

**Operator:** Greetings, and welcome to the Helios Technologies First Quarter 2019 Financial Results. At this time, all participants are in 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, Helios Technologies. Thank you, Ms. Howard, you may begin.

**Karen L. Howard:** Thank you, Jerry, and good morning, everyone. Welcome to the Helios Technologies, formerly known as Sun Hydraulics, first quarter 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 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.heliostechnologies.com](http://www.heliostechnologies.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 on our website or at [www.sec.gov](http://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 with summarizing key highlights for the first quarter of 2019; Tricia will go through the details of our financial results for the quarter and then, we'll turn it back to Wolfgang for his perspective on our outlook and 2019 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**. Business wise, we are off to a solid start for 2019, and let me first summarize our financial results. We reported sales of \$147 million, a 51% increase over last year's first quarter. Our Faster and Custom Fluidpower, or CFP, acquisitions contributed most of that growth, as changes in organic sales of our two segments were virtually offsetting. Organic sales of our Hydraulics segment grew a very strong 8% while our Electronics segment contracted by 12%. Our first quarter 2019 sales for Electronics were unfavorably impacted by some changes we made to our customer base, including the release of certain contractual obligations to customers, allowing us to leverage all products to a broader customer base. While this is temporarily dampening sales for 2019, it gives us the ability to secure new important customer commitments for 2020 and 2021 and allows us to further penetrate our sweet spot, which is mid-market OEMs.

Turning to the bottom line, we reported \$16.4 million of net income. On a non-GAAP cash net income basis, that represents \$20.3 million or \$0.63 per share, up 34% and 24% respectively over last year on a comparable basis. Adjusted EBITDA was \$34.7 million or 23.7% of sales. We do anticipate margin expansion as we progress in 2019 and I'll touch on that in a moment.

Referring to the balance sheet and our leverage, we reduced our net debt this quarter, closing at 2.3x net debt to adjusted EBITDA, as we progress toward our goal of less than two times.

Please turn to **slide 4** and I'll summarize the business highlights we achieved in the first quarter of 2019.

As anticipated, we completed our CVT manufacturing consolidation project in Sarasota. As most of you know, we began this 12-month project in April of 2018. This project involved consolidating manufacturing into our two adjacent Sarasota facilities by applying our lean enterprise principles and reorganizing our production lines. As we progress in 2019 and fine tune our processes, we expect our productivity to improve and free up about 15% of additional capacity leading to margin expansion, which we have built into our guidance for the year. Now that the CVT manufacturing consolidation project is complete, we are proceeding with establishing a center of excellence in our third Sarasota facility which is about two miles from the other two. It will house our global CVT research and development activities as well as certain administrative and operating functions, and is expected to be complete by the end of this year.

One of the synergies we identified as part of the Faster acquisition was to begin machining CVT components at our Faster facility near Milan, Italy. I am pleased to report that we are ahead of schedule and began making components this month. Faster will produce six critical parts for high-volume cartridge valves, initially representing a near-term vertical integration cost synergy. We expect the cost savings will ramp up to full realization in mid-2020. This represents the first phase of CVT manufacturing in Europe in accordance with our "in the region, for the region" initiative. The next phase of this project will involve full cartridge valve production capability for the European market.

Turning to the Asia-Pacific region, development of our new facility in China is also progressing ahead of schedule. It is strategically important given the strong growth and market share gains we continue to see in that region. We purchased equipment and customized the newly built facility during the first quarter as we prepare for production. By the beginning of the third quarter of 2019, we expect to be performing test and assembly to support CVT demand in the region. The mid-term plan for this facility is very similar to what I described for Italy and Europe. We will bring full cartridge valve production capability to APAC to support our "in the region, for the region" initiative.

Finally, I want to mention that our new product development investments remain very active in both of our segments. One very significant CVT product launch which took place last week was the addition of 16 new FLeX Series valves. We first launched this line of electro-hydraulic valves near the end of 2017. We have now added to the product offerings in that series, expanding our opportunities for many new applications. The FLeX product line provides robust electro-hydraulic control for mobile and industrial applications and creates a critical path to expanding systems business. To reiterate, our product development initiatives are an important component of our Vision 2025 strategic plan, to achieve global technology leadership in the industrial good sector, with critical mass exceeding \$1 billion in sales while maintaining superior profitability and financial strength.

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

**Tricia L. Fulton:** Thank you, Wolfgang, and good morning everyone. Let's begin on **slide 6** with the review of our first quarter consolidated results. Sales were up 51% compared with last year's quarter. Faster and CFP contributed \$49 million and our organic business sales grew 2% excluding the impact of changes in currency rates. Foreign currency had a \$1.3 million unfavorable impact on consolidated sales of our organic businesses. Faster and CFP sales were also unfavorably impacted by the decline in the euro and Australian dollar, resulting in \$2.4 million of lower sales, compared with their pre-acquisition exchange rates.

I'll now touch on sales by region, which are designated here in the sales bar chart on the left. There is a table in the back of the press release as well as a supplemental slide 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 46%, 30% and 24% of the consolidated total, respectively. In the prior-year quarter, this was 58%, 23% and 19% to the Americas, EMEA and APAC, respectively.

Regarding profitability, our consolidated adjusted EBITDA of \$34.7 million grew 49% over last year's first quarter.

Turning to the bottom line, non-GAAP cash earnings per share were \$0.63, about 24% higher than last year's first quarter. You may recall that last quarter, we indicated that we would be reporting non-GAAP cash EPS this year, which adds back our acquisition-related amortization and other non-recurring type items.

In the first quarter of 2019, we had \$4.5 million of acquisition-related amortization of intangible assets. We also recorded a charge of about \$719,000 for contingent consideration associated with the Faster acquisition. Both of these items have been added back in arriving at adjusted EBITDA and non-GAAP cash net income. Please refer to the tables in the back of the press release or slides for reconciliation of GAAP and to non-GAAP numbers.

Please turn of **slide 7** for review of our Hydraulics segment's first quarter operating results. Consistent with prior periods, 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 in the tables in the back of our earnings release and slides.

Sales for the Hydraulics segment grew 86%. We saw 58%, a 113% and 98% year-over-year growth for the quarter in the Americas region, EMEA and APAC, respectively. Those numbers benefited from the addition of Faster and CFP. On an organic basis, we realized 8% growth which was driven by increased market demand in all geographies, as well as price increases. Orders continued to outpace revenue. The CVT manufacturing consolidation project was completed at the end of the first quarter and is expected to expand capacity as we progress through 2019 in an effort to feed the strong demand. Foreign currency translation for the Sun Hydraulics business had a \$1 million unfavorable impact compared with the 2018 first quarter.

Gross profit increased by 82% on the higher sales, including the addition of Faster and CFP. While the Faster business demonstrated strong gross margin achievement in the quarter, the CVT business was down slightly compared to the first quarter last year due to a slow start in January. CVT margins improved throughout the quarter and are expected to improve further as we progress through 2019. Another factor impacting the gross margin comparison to last year is that CFP's integrator business model carries a modestly lower gross margin than a manufacturing business. While CFP detracted from margins by about 100 basis points in Q1, the strategic value of CFP remains very important to Vision 2025. CFP is our stepping stone into the Southeast Asian markets where we believe there is significant opportunity to gain market share.

Hydraulics segment operating income grew 78% to \$23.8 million. Higher selling, engineering and administrative expenses, or SEA, included \$8.2 million for the Faster and CFP businesses.

Please turn to **slide 8** for review of our Electronics segment's first quarter operating results. Revenue was down 12% compared with the first quarter of last year, impacted by timing of OEM model year rollouts and softening end markets.

First quarter gross margin increased substantially to 45.7%, up 40.9% in the prior year's quarter driven by cost management efforts. We also implemented price increases and realized material cost reductions, both of which drove significant margin improvements.

Operating margin in the first quarter improved to 21.4% of sales, despite the lower revenue level.

Please turn to **slide 9** for review of our cash loan capitalization. In the first quarter, we generated \$19.8 million of cash from operating activities, 35% more than the prior-year first quarter, with the increase driven by higher cash earnings, partially offset by a net increase in working capital. Our CapEx was \$8.8 million, up from \$4.2 million in the first quarter of 2018. The increase was primarily for manufacturing technology enhancements,

including equipment for completion of our CVT manufacturing consolidation project, our new China facility, and the addition of the Faster business. Capital expenditures are still estimated to be between \$30 million and \$35 million for 2019.

Regarding capitalization, cash flows drove an \$8 million reduction in net debt in the first quarter of 2019. We finished the quarter with our net debt to pro forma adjusted EBITDA of 2.3x. With our strong cash flow profile, we are focused on getting that down to below two times. I do want to mention that early in the second quarter, we made the final \$17.8 million earn-out payment associated with Enovation Controls acquisition. Given the strong performance of that business, the maximum earn-out was achieved, demonstrating a win-win for all parties.

Wolfgang, I'd like to turn it back to you for your perspective on outlook and our 2019 guidance before we open the lines for Q&A.

**Wolfgang Dangel:** Thanks, Tricia.

Please turn to **slide 11**. There are several macroeconomic factors impacting our current outlook. First, recent tariff negotiations over the weekend point to a higher degree of unpredictability for the remainder of the year. Also, as we have been expecting, the leading U.S. indicators that are important to Helios indicate that we are currently experiencing a slowing growth phase, with accelerating growth expected to resume in 2020. Around the world, nearly all major global economies are already in the slowing growth phase of the business cycle. Economic forecasts that we follow point to a mild recession in Western Europe in 2019. Similar to the U.S., all global economies are expected to return to accelerating growth in 2020. Geopolitical factors, including the impact of Brexit present uncertainty for our global business in the end markets we serve.

It is 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 products and solutions. Further, our intentional shift from the traditional business into more diversified end markets expands our ability to successfully weather economic cycles.

Please turn to **slide 12** for our thoughts regarding our outlook for Helios for the remainder of 2019.

On a consolidated basis, regarding quarterly cadence, we expect revenue to be evenly spread throughout the remainder of the year.

Also, as I mentioned earlier, I want to emphasize that we are continuing to aggressively invest in innovative manufacturing technologies and market-leading new products. These investments are critical to achieve our revenue and profitability goals.

In the overall macroeconomic environment, oil and gas, agriculture, recreational and most recently, construction and material handling end markets are softening. There has been a shift in the outlook of these markets over the last few months that has caused us to take a closer look at our expectations.

Referring to our Hydraulics segment, keep in mind that our second quarter and part of our third quarter will include acquisition growth for CFP, which will anniversary on August 1. Regarding operating profitability, we are very encouraged about the results we are seeing from actions taken to improve production flow at our facilities, as well as manage our fixed costs. As previously indicated, we saw better work flow in our Sarasota operations on a month by month basis throughout the first quarter. We expect that we'll continue to further improve as we progress through the balance of the year.

Turning to Electronics, this segment is highly driven by OEM engagement and, therefore, product launches are not consistent on a year-over-year basis, affecting the quarterly comparison. But we remain confident in our proven go-to-market strategy with OEMs as well as our ability to optimize operational efficiencies in an effort to maintain the superior growth margin levels Tricia referred to.

Please proceed to **slide 13**, where we provided our updated guidance for 2019 which demonstrates growth over 2018. As I noted a moment ago, in the overall macroeconomic environment, many of our end markets are softening. Nevertheless, we reiterate our Hydraulics segment revenue guidance. Our strong backlog and the completion of our CVT manufacturing consolidation project give us confidence to maintain Hydraulics revenue guidance for the year.

In Electronics, we initiated a deliberate shift in our customer base which materialized in the first quarter. We believe this change is in the long-term best interests of our business and puts us in a better position to take market share as we work towards achieving Vision 2025. This initiative includes the release of certain contractual obligations to customers that allows us to leverage all products to a broader customer base.

Electronics has experienced growth of over 50% in the last two years due to significant new product introductions in recreational end markets and overall growth in mobile and industrial end markets. Compared to prior periods, this year's rollouts are at lower volumes. This is partially due to the production schedule of specific vehicles as well as softening in end market demand. We have a strong OEM sales pipeline of opportunities with new and existing customers. We are currently in the development phase for these new products and anticipate the start of production for most in 2020 and 2021.

Our changing top line guidance translates to a revision in adjusted EBITDA margin. However, lower depreciation estimates for the year allow us to maintain our GAAP EPS and non-GAAP cash EPS guidance.

We remain committed to investing for long-term profitable growth throughout the business cycle to outpace the market as we work diligently towards our Vision 2025 goals.

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

**Operator:** Thank You. We'll now be conducting a question-and-answer session. [Operator Instructions] The first question is from Brian Drab, William Blair. Please go ahead, sir.

**Brian Drab:** Hi, this is Joe Aiken on for Brian today. I was wondering if you could talk about what you expect in terms of gross margin progression throughout the rest of the year.

**Tricia Fulton:** We talked about gross margins for the Hydraulics segment showing some expansion especially related to the completion of the CVT consolidation project, so we're looking somewhere between 50 basis point to 100 basis point increases there for gross margin as we progress through the year. On the Electronics side, we expect those gross margins to stay elevated. It's going to depend on what the top line sales are by quarter, but we expect them to be somewhere between 43% and 45% for the remainder of the year.

**Brian Drab:** Thank you. And you mentioned it in the outlook, but the risk of additional tariffs, are you able to quantify what that risk could potentially be at all?

**Wolfgang Dangel:** It's very difficult, Joe, at this stage to quantify. So far, we have been able to pass everything on to the marketplace in a pretty successful manner. And as you know, with the 'in the region, for the region' initiative, we are also ramping up value add in those places, particularly referring now to Korea and to China, where the new China facility is coming online shortly. At this stage, I think it is still too early to quantify the exact impact and, as we all know, these discussions I think are still in flux, and I think we have to wait for the exact outcome before we quantify any specific numbers here.

**Brian Drab:** Okay. Thank you for taking my questions.

**Operator:** The next question is from Mig Dobre, Robert W. Baird & Company. Please go ahead.

**Mig Dobre:** Good morning, everyone. My first question is really surrounding your outlook in Hydraulics. What I'm wondering here, your comments certainly point towards slowing end markets and some of your peers that have reported have seen that as well. But then you maintain your guidance and you talked about orders in the quarter, book-to-bill, being above 1. Can we try to flesh out what's really going on here? It seems like your orders are good. Your outlook is unchanged, but you're talking about slower markets. How should we think about what's really going on with the business and with you specifically in terms of maybe outgrowing the market?

**Wolfgang Dangel:** Good morning, Mig. Yes, exactly as you said. The book-to-bill ratio is still above 1, but we have recently, probably over the last, it's fair to say over the last four weeks to six weeks, seen softening in the end markets where we have seen exceptional growth over the last 18 months to 24 months and I'm here referring mainly to construction machinery and to material handling. Besides those end markets, the recreational markets have been under pressure for a bit longer, as you know that it's very much consumer driven. At the end of the day, and we are coming off of very staggering growth numbers over the previous years, we referred to the 50% organic growth on the Electronics side, we're working off a pretty solid and stable backlog on the Hydraulics side and anticipate sluggish development or maybe even further softening in some of those key markets that we serve. That gives us the confidence that we can maintain guidance for 2019.

**Mig Dobre:** I appreciate that Wolfgang, but what I'm struggling with is, if I'm looking at your comparisons in Hydraulics, especially if you look at them on a on a two-year sequential basis, as you move from the first to the third quarter, your comparisons are getting almost 20% harder in Hydraulics. I understand that you do have a backlog, but obviously we don't really know what the amount of that backlog is. On tougher comparisons with end markets slowing, is there enough in your backlog or do you have enough visibility to still feel comfortable with the outlook or should we be preparing ourselves for maybe a reduction in the outlook in the second quarter based on the trends that you're seeing exiting Q1?

**Wolfgang Dangel:** Well, as you know historically visibility with regard to the legacy business, the Sun business, is probably three to four months where we can basically say we have good visibility and know pretty well what is going on. This this gotten a little bit better with the acquisition of Faster as 80% of Faster business is tied to OEMs and they are dealing with concrete OEM schedules there. So, to summarize again, based on what we are seeing right now and based on the degree of softening that we're seeing we have to make some assumptions of what these end markets will do over the balance of the year, and considering the stability of the backlog. We have also taken into consideration inventory in the channel, and we feel pretty comfortable that we can meet the revenue guidance in the Hydraulics segment.

**Mig Dobre:** Okay. That's fair. Let me let me ask you really quick on the Electronics segment. I am not entirely clear what this intentional shift in the customer base that you're talking about really means. It sounds to me like you're, for lack of a better term, walking away from some customers for some specific reasons. What I'm wondering here is, is this not something that you contemplated three months ago when you issued the guidance? What changed and why now?

**Wolfgang Dangel:** Good question. We've been contemplating this for two and a half years since we went through due diligence with Enovation at that time. So this was a point that deserved our attention at that stage. We knew that, down the road, we would address this at some given point in time and it simply goes back to the overarching philosophy that we follow from our Helios Technologies perspective. We don't want to put too many eggs in one specific basket and we want to position ourselves so that we can diversify the business at any given point in time as far as customers are concerned, but also as far as geographies and specific end markets are concerned.

As I reiterated earlier on, this change gives us the opportunity to do exactly that, to further diversify our access to more customers, predominantly global customers, and we are pushing for that global expansion, as you know, and it will also give us the opportunity to tap into adjacent end markets that we are not necessarily serving today, or if we serve them, not to the degree we want to serve them. The timing for this can always be questioned, but it's been on our radar screen for almost three years, since we started due diligence at the time back in 2016.

**Mig Dobre:** Well, you know, the timing is just sort of interesting to me because you're talking about end markets slowing a little bit in Electronics as well. So in theory this would be a year in which you might actually need that extra volume rather than getting rid of that extra volume. Do you feel as if you need to free-up this capacity now, is that the idea here?

**Wolfgang Dangel:** No. I mean to be very outspoken and frank here, it's a deliberate move to take a short-term hit for the mid-term and long-term benefit of the corporation. This will position us better in terms of Vision 2025 because we are getting access to additional customers we want to be tied to, that we have not been tied to in the past. As I indicated earlier on, we have experienced over the last probably 6, 9, maybe 12 months specific inquiries for exactly such products and services. But we were bound by contractual restrictions. So in exchange for specific long-term contractual volumes, we want to resolve that. We want to put ourselves in a position where, from a longer-term perspective, we are better off. It's a short term hit for a mid-term and long-term benefit. I think that describes it in the best way Mig.

**Mig Dobre:** Perfect. That's very helpful. Last question for me is on free cash flow. Tricia, can you give us a little bit of help as to how you're thinking about that and how does the earnout play into this? Is it in the second quarter that we're seeing that outflow or what? Thanks.

**Tricia Fulton:** On the free cash flow, we're still targeting 10% of sales. In the first quarter, we didn't hit those targets, but we have some pretty marked improvements planned with the businesses, with new targets for the working capital components of those.

The earnout payment does play into that in that we had to make that payment in early April. So we are not sure that we're going to be able to improve the debt position from the end of Q1 to the end of Q2 significantly, given that we had to make that large cash payment. But for the remainder of the year, we still have confidence that we're going to be able to generate the cash flow to continue to pay down the debt.

**Mig Dobre:** Okay. Thank you.

**Operator:** We have a question from Jeff Hammond, KeyBanc Capital Markets. Please go ahead.

**Jeff Hammond:** Hey, good morning. I think you said the cadence over the final three quarters would be similar. Can you just talk about how you're looking at the cadence for Hydraulics versus Electronics, particularly as we go through this transition in Electronics?

**Wolfgang Dangel:** Yeah, the cadence for Hydraulics is actually evenly balanced over the remainder of the year, right Tricia?

**Tricia Fulton:** For Hydraulics, we expect a little bit of growth over Q1, but relatively steady then in Q2, Q3 and Q4 but it is growth over what we saw in Q1. And on the Electronics side, I think we mentioned last quarter that we do have model year roll outs coming in Q2 and Q3, so we're expecting slightly better top line results Q2 and Q3 and then our general seasonality that we see in Q4, with a little bit lower revenue.

**Jeff Hammond:** Okay, that's helpful. And then just on the Electronics change can, you give us what verticals that's impacting?

**Wolfgang Dangel:** What are you referring to Jeff, when you say verticals?

**Jeff Hammond:** End markets. Is it a particular end market or is it pretty broad based?

**Wolfgang Dangel:** It's relatively broad based but, as I indicated, we are opening up ourselves for adjacent markets where these products and services can be applied. It's going from a narrower end market exposure to opening up a pathway to a broader end market exposure. Does that answer your question?

**Jeff Hammond:** Yeah. What are some of the adjacent markets you'd be able to bump into then?

**Wolfgang Dangel:** Well, it's in industrial and mobile applications. It's actually both and then also in the Ag market. This move is also intended to help us accelerate even further the generation of revenue synergies with some of the other group companies that we have. In this particular case, Faster obviously, as Faster is in the Ag market.

**Jeff Hammond:** Okay. And then just on Hydraulics margins, I understand the CFP dilution, but your margins were down fairly substantially year-on-year against what were pretty easy comps, because you had all the headwinds last year. I'm just trying to understand what's going on there. If there is anything outside of some of the plant costs that are still around?

**Wolfgang Dangel:** No. There is nothing else specifically going on. We had a pretty slow start in January that was the main reason, but we have seen very satisfactory results the following months including going into Q2 already. We are pretty confident and, with having this consolidation project under our belt, now is really the time to optimize and ramp up productivity and efficiency and output. We feel pretty good where we are right now. There was nothing else, and there is nothing else in the cards.

**Jeff Hammond:** Okay. Then just one last question, Tricia. Can you just give us the new depreciation number for the year versus what it was before?

**Tricia Fulton:** Yeah, depreciation for the year is now \$18 million to \$20 million.

**Jeff Hammond:** Okay. Thanks.

**Tricia:** You're welcome, Jeff.

**Operator:** The next question is from Nathan Jones from Stifel. Please go ahead.

**Nathan Jones:** Good morning, everyone. I'll start on a bit more positive note, and say congratulations on having to pay out that full earn-out on Enovation Controls. It's always a good thing to have to pay that money out. A quick follow-up on this shift in strategy in the Electronics business. Can you give us an estimate of what the revenue is that you're walking away from? And do you have direct thoughts on the kinds of things that you're planning to book in 2021? Have you had these conversations with customers? Are they showing interest in these kinds of products now that they're available? Just any color you can give us on the magnitude of what you're getting out of in 2019 and what you can see to in 2020?

**Wolfgang Dangel:** Let me start with the second question first, Nathan. By releasing these contractual obligations, we are positioning us for a number of concrete development opportunities. I mentioned during my remarks already that there are specific SOPs lined up for 2020 and 2021. The answer to your second question is yes, we have concrete RFQs and projects on the table that will materialize in SOPs in 2020 and 2021. For the first question, now you have to understand this only impacts a certain range of products with existing customers. We still continue doing business with those customers. So the ramp down also depends on how these customers develop with regard to the purchases of the other products and services where we work very closely and collaborate very closely with them. I wouldn't want to quantify and throw out the numbers here because it depends on resolving the long-term contractual volume, but on the other hand, we continue to do business with these customers in other areas of our product portfolio.



**Nathan Jones:** Okay. I have a couple of questions on some of the cost savings here. You guys talked about being able to generate an additional 15% capacity out of the CVT consolidation. Can you talk about the cost reductions you're expecting to generate out of that, where you are in that process and how we should expect those to ramp up? And then any color you can give us on the cost savings on the shift to Faster manufacturing into Italy?

**Wolfgang Dangel:** Maybe we start with the second question again first. Basically parts supply out of Italy will translate into roughly a 15% cost reduction. That's pretty much what the analysis shows and we feel pretty comfortable and confident that we will reach or exceed that goal. To the first part of the question, this is all a result of reaching the end point of the site consolidation which I think puts us in an excellent position to drive efficiencies. As Tricia pointed out during her remarks, that puts us in a position of seeing gradual margin improvement over the balance of the year. Overall, I would like to look beyond only the legacy Hydraulics business, overall as you know very well Nathan, we are targeting roughly getting back to round about a 40% gross margin level across all the different businesses. The CVT legacy business, after the site consolidation, will contribute to that for the remaining three quarters this year. I think once we have reached that level by the end of this year or beginning of next year, it will be relatively difficult to further improve margin, but it would bring us back to really superior gross margin levels by the end of this year.

**Nathan Jones:** That's helpful. I've one last question around the tariffs. I think when tariffs were implemented last year, you guys had some supply chain disruptions, particularly around electronic components, things like ceramic capacitors, or something that you had availability issues with last year. Do you feel like you have supplies sorted out so that any disruption that might be caused by these increasing tariffs, or tariffs on new sets of products, or anything like that could disrupt the availability of components that you need rather than just increase the cost?

**Wolfgang Dangel:** First of all, you're exactly right. We had those types of challenges about 12 to 15 months ago, those challenges have been resolved in the middle of last year through long-term agreements with those key suppliers for those specific electronic components. As far as the tariffs are concerned, because, we are not sourcing everything, or all these components out of China to begin with, we are not overly concerned that that would impact the Electronics business and the gross margin level of the Electronics business at this stage.

**Tricia Fulton:** We have already resourced, some of those are secondary sources, after that issue, so I agree with Wolfgang that it should not be an issue.

**Nathan Jones:** Great.

**Wolfgang Dangel:** There have been dual sourcing activities in place, also deviating from only China sourcing.

**Nathan Jones:** Great. Thanks for taking my questions.

**Wolfgang Dangel:** Sure, Nathan.

**Operator:** [Operator Instructions] We have a question from Brian Lau, Sidoti. Please go ahead, sir.

**Joe Mondillo:** Good morning, everybody. I'm on for Joe Mondillo this morning. Just to touch on the depreciation again, what prompted the adjustment from what you reported in Q4?

**Tricia Fulton:** Yeah, we made some changes to the assumptions in the 2019 depreciation model that was originally built back in the beginning of the year. We had to revise the forecast for some inconsistencies in the inputs from the acquired businesses, specifically around the purchase price adjustment assumptions that they had made in that model.

**Joe Mondillo:** Okay. Thanks for that. Then, around Faster and its exposure to Ag in Europe, in general how did that business perform in the first quarter? And how do you see that trending throughout the year?

**Wolfgang Dangel:** I think overall, Brian, we are really happy with the post-merger integration of Faster, and we just had the first anniversary last month. As you know, about 60% of the business is to the Ag market, and about 20% or 25% has exposure to the construction machinery equipment market. The Ag market has been challenged. Luckily, Faster has a big footprint across all the major sectors within the Ag market. And they are pretty globally positioned, so we can dampen rather well the downturn of the Ag market which is softening. We are pleased with the performance and with what we're seeing there. Even more importantly than just looking at the current performance and very encouraging for us is, is all the new product development that is going on. A lot of new projects are in the pipeline with existing and new customers around the world, so we are pretty pleased where we are today as far as the performance of Faster is concerned. Nevertheless, having said that, we would like to see a little bit more exposure to industrial markets and there, we have efforts in place that the legacy business of Helios, namely Sun Hydraulics will pull Faster more into the channel and provide more access to the classical industrial end markets. I think, if we can accomplish that over the next couple of years, we are very well positioned for the future.

**Joe Mondillo:** That's helpful. Thanks for that. The last one for me on the fourth quarter call you stated you were hoping to reduce inventory levels, any update on that?

**Tricia Fulton:** We're still working pretty actively with the businesses to bring down the inventory. Overall, I don't think we made significant progress on that in Q1, but it's a slow process to work through all of that and understand where we have excess inventory. Certainly in the CVT business with the continuing demand that we're seeing there, we want to make sure that we have the product in place to be able to ship as much as possible, including our backlog items.

**Wolfgang Dangel:** I would like to add here, I think at this stage of the cycle and in times where we have been seeing orders outpacing shipments for a very long period of time, the optimization of working capital is important but it's secondary. Our prime focus is on operating margins and the generation of free cash flow. But nevertheless, as Tricia said, there is room for opportunity. We started an extraordinary project giving very specific and tougher targets to the individual business in order to bring the working capital further down. But as I say, it is secondary to operating margin and the generation of free cash flow, which is in the forefront of the thinking and acting right now.

**Joe Mondillo:** All right. I appreciate that. Thanks for taking my questions.

**Operator:** 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 for your interest in Helios Technologies and for your participation this morning. I also want to take this opportunity and thank all of the hardworking Helios employees who are driving these results. May I draw your attention to our online annual report which is available on our website. The proxy is also available for our annual shareholders meeting to be held in New York City on Thursday, June 13, 2019. Additionally, we look forward to updating all of you on our second quarter 2019 results in August. Thank you very much and have a great day.

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