of what our team in China has delivered. China has been tough, as you well know, for some time. And I think that Gates has delivered differentiated result in China, predominantly driven by – yeah, I mean, we have pretty broad-based, strong performance. I mean, mobility was up quite substantially. Personal mobility was up substantially. We have had terrific performance with our diversified industrial there. Even ag and commercial constructions were both constructive in China, as was automotive replacement. So, it's been quite good pretty much across most of the end markets that we are present with in China.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. And then just on...

[indiscernible] (01:11:53).

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

A

Yeah, my view is that I think it's really important to start seeing the turn in Asia in industrial because generally speaking Asia is an early precursor I think what's going to happen in more of the developed economies.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. No, it's a great point there and makes a lot of sense. I do wonder in this kind of particular time period, if some of that early cycle China strength could be maybe tariff pre-buy, that are flowing into I guess at least the US in the developed world in that context. Any views on that? Thank you.

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

A

I do not believe it's a pre-buy, by the way. We are in China for China predominantly. Our predominant presence is frankly with Chinese OEs, so less so with kind of the large multinationals. But I would kind of point out to another item and that is that our core growth in East Asia and India was as constructive as it was in China in Q4. So, that would kind of tell you that more broadly across Asia as a more ubiquitous region, you are seeing kind of a similar strength. So, I wouldn't say that it's specifically China-driven and pre-buy-driven. We have not seen evidence of that.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. I appreciate that.

Operator: Our last question will come from David Raso from Evercore ISI. Please go ahead. Your line is open.

David Raso
Analyst, Evercore ISI

Q

Yeah. Just wanted to let you expand a little bit upon the comment as our balance sheet continues to improve, it'll help widen our capital deployment aperture over the next few years. I'm just curious to get a little more color on how do you think about sort of what level of financial leverage? Is it clearly more of a time to lean forward, maybe the situation with Blackstone sort of being in the past, how that also might change how you think about utilizing the balance sheet, and then, I mean, just what are you seeing in opportunities if you've at least been kicking the tires a little bit on M&A?

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

A

Yeah. look, we believe that we have gotten the balance sheet to a good place. Again, in general, all else being the same, we have an ability to reduce our leverage by about half a turn a year through very strong cash generation capability of this business. We still believe that our stock is significantly undervalued. So, from where I sit, I have a significant amount of strategic initiatives that add tremendous amount of improvements to our financial metrics. You take a look at our ROIC, every project that we do gives us the ability to drive better returns, which is something that we are very laser focused on.

We have opportunities to invest organically into getting more exposed to highly positive end markets with strong secular drivers. So, we continue to do that. We continue to evolve organically. Our portfolio gives us the ability to

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position us in during the next cycle to deliver much stronger top line generation capability. And we obviously are looking at M&A, but we think that there is more opportunity to invest in our business vis-à-vis stock buybacks and/or internal investment. And, if we can find businesses that we believe that are highly accretive, that we can buy at a reasonable multiple, we are right there. We are happy to take a look at that.

David Raso
Analyst, Evercore ISI

Q

Thank you very much.

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

A

Thanks.

Operator: We have no further questions. I'd like to turn the call back to Rich Kwas for closing remarks.

Rich Kwas
Vice President-Investor Relations & Strategy, Gates Industrial Corp. Plc

All right. Thanks, everyone. If you have any follow-up questions, feel free to reach out to me and have a great rest of the week.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.

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