Operator: Greetings, and welcome to the Helios Technologies Second Quarter Fiscal Year 2022 Financial Results Conference Call. [Operator: Instructions] As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Tania Almond, Vice President, Investor Relations, Corporate Communications and Risk Management. Thank you. You may begin.

Tania Almond: Thank you, Operator, and good day everyone. Welcome to the Helios Technologies Second Quarter 2022 Financial Results Conference Call. We issued a press release announcing our results yesterday afternoon. If you do not have that release, it is available on our website at hlio.com. You will also find slides there that will accompany our conversation today. On the line with me are Josef Matosevic, our President and Chief Executive Officer, and Tricia Fulton, our Chief Financial Officer. They will spend the next several minutes reviewing our second quarter results, discussing our progress with our accelerated growth goals, affirming our outlook for 2022, and then we will open the call to your questions.

If you turn to **Slide 2**, you will find our safe harbor statement. As you may be aware, we will make some forward-looking statements during this presentation and the Q&A session. 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 were provided in our 10-K filed with the Securities and Exchange Commission. You can find these documents on our website or at sec.gov.

I'll also 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 with non-GAAP measures in the tables that accompany today's slides. Please turn to **Slide 3**. With that, it's now my pleasure to turn the call over to Josef.

Josef Matosevic: Tania, thank you, and good day everyone. Our team performed extremely well yet again and delivered strong results for the ninth consecutive quarter in this challenging macro environment. We are staying laser-focused on executing against the business system and our strategy to create accelerated growth with top-tier margins. We delivered solid increases across most of our markets and regions.

In fact, our diversification strategy is proving its value. We saw strength in our industrial, recreational, and mobile markets that more than offset some market shift we've seen in other areas this quarter. We are outpacing the competition on many fronts. We believe our competitive advantages lie in our engineering expertise, application know-how, pure-play focus as well as our manufacturing and operating strategy that we are executing. We have new product rollouts for customers in our Electronics segment that validate our innovative solutions. Our Hydraulics segment continues to introduce new solutions that are even changing the way our customers engineer their own products.

Beyond driving the top line, we are constantly strengthening our business model through our manufacturing and operating strategy. It helped drive greater operating leverage. We are taking a global look at our footprint and are maximizing our capabilities to best serve our customers with the greatest value proposition. This strategy is enabling top-tier margins and solid earnings despite the strength of the U.S. dollar and the impact that it has on foreign currency.

Our operational strength and the determination of our people are delivering solid earnings power in the face of hyperinflation and supply chain constraints. I am always so impressed with how our teams work together to produce remarkable results day after day. I want to thank each Helios colleagues around the world for your strong consistent performance and dedication to continue to build a great company. Their collective hard work fuels our financial strength and flexibility.

Our net debt to adjusted EBITDA leverage ratio is down to 1.68x at the end of the second quarter, giving us the ability to remain opportunistic for flywheel acquisitions. Mid-July, we closed the Taimi bolt-on acquisition, a perfect fit into our hydraulics segment. I would like now to provide some highlights on our manufacturing and operating strategy to help you better understand the significant progress we have made.

Please turn to **Slide 4**. At our last Investor Day, we presented the major areas for integration as we transform from being a holding company into an operating company. We have accomplished a lot of good work on flushing out the strategies and tactics and have several projects in various phases of ideation to execution.

Of course, the objectives are all underpinned by the Helios business system. We started with the Electronics segment and then moved to the Hydraulics segment. We developed manufacturing road maps with several programs each might stretch over a couple of years and is comprised of multiple projects that have clear structure and owners. Work is moving forward on multiple programs and projects simultaneously.

For example, a project can represent a product line move that enables global growth, increased profitability, and mitigates global supply chain risk. Currently, in electronics alone, there are 40 projects, each consisting of multiple phases. This is a continuous improvement process, which is already part of our DNA here at Helios. We are now doing this as an integrating operating company versus at the business unit level. As we grow into a larger, more global company and fold in more acquisitions, there will always be something that we can further do to improve upon. This discipline abroad sets us up for long-term margin enhancement and is one of the aspects that I find most exciting about our long-term investment story. As I have said in the past, we are just getting started.

Let me now turn the call over to Tricia to review the financial results and discuss our reaffirmed outlook in more detail before I come back for some closing remarks. Tricia, please?

Tricia Fulton: Thank you, Josef, and hello, everyone. On **Slides 5 through 9**, I will review our second quarter 2022 consolidated results. As Josef mentioned, we are delivering impressive financial performance against headwinds of foreign currency, supply shortages, and rapid inflation.

In the quarter, sales grew 8%, which on a constant currency basis was 12% as foreign currency exchange rates impacted sales by $7.5 million. Supply chain constraints delayed about $15 million in sales. This continued despite an expanded supply base, strategic investments in inventory, production schedule adjustments, and extensive work on product redesigns. We have solid demand in industrial, mobile, agricultural, and recreational end markets. While the health and wellness industry, specifically Balboa products shipping out of Asia serving Europe, slowed in the latter half of the quarter.

Geographically, the Americas have remained quite strong with more modest growth in Europe. Continued restrictions related to COVID have weakened the APAC region, specifically in China. Gross profit increased in the quarter on higher volume against a $2.2 million currency headwind. Gross margin contracted as supply chain and logistics challenges prevent optimal operations. We have additional strategic pricing actions planned. As supply chain conditions improve, this will help with output, absorption, and efficiencies.

Additionally, we expect to capture more benefits over time from our manufacturing and operating strategy. We also believe as we continue to advance the strategy that Josef highlighted, we can find greater efficiencies even in these less than ideal operating conditions. We are highly disciplined with our SEA expenses to strengthen operating leverage. SEA as a percent of sales improved 100 basis points to 13.5% of total sales. Adjusted EBITDA of $59 million was in line with the trailing quarter and up 3% over last year's second quarter.

Importantly, despite the impacts I just outlined, we are holding margins at top-tier performance levels. Our effective tax rate in the second quarter was a more normalized 22.5%, whereas last year's lower rate benefited from the resolution of transfer pricing disputes.

On **Slide 10**, you will find highlights of our Hydraulics segment results. Sales grew 7%, which on a constant currency basis was 13% year-over-year, driven by acquisitions and strong demand across most markets. The total impact to sales related to foreign currency exchange rates was $7 million. We delivered this growth despite an estimated $6 million of sales delays due to supply chain shortages. I would like to note the total amount of the delayed sales was improved from the trailing quarter based on our team's ability to work through the challenges and maintain our unsurpassed lead times.

Hydraulic segment gross profit was impacted by unfavorable FX of $1.9 million. SEA in this segment improved 110 basis points to 12.9% of revenue, demonstrating the leverage obtainable on higher sales. Profits and margins held up well given the very volatile environment.

Please turn to **Slide 11** for a review of our Electronics segment results. Our Electronics segment is more concentrated in the U.S. so foreign currency has less of an impact on revenue. Sales grew 9%, which on a constant currency basis, was 10% year-over-year. Delays in shipments because of supply shortages was about $9 million, which improved a couple of million from the trailing first quarter. We expect to continue to see this come down. The strength we are realizing in this segment is primarily related to new product rollouts that have been a few years in the making.

Electronics segment gross profit of $32.8 million in Q2 increased 5% from the prior year period on higher volume and pricing. Electronics gross margin of 33.2% was down from 34.5% in the year-ago period, reflecting increases in raw material costs. SEA expenses in this segment improved 20 basis points to 12.6% of revenue, reflecting the leverage on the higher top line.

Please turn to **Slide 12** for a review of our cash flow. Cash generation remains strong even as we continue to support an elevated inventory level to maintain and, in some cases, further improve lead times. CapEx came in at about 3% of sales for the quarter and 2.8% year-to-date. We will likely end the year near the lower end of our expected range of 3% to 5%. Free cash flow was almost $22 million in the quarter. We are intentionally investing in working capital to meet customer demand, outpace the competition and deliver on commitments.

You can see on **Slide 13** that we have a strong balance sheet and more than sufficient financial flexibility to execute our strategy. We are paying down debt, funding organic growth, paying our regular dividends and building up dry powder for acquisitions. In fact, total liquidity at the end of the quarter was $216 million.

Now let's turn to **Slide 14**. There continues to be a good deal of uncertainty globally that remains in the backdrop, including the war in Ukraine, China not fully operational, FX impacts, and a global recessionary environment. Despite all of this, we believe that the Helios business system provides the structure and discipline to execute our plans. We are maintaining our original full year guidance, while now expecting revenue, adjusted EBITDA, and earnings at the low end of the range. We anticipate that Q3 and Q4 effective tax rates may be a bit higher than the top end of the annual range based on forecasted geographic distribution.

Our guidance includes Taimi, which we recently closed on, but is not financially material. Guidance assumptions also include our expectations on supply chain, pricing, execution of our manufacturing and operating strategy, and our confidence in our ability to execute against our original plan.

With that, I will turn the call back to Josef for some final comments.

Josef Matosevic: Thank you much, Tricia. As I said on our last call, it is very important to us to continue to do what we said we would do. We are doing that through maintaining our original guidance range for the year. While we assume the lower end of the range, we will and have been working diligently to find creative ways to offset the headwinds and create faster momentum from the tailwinds. We also remain on track to achieve the milestones that we have accelerated by two years of reaching at least $1 billion in revenue by 2023. You can probably tell from the type of work we are doing with our manufacturing and operating strategy, we have a long runway of opportunities ahead of us. The diversification that we have been working on across the business, including the size and scope of each of our business segments, deeper and broader end market penetration and geographic mix is all coming to fruition.

Since the beginning of the pandemic, we have remained laser-focused on staying close to our customers and understanding their needs while innovating new products at an accelerated rate. In fact, we recently announced a new efficient energy-saving ecoline™ program a couple of weeks ago from our Hydraulics business. The program has several solutions to customize a system that can significantly boost and improve efficiency, reduce fuel consumption, and provide cost savings. We have more announcements coming this fall that we believe could be game changing for multiple industries.

Our intense focus on innovation will allow us to leapfrog our competition further extending our leading market position. This is an exciting time in our corporate history. We remain very optimistic about our future and our ability to build a world-class large-cap company over time. With that, let's open up the lines for Q&A please.

Question and Answer

Operator: [Operator: Instructions] Our first question comes from the line of Jeff Hammond with KeyBanc Capital Markets.

Jeffrey Hammond: So just on kind of the guidance change towards the lower end. I'm just trying to better -- you cited a number of things. I think the electronics being a little slower, FX, maybe just uncertainty. Just order of magnitude, how do you think about the headwinds?

Tricia Fulton: Yes. We're looking at the supply chain, we're seeing some headwinds on the steel and the electronic components. I don't think that's new, but we are continuing to see it. And coupled with that, we also see increases in European energy costs, which are pretty dramatic at this point. And then FX has been having more impact than anticipated with the strength of the U.S. dollar against the euro. But I would have to say that I still think the supply chain constraints is the number one driver.

Jeffrey Hammond: Okay. And then just on health and wellness, if you could just explain what's going on there. We've seen some evidence of destocking in kind of pool and spa. And I'm just wondering if it's -- I think you mentioned Asia shipping into Europe, if it's Europe weakness, if it's broader than that, if it's demand weakness versus destocking? Just a little more color there.

Josef Matosevic: Yes, Jeff. On the health and wellness in particularly in our Balboa segment, the biggest impact on Balboa is clearly China, followed by Europe and North America is holding steady. So that's kind of how I would answer your question, largely tied into China and Europe. China being the largest impact, Jeff.

Jeffrey Hammond: Okay. And then like the -- go ahead. Go ahead, Tricia.

Tricia Fulton: Yes, I mean, in both of those areas, there's some of the inventory issues that we're seeing of unbalanced inventory that needs to be worked through over a hopefully short period of time. And then there's also a demand impact on that as well. So, it's coming from both sides in both APAC and in Europe.

Jeffrey Hammond: And then the weaker China, is that -- that's demand related or that's noise around China lockdown?

Josef Matosevic: Combination of both, but mostly demand related, Jeff.

Operator: Our next question comes from the line of Chris Howe with Barrington Research.

Christopher Howe: As we think about some of the comments that you made on the last call, can you provide an update on the footprint? You mentioned it briefly in your prepared remarks, kind of where capacity utilization is today in support of the demand trends that you see across both segments?

Josef Matosevic: Yes. Certainly, Chris. So very active journey here as we really starting to think 2023 and beyond and taking a more global look at our current capacity. And going forward, what should it look like as we are in a position now where we think of folding additional flywheel acquisitions to further create this differentiation we have been talking about. And then we added an arm of a new team in terms of system sales that are cutting across. So, we're picking up some pretty nice steam in terms of orders and backlog coupled by the investments we have done over the last two years on new products. So, all those three areas are coming together now. So, to answer your question, we are now in the process of looking at the acquired companies, where they are in terms of current capacity.

Our goal is to free up an additional 20% to 22% of global capacity. We will reach that goal for our plan by the end of the year. That's a methodical step we need to take. So good progress. The cake in the oven is getting baked and we will certainly communicate the final outcome here on our Q3 call, where we will also provide additional color on new product development and other areas of the business.

Christopher Howe: Just to follow-up on Jeff's question about the different challenges that you're seeing that are factored into falling into, let's say, the lower end of the guidance range. As we kind of think about that in more detail, can you talk about what areas of the business or what regions of the business you are perhaps seeing a little bit better transparency as we compare this question with your prior comments about the visibility into the second half? What areas are you seeing some improved visibility?

Josef Matosevic: Yes. So, on the improved visibility, clearly, the U.S. construction gives us higher level of comfort as we look at second half, pretty much across our entire portfolio. Ag markets remain relatively strong and that holds true for the global markets. Really, Chris, in our case, it's a one, two, three punch: it's China, FX, and supply chain. That is pretty much it.

We anticipated supply chain to last into the second half, and that's the reason why we have taken steps proactively to protect the margin, and the team has done a great job on protecting it. On FX, once it has worked itself out of the system, they should get us even into a better, better stage and then once China opens up whenever that is -- we are really good to go. We really don't have any fundamental shift to the strategy or any execution issues. We have -- we could have sold north of $15 million additional dollars, if we wouldn't have the supply chain challenges, so to say.

Balboa was harder impacted mostly because of China. If you look at year-over-year comparison, I just wanted to make sure that our investors understand that we really have a one, two, three, punch going on between China, FX, and supply chain. That's pretty much it.

Christopher Howe: Okay. That's helpful. And I'll ask one more and then I'll hop back in the queue, I promise. As we look at the guidance towards the lower end of the range and kind of think about the composition of that guidance, it's being driven by both segments in rhythm towards this guidance? Or do you anticipate one segment doing a little better. For example, a little bit less of an FX headwind in the Electronics segment, although you do see continuous deferral of sales, but maybe you can comment on how the segments shake out towards that guidance?

Josef Matosevic: I think it's pretty balanced Tricia, right? I mean, it's very balanced Chris, it's just a little bit more visibility. And clearly, we want to maintain to be good stewards of the business and not send any wrong messages, but this is as far as we can see right now, and we wanted to take a proactive approach to just communicating effectively here that one, two, three punch I've been talking about. If things improve, then obviously, we will be in a better position. If things further deteriorate, you guys know the story.

Operator: Our next question comes from the line of Mig Dobre with Robert W. Baird.

Joseph Grabowski: This is Joe Grabowski on for Mig this morning. I know you put through some pricing in the first quarter. It seemed like price cost headwinds persisted this quarter. Am I reading that right? And will you need to push through more pricing in the second half?

Tricia Fulton: We did put through pricing in each of the businesses sometime in Q1. And with regard to price cost, by the end of the quarter, we were at a price cost neutral, but certainly not for the full quarter depending on how the pricing was rolling out. And we're looking at that really mostly from a materials perspective. Are we able to cover the cost of the rising material costs on the supply chain piece of it? And we've covered that. We've recovered also a little bit of the margin on it, but certainly not at the full margin. That's why you still see the gross margins being a little bit lower than what they were last year, but we're able to leverage the SEA costs and still come in with really strong EBITDA margins to the bottom line.

Joseph Grabowski: Maybe asking another way. Have you started to see your costs come down? I know a lot of commodities rolled over in the quarter? Have you started to see your costs come down? Or is there a little bit of a lag on that?

Josef Matosevic: A slight improvement, Joe, in the Hydraulics segment, but has it come down to the degree that we call it normal? No.

Joseph Grabowski: Okay. And then on the supply chain, you called out $15 million of delayed sales, which I guess were actually improved from the first quarter and you said you expected it to continue to improve. I guess, what gives you the visibility that it's going to continue to improve and what sort of order of magnitude, if it was $15 million in the second quarter, how much can it improve in the third and fourth quarter?

Josef Matosevic: Yes. So, our visibility on the Hydraulics segment, in particular, with CVT and Faster. We have a very consistent order pattern with our distributors. So, we have a slight -- we have additional visibility within our distribution channel now that we're starting to get a little bit more comfort and Faster being a direct OEM company, we traditionally don't see much change besides the last couple of quarters due to the Ukraine and Russia situation, there was some pushouts, but it's starting to stabilize a little bit. We just want to wait another couple to three months and see if that's going to stay consistent or is it just one of those one-offs.

On the electronics side, with innovation, there's a very good, strong consistent story and order pattern here. It hasn't fluctuated much. On the Balboa side, it's pretty much all impacted by China and Europe. So that's where the gray zone is, so to say, Joe.

Operator: Our next question comes from the line of Nathan Jones with Stifel.

Nathan Jones: I wanted to go back to the price cost question there. Tricia, you said you were -- you exited the quarter neutral on price cost relative to materials. So, are you saying that you're not price cost neutral, when you're including all sources of inflation like freight, labor, all of those kinds of things?

Tricia Fulton: My comment included freight, but not labor or the efficiencies that we would get at the labor and overhead of gross margin. We still have some disruption in the production cycles because of the supply chain issues that we have. So, we're not getting the full leverage that we would out of our labor and overhead to get to the gross margin level. That's what I was commenting on.

Nathan Jones: Okay. So, we've seen some increasing pressures on gross margins over the last couple of quarters. Maybe you can comment on that. I mean, is that just the inflation from the second half of last year starting to roll through? And how you think that we should be looking at that gross margin progression over the next few quarters?

Tricia Fulton: Yes. Gross margin is going to continue probably around the levels that we're at right now because we are still seeing -- where we're having to do broker buys on the electronics side and the costs are so high there. We are seeing some stabilization of that, though, which is encouraging. Steel prices are still high, but expected to start to come down, at least according to the projections that we have. So over time, we will get back to the gross margins that we had, but over the next couple of quarters, we still will have some of the same challenges.

Nathan Jones: Okay. And one on the CapEx number. I think you said you're probably going to come in at the -- at or below the low end of the 3% to 5% guidance range. I would think of a fair amount of this has to do with the manufacturing and operating strategy, seems to be going full steam ahead. So just any comment on whether you're getting this done more cheaply or whether it's taking longer from supply chain constraints. So just why is that money not getting spent this year?

Tricia Fulton: Yes. We're actually -- as we're moving things around to the different facilities to optimize the operations and manufacturing. We're actually realizing that in some cases, we had more capacity than we thought we did. So, we don't have to make those investments right away. So that's some of the benefits. Some of it is just the delay in the lead times on some of the machines that we're looking at. And as Josef pointed out, we're also looking at the acquisitions that we've made and seeing where we have capacity in those facilities as well, so that some of the investments don't have to be made this year because we have the capacity available.

Operator: Thank you. We have reached the end of our question-and-answer session. I'd like to turn the call back over to Ms. Almond for any closing remarks.

Tania Almond: Great. Thank you, Operator, and thank you everyone for joining us today. We appreciate your interest in Helios and look forward to updating all of you on our third quarter results in November. Please feel free to reach out to me directly if you have any follow-up questions. Have a great day and stay healthy. Thank you.

Operator: Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.