

Operator: Greetings. Welcome to Helios Technologies Fourth Quarter 2019 Financial Results Conference Call. [Operator Instructions] Please note that this conference is being recorded. I will now turn the conference over to your host, Karen Howard, Investor Relations for Helios. You may begin.

Karen L. Howard: Thank you, Ariel, and good morning, everyone.

Welcome to the Helios Technologies Fourth Quarter and Full Year 2019 Financial Results Conference Call. On the line with me are Wolfgang Dangel, our President and Chief Executive Officer; and Tricia Fulton, our Chief Financial Officer. Wolfgang and Tricia will review the results that were published in the press release distributed after yesterday's market close. If you do not have that release, it's available on our website at www.hlio.com. You'll also find slides there that will accompany our discussions today.

If you look through the slide deck, on **Slide 2**, you'll find our safe harbor statement. As you may be aware, we will make some forward-looking statements during this presentation and also during the Q&A. These statements apply to future events that are subject to risks and uncertainties as well as other factors that could cause actual results to differ materially from where we are today. These risks and uncertainties and other factors are provided in the earnings release as well as in other documents filed by the Company with the Securities and Exchange Commission. These documents can be found at our website or at www.sec.gov.

I also want to point out that during today's call, we will discuss some non-GAAP financial measures, which we believe are useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliations of comparable GAAP to non-GAAP measures in the tables that accompany today's earnings release as well as in the slides.

Wolfgang will get started by summarizing our financial performance and strategic progress during 2019. Tricia will go through the details of our financial results for the fourth quarter and full year, and then we'll turn it back to Wolfgang for his perspective on our outlook and 2020 guidance before we open up the line for questions and answers. And with that, it's now my pleasure to introduce Wolfgang.

Wolfgang H. Dangel: Thank you, Karen. Good morning, everyone.

I will start on **Slide 3**. For 2019, we reported a record-setting year at both the top and bottom lines. We realized sales of \$555 million, a 9% increase over last year. Our 2018 acquisitions of Faster and Custom Fluidpower drove our 2019 growth, contributing \$65.5 million of acquisition revenue in 2019. Organic sales on a consolidated basis, excluding currency, decreased 2% in 2019. Organic sales of our Hydraulics segment grew 1%, while sales in our Electronics segment declined by 11%, both excluding the effects of changes in foreign exchange rates. As expected, currency had an unfavorable impact during the year.

Despite the challenging macroeconomic backdrop, our fourth quarter consolidated revenue and quality of earnings were better than we expected. We have been successfully improving operational efficiency and throughput at all of our operations. Tricia will provide more details on each segment's performance.

Turning to the bottom line, for 2019, we reported \$60.3 million of net income, a 29% increase over the prior year. On a non-GAAP cash basis, net income was \$77.7 million, or \$2.43 per share, a 6% improvement over 2018. Adjusted EBITDA for the year was \$131.1 million, or 23.6% of sales.

As you may know, increasing cash flow and reducing debt have been important goals for us this year. We finished 2019 with very strong cash generation in the fourth quarter. This contributed to adjusted free cash flow for the year of nearly 14% of sales, significantly exceeding our 10% target level. During 2019, we reduced debt by over \$52 million, closing the year with a 2.1x net debt-to-adjusted EBITDA ratio. We are nearing our goal of less than 2x, which we anticipate achieving by the middle of this year.

Please turn to **Slide 4** and I'll summarize our strategic business highlights for 2019. Starting with our Hydraulics segment, as we reported earlier in the year, we completed our CVT manufacturing consolidation project. This involved consolidating manufacturing into our two adjacent Sarasota facilities, applying our LEAN enterprise principles and reorganizing our production lines. We improved our productivity as we progressed through the year and freed up additional capacity.

Next, we accelerated our "in the region, for the region" initiative in both the EMEA and APAC markets. I want to remind you that one of the synergies we identified as part of the Faster acquisition was to leverage the capacity and regional expertise presented by machining CVT components at our Faster facilities. In the middle of 2019, we began production of CVT components in Europe, which will ultimately drive efficiency and cost savings. We will produce six critical parts for the high-volume cartridge valves at that location, initially representing a near-term vertical integration cost synergy. We expect that cost savings will ramp up to full realization in the middle of this year. This represents the first phase of CVT manufacturing in EMEA. The next phase of this project will involve complete cartridge valve production capability for the EMEA market. We have approved site expansion plans to support our anticipated Hydraulics segment growth in that market.

Turning to the APAC region, we opened and began shipping products from our new facility in China, near Shanghai, ahead of schedule in the middle of 2019. We experienced significant demand, and volume ramped up as we progressed through the year. I'll touch on coronavirus later in this presentation. This factory is currently performing assembly and test for a selected range of products sold in the region. Over the next few years, we plan to expand the value-add manufacturing within this facility for our regional customers, ultimately, bringing complete cartridge valve rollout production capability to the Asian region, where we continue to make market share gains. This new capacity is complementary to our facility in South Korea, which we inaugurated in 2018.

Furthermore, the new engineering center of excellence in our third Sarasota facility is progressing as planned. As a reminder, this facility will house our global CVT research and development activities as well as certain administrative and operating functions and is expected to be completed next month.

Our R&D investments remain very active in our Hydraulics segment. We launched an initiative named E-Volved that is focused on the development of electro-hydraulic coupling solutions. As we have done in the past, we will leverage our electronics knowledge across our segments as we develop this innovative product offering. We anticipate continued product development and electro-hydraulic portfolio expansion.

During 2019, we also launched new valves in our FLeX series. As you might recall, we commenced this activity at the end of 2017, continued releasing FLeX products in 2018, and will expand and broaden the electro-hydraulics valves offering on an ongoing basis. This was an important strategic initiative for us as it provides robust electro-hydraulic controls for mobile, agricultural and industrial applications, creating a critical path to expand our systems business and opening the door to new opportunities.

Turning to our Electronics segment, we continue to make significant investments in collaborative R&D initiatives, actively pursuing projects jointly with OEMs that have model year rollouts beginning mid to late 2021 and continuing through 2023. These elevated levels of engagement with existing and new customers require additional upfront investments in R&D and engineering resources as the projects progress.

2019 marked the third and final payment of the contingent consideration payout to the group from whom we acquired Enovation Controls. Given the strong performance of that business, it is truly a win-win situation for all parties involved.

Finally, we are very pleased with the gross margin expansion realized in the Electronics segment in 2019, which is a result of simultaneous engineering capabilities, meaning state-of-the-art product design capabilities in combination with sophisticated manufacturing execution.

All of these initiatives are important components of our Vision 2025 strategic plan to achieve global technology leadership in the industrial goods sector, with critical mass exceeding \$1 billion in sales, while maintaining superior profitability and financial strength.

With that overview, I'll now turn the call over to Tricia to review the financial results for the fourth quarter and full year in a bit more detail.

Tricia L. Fulton: Thank you, Wolfgang, and good morning, everyone.

Let's begin on **Slide 6** with a review of our fourth quarter consolidated results. Organic sales were down \$11.1 million or 8% compared with last year's quarter, excluding a \$1.7 million unfavorable currency impact.

I will now touch on sales by region, which are designated here in the sales bar charts on the left. During the 2019 fourth quarter, APAC realized year-over-year growth of 9%, while the Americas and EMEA markets declined by 18% and 10%, respectively. Sales to the Americas, EMEA and APAC regions were 44%, 26% and 30% of the consolidated total, respectively, in the fourth quarter.

Despite lower revenue in the quarter, profitability remained relatively comparable with consolidated adjusted EBITDA margin at 23.2%, compared with 23.4% in the prior year period.

Turning to the bottom line, non-GAAP cash earnings per share were \$0.54, down \$0.02 compared with last year's fourth quarter. The adjustment to arrive at non-GAAP cash earnings consists of acquisition-related amortization of intangible assets in this year's quarter and also the impact of tax reform and some other nonrecurring items in last year's quarter. These are shown in the reconciliation tables in the back of the slide deck and release.

Please turn to **Slide 7** for a review of our Hydraulics segment fourth quarter operating results. Consistent with prior periods, I want to point out that acquisition-related costs, including amortization, are not included in our operating segment numbers. They are accumulated in our Corporate and other segment reported in the tables in the back of our earnings release and slides.

Sales for the Hydraulics segment declined 8%, excluding currency, which had a \$1.7 million unfavorable impact. From a geographic perspective, excluding the effects of currency, we saw 11% year-over-year growth for the quarter in the APAC region, which was offset by an 18% decline in the Americas and an 8% decline in the EMEA market. The primary drivers for the decline in the Americas and EMEA regions were seasonality and softer end market demand. As a result of the lower sales volume, gross profit declined 6% for the quarter, while gross margin increased by 70 basis points. The gross margin expanded as improved productivity, net price increases and cost management efforts more than offset unfavorable product mix and foreign currency.

Hydraulics segment operating income decreased \$2 million, primarily due to lower revenue in the quarter. However, cost management efforts drove a \$500,000 reduction in SEA expenses in the quarter compared with the prior-year quarter.

Please turn to **Slide 8** for a review of our Electronics segment fourth quarter operating results. Revenue was down 14% compared with the fourth quarter of last year. The decrease was due to continued softer demand in the recreational and oil and gas end markets as well as the ongoing impact of the customer contracts that we renegotiated in the first quarter. Recall that this allows us to offer all of our products to a broader, global and more diversified customer base.

Fourth quarter gross margin was 43.5%, reflecting the impact of lower revenue during this quarter. The decline was primarily offset by cost management efforts, which resulted in production efficiencies. Due to the lower revenue and gross margin, operating margin in the 2019 fourth quarter declined to 12.9% of sales.

Please turn to **Slide 9** for a review of our 2019 consolidated results. Sales were up 9% over 2018. Faster and CFP contributed \$65.5 million of acquisition revenue, while our organic sales declined about \$10.7 million or 2%, excluding the impact of currency. Currency had an \$8.1 million unfavorable impact on the consolidated sales for our organic businesses.

During 2019, sales to the Americas, EMEA and APAC regions were 47%, 27% and 26% of the consolidated total, respectively. Regarding profitability, consolidated adjusted EBITDA increased 5% compared with last year. Non-GAAP cash earnings per share were \$2.43, up 6% over last year.

Please turn to **Slide 10** for a review of our Hydraulics segment operating results for 2019. Sales for the segment grew 16% compared with 2018. The growth included \$65.5 million of acquisition revenue contributed by Faster and CFP, and 1% organic growth, excluding the \$7.6 million unfavorable impact of currency. Gross profit increased by 14% during the year. The significant increase resulted primarily from acquisitions as well as production efficiencies and price increases, partially offset by higher material costs and the impact of changes in product mix. The same drivers applied to Hydraulics operating income, which increased 3%. SEA included \$11.3 million of incremental costs for the acquisitions. Additionally, \$4.4 million of one-time unusual items in the third quarter unfavorably impacted operating income for the year.

Please turn to **Slide 11** for a review of our Electronics segment 2019 operating results. Sales for the segment decreased 11% compared with 2018. The decline was primarily due to softer demand in end markets and the renegotiated customer contracts. Despite the lower revenue, gross margin increased by 160 basis points to 45.5% and operating margin declined by only 10 basis points to 19.7%. The significant improvement in gross margin was primarily the result of lower material costs as well as cost management efforts, which drove production efficiencies. The same drivers apply to operating margin, which remained relatively comparable to the prior year.

Please turn to **Slide 12** for a review of our cash flow and capitalization. In 2019, we generated \$101.2 million of adjusted cash from operating activities and \$76.2 million of adjusted free cash flow, both of which reflect significant improvements over 2018. Benefiting from our strong fourth quarter performance, our adjusted free cash flow as a percent of sales for 2019 was 14%, significantly exceeding our 10% target. Our CapEx was \$25 million, down from \$28.4 million in 2018 due to timing and lower CapEx related to the manufacturing consolidation project. As planned, spending was primarily for manufacturing technology enhancements, capacity expansion, machinery and leasehold improvements for our China facility that opened in June, equipment for our new engineering center of excellence and also for the addition of the Faster business. In 2020, capital expenditures are estimated to be between \$20 million and \$25 million.

Regarding capitalization, we reduced our debt by nearly \$18 million in the fourth quarter, contributing to over \$52 million of debt reduction for the year. Throughout the year, we improved our net debt-to-adjusted EBITDA, finishing at 2.1x. With our strong cash flow profile, we are focused on getting that below 2x, which we expect to achieve by the middle of this year.

Wolfgang, I'd like to turn it back to you for your perspective on outlook and our 2020 guidance before we open the lines for Q&A.

Wolfgang H. Dangel: Thanks, Tricia. Please turn to **Slide 14**. The macroeconomic climate continues to be filled with uncertainty. In addition to the human toll that the coronavirus is having, it has caused significant economic disruption leading to future uncertainty. Helios Technologies generates approximately 9% of global revenue with Chinese customers. Like most Chinese companies, Helios Technologies is gradually resuming work within our facilities. We have no subsidiary in Hubei province, which remains in a lockdown state. Our factory and offices are in the expanded Shanghai metro area.

After having received approval from the local authorities to reopen our businesses in mid-February, right now

we are operating at about 50% working capacity. The reduced staff level is driven mainly by the 14-day quarantine period imposed on all travelers returning to the Shanghai area from other provinces. Tracking services across all cities remain limited because of the closure of selected highways and shortage of drivers causing cargo deliveries to be under tight delivery constraints. We are monitoring the China situation closely, and we are adjusting well to support our customers and channel partners on an ongoing basis.

China remains a key market for Helios, and the coronavirus will not change our localization plans, which involve sourcing activities and revenue growth on a mid- and long-term basis. We expect a gradual improvement in China over the next few weeks.

Most recently, several jurisdictions in Northern Italy, near our Faster facility, are under quarantine. Today, our operations are marginally impacted by the imposed Italian travel restrictions. We are observing ongoing developments.

Given these disruptions, we have seen delays in demand for Q1 and expect this to continue into Q2. Other factors such as the U.S. presidential election provide a lot of media hype, but are not expected to have a significant macroeconomic impact. It appears that the U.S.-China trade wars have cooled for the time being, but we all know the situation is fluid. With the United Kingdom exiting the European Union last month, it is unknown what the ensuing negotiations will yield. We believe that mitigating factors will reduce the potential downside to our results and therefore, we do not expect a material impact, but uncertainty remains. Lastly, anxiety in the Middle East continues to disrupt that part of the world.

Considering all of these factors, leading U.S. indicators suggest that we continue to be in a slowing growth phase, expecting a new cyclical rise in the second half of this year. Around the world, nearly all major global economies are still experiencing either a slowdown of growth or negative growth. Specifically, Western Europe and Japan are in a mild recession, and economic growth in China has decelerated. Again, the good news is that, similar to the U.S., all global economies are currently expected to recover in the latter half of this year.

As we have said in the past, in accordance with our Vision 2025 plan, we expect to outpace macroeconomic growth over the long term. This is being driven by the investments we have been making to expand our coverage in the field, increasing and broadening relationships with OEMs, penetrating regions where we have white space, and continuing to introduce new and innovative products and solutions. Further, the actions we have taken to broaden from our traditional end markets into more diversified markets, expand our ability to successfully weather economic cycles.

Please turn to **Slide 15** for our thoughts regarding our outlook for Helios in 2020. We have selectively managed costs as we continue to invest in innovative manufacturing technologies and market-leading new products. These investments are critical to achieve our long-term strategic revenue and profitability goals and position us well when our end markets recover. Given the economic climate and the temporary uncertainty surrounding coronavirus, we are approaching 2020 guidance cautiously. We currently expect Q1 will be the weakest of the year from an absolute dollar standpoint.

Referring to our Hydraulics segment, demand remains soft and activity in China, in particular, is being impacted by the coronavirus on a short-term basis, which presents uncertainty at this point. Accordingly, we expect a slow start to the year, with some anticipated catch up during the second quarter, which we currently forecast is our strongest for the year. In accordance with our Vision 2025 goals, we anticipate a CAGR rate of 8% from 2019 to 2025 for the Hydraulics segment, with 2025 revenue of approximately \$700 million. This will result in market share gains relative to an expected market growth of 3%.

Our 2020 outlook for our Electronics segment also continues to be challenging. Given model year rollout schedules, we currently expect our third quarter to be the strongest for this segment. However, we are encouraged by considerable demand for projects slated for mid to late 2021 and continuing through 2023. We will incur incremental R&D and engineering expense during 2020 for development of these projects. Given the

projects we have in our pipeline at this time, we believe we can increase our Vision 2025 sales target for the Electronics segment to approximately \$220 million, representing a 12% CAGR from 2019 through 2025.

Please proceed to **Slide 16**, where we provided our guidance for 2020. I would like to note the following: first, given the level of macro uncertainty, as I described a moment ago, we are providing wider guidance ranges than we have in past years. Second, we are optimistic about the second half of 2020, based on the economic reports that we track and feedback we receive from our customers. Some level of recovery in the back half of 2020 is built into the top end of our guidance and can be seen in the expected 50-50 split in revenue between first half and second half of 2020, which deviates from normal seasonality. We remain committed to investing for long-term profitable growth throughout the business cycle to be ready when our markets start to pick up and to outpace the market as we work diligently towards our Vision 2025 goals.

Now let's open the lines for Q&A.

Operator: [Operator Instructions] Our first question comes from Nathan Jones of Stifel.

Nathan Jones: Let's start with the incremental R&D and engineering expenses in 2020 to support these projects in '21 through '23. Can you give us a little more information on what the incremental spend is in 2020, just so we can see how that's impacting 2020 results? Can you talk a little bit more about the kind of revenue levels, kinds of products, et cetera, that these projects are going into in '21 through '23?

Wolfgang H. Dangel: Sure, Nathan. So with regard to the first question, if you look at the incremental spend, and as I explained earlier on, we have quite a number of attractive projects in the pipeline that are slated for revenue generation in the latter part of next year, '21, and into '22 and '23. We decided in order to support these projects professionally, to invest into R&D and engineering expense at this point in time. We are talking roughly an increase of about 20 people, which is quite sizable. If you put that in relation to the entire workforce of Enovation Controls, it is an increase of ~5% basically right there. As you know, about 40% of the entire workforce is working in R&D and engineering-related positions. We are talking roughly about 20 people. We are adding these people during the course of the year, have pretty much started already at the beginning of the year and are progressing according to plan.

With regard to your second question, from a revenue recognition perspective, as we indicated, we are pretty confident based on the number of projects we have in the pipeline and based on the degree of discussions and collaboration with our OEM partners that they will generate double-digit growth in '21 and '22, '23. Based on the guidance for 2020, we are pretty much flat compared to 2019, but as of next year, we expect double-digit growth in terms of sales revenue, continuing in '22 and '23.

The last statement I would like to add to your first question because you were asking about the incremental spend is, we are doing this in terms of step-up function. These 20 people will support projects for the next years and beyond, meaning that the investments in R&D expenses in '21 and '22 are expected to be significantly lower. These are step-up investments that you have to make upfront. You make it in one go over a certain period of time and then the following one or two years, normally, investments in that particular area will be at a lower pace.

Nathan Jones: Okay. So these 20 people become part of the base going forward, and then we stay a little flatter after that going forward down the line.

Wolfgang H. Dangel: Exactly. We'll stay flatter in '21 and '22, except there is still some incremental costs that come in, merit increases and so forth, but it's a step-up function that we have basically built in guidance for 2020, and you won't see that in '21 and '22.

Nathan Jones: Okay. My follow-up question, you guys had a lot of projects going on there over the last few years, you've done two major acquisitions. So the Company has seen a lot of disruption over the last few years.

Can you describe the differences in the culture, the level of talent in the organization relative to three or four years ago? Where do you still need to add talent to support this ramp-up in revenue you see over the next few years? What functions are you still upgrading and what's your view of the culture within the Company today?

Wolfgang H. Dangel: I wouldn't call it disruption. I call it evolution. As a classic hydraulic cartridge valve company, we entered into the electrical side of the business to enhance our capabilities. From a culture perspective, I would say there is not one culture in the Helios companies because if you look at the acquisition strategy, we are looking for very strong stand-alone companies that have already a very strong existing culture. We don't want to destroy that DNA and I think we have done a very good job, if I look at Enovation, if I look at Faster and even if I look at the most recent acquisition in Australia, with Custom Fluidpower, to protect the successful DNA that made these companies what they are made of and what they bring to the table for us.

With regard to your question on the talent pool, as you know, and we highlight that on an ongoing basis, covering the marketplace is key for us down the road. Occupying white spots and expanding the business on a global basis, is one of the key challenges that we still have. If we look at the pipeline from a talent pool perspective, that is probably where we still have to focus on the development of people that we have onboard already today, to develop the skill in them that they can help us to globalize the business even more in years ahead. That's the area where I would say from a talent-need perspective, we have probably the most significant need.

Operator: Our next question comes from Jeff Hammond of KeyBanc Capital Markets.

Jeffrey Hammond: Wolfgang, just to come back on the Electronics investments, is there a way to quantify the incremental spend in dollars? I'm just trying to get at the margin impact on 2020.

Wolfgang H. Dangel: It's 20 people, as I said, and we are hiring on these people during the course of 2020. It's more front-end loaded, though, because we want to have these people on board, and we have a number of them already hired over the last six or seven weeks. If you quantify it in dollars, it's somewhere in the range of about \$2.5 million to \$3 million fully loaded for 2020.

Tricia L. Fulton: And clearly, that's built into the guidance that we've given on the profitability side.

Jeffrey Hammond: Right. Okay. The margin resilience in Hydraulics is pretty impressive. What was really working there and then how should we think about decrements in Hydraulics into 2020 on that? I guess, it's flat to down 6%.

Wolfgang H. Dangel: I'll let Tricia answer the decremental margins, but to the first part of the question, what has been working well, you have seen an improvement over the past couple of quarters already. It's mainly driven by productivity and efficiency improvements, so it's a much better oiled machine, I would say, than it was probably a year ago. I'm actually pretty pleased with what the team is doing in that regard. I'm pretty encouraged looking at some of the initiatives that are outlined for the balance of this year.

Besides productivity and efficiency improvement, the other factor that comes into play is pricing. We have done reasonably well from a pricing perspective. We were not always very lucky from a mix perspective. As we explained on the last call, you might recall, we still have idle capacity in a certain area of manufacturing that is pretty attractive from a profitability perspective. That challenge has not been overcome yet, so there is additional potential there for margin improvement down the road.

Mid and long-term, I would just like to repeat, the goal is that all of our businesses generate gross profit margins of 40% on sales revenue. I am hopeful with everything I'm seeing there that we will get there over time.

Tricia L. Fulton: On the decremental margin side, we're going to see more traditional decremental margins of 30% to 40% that we historically saw in these businesses. I will say that over the last couple of quarters, we've

done a good job of rightsizing the businesses from the perspective of being able to flex a little bit on the fixed cost side and the labor side. I don't think we're going to see huge decrements on the Hydraulics side as we roll through 2020, if we experience a little bit lower revenue.

Jeffrey Hammond: Okay. On the 2025 targets, I think you fine-tuned the absolute revenue number for Hydraulics down, but I think the growth rate is actually higher, just kind of where we stand today. Is that a function of, we get a snap back in the market or something around confidence for share gains and outgrowth?

Wolfgang H. Dangel: It's a mixture of both there. As you know, we were always hovering around that 7% to 8% CAGR range for the Hydraulics business going back all the way, I think, to 2017. It's tied to all the investments that we are making. Again, from a global coverage perspective, I think we are covering the marketplace significantly better than we did three years ago, and also from a product development perspective. There is still a lot lined up to broaden and expand the product portfolio as I stated earlier on with electro-hydraulic products. That in combination, I think, makes us pretty comfortable to look at an 8% CAGR rate in between now and 2025.

Operator: Our next question comes from Jim Sheehan of SunTrust Robinson Humphrey.

Peter Osterland: Good morning this is Pete Osterland on for Jim. On your third quarter gross margin commentary, you discussed a change in the margin profile of your products. Was this more of a negative mix shift or was it based on pricing versus raw materials and what are your expectations for gross margins in 2020?

Tricia L. Fulton: It was a mix shift. It was the shift that we've been talking about the last couple of quarters, specifically in the CVT business, between auto-cell products and U-cell products. They have a little bit different margin profile. We've seen a decline in the auto-cell products over the last couple quarters, so it skewed more toward the U-cell. That's a function of the consolidation project as well that we've moved to this U-cell manufacturing.

With regard to gross margins, we don't guide to gross margin, but I think that we can infer from one of the previous questions on what the decremental margins might be that we can roll forward the Q4 margins with some potential downside given the guidance that we provided in the Hydraulics segment.

Peter Osterland: With your net leverage closing in on your target of 2x, how are you thinking about free cash flow deployment this year beyond debt reduction? Do you have an active M&A pipeline or would you consider share repurchases?

Wolfgang H. Dangel: We want to be consistent with the messaging of last year. So getting below a ratio of 2x as far as net debt-to-adjusted EBITDA is concerned is pivotal. We will continue and use the free cash flow generation to delever the Company. Irrespective of that, we have an ongoing M&A process in place where we continuously look at companies and evaluate businesses, but de-levering at this point in time is still high up on the agenda.

Operator: Our next question comes from Mig Dobre of Robert W. Baird & Co.

Mircea Dobre: A few questions on Hydraulics first. Can you comment at all on where you stand from a backlog standpoint? Why I'm curious is, when we're looking at 2019 of \$443 million of revenue, how much of that revenue would you say was associated with you being able to convert on the backlog build? Put differently, how much of that revenue do you think is associated with the backlog decline through 2019, to level set us into 2020?

Wolfgang H. Dangel: From a backlog perspective, Mig, I think we're exactly in line with what we told you two quarters ago. We've said that, based on what we could see and based on softening in the economy and expected order intake, we can foresee that backlog is still supporting revenue generation in Q1, maybe

marginally into Q2 as well. I think what we have seen over the last couple of weeks or last couple of months was exactly in line with that statement. So backlog, overall, is depleting because the order environment is soft and the coronavirus situation is not helping, as I said, having 9% of revenue tied to Chinese customers. That was a specific geography where we have won quite some market share and they've done exceptionally well over the last three to four years. Backlog is depleting, but I still expect it to support Hydraulics revenue in Q1 and maybe even leading into Q2.

Mircea Dobre: So just to make sure I understand what you're saying here, you expect further backlog depletion into Q1 and Q2? The way I kind of read that is that the order intake that you're taking is not necessarily what's reflected in revenue. There's that plus the backlog burn. That's how I should be thinking about it, right?

Wolfgang H. Dangel: Yes, exactly. We are tapping into backlog, and we are depleting the backlog. Exactly as we said already during, I think, it was the Q2 earnings call last year, so I think we're exactly in line with those projections at that time.

Mircea Dobre: Understood and the reason why I'm asking all of this is a big picture question here. This was your first quarter of revenue decline in Hydraulics. Can you maybe give us a framework for how you're thinking about the current environment versus prior downturns? When I'm looking at my model here, I typically see 4-plus quarters of revenue declines, whenever the market turned softer, but this time, we had this backlog dynamic that I don't think we've seen in prior cycles. So how do you think about the current environment and how long revenue contraction might be lasting here?

Wolfgang H. Dangel: Maybe it will be helpful if we look at seasonality this year and compare it to previous years. Last year in Hydraulics, we generated 52% of revenue in the first half, 48% in the second half. We expect this to be evenly split in 2020, 50-50, and the 50% in the first half is still supported by backlog as I mentioned just now. If we look at the 50% in the back half of 2020, that is in line with the second half of 2019. It's actually a little bit higher. We are expecting orders to increase as we enter into the third quarter this year. If you put the two statements together, backlog will be depleted no later than mid of this year, I said actually early second quarter. We are then counting on order gains in the second half of this year in Hydraulics compared to the second half of 2019.

Mircea Dobre: Which in theory, should be quite strong in order to offset your comparison on the backlog burn, right, because you're starting from a lower place, I would presume?

Wolfgang H. Dangel: Yes, but nevertheless, it will be a single-digit increase compared to the second half of 2019, but that's pretty much what our own forecast is based on.

Mircea Dobre: Understood. This question on incrementals and decrementals was asked earlier, but I want to make sure that, first, we're kind of talking about gross margin, Tricia, in terms of your comments on the 30% to 40% for incrementals, decrementals, correct?

Tricia L. Fulton: Yes.

Mircea Dobre: Do you contemplate any adjustments to your SG&A in Hydraulics given the market volatility that we've got here?

Tricia L. Fulton: No, we don't expect a lot of change on the Hydraulics side. We did have the restructuring that we did in Q3 of last year, most of which hit the SEA line for Hydraulics. So, that will carry forward into the year, but we have some other expenses at the corporate level that may offset some of that. We don't expect to see the large increase in SEA like we're seeing in Electronics for R&D, but we won't see a huge decline over the SEA that we had last year in total.

Mircea Dobre: Okay, moving to Electronics, these incremental investments, you're saying that those are going to flow through the SG&A line. They're not going to flow through gross margin?

Tricia L. Fulton: Correct.

Mircea Dobre: Okay, good. Lastly, here, I'm kind of scratching my head a little bit on how you structured the top line guidance, simply because unless I'm mistaken here, the first half of the year is going to be down maybe north of 13%, but then you've got pretty robust growth, double-digit growth, in the back half. So I'd like a little more color on what gives you guys the confidence that we can have this level of swing and if that's driven by your broader end market assumptions, like it is in the case of hydraulics or if this is something that's specific to customers and products that you really have good visibility on?

Wolfgang H. Dangel: I think it's both, Mig. As you know, in the meantime, more than 50% is tied to OEM business. We have much better visibility on what is expected for the balance of the year. If we look at their forecast and their schedules, I think it's pretty obvious that everybody is counting on a rebound in the second half of the year. If you look at the macroeconomic picture, and the forecast for industrial production in the seven largest economies around the globe, you also see that there is an upswing expected in the second half of the year. I think it's a combination of both what we're seeing from a macroeconomic perspective and feedback that we are getting from our customer base in both segments.

Operator: Our next question comes from Brian Drab of William Blair.

Brian Drab: Wolfgang, you mentioned in the prepared comments that the back half of the year looks stronger from a macro perspective, kind of across the board, across the regions, but then I think you just said that you're expecting your business to be flat in the second half of '20 versus second half of '19. So I'm just wondering why that is and is there some conservatism just given the uncertainty that is obviously out there?

Wolfgang H. Dangel: I think Brian, you misunderstood. I said the business will be slightly up in the second half of 2020 compared to the second half of 2019 and that's applicable for both segments. When I discussed with Mig, we said in the Hydraulics segment, it will be up in single-digit percentage ranges, and it will also be up on the Electronics side in the second half of 2020 compared to 2019. Overall, we currently expect the business to be flat in the second half of '20 versus the first half of '20.

Brian Drab: Okay, you didn't sound like you had a ton of conviction in the back half growth. I thought at one point you did say flat and actually then slightly up, but just given the rebound and given the challenges that we've had in the back half of 2019, I was just wondering if there's some conservatism there.

Wolfgang H. Dangel: I can help you a little bit more on the Electronics side. In 2019, the ratio between the first and second half was 54% versus 46%, and we expect that ratio to go to 48% versus 52% in '20. It is back-end loaded in Electronics.

Brian Drab: Okay. If we're in a tougher scenario and growth doesn't come in the second half and you're flat in the second half, would you expect your gross margin to improve given the productivity improvements that have been in place even on flat revenue?

Wolfgang H. Dangel: Yes. I think based on the initiatives that we launched last year in Q3 and Q4, in particular the restructuring and everything associated with that, this benefit will carry forward. We would expect margins to at least stay stable or slightly improve.

Brian Drab: Okay. Wolfgang, just finally, can you put a final point on some of the activity that you're seeing in some of the end markets and maybe even a little color regionally, just a little more on like ag, construction, mining, material handling since you've got such a good finger on the pulse of all of those end markets?

Wolfgang H. Dangel: If I look at the four main clusters that we are supporting, industrial, mobile, ag and recreational end markets, it's definitely a fair assessment to say there is softness across all the four clusters. Now, if you break it down into individual geographies and into individual sectors and the needs there, then we are seeing actually a few positive spots. I repeat again what I said last year, I think renewable energy is still an attractive market. We grew a lot there in China over the last couple of years. I think that will continue despite the coronavirus situation that we consider being temporary.

The other more positive note that we saw after the easing of the trade negotiations between U.S. and China this past December is ag in North America is a little bit stronger than we anticipated. That's a positive sign, but if you look at all the other sectors within construction, material handling, energy, oil and gas, it is rather soft. We expect that to continue during the first two quarters of 2020.

Operator: Our next question comes from Joe Mondillo of Sidoti & Company.

Joseph Mondillo: I just wanted to follow-up on a couple of the questions regarding, at the end of the day, we're talking about the revenue guidance. It just seems like the high end of that revenue guidance in terms of sort of flattish sales, seems a bit aggressive when you're talking about Hydraulics backlog declining into the second quarter. You have Asia region, which was a really good growth factor for you in 2019 and with what's going on with coronavirus in China, it was already slowing before then. On top of that, you said over 50% of your Hydraulics sales are OE. We're hearing Deere down 5% to 15% and Caterpillar similar. A lot of these OEs are talking about how their production is going to be down quite a bit. So I'm just wondering how you get to the high end of the guidance, considering all that?

Wolfgang H. Dangel: Joe, I can just repeat what I already said, based on the initiatives we have in place, it's a split of 50-50 roughly, OEM and channel. The initiatives we have in place on a global basis on the channel side are there in order to cover geographies in a much better way than in the past. There, we are dealing more with end users and small and medium-sized OEMs. I would still expect business to trickle in there and grow, particularly in geographies where we had nothing in the past. I'm referring to places like Southeast Asia. We still have opportunities to do more even in countries like China, Japan and so forth.

On the OEM side, we work with both, partly with the large OEMs you are referring to that are obviously reasonably negative at this point in time, but we are also working with a lot of small and medium-sized OEMs. The picture is a little bit rosier or a little bit more optimistic there. All of that embedded into this forecast is pretty much what we reflected in the numbers here.

Joseph Mondillo: Okay. Could you talk about the decremental margin for the Electronics segment since we've already talked about Hydraulics, just wondering how that looks?

Tricia L. Fulton: There's a much smaller fixed cost base on the Electronics business. Accordingly, I would expect that decrementals would be in line with the actual gross margins, probably somewhere around 43%-45%.

Joseph Mondillo: Okay. Regarding the margin expectations that you're looking at Hydraulics, is there anything baked in there in terms of more improvements or more costs restructuring or anything related to your cost structure going forward?

Tricia L. Fulton: No. Regarding Hydraulics, most of the cost savings from our 2019 cost reduction initiative will be offset by cost increases resulting from the flow-through effect on the corporate side, to support our ongoing growth plan. Overall, the only thing that's different from a cost structure perspective is what we've already touched on with regard to the addition of engineering resources for R&D in the Electronics segment, which is in the SEA line. Nothing else is different from before.

Operator: We have reached the end of the question-and-answer session. I will now turn the call over to management for closing remarks.

Wolfgang H. Dangel: Thank you for your interest in Helios Technologies and for your participation this morning. Also, thank you to all of the hard-working Helios employees who are driving these results. We look forward to updating all of you on our first quarter results in May. Thank you very much, and have a great day.

Operator: This concludes today's conference call. You may disconnect your lines. Thank you for participating, and have a pleasant day.