

**Operator:** Greetings, and welcome to the Helios Technologies Third Quarter 2018 Financial Results. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Karen Howard, Investor Relations for Helios Technologies. Thank you, Ms. Howard, you may begin.

**Karen Howard:** Thank you, Deven, and good morning, everyone. Welcome to the Helios Technologies, formerly known as Sun Hydraulics, third quarter 2018 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 be reviewing 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.helios technologies.com](http://www.helios technologies.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 see 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 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](http://www.sec.gov).

I also want to point it 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 with some highlights for the quarter; Tricia will go through the details of our financial results; and then, we'll turn it back to Wolfgang for his perspective on our outlook before we open up the line for questions and answers

And with that, it's now my pleasure to introduce Wolfgang.

**Wolfgang Dangel:** Thank you, Karen. Good morning, everyone. I will start on Slide 3. As many of you learned just over a month ago at our Investor Day in New York City, we are making very good progress in advancing execution of our Vision 2025 strategy.

Before I get into our financial results for the third quarter, for those of you who do not know us well yet, I want to remind you that our 2018 results include a couple of acquired businesses that were not in our 2017 results. We acquired Faster, a global leader in quick release couplers for hydraulic applications, in April of this year.

And more recently, we acquired Custom Fluidpower in August. Custom Fluidpower, or CFP, was Australia's largest independent fluid power solutions distributor. They deliver value-add services from their 8 branch locations across Australia. We view this business as a very strategic stepping stone to accelerate Helios' penetration of the Southeast Asia market.

Now, I'll summarize some of our highlights for the third quarter. Sales grew by 54% to nearly \$136 million. Of the nearly \$48 million in growth, about \$32 million was contributed by Faster, more than \$8 million was contributed by CFP and about \$8 million was organic growth. The Faster business grew about 9% over last year's quarter on a pro forma basis, excluding the impact of changes in exchange rates.

While this is good solid growth, I want to point out that Faster has a normal 2-week summer shutdown that impacts our third quarter. Accordingly, their sales are down compared with the sequential second quarter, but that pattern is normal. Additionally, we are starting to see slower growth in the agriculture market. CFP contributed 2 months to this quarter and grew 15% over the prior year period, also excluding the impact of changes in exchange rates. Our organic growth was 9%.

Regarding our organic businesses, we continue to experience strong order demand in both our legacy Cartridge Valve Technology, or CVT, business as well as Electronics. Our CVT revenue was up 13% over the prior year third quarter; however, despite these good results, shipping flow was somewhat disrupted on a

temporary basis by our project to streamline and consolidate our Sarasota facility. I will talk about that project more in a few moments.

With respect to our Electronics business, year-over-year growth was a modest 1%. Revenue was impacted by the timing of customer projects. All of our businesses were impacted by the recent tariffs.

We reported net income of \$11.6 million for the quarter. When we add back nonrecurring items, our non-GAAP net income was \$14.1 million, a 21% increase over the 2017 third quarter. Adjusted EBITDA was \$33.6 million or 24.8% of sales.

Tricia will provide details on the comparison of our financial results, but I want to point out a few things.

First, we were very pleased with the operational improvements realized in our CVT and Electronics businesses. Both businesses reported sequential gross margin improvement compared with the past several quarters.

I also want to point out that, as our business is growing and changing, our quarterly comparability is changing. As I mentioned previously, Faster's revenue is lower in the third quarter each year due to its summer shutdown in Europe. This also results in a lower gross margin in the third quarter for Faster.

I also want to remind you that CFP is a value-add integrator, not a manufacturer. Accordingly, it carries a lower gross margin than the historical Helios average.

Finally, currency fluctuations unfavorably impacted revenue comparisons to the pre-acquisition periods for Faster and CFP. All of these factors combined had an impact on our results for the third quarter, as well as our updated expectations for the full year.

Please turn to Slide 4, and I'll update you on our Sarasota manufacturing consolidation project. As we have mentioned in the past, since April of this year, we have been relocating our U.S. CVT manufacturing into our 2 adjacent facilities in Sarasota, freeing up the third one. To accomplish this, we are applying LEAN principles in streamlining our processes. We have a very detailed plan that we have been working through step by step.

We have been working very hard to minimize the interruptions to production and shipping; however, we did realize some disruption to our shipping flow in the third quarter that we anticipate continuing until the project is complete. We expect to complete this part of the project by the end of the first quarter of 2019. By the end of 2019, we expect at least a 15% increase in capacity as well as significantly enhanced workflow.

In addition to the added capacity, we expect higher gross margin and even better customer responsiveness from the improved efficiency. Upon completion of that part of the project, we will create a center of excellence within the third facility, which is located about 2 miles away from the 2 manufacturing plants. That facility will house our Americas CVT engineering teams in an expanded state-of-the-art testing center.

Our engineering teams include an innovation team, which is focused on new product development, and a sustaining team, which is focused on improving our existing product portfolio. We will also look at prototyping, marketing, product management and training within this facility. We look forward to having all of these functions co-located in support of our growing CVT Americas business.

Please turn to Slide 5. In August, we opened our newly constructed 50,000 square foot, state-of-the-art facility in South Korea. We previously had a small operation in an 11,000 square foot leased facility. We completed this project very efficiently in just 11 months from a greenfield site to production. This facility is strategically very key for us, in alignment with our "in the region, for the region" philosophy to service our fastest growing region, Asia Pacific. Within it, we will design and manufacture integrated packages for the Asia Pacific market. Down the road, we plan to build, test and distribute cartridge valve products for customers in this region as well. We now have complete commitment to support the growing manufacturers in this region. We had many OEM customers visit and evaluate us upon opening, and they were very pleased.

Also, on this slide, in its early stages, we're establishing a new facility in China in alignment with our "in the region, for the region" philosophy. The shell of the facility has been built. We are currently planning the layout and scope of value-add in this plant. Then, of course, we will purchase the equipment and setup the production cells. We expect that facility to be operational in the next 18 to 24 months.

With that overview, I will now turn the call over to Tricia to review the financial results for the quarter and first 9 months in a bit more detail.

**Tricia Fulton:** Thank you, Wolfgang, and good morning, everyone. Let's begin on Slide 7 with a review of our third quarter consolidated results.

Sales were up 54% compared with last year's quarter. Faster contributed about 2/3 of the growth, CFP contributed almost 20% of it and our organic businesses sales grew 9%.

As Wolfgang mentioned, order demand remains strong in our organic businesses, but shipments were dampened by our CVT manufacturing consolidation project and Electronics growth was impacted by project timing. Foreign currency had minimal impact on consolidated organic sales during the quarter compared with the prior year.

I will now touch on sales by region, which are designated there in the sales bar charts on the left. There is a table in the back of the press release, as well as the supplemental slides, summarizing this information. As you can see, all geographic markets realized considerable year-over-year growth. With the addition of Faster and CFP, the EMEA and APAC regions are now larger contributors to our sales base. Sales to the Americas, EMEA and APAC regions were 48%, 28% and 24% of the consolidated total, respectively.

Regarding profitability, our consolidated adjusted EBITDA was up almost 50% over last year's third quarter to \$33.6 million. We are pleased that the supply chain constraints and input cost pressures realized in the first half the year were significantly alleviated this quarter; however, the comparability of the margins was impacted by other factors which Wolfgang touched on. I'll get into this more as we review the segment results on upcoming slides.

Turning to the bottom line, adjusted earnings per share were \$0.44, but were somewhat inconsistent when compared with the prior year, given our equity offering earlier this year, which increased the number of shares outstanding. Additionally, we have more expense from amortization of intangibles, as well as interest on new debt resulting from our acquired businesses.

This year's quarter includes \$0.18 and \$0.12 per share for amortization and interest expense, respectively, compared with \$0.05 and \$0.03 per share for amortization and interest expense, respectively, in last year's third quarter. Together, these 2 acquisition-related items had a \$0.22 impact on the third quarter comparison on both a GAAP and non-GAAP basis. Additionally, primarily given our equity offering, which helped to finance our Faster acquisition earlier this year, the comparison to last year on a per-share basis is impacted by 4.8 million additional weighted average shares outstanding in the 2018 third quarter.

I'd like to bring to your attention the items that impacted our consolidated results that we added back for purposes of reporting adjusted EBITDA and adjusted EPS shown here. Please refer to the tables in the back of the press release or slides for reconciliations of GAAP to non-GAAP numbers. During the third quarter of 2018, we incurred the following. First, \$2.1 million for amortization of inventory step-up costs resulting from purchase accounting for Faster. Next, we incurred about \$700,000 of costs for acquiring and financing Faster and CFP. Finally, we recorded a charge for about \$300,000 for contingent consideration associated with the Enovation Controls acquisition.

Please turn to slide 8 for a review of our third quarter Hydraulics segment operating results. I want to point out that acquisition-related costs, including amortization, are not included in these segment numbers. They are accumulated in our Corporate and Other segment reported on the tables in the back of our earnings release and slides.

Sales for the Hydraulics segment grew 84%. We saw 52%, 115% and 105% year-over-year growth for the quarter in the Americas region, EMEA and APAC, respectively. Those growth numbers benefited from the addition of Faster and CFP. On an organic basis, we realized growth of 11%, 2% and 29% in the Americas region, EMEA and APAC, respectively.

Late last quarter, the regional allocation was impacted by a shift based on specific customer requests to have product delivered directly to their East Asian facilities and startup delivery to their North American location. This inflates the APAC growth and decreases the Americas results for the quarter. This trend will continue in the future quarters, making comparability a little more difficult, but highlights the global view we have of our business.

The organic growth was driven by our increased market demand in all geographies and end markets, and results are positively impacted by global sales and marketing initiatives. While our legacy CVT business

realized 13% growth, it could have been even higher, except that it was dampened by disruption from the manufacturing facility consolidation project.

Faster sales were lower in the third quarter than they were in the second quarter due to normal and expected seasonality. Also, changes in foreign currency exchange rates worked against us this quarter, specifically the euro and Australian dollar relative to our expectations for Faster and CFP. Compared with the rates in effect at the respective acquisition dates, our actual sales were unfavorably impacted by \$1.8 million.

While gross profit increased by 71% on the higher sales, including the addition of Faster and CFP, the changing mix of our businesses caused gross margin to decrease. This includes a lower margin on the lower seasonal sales for Faster this quarter, as well as the fact that CFP, being a value-add integrator, carries a lower margin than a manufacturer. We will reconcile the gross profit change in detail on the next slide. Operating income increased 68%. Our selling, engineering and administrative expenses, or SEA, grew \$7 million. The increase was entirely due to the inclusion of the Faster and CFP businesses.

Please turn to slide 9, and I will reconcile the change in gross profit from the third quarter of 2017 to the third quarter of 2018 for the Hydraulics segment. Gross profit in the 2017 third quarter was \$22.9 million or 40.4% of sales. First, we recognized \$3 million of gross profit on the additional organic sales volume, as well as the benefit from our Sun Hydraulics July 1 price increase. Next, we incurred about \$800,000 for higher material costs, net of tariff-related surcharges. Including the benefit of the price increase that I just mentioned, we nearly offset the cost inflation incurred by our CVT business this quarter. We expect the price increase to fully cover our costs in the fourth quarter. An improvement in production costs favorably impacted gross profit by about \$500,000. This was driven by further improvements with our supply chain and throughput. Next, an additional \$300,000 was incurred due to the timing of freight costs. Finally, Faster and CFP contributed \$11.3 million and \$2.5 million of gross profit to the quarter, realizing 35.5% and 29.8% gross margins on their sales.

Please turn to slide 10 for a review of our Electronics segment operating results. Revenue for the third quarter was up only modestly compared with the third quarter of last year. This was due to the timing of project revenue, most of which was shifted into the fourth quarter. Accordingly, we are reiterating our Electronics sales guidance for 2018 at the upper end of our previously provided guidance.

Gross profit for the segment increased 10%. We also experienced sequential gross margin improvement in this part of our business, recovering from the cost pressures realized over the past several quarters. I will reconcile the gross profit change in detail on the next slide.

Operating income in the third quarter grew 5% over the third quarter of 2017. SEA expenses grew \$1.1 million. This increase reflects planned investments in selling and marketing initiatives, as well as R&D to support our growth strategy. The increases were partially offset by cost savings from consolidating our HCT business into Enovation Controls.

Please turn to slide 11, and I'll reconcile the change in gross profit from the third quarter of 2017 to the third quarter of 2018 for the Electronics segment. Gross profit in the 2017 third quarter was \$13.4 million or 42.8% of sales. The incremental gross profit on the modest sales growth for the quarter reflects variations in product mix. We incurred about \$100,000 for higher material costs, reflecting significant improvement over the first half of the year. Production costs contributed favorably to the 2018 quarter compared with the 2017 quarter by about \$100,000.

Please turn to slide 12 for a review of our year-to-date consolidated results. Sales of \$369 million were up 43% over last year's first nine months. Regarding profitability, our consolidated adjusted EBITDA grew 31%, but the margin declined. The erosion resulted primarily from the cost pressures realized in the first half of the year, as well as the business mix impact in the third quarter.

Turning to the bottom line, adjusted earnings per share were \$1.33 but, like the quarter, were somewhat inconsistent when compared with the prior year due to our equity offering earlier this year, which increased the number of shares outstanding. Additionally, we have more expense from amortization of intangibles, as well as interest on new debt resulting from our acquired businesses. This year-to-date period includes \$0.43 and \$0.23 per share for amortization and interest expense, respectively, compared with \$0.16 and \$0.07 per share for amortization and interest expense, respectively, in last year's period.

Together, these two acquisition-related items had a \$0.43 impact on the year-to-date comparison on both the GAAP and non-GAAP basis. Additionally, like the third quarter, this comparison is impacted by higher weighted average shares outstanding in 2018, primarily due to our equity offering, which helped finance our Faster acquisition.

Please turn to slide 13 for a year-to-date review of the Hydraulics segment. Sales of \$270 million were up 58% over last year, gross profit increased by 45% and operating income increased 41%.

Please turn to slide 14, and I'll reconcile the change in gross profit from the first nine months of 2017 to the first nine months of 2018 for the Hydraulics segment. Hydraulics gross profit in the 2017 first nine months was \$70.5 million or 41.1% of sales. We realized \$7.1 million of incremental gross profit on the higher organic sales, as well as the benefit of our Sun Hydraulics July 1 price increase.

Material costs were about \$2.7 million, net of tariff-related surcharges. As I mentioned previously, the quarterly impact improved in the third quarter and we expect to cover our costs in the fourth quarter, but changes in shipment expectations make it now unreasonable to expect to cover the full-year cost impact in the second half of 2018.

Recall, we incurred interim labor cost in the first quarter. We discontinued the use of this type of labor, so these costs did not repeat in the second or third quarter. Supply chain constraints and resulting inefficiencies cost about \$500,000 on a year-to-date basis, reflecting the improvements realized in the third quarter. Next, we had about \$500,000 of extra logistics costs, all incurred in the first and third quarters, impacted by timing. Finally, changes in exchange rates had an \$800,000 favorable impact during the year-to-date period, primarily due to the weaker U.S. dollar in the first half of 2018. Finally, Faster and CFP contributed \$25.2 million and \$2.5 million of gross profit in the period, realizing 35.7% and 29.8% gross margins on their sales, respectively.

Please turn to slide 15 for a year-to-date review of the Electronics segment. Sales are up 14% over last year's first nine months. Gross profit increased by 10% and operating income increased 8%.

Please turn to slide 16, and I will reconcile the change in gross profit from the first nine months of 2017 to the first nine months of 2018 for the Electronics segment. Electronics gross profit in the 2017 first nine months was \$39 million or 44.7% of sales. We realized \$5.2 million of gross profit on the incremental sales. We incurred about \$3.1 million of higher material costs. The majority of these higher costs, approximately \$2.5 million, were incurred in the first quarter. Additionally, we calculated approximately \$1.9 million for favorable costs due to improved efficiencies, as last year we were in the midst of the carve-out process.

Please turn to slide 17 for a review of our cash flow and capital structure. In the first nine months of 2018, we've generated \$44.2 million of cash from operating activities compared with \$38.4 million in 2017, with the increase driven by higher earnings, partially offset by higher working capital needs. We finished the quarter with almost \$16 million of cash, \$365 million of debt and \$527 million of equity.

The significant changes from year-end reflect our equity offering in Q1, the Faster acquisition in Q2 and the CFP acquisition in Q3. Recall that we used about \$9 million of cash and about 333,000 shares of equity for the CFP acquisition. We've closed the quarter with our net debt to pro forma adjusted EBITDA of 2.7 times, driven by recent acquisitions. With our strong cash flow profile, we are focused on getting that down to below 2 times.

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

**Wolfgang Dangel:** Thanks, Tricia. Please turn to slide 19. The leading indicators that are important to Helios signal ongoing growth through the middle of 2019 with continued accelerating growth through 2018. This reflects an improvement from last quarter, when the rate of growth was expected to start slowing in late 2018. The economic reports that we refer to, now push it out by about two quarters. They continue to point to leading indicators that signal a mild recession in the next 12 to 24 months with recovery thereafter.

Important to note, as we have said before, in accordance with our Vision 2025 plan, we expect to outpace macroeconomic growth. 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 product line solutions. Further, we are

much more diversified by end market in the legacy business world, and we expect these factors to help us successfully weather economic cycles.

Please turn to slide 20 for our thoughts regarding our outlook for Helios. Regarding our organic CVT business, strong order demand continues; however, shipping challenges, as we are completing our manufacturing facility consolidation project, had caused us to lower our revenue and operating margin for 2018. Additionally, we have started to see some softening in the agriculture markets. These factors, along with unfavorable currency exchange rates and uncertainty around the ongoing impact of tariffs, have caused us to lower our outlook for revenue and profitability for our Hydraulics segment for the remainder of 2018.

May I point out that our historic Sun and Enovation Controls businesses are seasonally weakest in the fourth quarter; however, we don't expect this to be the case this year for our Sun business, given the demand we have seen from the marketplace and our strong backlog. Regarding Faster, their historical pattern is that the first half of the year is stronger than the second half by a ratio of about 53% to 47%, with the fourth quarter typically stronger than the third. Finally, CFP is generally not impacted by seasonality, but we will have the full three months in our fourth quarter as opposed to only two months in the third quarter, due to the timing of the acquisition.

Please proceed to slide 21, where we updated our guidance for 2018. Compared with the guidance we provided in August, we now have better visibility as to our expected results for the year. First, we have narrowed and lowered our consolidated revenue guidance. This was driven by our Hydraulics segment as I described a moment ago. We still have a high degree of confidence in our Electronics segment revenue expectations and tightened it to the top end of our prior guidance. These updated ranges result in consolidated growth of 46% to 48%. This includes organic growth of 9% to 11%. Our organic Hydraulics business is now expected to grow between 8% and 10%, and our Electronics business is expected to grow between 11% and 13%.

We revisited our consolidated adjusted operating margin guidance and lowered our guidance range to 20.5% to 21.5%, following our current reporting methodology, which excludes acquisition-related amortization of inventory step-up and intangibles, as well as other one-time type costs. This change was driven by the factors that I discussed a few minutes ago.

We narrowed the range for our interest expense guidance, and we narrowed and lowered our depreciation and amortization guidance ranges. We lowered our effective tax rate guidance upon further evaluation of the impact of the new U.S. tax legislation, which will result in further cash tax savings for us. Our capital expenditure guidance is unchanged.

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

**Operator:** Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Jeff Hammond with KeyBanc Capital Markets. Please proceed with your question.

**Brad Vanino:** Good morning, everyone. This is Brad on for Jeff.

**Wolfgang Dangel:** Good morning, Brad.

**Brad Vanino:** Good morning. On the CVT consolidation, how should we think about incrementals moving through the rest of the year and into 2019? It seems like some nice progress in the third quarter. Should we continue to think about sequential progress moving into 1Q when that completes?

**Tricia Fulton:** Yes, we're definitely seeing some sequential improvement in the margins. Until we get through this project, it's a little bit difficult to tell, because there's still a lot of work to do. I think we're about two-thirds of the way through the project. Until we get to the end of Q1 2019, I think we will still have some challenges ahead of us, but once the project is complete, I do expect the incremental margins will improve. They likely will not get back to the historical levels where we had been a few years ago, at 50% incremental drops, but certainly, we should continue to see some improvement once the project is complete.

**Brad Vanino:** Okay, that's helpful. Then you mentioned Ag slowing down. Can you give a little more color there on how material it was to the lowered guidance for Hydraulics, and where you see Ag going into 2019? Thanks.

**Wolfgang Dangel:** Brad, that's mainly referring to Ag in the European marketplace, where we see the demand for tractors softening; that's where the statement derives. Combines, which is the second largest segment for us, are doing better, but there is also a similar trend there. Year-to-date, North American numbers are still very strong for tractors and combines. We are clearly outpacing the market growth rates in North America, as well as in Europe, but we are seeing softening in Europe, predominantly on the tractor side.

**Brad Vanino:** All right. I'll pass it on there. Thanks for the time.

**Tricia Fulton:** Thank you.

**Wolfgang Dangel:** Thank you, Brad.

**Operator:** Thank you. Our next question comes from the line of Charley Brady with SunTrust Robinson Humphrey. Please proceed with your question.

**Charles Brady:** Thanks. Good morning. I would like to go a little bit more into the CVT facility consolidation issues that are impacting the revenues and the margins here. What exactly has changed? What happened in the planning process and the execution process to where we are today versus where we were three months ago. I'm just trying to understand what shifted?

**Wolfgang Dangel:** Good morning, Charley. Well, nothing has changed with regard to the planning process. Let me step back and explain this in some more detail. We saw significant increases in orders as early as Q3, Q4 2016, as you know. This continued in 2017, where we had outstanding growth, as you know, Charley. At that point in time, we knew we were in need of putting in additional capacity in order to absorb the amount of orders that we gained.

The project itself has not changed. It has been very diligently prepared and planned, and the project itself is on track. I would say we are about two-thirds, or 70%, through the project right now if I look at the Gantt chart; however, we also have to take into consideration that we were planning on record shipments in Q2 and Q3 at the same time. We are shipping more hardware than ever before, but the project, of course, is influencing the efficiency and productivity in the other manufacturing areas and processes.

That is essentially the impact that we are seeing. The project itself, Charley, is on track. We are executing exactly on the schedule and on the plan we talked about three or five months ago. This project started in April of this year, as you know, and it's scheduled to be completed at the end of Q1 of 2019. Does that answer your question, Charley?

**Charles Brady:** It did. Yes. Thanks. That's helpful. I guess, one more. On the Ag business in Europe, the slowdown you're seeing there, particularly in tractors, given Faster's significant exposure into the European Ag market, can you walk through what the impact of Faster specifically is going to be on that? And as we look into 2019, should we be dialing back expectations for either synergies, or just the overall Faster margin, given that you have significant exposure in Euro Ag?

**Wolfgang Dangel:** I would definitely say this has no impact on synergies, not at this stage. From a synergy perspective, we are trying to utilize Faster to pull in the other businesses that we have, so that will not have any impact on the synergies and the projects around the synergies, as such.

Just again, to highlight here, we are still seeing growth in Ag, it's just slower growth. If we look at the orders from Q3 2018 to Q3 2017, Q3 2017 was the highest order intake in Faster's history, so we are comparing to a very high base. We're down compared with base, but overall, we are still growing, so, it's just a slower rate of growth, Charley.

**Charles Brady:** Okay, that's helpful. On Electronics, can you speak to the timing of shipments as to what's going on there? Is that just the customer saying we need it later than we originally thought?

**Wolfgang Dangel:** This is actually connected to a negotiation of the master contract we had with one of the larger customers. It was just pretty much on the brink between the third quarter and the fourth quarter that pushed shipments into the fourth quarter. We had a slowdown there in September due to those negotiations. They are all settled to the mutual satisfaction of all parties here. We will see a pickup in revenue from that particular OEM in Q4. So, it's just purely a shift from Q3 to Q4.

**Charles Brady:** Can you quantify that shipment delay or shipment push out?

**Wolfgang Dangel:** I would say it's about \$2 million. That's my estimate.

**Charles Brady:** Great. Thanks. I'll hop back in the queue. I appreciate it.

**Wolfgang Dangel:** You're welcome.

**Operator:** Thank you. Our next question comes from the line of Joe Mondillo with Sidoti & Company. Please proceed with your question.

**Joe Mondillo:** Hi, everyone. Good morning.

**Wolfgang Dangel:** Good morning, Joe.

**Tricia Fulton:** Good Morning, Joe.

**Joe Mondillo:** Since Charley finished on Electronics, I'll start there. Even accounting for that delayed shipment, your guidance is not suggesting a huge pick up in the fourth quarter, so there's certainly a very big slowdown of growth in the back half of the year. Could you talk about some of the end markets that you're seeing, where the slowdown is coming from mainly, and how you're thinking about things as we head into 2019?

**Wolfgang Dangel:** First of all, from a seasonality perspective, Joe, the fourth quarter at Enovation has historically been low. It will be much stronger this year, and that's why we actually indicated here that we'll end at the upper end of revenue guidance there. We expect significant growth in Q4 2018 over Q4 2017.

If we look at the recreational markets, as well as the other sectors that are overlapping with Hydraulics, we see exactly the same tailwind that we are seeing on the cartridge valve side, so there is still strong activity there. Also, on the recreational side of the business, we are still seeing relatively solid market activity. There is no big change compared with the past. The only change is, I think, this Q4 will be much stronger compared with any fourth quarter that we have seen in recent years.

**Joe Mondillo:** Okay. And to sort of nitpick on that segment still, I think the selling, engineering and administration costs were fairly consistent with the second quarter. Could you help out with the cost situation there, anything going on abnormally?

**Tricia Fulton:** There was a small amount of that total additional spend on SEA that was a shift out of gross margin into SEA. We moved some people out of manufacturing overhead and into SEA, so you see a little bit of a shift there. The other was just normal planned investments in R&D. As you know, we spend about 8% in R&D in that segment. It's a very healthy part of the ongoing growth that we see in Electronics. It's important to keep those resources in place and additive to the business.

**Joe Mondillo:** Okay. Shifting to other topics, I wanted to ask about the operating margin guidance. The range is still fairly wide, considering that we just have one more quarter here. Is that just a case in point related to the CVT consolidation, and not being sure how the inefficiencies play out in terms of the fourth quarter? Do you now have the visibility? Could you talk about that?

**Wolfgang Dangel:** That is right, it's true. It's due to the CVT site consolidation, that's why you see a little bit of the wider margin there, Joe, on adjusted operating income. From a visibility perspective, nothing has changed. I think we have reasonably good visibility in all businesses across the board until the end of the first quarter. Over the next five months, I think we know pretty well what is going on in the marketplace.

**Joe Mondillo:** Okay. In terms of the CVT inefficiencies, when you went through the Hydraulics segment gross margin bridge, you said production efficiencies were actually a net positive, so I assume the CVT inefficiencies related to that, I guess, kept that net positive to a lower net positive. Could you quantify how much the inefficiencies with the CVT consolidation have amounted to?

**Tricia Fulton:** It's very difficult to tell exactly what's coming specifically from that project, but we know that there are inefficiencies in the system. For example, we have some parts, because lines are being moved each day, that have to be transported between the buildings multiple times. We have people that are in training in the new U-cells, and we have to pull trainers out to train them, so we know there is inefficiency. It's very difficult to calculate exactly what it is at this point, but we are encouraged by the fact that we're seeing some improved efficiencies on the production side. We expect to see even more when this project is complete, but it's very difficult right now in the middle of it to be able to quantify it.



**Joe Mondillo:** Okay, I understand, but in terms of my analysis, that production efficiencies line item in the Hydraulics gross margin bridge would be much higher if you did not have the issues going on with CVT consolidation. Is that correct?

**Tricia Fulton:** That's correct.

**Joe Mondillo:** Okay. And then last question from me. I don't know if you said this in your prepared remarks, but could you tell me what the revenue year-over-year change was at Faster?

**Tricia Fulton:** Yes, just a second. For the quarter, you mean?

**Joe Mondillo:** For the quarter, yes.

**Tricia Fulton:** Revenue was up in terms of euros converted to U.S. dollars about \$3 million.

**Joe Mondillo:** Okay. And then, last question really, on the tax rate. It looks like it translates to a high-teen. Looking at 2019, what would be a normalized tax rate? I think we were looking at 25%, 26% beforehand. Is that still the normal? Is this just a temporary type thing that you benefit from in the back half of the year?

**Tricia Fulton:** We're guiding for 2018 to be 19% to 21%. We do expect that the ongoing rate beginning in 2019 will be a few points higher than that, but will still be lower than the original ranges that we gave after the new tax laws went into effect.

**Operator:** Thank you. Our next question comes from the line of Mig Dobre with Robert W. Baird. Please proceed with your question.

**Joe Grabowski:** Good morning, everybody. It's Joe Grabowski on for Mig this morning.

**Tricia Fulton:** Hi, Joe.

**Joe Grabowski:** Good morning. Most of my questions have been answered. I'll just drill in a little further on the revised guidance. The operating margin guidance was reduced by 135 basis points at the midpoint. That was guidance given midway through the year, so it's a pretty significant reduction. It implied anywhere from a 16% to 20% operating margin in the fourth quarter, which would be comparable to last year. Last year had multiple margin headwinds in both businesses. I know the business mix is slightly different. Is the vast majority of that 135 basis point reduction inefficiencies from the consolidation project, or are there other factors that have gotten worse over the last three months?

**Tricia Fulton:** There are a few things that affect it. About two thirds of it is related to site consolidation. We talked about the lower Ag rate, and we're seeing a small effect from the lower expectations in the fourth quarter related to Ag. We have some exchange rate headwinds as well and, obviously, the tariffs. We still have a bit of an unknown around the tariffs at this point, and we do expect to have some negative effects on the margins related to tariff in the fourth quarter.

**Joe Grabowski:** Got it. Okay. And a similar question on the Hydraulics sales, which reduced about \$15 million at the midpoint. Obviously, you called out a few different factors. Can you segment how much of a reduction was due to the inefficiencies versus the slower Ag market versus the FX?

**Wolfgang Dangel:** Same percentage, about two-thirds as well, Joe.

**Joe Grabowski:** Two-thirds from the consolidation?

**Wolfgang Dangel:** Right.

**Joe Grabowski:** Okay. Then the margin inefficiencies from the consolidation and the lower sales from the consolidation, are we expecting those to continue into the first quarter?

**Wolfgang Dangel:** Yes. We expect those to continue until the project is completed.

**Joe Grabowski:** Okay, and completed by the end of the first quarter?

**Wolfgang Dangel:** Right.

**Tricia Fulton:** Correct.

**Joe Grabowski:** Okay. And then, maybe just one last question. Same thing about the normalized tax rate going forward, maybe pin you down a little bit to give a specific range 2019 and beyond?

**Tricia Fulton:** This is a guess, because we're not giving 2019 guidance right now, but I would say, probably 22% to 24%.

**Joe Grabowski:** Great. Okay. Thanks for taking my questions.

**Operator:** Thank you. Our next question comes from the line of Brian Drab with William Blair. Please proceed with your question.

**Brian Drab:** Good morning. Thanks for taking my questions. The first is on the Hydraulics segment. If we step back and look at what has been really solid growth in that segment, and again, 13% organic in the third quarter, do you have a sense for whether you're taking share, and does that have to do with your push on electro/hydraulic components and solutions? And do you have a sense for how fast you're growing relative to the competition?

**Wolfgang Dangel:** Yes Brian, as I pointed out earlier on when Jeff asked the question, we saw a significant pickup in orders in Q3 2016, and we have done benchmark and competitive analysis over the last eight quarters. I would say, based on that, we clearly took quite some share, particularly in the early stages of the recovery, predominantly in 2017, but also leading us into 2018.

If you benchmark the organic growth numbers with the peer group, I think you'll see the difference. I think the majority of that is due to the initiative that we took on in early 2016 when we deployed application specialists around the world, North America being one region, but we also accelerated those efforts, as you know, in some other parts of the world. I think they paid tribute and we saw a lot of activity resulting out of that. New product development has contributed as well, but there, we're still at the very early stages, as we expect more significant positive impacts from new product development in the next couple of years.

**Brian Drab:** Okay. Thank you. And then, could you talk a little bit more on tariffs and what impact you would see? What percentage of your inputs would be on the list that might see an increase of 25% tariffs in the first quarter? How concerned you are going into the first quarter of 2019?

**Wolfgang Dangel:** Well, there is concern I think, because this is not a very transparent situation that we're having. As you know, we tried to convert the tariff impact immediately into a surcharge and tried to pass it on to the marketplace, but there has been resistance in accepting the surcharges. That's still an ongoing activity, so I can't give you a full and clear picture what it means as we go into 2019.

We have quantified the tariffs for the balance of the year, for Q3 and Q4. As Tricia pointed out before, if you go to the midpoint of revenue guidance drop and the adjusted operating income drop, about 10% of the profitability impact is attributed to tariffs.

**Brian Drab:** Okay. That's helpful. Thank you very much.

**Wolfgang Dangel:** You're welcome.

**Operator:** Thank you. Our next question comes from the line of Jon Braatz with Kansas City Capital. Please proceed with your question.

**Jon Braatz:** Good morning, Wolfgang, Tricia.

**Tricia Fulton:** Good morning, Jon.

**Wolfgang Dangel:** Good morning, Jon.

**Jon Braatz:** Wolfgang, obviously Sun Hydraulics was not the only company raising some concerns about the macro outlook for 2019, maybe a little bit into 2020. I guess my question is, as it relates to Faster, what kind of volatility in terms of margins have we seen across the cycle with Faster? I understand, Wolfgang, that they're still showing growth, but there's some additional weakness. How operationally leveraged are they, and what kind of variability might there be in the operating margins at Faster?

**Wolfgang Dangel:** Jon, Faster has a pretty steady margin profile. It's due to the fact that the value-add, how they are set up between insourcing and outsourcing activity, is pretty flexible, so they can adjust that model in a pretty speedy manner.

If you go back in history, and we looked at this during the due diligence, I think two points caught our attention. First of all, over the last 18 years, Faster had only one year where organic revenue did not grow. That year was 2009. In any other year, organic revenue grew. And secondly, if you look at the margin profile, they were able to maintain that superior gross margin profile all along, because they tweak the value-add model between outsourcing and in-house manufacturing. I'm not so much concerned going down the road. With Faster, the Ag business is probably a little bit more steady compared with the other end markets that we are serving. I'm pretty confident that we can maintain a high gross margin profile.

**Jon Braatz:** Okay. Thank you. On the Electronics side, and I know you're not giving 2019 guidance, but when you look at 2019, do we see a number of new platforms for the Electronics segment, new business development, new business projects and platforms that weren't there in 2018?

**Wolfgang Dangel:** That's an ongoing process. The Enovation team is very active with current customers, as well as with new customers, on a number of projects, and there are new product launches already scheduled for next year as well, so the answer is yes.

**Jon Braatz:** Maybe I should clarify, are they significantly larger projects?

**Wolfgang Dangel:** I think it's both. It's predominantly higher pull-through products with existing customers on platforms and programs that we are on, but, at the same time, they are also working with new OEMs. There are a couple larger projects lined up for 2019, but it's a mixture of both.

**Jon Braatz:** Okay. All right. Thanks, Wolfgang.

**Wolfgang Dangel:** You are welcome.

**Operator:** Thank you. Our next question comes from the line of Josh Pokrzywinski with Morgan Stanley. Please proceed with your question.

Josh, are you muted on your end? You're live in the conference. Okay, Josh may not be on the line.

[Operator Instructions] There are no further questions at this time. I'd like to turn the floor back over to management for closing comments.

**Wolfgang Dangel:** Thank you. Thank you for your interest in Helios and for your participation this morning. Also, thank you to all of the hardworking Helios employees, who are driving these results. We look forward to updating all of you on our fourth quarter and full-year results in late February. Thank you very much, and have a good day.

**Operator:** This does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation.