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Gates Industrial Corp. Plc (GTES)

Q1 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by. My name is Greg, and I will be your conference operator today. At this time, I would like to welcome everyone to today's Gates Industrial Corporation Q1 2025 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I would now like to turn the call over to Rich Kwas, Vice President of Investor Relations. Rich?

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

Greetings, and thank you for joining us on our first quarter 2025 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 2025 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 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 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 differ materially different from those expressed in or implied by such forward-looking statements. These risks include, among others, matters that we have described in our most recent Annual Report on Form 10-K and other filings we make with the SEC. We disclaim any obligation to update these forward-looking statements.

We will be attending the Wolfe Global Transportation and Industrials Conference and KeyBanc Industrials and Basic Materials Conference next month and look forward to meeting many of you.

Before we start, please note all comparisons are against the prior year period, unless stated otherwise. Now, I'll turn the call over to Ivo.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you, Rich. Good morning, everyone, and thank you for joining our call today. Let's start on slide 3 of the presentation.

Our first quarter sales outpaced our initial guidance supported by positive core sales growth of 1.4% with both volume and price contributing. Our replacement channel sales grew mid-single-digits, driven by high single-digit growth in automotive replacement.\

At the end market level, ongoing softness in the agriculture and construction markets and weakness in energy were more than offset by strong growth in personal mobility and mid-single-digit growth in our automotive end market all in.

Our adjusted EBITDA margin exceeded 22% and our gross margin expanded to 40.7%. We continue to advance our various enterprise initiatives, which are primarily focused on gross margin improvement. Our net leverage finished at 2.3 times at the quarter end and decreased slightly year-over-year. Our free cash flow performance was consistent with normal seasonality.

Our balance sheet is in solid shape. We repurchased $13 million of our shares during the quarter and have over $100 million remaining under our existing authorization. We are maintaining our initial 2025 financial guidance. We have implemented actions to mitigate the relevant tariffs impact on our business based on current tariff rates, with price increases being the predominant tool.

Our existing in-region, for-region operational structure limits the present tariff regime exposure and we anticipate offsetting the estimated tariff impact through price implementation and various operational initiatives.

Brooks will provide more detail on our exposure in a few minutes. Since the US Presidential administrations announcement on tariffs on April 2, we have not observed a noticeable change in customer demand or behavior. That said, there is more uncertainty in the market now relative to the start of the year and we continue to exercise a healthy dose of pragmatism in our forward planning.

We are managing costs more closely and we are prepared to take additional actions as needed. Our manufacturing footprint is largely in-region for-region, which we believe is an advantage relative to our competition.

Furthermore, since 2022, we have worked extensively to optimize our sourcing and logistics networks. We are well positioned to continue to deliver further optimization as the current tariff policies take additional hold.

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Our seasoned management team has experienced multiple economic cycles as well as previous supply chain dislocations. I'm confident in our team's ability to effectively manage our business as we enter this period of increased uncertainty.

Please turn to slide 4. First quarter total sales were $848 million, which translated to core growth of 1.4% and was slightly better than our guidance. Total revenues were down just under 2%, inclusive of unfavorable foreign currency effects.

Our automotive growth was healthy, supported by the replacement channel growing high single-digits on a core basis which more than offset weakness in automotive OEM.

Industrial and market demands generally remained soft, although core revenue decreases were less of a headwind relative to prior quarters. Personal mobility continued to recover and contributed nicely with more than 30% growth. This was offset by continued soft demand in the agriculture and construction end markets, which decreased in the mid-single-digits.

We experienced greater stability in the industrial replacement channel with core sales performance about even with the prior year period.

Book-to-bill finished just above 1 for the quarter. In general, business activity followed our normal seasonality and we did not observe material pre-buy activity during the quarter.

Adjusted EBITDA was $187 million and represented a margin rate of 22.1%, a decrease of 60 basis points. The year-over-year margin performance was in line with the midpoint of our guidance. Recall, we had a non-recurring profit benefit primarily related to insurance proceeds in the prior year period that added approximately 100 basis points to last year's margin performance.

Gross margin measured 40.7%, and we exceeded the 40% threshold for gross margin for the fourth consecutive quarter. Adjusted earnings per share was $0.36, an increase of approximately 6%.

Underlying operating performance was positive, although offset by the non-recurring favorable items from last year discussed earlier and unfavorable foreign exchange. Lower interest expense and lower share count combined contributed about $0.03 to adjusted earnings per share.

On slide 5, we'll review our segment highlights. In the Power Transmission segment, we generated revenues of $527 million in the quarter, which translated to approximately 2% increase on a core basis. The replacement channel was up year-over-year, led by mid-single digit growth in automotive replacement.

Overall, our transmission OEM sales were slightly down, driven by high single-digit decrease in automotive OEM sales. Industrial OEM sales benefited from double-digit growth in personal mobility. Demand was muted across the balance of industrial end markets in Power Transmission.

In the Fluid Power segment, our sales were $320 million. On a core basis, sales were approximately flat. Demand in the replacement business was healthy, supported by automotive replacement, which grew mid-teens.

Industrial replacement stabilized with sales approximately flat. Industrial OEM sales declined low double-digits on a core basis. With respect to profitability, both segments were impacted by foreign currency headwinds as well as

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incremental SG&A expenses related to investments in system improvements we referenced on our last earnings call.

The Power Transmission segment partially offset these headwinds with benefits from strengthening recovery in personal mobility. While the fluid power segment experienced greater margin pressure due to ongoing demand, softness in the agriculture and construction end markets.

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 with slide 6 and review our core sales performance by region. North America returned to growth in the quarter while China and the East Asia continued to experience positive core sales growth consistent with the trend experienced during the second half of last year.

EMEA and South America both declined year-over-year. In North America, core sales grew low single-digits, driven by mid-teens growth in automotive replacement. The underlying demand in the channel remains constructive further supported by incremental revenue from inventory load in with a new channel partner.

Personal mobility core sales also increased double-digits. This growth was partially offset by lower OEM demand. Industrial OEM channel sales decreased low-teens. In EMEA, core sales fell just under 1%. OEM sales were approximately flat with automotive weakness offset by growth in industrial.

Industrial OEM sales were supported by recovery in personal mobility. Replacement sales were mixed with automotive replacement core growth in the low-single-digits and industrial replacement down mid-single-digits. The energy end market continued to be a headwind within the regions results.

China core sales expanded 3.5% with broad based growth. Industrial end markets grew mid-single-digits with diversified industrial being a significant contributor. OEM sales grew low-single-digits with industrial growth offset by weakness in automotive. The replacement channel grew mid-single-digits, supported by growth in both industrial and automotive. East Asia and India posted approximately 5% growth in core sales. Automotive replacement, diversified industrial and personal mobility were the major contributors. South America core sales declined low-single-digits.

On slide 7, we lay out the key drivers of our year-over-year change and adjusted earnings per share. Operating performance contributed approximately $0.04 per share driven by gross margin expansion. The operating performance was offset by unfavorable foreign currency and a $0.02 per share headwind from the non-recurring favorable items realized in the prior year period. Lower interest expense, a lower share account and higher other income collectively contributed $0.04 per share.

Slide 8 has an update on our cash flow performance and balance sheet. Our free cash flow for the first quarter was an outflow of $19 million, which is in line with our normal seasonal performance.

As we mentioned on last quarter's call, we have increased our CapEx investments for this year to support key footprint optimization and system enhancement projects. Our net leverage ratio declined to 2.3 times, which was a 0.1 times improvement relative to the prior year period.

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We repurchased $13 million of our shares in Q1 and have over $100 million remaining under our existing authorization. Our trailing 12-month return on invested capital was 22.5%, a modest decline compared to the prior year. Our capital spending has increased to support projects that we anticipate will contribute to future expansion of our return on invested capital.

Turning to our 2025 guidance on slide 9, we are reiterating our full year 2025 guidance, which includes core revenues to be in the range of down 0.5% to up 3.5% relative to 2024.

Adjusted EBITDA is forecasted to be in the range of $735 million to $795 million. And adjusted earnings per share is estimated to be in the range of $1.36 per share to $1.52 per share. These ranges incorporate the anticipated incremental impact of all enacted tariffs, which I will cover in more detail in a moment. Additionally, we still anticipate capital expenditures of approximately $120 million and free cash flow conversion to exceed 90% of our adjusted net income.

For the second quarter, we estimate total revenues to be in the range of $845 million to $885 million and core revenues to be approximately flat at the midpoint.

For the second quarter, we expect our adjusted EBITDA margin to decrease in a range of 10 basis points to 60 basis points compared to Q2 of 2024. Recall that we had a non-recurring real estate gain in last year's second quarter that contributed approximately 80 basis points to last year's adjusted EBITDA margin.

On slide 10, let's discuss our tariff exposure based on the current landscape and the associated mitigation actions we are implementing. Based on all enacted tariffs as of April 29, we estimate our exposure is approximately $50 million for 2025.

At the regional level, North America represents about $35 million of the tariff cost, and our exposure in China is approximately $15 million. The impact in other geographies, including the EU, is estimated to be immaterial. We intend to offset the majority of our estimated tariff impact with price actions. We communicated price increases to our channel partners in early April and expect price realization to match the timing of the incoming tariff cost.

Furthermore, we are employing various operational initiatives to mitigate potential margin erosion from the inactive tariffs. Assuming the state of play as of today, we intend to fully offset the incremental tariff impacts estimated to be incurred this year and anticipate no meaningful impact to our adjusted EBITDA for the full year.

I will now turn the call back over to Ivo.

Ivo Jurek

Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you, Brooks. On slide 11, I'll summarize before we take your questions.

First, we are pleased with the start to the year. Core growth was slightly positive and our underlying operating performance was rather strong when considering the non-recurring positive items from last year's first quarter and the headwind caused by foreign exchange. Our gross margins continue to increase.

Second, customer demand so far in the second quarter has been consistent with our initial guidance. However, we acknowledge there are potential risks to demand as the existing tariff regime becomes further entrenched. As such, we are tightening our focus on our compressible cost structure, such as SG&A and other spending. We have action plans prepared to implement should demand trends soften relative to our expectations.

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Third, I would like to re-emphasize that our team is seasoned and has been through periods of business uncertainty in recent times. Our global teams are working closely together to fully mitigate the tariffs, dollar cost impact. Additionally, we continue to progress our enterprise initiatives, which we believe will structurally improve our cost base for the long-term and help mitigate the tariff headwinds in the short-term.

Lastly, I want to accentuate that our balance sheet is in a strong position and we have significant capacity to deploy capital. We have over $100 million remaining under our existing share repurchase authorization and plan to be opportunistic deploying capital.

Before taking your questions, I want to extend my gratitude to more than 14,000 Global Gates Associates for their dedication, focus and execution to our customers' expectation and resiliency, especially during this period of macroeconomics and geopolitical uncertainty.

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

QUESTION AND ANSWER SECTION

Operator: Thank you so much. [Operator Instructions] And it looks like our first question today comes from the line of Michael Halloran with Baird. Michael, please go ahead.

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

Q

Hey, thank you. Good morning, everyone.

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

A

Hey Michael.

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

A

Good morning, Michael.

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

Q

Hey just on the tariff side of things. Obviously very clear messaging that on a dollar basis you'll be offsetting the tariff impact. Maybe just talk about how that cadencing works out as you look through the remainder of the year. Is there any mismatch as you think about it in 3Q and then fully catch up by the fourth quarter, kind of how does that dynamic play out?

And then secondarily, if you could add just how you feel about your competitive positioning, all else equal and from a global footprint perspective.

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

A

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Hey, Michael. I'll take the first part and I'll let Ivo take the second part. So, from a dollars perspective, we expect not to be negative in any quarter. We expect the second quarter to be minimal impact. And then we expect third and fourth quarter to be matched pretty, pretty, pretty closely. And so very immaterial impact from a dollars perspective. We do expect about a 25 bps EBITDA margin dilution for the year because it's dollar for dollar. But no – but zero-dollar impact and no real, kind of quarter-to-quarter impact that's going to be material. So, I'll let Ivo handle the second part there.

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

A

Yeah. Let me try and maybe add additional clarity. I'm sure that there is going to be a ton of questions around the tariffs, but maybe put a pin into it. But we anticipated at about 75% to 80% of that $50 million will be offset with price. So we got about 20% to 25% that we anticipate to offset through operation initiatives and supply chain realignment.

I'll remind you that we have done a lots of supply chain realignment and reconfiguring post-Ukraine Russia conflict. So, we feel that we are reasonably well positioned to be able to drive that forward.

As to the competitive positioning, look, we you know, we have done a lot since frankly, since Blackstone bought the company, 10 years ago we've started to position the organization for in region, for region manufacturing philosophy. And so, we have been doing quite a bit.

Let me remind you that in 2017, 2018, 2019, we've put a bunch of monuments in the ground and rebuilt our operational capacities. So we have – it's been well positioned, and I feel that today we have one of the better footprints to be able to deal with the disruptions that we are seeing that were brought by this tariff regime. So I think that we are competitively well positioned. I know that we are all focusing on some of the impediments and there are impediments that we will need to operate through.

That being said, we do also see a ton of new opportunities out there, particularly in the United States, because we are well positioned. So, while we are pragmatic in our approach and we are focusing on operational cadence and offsets to what we see today through this regime, we are also being very agile in focusing on new opportunities in the marketplace.

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

Q

That makes a lot of sense. Appreciate that. And then follow up, just maybe where, an update on where we stand on the internal initiatives progress and tying it to the current trends. I'm assuming the dynamics that are happening on the tariff side don't impact your ability to push forward with the internal initiatives, but is there an opportunity to pull that forward even more if demand softens? And maybe how does that correspond or interrelate to the tariffs remediation actions you are taking.

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

A

Yeah. I think there's a lot to unpack in the – in this short question, I think, Mike. But let me say that we – these are the initiatives, the corporate 80-20 driven activities, we have had a rather solid execution. And I would say in general, we are a little bit ahead of our schedule. And that frankly filters in in the gross margin performance again, another quarter of north of 40% gross margin. So we are well on track to deliver on what we've committed to our shareholders. Again, we have done a ton of work on material cost out as a huge opportunity. You saw big

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progress last year. We continue on that trajectory in 2025. And we feel reasonably confident that we are going to see another year of strong performance here.

The underlying productivity and price are additive to what we are doing so that all is helping out to offset these headwinds that we are seeing right now. And look, the footprint optimization that we have discussed that's going to build on its progress as we continue to progress through the year. And remember, it really is a little more complex. It's not as, hey, look, we have a window, so we're going to pull some things forward. We have a schedule of delivery of new equipment that we are installing that generally speaking is fixed under fixed lead times. And it's really kind of the gating item on your ability to pull anything forward.

But that being said, there are other things that are under control that we can manage through as we see more of these impediments being layered in, we can manage compressible cost. There's a ton of compressible cost across the company and we are tremendously focused on managing those, controlling those and being very cognizant that we want to ensure that we protect our underlying operating margins. So, I know it's a longwinded answer, but hopefully I have captured the essence of what your question was.

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

Q

You did. Thanks, Ivo. Appreciate it, guys.

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

A

Thanks, Mike.

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

A

Thanks, Mike.

Operator: And our next question comes from the line of Julian Mitchell with Barclays. Julian, please go ahead.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. And maybe just wanted to start with a demand question. So, you've given sort of very good color on the geographic sort of trends, maybe just thinking about the end markets for a second. You gave a good update on the end market expectations globally on the prior call. Just wondered how those have moved around since then. I suppose in particular sort of interested in the perspective on personal mobility where it looks like a stronger start to the year than the full year guide had implied. And also, any help you could give us on what's happening in the auto world at the moment and not just demand, but kind of how are your products into auto OE bracketed in terms of tariff classifications?

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

A

Good morning, Julian. And again, a lot to unpack. So, hopefully you don't mind a longwinded answer in here. But let me try to hit on all of these points. Look, when we are – let's just kind of ground ourselves up as the year started, we did not expect any meaningful recovery in the first half. And it was for a number of different reasons. Nothing to do with tariffs, obviously, but we just were waiting for the PMIs to recover. And we thought that we

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have pretty well bracketed a much slower recovery in the first half. And I think that the general underlying demand is, frankly not playing significantly differently than what we have anticipated.

Yeah. There are some incremental headwinds now that I think everybody's getting more concerned. And we will obviously manage those. 1Q came a little bit better than what we expected, and Q2 is looking very much in line with what our expectations are vis-à-vis order rates, exit order rates from Q1. And frankly, order rates that we have seen throughout April month-to-date. So, I feel that we are reasonably well positioned to support what we have just shared with you all.

We've always anticipated – [ph] now starting (00:30:55) to hit on some of the end markets. But we've always anticipated that auto builds would be down. We felt when we were coming into the year, we felt that all the forecasts that were being done by the third-party were a little bit too optimistic. And we were much more negative on auto builds when the year started. The auto builds got a little worse, obviously, particularly exiting Q1 into Q2, but it's more around the edges.

Our sense was that the auto builds globally will be down around mid-single-digits. What we are seeing now is more down high-single-digits. I would not be surprised if for the year – at least for the next couple of quarters we see auto builds being down kind of around the 10% range year-on-year. And we've kind of bracketed that in our forecast.

Conversely, what we do see and frankly, when we became IPO, that was kind of the pretext of our thesis. We see the auto replacement market being quite robust. And when you take a look at even the reporting channel partners that we have had so far, the market is not that bad. They reported positive store comps and we have reported rather a robust AR performance with high-single-digits. But I would remind you that that's predominantly on the back of the market share gains that we have had last year. So, both of these are additives. But the underlying AR market is rather okay. And if you take into account the aging car fleet, employment is still rather okay, people still – they are going to probably cut flights, but they still want to go visit grandma and/or family. And so they instead of taking a plane, they'll drive a little bit longer. So all of that bodes well for AR, and we anticipate that that's going to be accretive for the year.

If I think energy, energy we had a muted outlook and energy got a little bit weaker when you take into account the deceleration in price of oil. And what I think is anticipated slowdown in the global economy. So they've got around the edges weaker.

Off-highway, we felt that that was going to be kind of neutral. That is maybe down mid-single-digits or slightly worse than what we have anticipated. Construction and ag came in about what we've anticipated. Again, I'll remind everybody that construction and agriculture was rather negative in particularly in the second half of last year. The machine builds were down between 20% and 30% in the second half. So, that not being as bad but still being negative is what we've anticipated. You could anticipate that gets slightly worse. But I think that taking into account how negative the off-highway ag and construction equipment performed last year, my sense is that it's going to be more around the edges negative, if not dramatically more negative. So that I think is kind of okay.

And the diversified industrial, diversified industrial hung in there, that came about flattish for the quarter. And we anticipate that that's going to hang in there. But again, I'll remind everybody that was rather negative for seven to eight quarters in 2024 and 2023. So the inventories are very lean in the channel. And I think channel partners actually are performing a little bit better than some of the orders that we have seen. So we have seen, the incoming orders being slightly under what our channel partners are consuming. So, I feel that that end market is around the edges as we've anticipated and maybe leaning more slightly positive.

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And then the last piece is personal mobility. That came very robust. And I know that, maybe the first question is going to be pre-buys. We did not see any pre-buys from our channel partners. We have plenty of capacity. We have predominantly in region, for region in that end market, the biggest growth that we have seen came out of Europe and Asia for consumption in Europe and Asia. So, we did not necessarily feel that there was any pre-buy associated with that. So I know I've given you a longwinded answer, but I wanted to make sure that I fully encompass in my answer the essence of your question.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

That's super helpful. Thanks very much, Ivo. And just one very brief follow-up. The sort of auto sector and auto parts has a lot of unique things going on on the tariff front and how things are classified or exempted and so on. Maybe just help us understand your own, it's a small part of the company now, high-single-digit share of sales, but your own auto OE business, say, within the US, are those sort of classified within what we see going on with the broader auto companies in terms of tariff movements or it's sort of different to them?

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

A

Yeah. I apologize, I forgot that part of the question, Julian. That is not that big of a concern for us, for the OEs, because if I take a look at, what we do out of our plans in Mexico for the auto OEs, they pick up in Mexico. So we are really not responsible for whatever the tariff situation would be. And most of everything that we do in Mexico and in Canada for auto components is USMCA compliant as well. So that – that's not that critical. And we really don't export anything from the US to Europe as an example. And I think that you saw it on that tariff summary that we have had in slide deck that we have de minimis exposure in Europe as an example to any tariffs. So, the auto components are very, very neutral for us vis-à-vis the OEs.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

Operator: All right. Thank you, Julian. And our next question comes from the line of Jeffrey Hammond with KeyBanc Capital Markets. Jeffrey, please go ahead.

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

Q

Hey, good morning, guys.

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

A

Good morning, Jeffrey.

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

A

Good morning.

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

Q

Just on the core growth, unchanged. I just wanted to understand some of the moving pieces there. One, kind of what's the magnitude of the price increases that you've announced? What incremental pricing do you have in the guide? And then FX, I think was a 2.5-point, 3-point headwind and $34 million on EBITDA. Just how were you thinking about that? And then I guess the offset would be lower volume.

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

A

Right. So, let me kind of walk through that. So, in our presentation, we talked about offsetting the $50 million of tariff impact were 75% to 80% on pricing. And then we now think that what we were thinking that the other $10 million is going to be offset with operational improvements and supply chain changes and things like that. So, we didn't change our guide from a core growth perspective. So that $40 million kind of comes out of volume, when you think about it over the balance of the year, and that's kind of what Ivo was talking about earlier, some of the weaker OEM, particularly around automotive sector and then also the industrial sector. So that's kind of the offset there, right?

I think from an FX perspective, we're seeing about 100 bps less of a headwind than we initially thought. And that filters through the EBITDA kind of in a normal fashion. So not as much headwind as we were thinking from an FX perspective. And we base that on the end of March, end of Q1 rates and those move around quite a bit. And so those will flex through the year and they'll be – we'll update those impacts as things move around. But they moved around quite a bit since the end of the year up through now. So, we'll continue to update those depending on what FX – what the prevailing FX rates are, so.

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

Q

Okay. And then just a follow up, can you just quantify your manufacturing base in Mexico and then anything you can do just to kind of inch up that USMCA compliance closer to 100%. Thanks.

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

A

Yeah. So, look I think there's – the things that we could do on USMCA compliance is probably more around our manufacturing base in the US. We have some flexibility in terms of where we manufacture things and we have capacity that we've added not just in Mexico but also in the US, the new machinery and equipment and things like that.

And so depending on the tariffs and where we source things from and things like that, our biggest kind of flex where we can offset the tariffs. And it's always going to be a cost versus the tariff cost, right, internal cost versus the tariff cost is really take advantage of our US footprint, which is still pretty substantive in terms of manufacturing. And so that's really what we're looking at when we talk about the $10 million of offset from a sourcing and operational perspective. That's what we're talking about. Then we do more stuff in the US that's less impacted by tariffs and things of that nature. So, that's going to be the biggest thing we can do to offset or to kind of bump up the USMCA compliance aspect.

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

A

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And Jeff, I would add that the USMCA non-compliance is really diminutive, around the edges for us. I mean, it's almost immaterial in nature.

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

Q

And what's the mix of your manufacturing base in Mexico?

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

A

In Mexico, we manufacture every product that we manufacture in the US. So, we have full footprint on product transmission, we have a full footprint for fluid power and so we can manufacture just about everything in Mexico that we can manufacture in the US with the exception of mobility products. Mobility products we can only manufacture out of United States plant.

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

Q

Okay. Thank you.

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

A

Thanks, Jeff.

Operator: And our next question comes from the line of Nigel Coe with Wolfe Research. Nigel, please go ahead.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning, guys. Great color on the tariffs.

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

A

Good morning.

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

A

Good morning.

Nigel Coe
Analyst, Wolfe Research LLC

Q

So, it sounds like about 2 points of price coming through in the back half of the year. But is the plan to translate those price increases in the US? So, therefore, we're looking at maybe, I don't know, 4%, 5% price increase in the US? And are you going to spread the love across the whole portfolio? So, that's the first part of the question.

And the second part would be, do you have material – materials [indiscernible] (00:43:32), do you have larger competitors that don't have the same sort of local for local manufacturing footprint? So importing more into China

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or importing more from China into the US, less USMCA compliance in Mexico, just wondering if there's any competitive differentiation here?

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

A

Yeah. So, I'll take the first part of your question. So look, the pricing is really based on – it's not as regionally based as it is more what can we do to offset the sourcing, where we source from or where we make stuff from and kind of what's the net impact that needs to be passed along, right. And so, I would say probably a little bit more pricing maybe in the US, but really that's based on just your ability to run it, reconfigure your supply chain, reconfigure your manufacturing base and then kind of the net impact of the tariff versus the increased cost, right. So, we're going to have pricing all over the world where we're impacted by tariffs, but that's largely going to be based on both the supply chain aspect of it and the manufacturing aspect of it. So, hopefully that answers that part of the question.

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

A

And on the competitive positioning, Nigel, I would say that we are probably best positioned for manufacturing footprint. Again, as you saw from our quantification of the tariffs, I mean, for us while I don't want to diminish $35 million of tariff impact on about $1.6 billion, $1.7 billion North America base of revenue, it's really not that substantial and that just gives you an indication that we have a full capability to do everything in region, for region.

We predominantly are dealing with more of a raw material supply that impacts that number and not necessarily imports of finished goods into the US. And so most of our competitors are foreign competitors. And many of them or some of them have some limited capabilities to do either some limited assembly or they have capability to build some of these products. But we have very few competitors. And so maybe Parker in Fluid Power, I would say, is probably somebody that comes to mind that has a very similar footprint to Gates.

But outside of that, I think everybody else is in less favorable position than Gates Corporation and maybe Parker and Fluid Power. In the power transmission side, we just simply have the biggest footprint and we are well positioned to be able to deal with this. And we will continue to lean towards taking advantage of competitive positioning.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. And then my follow up question is just changing gears a little bit. I know liquid cooling is a very small business today, but it's got good potential. So it does sound like that value chain is starting to cranking the gear. So just wondering if you've seen that and any color there?

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

A

Yeah. Well, thank you for asking the question, actually. We've kind of omitted from the update today, not for any other reasons other than we understand that there are some other more pressing issues. But look, we continue to have a growing – we continue to have a really good growing engagement with a very significant number of new customers from server manufacturers, system integrators, all the way to kind of the data center operators and hyperscalers.

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So we feel pretty good at what's happening. We are in various stages of testing and validation of our products in these applications as we speak. I've just had a couple of reviews on our e-water pump that goes into data centers and run in significant number of opportunities that we are in a position to capitalize on. And we are rushing sample builds and validation of those samples. And frankly interestingly enough, it's not just in the US, but it's in Asia as well.

We've seen a rather nice step up in significant interest for our water pump in – particularly in Taiwan and in China, as these companies, particularly on the [ph] ESM (00:48:34) side ramping up, build out of more advanced white boxes and branded boxes in the server side. So that's really exciting. We are in kind of final stages with hyperscaler in validation of assemblies that have a very unique value proposition.

We have not seen any slowdown, frankly, in interest. If anything, it's been a rather nice step up and the set of opportunities on which we are quoting or delivering samples. So, I'm quite confident that in not too distant future we're going to be talking about business that is going to be ramping up rather than on opportunities that we are quoting or we are engaged in validation testing on.

Nigel Coe
Analyst, Wolfe Research LLC
Q

That's great. Thank you.

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

Thank you, Nigel.

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

Thanks, Nigel.

Operator: And our next question comes from the line of Deane Dray with RBC Capital Markets. Deane, please go ahead.

Deane Dray
Analyst, RBC Capital Markets
Q

Thank you. Good morning, everyone.

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

Hey, Deane.

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

Good morning, Deane.

Deane Dray
Analyst, RBC Capital Markets
Q

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Hey, maybe we could talk about the channel. Your channel partners, inventory in the channel, sell-in, sell-through. I appreciated that you called out early in your prepared remarks that you did not benefit from any sort of pre-buy. I trust that was in reference to the channel partner activity, but just what's your assessment on how do you think they react during the course of tariff mitigation?

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

A

Yeah. Thank you for the question, Deane. Look, we have not observed any meaningful change in behavior through the end of April. These channel partners, I think one of the one of the pragmatic issue is that is these folks are buying millions of SKUs as you can imagine. And I think it'd be rather difficult for them to pull demand forward. Maybe they would do something on some critical components. But the availability of our products on a short cycle is very good. Our service rates are very good.

And the cost of our products in a system is frankly, still de minimis, despite the fact that we offer mission critical support in applications. So we have not really seen any meaningful pull forward. When I take a look at the sales in versus sales out statistic from our major channel partners, we have been very much in balance with sales out, and I would say maybe even around the edges, we are underselling into the channel versus what we are seeing with our channel partners sales out.

So that would tell me that from the data that I see, there has not been any meaningful change in behavior. That being said, look, we are super short cycle company. And we – if things change, we will see them change. But I have characterized that through April we feel reasonably good about where we sit. The demand is very much in line with our expectation, both from our original assumptions as we were coming into the year, as well as with how we have quantified the second quarter guidance today.

Deane Dray
Analyst, RBC Capital Markets

Q

Great. Any line of sight on new channel partners you might be adding? And what's the update and status on the latest one that you added?

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

A

Well, the latest one we have – we are fully ramping up, we should be completely ramped up with that channel partner within this quarter. And so from kind of the second half of the year, it's going to be more run rated state of business. There are still some other opportunities for other product lines that we can secure, that we are working on. And I'm not in a position to be talking about any other incremental channel partners. But again, as I said as a part of my answer to Nigel, I think that we will have incremental opportunities and we will let you know as we are capturing those opportunities into the future.

Deane Dray
Analyst, RBC Capital Markets

Q

Thank you.

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

A

Thanks, Deane.

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

A

Thank you.

Operator: And our next question comes from the line of Chris Snyder with Morgan Stanley. Chris, please go ahead.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. I just want to follow up on the commentaries around potential pre-buy. And I know it's probably hard to always know exactly what's happening, but I guess what gives the company confidence that there wasn't any pull forward in Q1? And I ask because it's the first quarter of positive organic growth in a couple years. Would you guys attribute that pre – that improvement in growth just to the new customer wins in the quarter? Thank you.

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

A

Yeah, Chris, thank you. Good morning. And thank you for your question. Look, I will come back to my answer that I just provided to Deane. I can only look at the data that is available to me. And the data would indicate that actually we were probably around the edges, a little bit behind with receiving orders and selling into the channel, taking into account the sales out by channel partners.

And in the US, we actually have a reasonably good visibility to that because most of our large customers are public companies, and we have good agreements with them. So we receive weekly and monthly data on their sales out into the end market. And that data would indicate that they are very much in balance and inventories have not built out. We've talked about inventories in a channel coming out over the last eight quarters or so. So absent of that, the data would indicate that channel sales were balanced and there was no pre-buy.

The second part of your question, hey, what caused you – the second part of your question associated with what's – what has driven positive core growth? Well, look, first of all, I think we were reasonably pragmatic coming in into the year. We really didn't anticipate that it's going to be a super jazzed up year. We thought it's going to be muted end market environment. And I think I have delineated to excruciating detail what is happening in the end markets to Julian's question.

We see behavior that's more in line with what we've anticipated, and we have had better performance out of mobility. Mobility had seven negative quarters of growth that had – that inventory has depleted. And we have delivered a very strong growth in mobility. And then, the second part of why positive growth is, we have taken market share. We've discussed last year in AR. We continue to see very constructive end market behavior in automotive replacement, not just here in the US, but in Europe as well as in China. And both of those – all of the – all the three of these regions have continued to grow. Our business in AR is growing nicely in India now as well. So we have done just slightly better.

But I tell you, I'm not high-fiving that we have delivered 1% core growth. We really would like to see much more robust growth. But that's going to be challenging taking into account the present economic macro.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

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Thank you. I really appreciate that thoughtful response. I guess, maybe following up, are we right to assume that the price increase that you guys are pushing through is more of a Q3 event than Q2 event? Any color on that is helpful. Thank you.

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

A

Yeah. From – look from an implementation perspective, it's a Q2 event; from a realization perspective, it really doesn't impact Q2, it starts to impact Q3. And it's really well-matched with how the cost of the tariffs are going to come in, right. I mean, we're sitting on about a quarter of inventory and that'll flush through in Q2. We've implemented all the price increases. We've talked to all of our channel partners. They understand what's coming.

That'll start to come in Q3 as well. So, like we said in the prepared remarks, the tariff impact is a relatively de minimis event in Q2 and we'll really see that in the back half of the year, both the cost impact and the price impact. And then most of the dilution impact we'll see in the back half of the year, the EBIDTA dilution impact.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. I appreciate that.

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

A

Thanks, Chris.

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

A

Thanks, Chris.

Operator: And our next question comes from the line of Andy Kaplowitz with Citigroup. Andy, please go ahead.

Q

Hey. Good morning, everyone. This is actually [ph] Jose (00:58:27) on for Andy.

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

A

Hey [ph] Jose (00:58:29), how are you?

Q

Good. So, maybe to start, you kind of touched on 80-20 in an earlier question [indiscernible] (00:58:37), could you give us an update on how the implementation has been progressing? And if you're planning to accelerate that in 2025 to offset the potential margin dilution from tariffs? You talked in the past North America is fully on board with the front end and you're making progress on the back end. And there's still plenty of runway in Europe which could help you offset some of the weakness in that region? So, any color here would be helpful.

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

A

Look, 80-20 is becoming a central part of our operating business model and kind of operating DNA and we're making good progress. We're making measured progress in 80-20. Again, I will reiterate what you said, North America, good progress with front end. We are now starting to address the back end. In the operations we feel we got ton of opportunities there, and it's really quite – actually, it's quite interesting. It's super powerful in the operations where we deploy in specific cells. You see a rather substantial jump in productivity.

So, we'll be pretty focused in driving it across our factories in North American footprint and we anticipate it will start pulling 80-20 into the back end in Europe as well. We view that as certainly a lever that will be accretive to us to deal with the macroeconomic challenges.

I'm not going to be sitting in here and telling you that we're going to do better or we're going to do worse. I think that we are laser focused, this management team is super focused on dealing with the impediments that are ahead of us. We are all pretty sober about it. We know that things change and they change every day. This has been one of the most difficult, most challenging, seven to eight weeks that we have had since the announcement on April 2.

Our management team is working super hard. All of our employees across the company are laser focused on dealing with this, and we are fully committed and fully on board to drive the best results for our shareholders, for our customers, and for all of our stakeholders across the company.

Q

Thank you. And then maybe a quick one in terms of capital deployment. You guys finished the quarter with a net leverage of 2.3 times, and you've talked about being able to reduce your leverage by half a turn in the year just based on your cash conversion, which would put you within your one to two leverage target. And you've talked a lot about the organic investment and the share repurchases remaining in focus. But I'm just curious if you could talk about what you're seeing in the M&A environment.

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

A

Yeah. Look, great question. I would remain consistent with my answer. Our stock is super cheap. We will continue to be opportunistic in utilization of our $100 million plus authorization that we have outstanding. So I think that we will certainly – we certainly anticipate to lean into that lever. We, in general, deliver very strong free cash flow generation in the second half of the year. So we certainly see an opportunity to continue to delever and come close to our metrics that we have committed to our shareholders.

We see really nice set of opportunities to do M&A, but before we would be doing any transactions we've got to make sure that they will be accretive to our long-term strategy. We will certainly be cognizant of the fact that any potential transaction would have to deliver double-digit ROIC by year three. That is non-negotiable from our end.

And while we see opportunities out there and there are some really nice assets that are available, we're going to be very disciplined. We have a great company. We have terrific strategy. I think we are executing on a trajectory that we have committed and we are not under any pressure to be doing any deals that would potentially derail what we have envisaged here.

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

A

And let me add to that. We – last year we did a lot of really, really good work. In fact, probably I would say best-in-class work around our balance sheet and our debt structure. We don't have any big principal payments due until 2029. We've locked in a pretty favorable interest rate structure in terms of what our fixed versus variable is.

We're confident in our cash flow, our ability to generate cash flow and what the stock trading is today. We still have over $100 million of authorization on share buyback. In the short run here given the – given what's going on in the economy, that's probably where we'll lean into here over the short term. We're confident in our ability to delever. We've done it over time. And so the opportunity set for us right now is – there's probably more in the share buyback side.

Q

Thank you for your time, guys.

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

A

Thank you.

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

A

Thanks.

Operator: And that does conclude our Q&A session today. So I will now turn the call back over to Rich Kwas for closing comments. Rich?

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

Yeah. Thanks, Craig. Thanks, everyone, for joining us today. If you have any follow up questions, please feel free to reach out and have a great rest of the week. Take care.

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