

ATS Automation Tooling Systems Inc.

First Quarter FY 2022 Conference Call and Webcast

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the ATS Automation First Quarter Conference Call and Webcast.

This call is being recorded on August 11, 2021, at 8:30 AM Eastern Time.

I'll now turn the conference over to Shereen Zahawi, Director of Investor Relations at ATS. Please go ahead.

Shereen Zahawi — Director, Investor Relations, ATS Automation Tooling Systems Inc.

Thank you, and good morning, everyone. Your main hosts today are Andrew Hider, Chief Executive Officer of ATS, and Ryan McLeod, Chief Financial Officer.

For those who have joined us by phone, our remarks are accompanied by a slide deck which is available at atsautomation.com.

Before we begin, I am required to provide the following statement respecting forward-looking information, which is made on behalf of ATS and all its representatives on this call. You are cautioned that the oral statements made on this call will contain forward-looking information that involves risks and uncertainties, including those introduced by the COVID-19 pandemic. The actual results could differ materially from a conclusion, forecast, or projection in the forward-looking information. Certain material

factors or assumptions were applied in drawing a conclusion or making a forecast or projection, as reflected in the forward-looking information. Additional information about the material factors that could cause actual results to differ materially from the conclusion, forecast, or projection in the forward-looking information and the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection, as reflected in the forward-looking information, are contained in ATS' filings with the Canadian provincial securities regulators.

Now it's my pleasure to turn the call over to Andrew.

Andrew Hider — Chief Executive Officer, ATS Automation Tooling Systems Inc.

Thank you, Shereen.

Good morning, ladies and gentlemen, and thank you for joining us.

We're pleased to report a strong quarter for ATS, including record order bookings and backlog. With robust organic revenue and good progress on margin expansion, we're building on recent momentum. We continue to execute our M&A agenda and closed two acquisitions in the quarter, BioDot and CIM. BioDot is now part of our life sciences group and will expand our capabilities and our offering for this important end market. CIM joins our process automation solutions business and helps expand our customer and geographic reach. We are excited to welcome both businesses to the ATS family. Additionally, CFT, which we acquired late in the fourth quarter, is performing in line with our expectations, and the integration is progressing well.

Today I will update you on business conditions and then Ryan will provide his report.

Starting with our financial value drivers, Q1 revenues were \$510 million, up 57 percent from Q1 last year and up 28 percent sequentially, driven by the addition of CFT, which closed in late March 2021, as well as broad-based business strength. Organically revenues grew 28 percent year-over-year, an improvement that was augmented by the impact COVID-19 had on Q1 revenues last year.

Q1 order bookings were \$637 million, almost double last year's level and up 38 percent sequentially. CFT and BioDot contributed approximately a third of order bookings growth versus Q1 last year and we saw strong bookings across most markets, with large customer awards in life sciences and transportation.

Our Adjusted EBIT margin for the quarter was 12.8 percent, representing over 360 basis points of margin expansion versus Q1 of last year and over 40 basis points of expansion sequentially.

Moving to our outlook, our backlog grew to \$1.2 billion at the end of Q1, providing us with good revenue visibility and a solid business foundation for Fiscal 2022. As vaccine rollouts picked up pace in a number of our global markets, we're seeing improvement in customer site access and reduced travel restrictions compared to the same period last year. While the situation remains fluid, I'm proud of how our people adapted and our ability to find creative ways to serve our customers.

By market, we saw positive conditions in life sciences, with strength in key sectors of medical devices, pharma and radiopharma. We continue to win mandates related to COVID-19 as we help our customers in the fight against the pandemic. This work represented around 10 percent of our life sciences bookings and 6 percent of our total bookings in Q1. We are also seeing more traditional non-COVID related opportunities in the funnel as customer revive pre-pandemic investment priorities. Life

sciences represented 64 percent of our bookings this quarter, and we expect it to remain a key market for ATS.

In EV, we are seeing robust activity levels from both traditional OEMs and newcomers looking to expand their electrical offerings. We continue to be selective in the opportunities we pursue and won a number of mandates, including a large award in the quarter. Our long track record and proven expertise in battery assembly and test make us a trusted partner as our customers navigate the complexities of evolving battery technologies.

We saw strength in food and beverage, and with the addition of CFT, we're now separately reporting activity in this market. In other areas of consumer, we saw good activity in warehouse automation, while cosmetics still hasn't recovered yet to pre-pandemic levels. In energy, we continue to execute and see opportunities in nuclear for both refurbishment and decommissioning in Canada and globally.

On after sales services, order bookings remain healthy and revenues were up double digits versus Q1 last year and in line with our expectations. We continue to utilize our regional service networks and digital tools to facilitate access to customer sites as we navigate pandemic travel restrictions in some geographies. We see opportunities to expand the aftermarket services footprint to support additional areas of our business and create a better customer experience.

To summarize our outlook, this was another quarter of strong order bookings that has led to record order backlog. Our funnel remains healthy and we are seeing a pick-up in customer activity. The

pandemic environment continues to introduce some timing and approval uncertainty when it comes to our customers' buying decisions; however, we're encouraged by recent customer demand signals.

Moving to the ABM, our continuous improvement playbook, this was another busy quarter for our teams with multiple virtual kaizens and problem solving workshops held across the Company, with a focus on both operational and commercial improvement. A few ABM highlights, we held 15 kaizens and problem solving workshops across various ATF divisions. These events drove improvements in multiple areas including bookings, sales and operations. One division in our life sciences group used the kaizen to eliminate approximately 600 hours it spends annually on non-value added time by improving work flow and shop floor layout. At CFT, we held a workshop aimed at improving the on-time delivery of spare parts. By implementing a daily visual management system, we expect on-time delivery to improve to 90 percent or better in the next three months from approximately 80 percent today. Our industrial automation team hosted another joint customer event in Q1 focused on simplifying the process for handling change orders and significantly shortening the length of the process. This is the second collaboration with customers and another positive outcome.

We also launched our second global virtual ABM boot camp on the back of a similar event in Q4 that received positive company-wide feedback. The camp runs over a six-week period and combines self-paced learning and real-time discussions with ABM leaders. This modified virtual format enables us to continue scaling our training and demonstrates how businesses across ATS are using the ABM to deliver tangible results.

On M&A, acquisitions continue to be an important complement to ATS' organic growth. The integration of the CFT acquisition which closed late in the fourth quarter is progressing well with performance tracking to plan. As you know, CFT scaled up our food and beverage exposure and complements our other food business, MARCO. During this first quarter, we acquired two businesses, BioDot and CIM. BioDot expands our life sciences capabilities in low volume dispensing and enhances our position in the point-of-care and lab automation end markets. CIM, a system integrator with a focus on industrial automation, adds to our capabilities and expands our customer base and reach in the pharma market. CIM now operates as part of our process automation solutions business.

We will continue to cultivate and evaluate acquisition opportunities consistent with our proven strategy. Of course, timing of acquisitions will be variable and our approach to deploying our balance sheet will be disciplined and strategic.

In summary, first quarter results present another proof point of the strength and resiliency of our business. Going forward, our priorities remain unchanged: ensuring the health and safety of our employees, serving our customers well, and creating value for our shareholders. Our strong backlog provides good revenue visibility while our healthy balance sheet enables us to pursue our M&A playbook when strategic targets arise.

Now I will turn the call over to Ryan.

Ryan, over to you.

Ryan McLeod — Chief Financial Officer, ATS Automation Tooling Systems Inc.

Thank you, Andrew, and good morning ladies and gentlemen.

This morning, I will provide an overview of our Q1 operating results that featured growth in revenues and operating margins and record order bookings and backlog. I will then provide colour on our balance sheet.

I'll start with operating results, and as an opening comment, we are pleased with the pace of year-over-year in growth. In part, this reflected both the impact of the pandemic on results on Q1 last year and the contribution of acquisitions. That said, our global operations have continued to execute well using our ABM playbook, with strong performance delivered as a result of our ongoing focus on growth and margin improvement.

Bookings were \$637 million, up 96 percent over Q1 last year when activity levels were depressed by the onset of the pandemic. Organic growth in bookings was 74 percent, partially offset by an 8 percent headwind from foreign exchange translation. Organic growth primarily reflected new orders in life sciences, headlined by a \$120 million order booking from a global medical device company for a fully automated manufacturing solution that we announced in early June. Acquisitions contributed 30 percent, with the majority of the incremental order bookings coming in food and beverage due to the addition of CFT.

Compared to Q4, order bookings were up 38 percent sequentially, reflecting increased orders in food and beverage due to CFT and continued strength in life sciences. On a trailing 12-month basis, our book to bill ratio was 1.2 : 1, positioning us well for this fiscal year.

Moving to revenues. Q1 revenues grew 57 percent compared to the prior year. Organic revenue growth was 28 percent due to higher order backlog entering the year as well as year-over-year growth in services and after sales parts revenues, while foreign exchange was a 6 percent headwind compared to Q1 last year. Acquired companies added 35 percent to our growth. Revenues from acquired companies, primarily CFT and BioDot, were ahead of plan due to the timing of project activities. CFT typically experiences some seasonality in its business, with higher revenues in Q1 and Q2 of ATS' fiscal year due to targeted equipment deliveries ahead of the harvest season of some of the key end markets. BioDot continued to experience favourable tailwinds due to COVID-related activity. Sequentially, our revenues increased 28 percent from Q4, primarily reflecting CFT and BioDot.

Our record Q1 ending backlog of \$1.25 billion was 37 percent higher than last year's \$909 million. Organic growth in backlog was 24 percent due to higher order bookings through the year partially offset by foreign exchange translation, with the balance of the increase related to backlog acquired with CFT and BioDot. Life sciences represented 59 percent of our period end order backlog with food and beverage representing 11 percent, up from one percent a year ago. Looking forward, our revenue conversion for Q2 is estimated to be in the higher end of the 35 to 40 percent range of backlog.

While we are pleased with the strength and resiliency of our business, COVID will continue to influence the timing of customer orders and service revenue in the near term.

Moving to margins, Q1 gross margin was 28.2 percent, up over 380 basis points from last year. Higher gross margin reflected improvements made in the cost structure of our core business through our reorganization, improved program execution, increased service revenues, and other continuous improvement efforts. As expected, these improvements were partially offset by acquired businesses, which operated with lower gross margin. We also had lower recoveries under the Canadian Emergency Wage Subsidy program compared to the prior year.

Our teams have done an excellent job adapting to the current environment. Globally, ATS operations continue to effectively address the challenges of operating with a significant portion of our workforce at home, the presence of extra health and safety measures in our facilities, similar protocols at customer locations, and travel restrictions.

Moving to SG&A, expenses were \$26.7 million higher than Q1 last year. This year's costs included \$11.3 million of acquisition-related amortization and \$2.1 million of M&A transaction costs. Excluding comparable items in both periods, Q1's SG&A was \$69.8 million, \$21.9 million higher than last year, reflecting incremental SG&A costs from acquired companies, primarily CFT for the full quarter and BioDot for one month.

First quarter stock compensation expense was \$8.7 million compared to \$1.6 million last year.

Q1 adjusted earnings from operations were \$65.4 million or 12.8 percent compared to \$29.7 million or 9.1 percent last year. The increase in margin reflected efficiency gains made in our cost structure, improved program execution, and higher after sales service revenues compared to a year ago. Excluding acquisitions, our core business operated at a 14.1 percent adjusted earnings from operations

margin. Operating margins from our acquired businesses were 8.2 percent. As a reminder, CFT operated at a low single-digit EBIT margin prior to acquisition. We expect to realize cost and revenue synergies over the next three years that will add earnings of approximately €14 million, consistent with our previously announced integration plan. After operating the business for a full quarter, we are confident that we can unlock value in our stated time frame.

With respect to BioDot, as I noted, part of the business is benefiting from COVID-related activity. As these COVID tailwinds reduce over time, improvements to BioDot's business will be pursued through cost and revenue synergies we have identified and targeted growth in its high margin consumables and aftermarket service business. Although we're in the early stages, integration activities are progressing well.

Moving to the balance sheet, in Q1 we generated cash from operations of \$48.4 million compared to cash generation of \$47 million last year as higher income was partially offset by an increase in working capital investment. Our non-cash working capital as a percentage of revenue is very low at 5.4 percent in Q1, down from 6 percent in Q4 and well within our target of maintaining working capital as a percentage of revenues below 15 percent. While we're pleased with this result, we do expect our non-cash working capital investments to increase during Fiscal '22.

We invested \$14.3 million in CAPEX and intangible assets in Q1 compared to \$5.7 million last year, prior investments primarily related to the expansion and improvement of certain manufacturing facilities and investments in IT. As a reminder, our CAPEX budget for Fiscal '22 is \$50 million to \$60

million, an increase over last year, reflecting our plans to add capacity to support growth and continue to invest in innovation.

We ended the quarter with good liquidity consisting of cash of \$216 million and availability on our credit facility of approximately \$664 million. From a leverage standpoint, our June net debt to Adjusted EBITDA ratio was 1.7 : 1. We have further room to deploy capital to pursue our strategies within our normal course target leverage range of up to 2 to 2.5 times.

In summary, Q1 was a strong start to the year, including adjusted EPS of \$0.48, up 182 percent over a pandemic-impacted quarter last year. The investments and improvements made in our business are driving growth, resiliency, and margin expansion. Our teams executed efficiently to meet customer needs while maintaining a safe working environment. Through our M&A activities, we've created a broader platform in food and beverage by adding CFT as a complement to MARCO, while the additions of BioDot and CIM provide us with new capabilities in life sciences. Going forward, we have record order backlog, a strong balance sheet, and available liquidity that combine to provide ATS with a solid foundation to pursue our growth strategies.

Now we will open the call to questions from our analysts.

Operator, could you please provide instructions? Thank you.

Q & A

Operator

Thank you.

Your first question comes from Mark Neville from Scotiabank. Mark, please go ahead.

Mark Neville — Analyst, Scotiabank

Hi, good morning, guys, great results. **Maybe to start with, I just want to understand the margin. I guess apples to apples, it looks like EBIT margin is up roughly 170 basis points sequentially. I appreciate some of the things you mentioned, but just maybe try to help us understand what drove the quarter-over-quarter performance and maybe try to piece it apart, if you could.**

Ryan McLeod —

Yes, hi Mark, good morning. So, you're asking for a comparison to Q4, is that correct?

Mark Neville — Analyst, Scotiabank

Yes, I think you're 14.1 this quarter ex-acquisitions. Last quarter, you were 12.4.

Ryan McLeod —

Right, okay, so our core business, yes, got it.

Mark Neville — Analyst, Scotiabank

Yes.

Ryan McLeod -

I mean, we're seeing a couple of items. First, we're realizing benefits from our improved cost structure, so we undertook restructuring activity last year, and we're seeing the payback on that. We've also continued to have really good program execution in our core business and we've had good progress on our other margin expansion initiatives. As I think about it, it's all normal course, good execution in the business.

Mark Neville — Analyst, Scotiabank

Great, sounds good. Maybe just a question—it doesn't feel like there's any impact, but maybe Andrew, I'm just curious as we're hearing all these—every manufacturing company we cover talking about inflationary pressures, supply chain issues. I'm just curious if you're actually seeing an impact. It doesn't seem like it, but I'm curious if there's any impact.

Andrew Hider —

Yes, hi, good morning Mark. Look, the short answer is we really haven't seen anything material to date, but at this stage, our supply chain teams are remaining and they're focused on being vigilant on this aspect; and a couple of comments to wrap that summary. Where we are seeing an impact is when we've seen, call it, shorter lead time products or quick turn products, call it a day or several days. Those have moved out to three to four weeks and, at times, longer, and so the shorter turn items have created a bit more of a challenge. Now fortunately, we've been able to have workarounds where we know the lead times and we can work to mitigate those areas that we've seen an impact on.

Additionally, when you think about the inflationary areas, and we're not immune to those areas, we also have a very strong playbook in those areas of our business to go after where we want to keep driving our supply chain and a longer-term strategy in place around where we're going to continue to move our supply chain. Where we've seen pressure and where we've seen, call it, this area arise, we've been able to be proactive and mitigate or even continue our trajectory in our margin expansion.

Overall, I'd say the team has just done a terrific job and we're really pleased with the progress. That said, it is something we've been very, very focused on and very vigilant around to ensure that we continue to mitigate impact across ATS.

Mark Neville — Analyst, Scotiabank

Great, thanks a lot. I've got a bunch of other questions, but I'll jump back in queue. Thanks.

Operator

Your next question comes from Cherilyn Radbourne from TD Securities. Please go ahead.

Cherilyn Radbourne — Analyst, TD Securities

Thanks very much, and good morning. Andrew, I think the supply chain disruption resulting from COVID has been really unprecedented in terms of the duration and severity, so first question is could we get a bit of an update on your customer interactions and just what they're thinking in terms of re-shoring and other adjustments to their supply chain?

Andrew Hider —

Sure. Good morning, Cherilyn.

I am going to piece this one apart a little bit, and I'm going to talk about, first and foremost, the order process. We haven't seen customers pulling in or pushing out based on this, and a natural area you would go to is automotive, and that would be a natural consideration. In our automotive, our focus has been on the EV and battery pack and tests and module part of the process, which is core to that shift, so we haven't seen an impact here from a push-out or pull-in. It's been aligned with customers' long-term plans for their capital spending and capital deployment.

If you step back then and look at the on-shoring—you know, we call it on-shoring supply chain de-risking. We don't separate those two, we kind of bucket-ize them both. When I've talked to customers, and as you're well aware, I talk to customers on a frequent basis, I would say roughly 50 percent are talking to this, and about 25 percent have placed orders with our business. Additionally, when you look at some of the awards we've gotten, while they might not be aligned to this (phon), they will be wrapped around expansion of capacity, and so if you look at that \$120 million order that we won on the medical device business in Q1, which was a big win, big order for us, and certainly has been an area that we've been aligned with this customer for some time, their focus was around being able to build out their capacity to meet demand, and they saw demand increase from this environment, this situation and they aligned to say, our strategic direction is we need to build that capacity, that demand out, so we have seen some shift there.

I would say, is it directly in line with on-shoring? No, it's more aligned with their strategic plan around building out capacity and capabilities, and automation is a natural consideration for those

expansions, so overall we do think this is an area that's going to continue to support automation. We view it as an area that certainly it's going to be a key focus for us, but we haven't seen, call it, an increase in demand as of yet.

Cherilyn Radbourne — Analyst, TD Securities

Okay. My second question is probably more for Ryan. The year-over-year increase in parts sales is pretty massive. Just wondering if you can speak to how much of that was organic versus acquired and qualitatively give some colour on what that means from a mix perspective.

Ryan McLeod —

Yes, good morning, Cherilyn. Part of that certainly was due to acquisitions. The majority was due to acquisitions, so CFT has a large parts business. There was year-over-year organic growth in the core business as well.

Cherilyn Radbourne — Analyst, TD Securities

And just directionally, is that positive from a mix perspective?

Ryan McLeod —

In terms of margin, are you asking?

Cherilyn Radbourne — Analyst, TD Securities

Yes.

Ryan McLeod —

Yes, so generally speaking, yes. Generally speaking, yes.

Cherilyn Radbourne — Analyst, TD Securities

That's my two. Thank you.

Andrew Hider —

Thank you, Cherilyn.

Operator

Your next question comes from Justin Keywood from Stifel GMP. Justin, please go ahead.

Justin Keywood — Analyst, Stifel

Good morning. Thanks for taking my call. Nice to see the results. For the CFT acquisition, there's implied good organic growth in the quarter, and setting up pretty well as far as the outlook for the vertical. I'm just wondering if you can provide some context on what's the demand drivers for the food and beverage space and if the inflationary backdrop is impacting any of the demand.

Andrew Hider —

Yes, good morning, Justin.

We have seen nice progress here. I'll just start with it's still early with CFT as part of our journey, and as I highlighted in my opening remarks, we're pleased with the playbook that we've launched for the integration, the engagement from the team, so as I step back and look at this business, we did four kaizen events through the quarter, and it just highlights the drive for this organization to really, call it continue to improve and focus on their markets. We've also seen a nice, call it, balance around potential and the strong customer engagement from CFT.

Really the area I would just highlight is, we identified some synergies early in the process, and while it's early and I state that directly, we've only had them for several months of our business, we have already started quoting the CFT robotics in some of our life sciences business, and so pleased with the technology and pleased with the progress, and certainly with the synergy aspect we're seeing some real strong potential to really align around what we signed up for on delivering the results.

Ryan, is there anything you would add to that?

Ryan McLeod —

Yes, so Justin, just a couple items. As I talked about in my remarks, there is some seasonality to CFT's business, and so when I look at their margin performance this quarter, they are a little bit ahead of—they're executing well, and some of that is related to some of the cost-out, so some of the cost synergies we identified, and some of that is higher volumes, and part of that is related to seasonality.

Justin Keyword — Analyst, Stifel

Okay, thank you for that context. Then for acquisitions, is the pipeline still active, or is the focus on integrating the recent acquisitions that were just completed? And if you can just provide us an update on the targeted verticals that you could possibly enter, if it's new or existing, and also what you see as the capacity for additional M&A.

Andrew Hider —

Sure, headline here, Justin, it is and remains active. The funnel is healthy, and it's focused both on platforms as well as tuck-ins. For instance, in the quarter, we announced CIM and BioDot, both very attractive additions to ATS, and we view we can help those businesses achieve full potential, and so the funnel remains healthy, no surprises (phon) in the markets that we've been targeting, and we view that our ability to cultivate is on the increase. Case in point, after we acquired CFT, one of the benefits we had was certain customers or certain, call it, competitors, or in the same area of processing, reached out and really aligned around whether it's a potential discussion on cultivation, or around a potential partnership, and it's just an area that we certainly have continued to drive, and as I will always state, we are disciplined and when we identify the right targets, we can move at a very fast pace.

Ryan McLeod —

Just to answer your question on capacity, from just purely balance sheet, we still have ample capacity in the \$500 million, \$600 million range. It really depends on price and financial profile of the asset, but that's the general range that we would have available today.

Justin Keyword — Analyst, Stifel

That's helpful, and thank you for taking my questions.

Operator

Okay, Mr. Hider, there are no further questions at this time.

Andrew Hider —

Thanks, Operator.

Before we let you go, a reminder that we will host our Virtual Annual Meeting tomorrow beginning at 10:00 AM. Details are available in the Management Information Circular and on our website.

This was another strong quarter for the Company and a great way to start our Fiscal 2022. I'd like to recognize the hard work and dedication of our teams across ATS that made this possible.

Thank you for joining us today. I look forward to speaking to you on our Q2 call in November. Stay safe and goodbye for now.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating.