ATS Automation Tooling Systems Inc.

Second Quarter Fiscal 2022 Earnings

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the ATS Automation Second Quarter Conference Call and Webcast. This call is being recorded on November 3, 2021 at 8:30 a.m. Eastern Time. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at the time for you to queue up for questions. If anyone has any difficulties hearing the conference, please press star followed by the zero for operator assistance at any time.

I'd now like to turn the call 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, operator, 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 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's filings with the Canadian 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 solid order bookings and record order backlog. We saw robust organic revenue growth and continued to drive margin expansion across businesses in line with our plan.

On the M&A front, we announced three acquisitions that in turn strengthen ATS's consulting capabilities and processes engineering and serve to enhance our digital offerings, expand our precision conveyor technologies for regulated markets, and bolster our portfolio of pharmaceutical processing and packaging solutions.

Reflecting our ongoing focus on improving our ESG efforts, the third quarter also saw the release of our Fiscal 2021 Sustainability Report. It highlights recent accomplishments in the key priority areas of ethics and integrity, people, social responsibility, and responsible manufacturing and service, and

introduces five sustainability goals, including our ambition of becoming carbon neutral by 2030. These targets compel us to act with the discipline and accountability that are vital to achieving a successful sustainability journey, which we believe has positive implications for all customers, shareholders, and employees.

This morning I will update you on business conditions and then Ryan will provide his report. Starting with our financial value drivers, Q2 revenues were $522 million, up 56% from Q2 last year, driven by the addition of CFT, which closed in late March 2021, and strength across our businesses. Organically, revenues grew 24% year over year, a good result that was augmented by the pandemic impact on Q2 revenues last year. Q2 order bookings were $510 million, representing a 27% increase year over year. We saw robust booking activity across most markets, with strength in transportation, food and beverage, and energy. Our adjusted EBIT margin for the quarter was 13.5%, representing over 150 basis points of margin expansion versus Q2 of last year.

Moving to our outlook, we ended the quarter with over $1.3 billion in backlog and a solid business foundation that also provides us with good revenue visibility for the balance of 2022. With the pandemic situation improving in some geographies, we're seeing a better operating environment with greater access to customer sites and reduced travel restrictions compared to last year. That said, we continue to work with our customers and employees to manage the pandemic-related logistical challenges that persist.

By market, conditions remain positive in life sciences with good activity levels in medical devices, pharma, and radiopharma. Most of the funnel today is comprised of traditional, non-COVID-related opportunities as customers revive pre-pandemic investment priorities. Life sciences represented

approximately 50% of our bookings this quarter and we expect it to remain a key market for ATS going forward.

In EV, auto manufacturers are stepping up their investments to expand their electrical offerings with robust activity levels from both newcomers and traditional OEMs. We won a number of mandates in the quarter, including a large award from a repeat customer and new work in Europe. Our long track record and proven expertise in battery assembly and test make us a trusted partner in the space, particularly as evolving battery technologies introduce new complexities for our customers.

In food and beverage, we're seeing opportunities in food and an improved funnel in beverage.

In consumer, we saw good activity in warehouse automation while the cosmetics funnel is showing some improvement but still hasn't recovered to pre-pandemic levels.

In energy, we won a nuclear refurbishment award based on a highly-innovative automation solution and see opportunities in nuclear decommissioning in North America and globally.

In after-sales services, revenues exhibited solid growth versus Q2 last year, driven by retrofit projects, spare parts, and digital services. We continue to utilize and expand our services network to support additional areas of our business. We're making good progress on the deployment of our digital service platform and increased customer adoption. To create an even better customer experience, we see opportunities to expand our aftermarket services footprint.

To summarize our outlook, order backlog is strong and our funnel is robust. Overall demand signals are healthy and we are keeping a close eye on developments within our supply chain, where the situation

remains dynamic, to ensure we're taking the proper mitigating actions. We're still seeing some timing and approval uncertainty related to the pandemic environment when it comes to our customers' buying decisions; however, we're encouraged by recent pick up in customer activity levels.

Moving to the ABM, our continuous improvement playbook, this was another busy quarter with a focus on improving our value drivers, both from an operational and commercial perspective. We held over 25 kaizen and problem solving events across various ATS divisions. These events targeted improvements in multiple areas, including bookings, sales, profitability, delivery, and quality.

Our ATS life science business held a joint kaizen event with a customer. By working together, we were able to identify actions to achieve lead time and cost reductions. This is the third ATS collaboration with a customer and a great way to strengthen our relationship.

One division within our CFT business held a kaizen event with a focus on reducing lead times. The division is projected to improve lead times from greater than 120 days currently to under 90 days by reducing the time needed to locate parts, creating and monitoring standard times for assembly, and improving the kickoff and parts ordering process. Lower lead times will improve competitiveness and support quicker revenue conversion.

Also at CFT, in the aftermarket services group we held a kaizen event and implemented a daily visual management system for spare parts that proactively identifies and resolves material issues. In the first two months of implementation, on-time delivery improved from 70% to greater than 85% today with a path towards 90%.

We also launched our third global virtual ABM boot camp on the back of a similar event in Q1. 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.

Moving to M&A, consistent with our strategy, acquisitions continue to be an important complement to ATS's organic growth. Let me start with the integration of CFT. Over the last six months we have made good progress on rolling out the ATS business model and firming up synergy opportunities in our supply chain and cost structure. We're also exploring cross-selling opportunities between CFT and ATS in a number of areas, including conveyance products and services. BioDot's integration is on plan and we are pleased with its early progress since acquisition in June.

During the second quarter we announced three acquisitions. BLSG is a consulting company specializing in process engineering. Now serving as part of the ATS process automation solutions group, it expands our ability to holistically serve customers from problem identification to solution implementation and enhances our overall value proposition, particularly in the area of digital offerings.

NCC provides turnkey automation solutions in high precision pallet handling and sanitary conveyance products. It expands our portfolio of precision conveyor technologies through the addition of products adjacent to SuperTrak and serves as an important pillar of our automation product strategy while strengthening our position in the food and beverage end market.

DF is a specialized manufacturer of pharmaceutical processing and packaging equipment and systems. Upon closing of the acquisition, expected in calendar Q4, DF will join our Comecer business to provide a complementary portfolio of products and expand our offerings in the aseptic fill finish market.

We welcome all three businesses to the ATS family.

With a strong balance sheet, we will continue to cultivate and evaluate acquisition opportunities consistent with our proven strategy. Timing of acquisitions will be variable and our approach to deploying our balance sheet will be disciplined and strategic.

In summary, we're pleased with our results this quarter and view them as further proof of the strength and evolution of our portfolio. Our focus on ensuring the safety and engagement of our employees, serving our customers well, and creating value for our shareholders is unchanged. Our objective is to build a great ATS business and our people are making good progress every day towards achieving our collective goal.

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 review our Q2 operating results and feature growth in revenues and operating margins, both year over year and sequentially, as well as continued strong order bookings and backlog. I will then provide colour on our balance sheet.

Starting with our operating results, bookings were $510 million, up 27% compared to Q2 last year. Organic growth in bookings was 5%, partially offset by a 3% headwind from foreign exchange translation. Organic growth came primarily from the transportation and energy markets as a result of new and follow-on work in EV and nuclear. Acquisitions contributed 25% growth in order bookings with the majority coming in food and beverage markets due to the addition of CFT. Compared to Q1, bookings were down $127 million as Q1 benefitted from a $120 million life sciences order. On a trailing 12 month basis our book-to-bill ratio was 1.13 to 1, positioning us well for continued organic growth.

Moving to revenues, Q2 revenues grew 56% over last year. Organic revenue growth was 24% due to higher order backlog entering the quarter as well as year-over-year growth in service and parts revenues as travel restrictions and limitations on access to customer facilities eased compared to Q2 last year. Foreign exchange was a 4% headwind compared to Q2 last year and acquired companies added 36% to revenue growth, primarily CFT and BioDot. Due to seasonality and as expected, CFT revenues declined in the second quarter following a strong Q1. CFT's Q2 equipment revenues are typically lower during the harvest season in some key end markets and are also impacted by summer vacation periods in Europe. Our Q2 ending backlog of $1.3 billion was 35% higher than last year. Of note, 60% of our period end order backlog is for life science applications. Looking forward, our revenue conversion for Q3 is estimated to be in the 35% to 40% range of backlog.

Moving to margins, Q2 gross margin was 29.2%, up over 200 basis points from last year. Higher gross margin reflected efficiency gains realized in the cost structure of our core business through previous reorganizations, strong project execution, increased service revenues, and other continuous improvement efforts through the deployment of our ABM. Disruptions in supply chain, which have led to increased lead

times and in some cases cost increases in our supply base, have not had a material impact on our profitability to date. This is a dynamic area that we are watching closely. Our teams are focused on daily visual management and have implemented countermeasures such as advancing order timing and securing alternative sources of supply to mitigate inflationary pressures and lengthening lead times.

Moving to SG&A, expenses were $28.1 million higher than Q2 last year. This year's costs included $13.2 million of acquisition-related amortization and $2.1 million of M&A transaction costs. Excluding comparable items in both periods, Q2's SG&A was $71.5 million, $21.4 million higher than last year, reflecting incremental SG&A costs from acquired companies, primarily CFT and BioDot. Second quarter stock compensation expense was $10.5 million, up from $1 million last year.

Q2 adjusted earnings from operations were $70.7 million or 13.5% compared to $40.1 million or 12% last year. The increase in margin reflected efficiency gains made in our cost structure, improved program execution, and increased after-sales service revenues compared to a year ago. Excluding acquisitions, our core business operated at a 14.4% adjusted earnings from operations margin, up 240 basis points over Q2 last year. Operating margins from our acquired businesses were 10.7%.

Q2 adjusted EPS was $0.53 per share compared to $0.26 per share in the corresponding period a year ago. The increase is primarily attributable to the growth in revenues and improved operating margins along with lower interest costs.

On our most recent acquisitions, and as a reminder, CFT is operated at a low single digit EBIT margin. Actions to improve the cost structure of the business and drive savings through supply chain synergies are underway and on track. ABM activities to implement core tools such as daily visual

management, problem solving actions, and kaizen events are driving operating improvements in the business. As expected, lower margin legacy programs will continue to act as a headwind in the short term until they are completed. As announced today, we have initiated actions to reorganize certain CFT subsidiaries that will consolidate product lines and drive cost efficiencies in line with our plan. This is expected to result in restructuring costs of approximately $4 million that will be incurred in the third and fourth fiscal quarters.

With respect to BioDot, part of the business is benefitting from COVID-related activity, which we expect will reduce. Improvements to BioDot's business will be pursued by cost and revenue synergies we've identified and targeted growth in its high-margin consumables and aftermarket service business. Integration activities are progressing well.

Moving to the balance sheet, in Q2 we generated cash from operations of $55.7 million, up from $20.3 million last year. Year to date we've generated cash from operations of $104.1 million, up from $67.4 million last year. The increase primarily reflects growth in revenues and operating margins.

Our non-cash working capital as a percentage of revenue remained very low at 5.7% in Q2, up from 5.4% in Q1 and well within our target of maintaining working capital as a percentage of revenues below 15%. We are pleased with this result; however, we do expect our non-cash working capital investment to increase during fiscal 2022.

We invested $11.3 million in CapEx and intangible assets in Q2 compared to $5.7 million last year. Higher investments primarily related to the expansion and improvement of certain facilities and

investments in IT. As a reminder, our CapEx budget for fiscal 2022 is $50 million to $60 million, an increase over last year reflecting our plan to add capacity to support growth and continue to invest in innovation.

We ended the quarter with good liquidity, consisting of cash of $181 million and availability on our credit facilities of approximately $689 million. In the second quarter we amended our $750 million primary credit facility and extended its maturity to August of 2024. From a leverage standpoint, our September net debt to adjusted EBITDA ratio was 1.5 to 1. We have further room to deploy capital to pursue our strategies within our normal course target leverage range of up to 2x to 2.5x.

In summary, we've continued our strong start to fiscal 2022, including record quarterly revenues and continued margin expansion. These achievements were accomplished through both organic growth as well as the contribution of acquisitions. Our global teams demonstrated strong performance in the second quarter, delivered through the application of our ABM playbook, ensuring customer needs are met while delivering profitable growth.

Now we will open the call to questions from our analysts. Operator, could you please provide instructions? Thank you.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now conduct a question-and-answer session. To allow as many voices to be heard as possible, please limit yourself to two questions per turn. If you do have a question, please press the star followed by the one on your touchtone phone. Your questions will be polled

in the order that they are received. Please ensure you lift the handset if you are using a speakerphone before pressing any keys. One moment please for your first question.

Your first question does come from Mark Neville from Scotiabank. Please go ahead.

Mark Neville — Analyst, Scotiabank

Hey, good morning, guys. First off, great quarter. I guess my first question, maybe just around supply chain. I'd just be curious to hear some of the things, some of the issues that you're dealing with, how you're mitigating those, because it seems to be quite well, and just curious around inflationary pressures. Is it something that you're seeing and would there be any risk to what's in your backlog if we see further inflation? Thanks.

Andrew Hider

Good morning, Mark, and thank you for the comment. Let me start with kind of the answer and then I'll unpack it a little bit. So today, the shorter answer is we haven't seen anything material. But our supply chain teams have been very, very focused and vigilant on this area and it is a very dynamic and challenging environment. And let me walk through that a bit.

When we look at some of the impact, some of the areas that we've seen, really it's been around mostly extended lead times, and so some of the areas that we have been able to order and receive in days have now gone off to three and four weeks and have sometime extended beyond that. And so our teams have implemented really daily visual management around this. And so if you think about it from a standpoint of daily, they're counteracting, they're identifying areas to proactively drive to ensure that we

minimize impact to our customers. And so where you might see an implement or you might see an extended lead time, you might take on selective inventory to mitigate that risk, you might identify an early buy to mitigate that risk, as well as really identifying on an ongoing basis where you can substitute.

And so we've been, as you're well aware, part of our five focus areas has been focusing on standardizing our production process, standardizing our business, and part of that has allowed us to really look and have alternative solutions where needed. So lead time, ensuring that we continue to execute for our customers, has been a key focus, and really proud of the work that our supply chain teams have done here. And they're working with the businesses and across the globe. And I've visited every site and this is a conversation at every facility.

Additionally, we are seeing some areas where we are having a higher cost and, as you're well aware, additionally in our five points, supply chain and a strategic focus on reducing supply chain costs has been ongoing. And so we've been able to mitigate those and we've been able to really drive our business to, when we find a challenge, really be able to offset that. And so, overall, pleased with the progress to date. That said, it is a very dynamic and challenging environment that we are staying very focused on as a global corporation.

As far as inflationary pressures, again, nothing mature, but we are monitoring and we're continuing to evaluate this area. And from a standpoint of how we understand our supply chain and our labour areas, we're building it into our thinking across our business around how we're going to be approaching the markets and ensuring that we understand that implication, that impact, to then really drive that across our business.

We also look at this from an automation perspective and, call it, in the next year to three years, see this as an opportunity in automation where, as companies are going through this, it lends itself to an automation area, and whether it's labour or whether it's a retirement, we view that really as an opportunity to help our customers through this and really drive a potential automation solution through that process.

Ryan, would there be anything else you'd want to add here?

Ryan McLeod

Yeah. So, just in respect of mitigation, Mark, so we've got fixed price contracts and when we're engaging in the proposal and the bidding phase for those we will typically lock in the majority of our supply chain costs at that point. So we're not taking a lot of risk on those contracts from a pricing standpoint. As well, from a schedule standpoint, as Andrew said, we have daily visual management around key supplier lead times, so we're able build in, at that point, if there's any risk to what a typical schedule would be and make sure that we're setting customer expectations around delivery time appropriately. On our non-fixed price contracts, we are making pricing adjustments where it's appropriate, and so, as we've said, we've largely been able to mitigate the supply chain lead time and price inflation to date.

Mark Neville — Analyst, Scotiabank

Thanks a lot, guys. That was very comprehensive. Great. Maybe just on the margin, again, another really impressive year over year but also sequential improvement, both on gross margin and EBIT, I guess I'm just curious is there any sort of, when we think about the gross margin going forward,

is there any sort of mix changes that we need to be aware of or just anything maybe in this quarter that drove it maybe above what you might consider to be a normalized run rate? Thanks.

Ryan McLeod

So the short answer is no. I mean there's always going to be different project mixes within a quarter but, generally speaking, I'd say we still have opportunity in terms of mix. I'm speaking more specifically to after-sale services, where we've made progress, we're in a good position, but there's still opportunity to grow that business and it is a higher margin business.

The rest of the improvement we've seen is really from the areas that I laid out in my prepared remarks. So we're seeing benefits from improved cost structure, our project management has been strong, and both of those, I expect, will continue, and as well, to your question, some mix impact from higher after-sale services on a year-over-year basis. But, as I said, we still have room to improve that revenue stream.

Mark Neville — Analyst, Scotiabank

Okay, guys. Thanks for the time. I'll get back in queue. Great job.

Operator

Your next question comes from Justin Keywood from Stifel. Please go ahead.

Justin Keywood — Analyst, Stifel GMP

Hi. Good morning. Thanks for taking the call and nice to see the results. I just had a follow-up question on the margins. In the outlook section there is mention of a still expanding adjusted earnings from operations from 13% to 15% over the long term. Just wondering if there's any more specifics on that timeline just given the velocity of the margin expansion. I think you mentioned it was 150 basis points this quarter from last.

Ryan McLeod

Yeah, hi. Good morning, Justin. So, when we set that 500 basis point target initially, we were around 10%, just under 10%. Our core business, we finished Q2 at 14.4%. So we've made good progress, we're getting close to the target, but still have a bit of room to go.

With the acquisitions, we've added in a different mix and so, as we've talked about, CFT, it's a low single digit EBIT business, and when we did the acquisition we laid out our plans for improving those margins over time. So that mix has changed and that's changed our overall margins to where we finished the quarter at 13.5%.

So, while we're making good progress, we still have a ways to go. We're not setting a timeline on it. I think our core business will get there sooner than the total business. And that CFT business plan really starts to ramp up in years two and year three post acquisition. So I mean that kind of gives you a sense of timing, but I'm not going to put a firm stake in the ground.

Justin Keywood — Analyst, Stifel GMP

Okay. That's helpful context. And then my next question is on acquisitions. We've been noticing the multiples have been trending higher for the public peers, I think they're up at around 20 times EBITDA, and my question is what is ATS's ability to still acquire good assets at the multiples that you've done historically and if the multiples have followed the public peers in the private space.

Andrew Hider

Good morning, Justin. When we step back and look at this, one of the areas that, you know, I just want to say that has been a big transition, call it, in the last two years and has helped us through this pandemic is, you know, our approach to M&A. It started with the corporate group and really aligned around us building out that cultivation process from a corporate entity. And largely over the last two years that's been now pushed into the business units and the business units are really driving a lot of that cultivation. And so when we look at these additions that we've added, and I think it's six year to date or close to six this year, it's really largely been around our ability to cultivate and build those strong relationships, which we view puts us in a lead position.

Now we're not immune to the market, we're not immune to what goes on in the market, but I do think that's been an area that has really helped ATS achieve success in the targets we've identified. And so, as you're well aware, our portfolio has been evolving. We're targeting very attractive areas. The multiples tend to be a broad range in those areas. And so you're going to see us continuing to drive that. We're extremely disciplined in our approach, but I do view that the cultivation aspect has been a key enabler for us to build out that value, both for the sellers and for the shareholders of ATS.

Justin Keywood — Analyst, Stifel GMP

Understood. And are you able just to describe the size of your funnel, like the number of acquisitions that you're potentially looking at, and if there is a target vertical that you're looking to acquire into?

Andrew Hider

Yeah. So, Justin, it's a large funnel. And some of the cultivation we're doing today will be two year's out. And we do look at short-term and long-term cultivation targets. And it's all about building relationships.

Just to walk through, when we acquired CFT and we looked at the food space, and I'm just going to walk through it, so there's primary and secondary processing. And this was largely primary, had some exposure to secondary, which is the initial processing and the secondary processing, and we like both areas. We're moving more and more into the secondary. We had potential targets reaching out to us after that. And so, you know, success here and alignment to really creating value for the targets and building and building capability has really helped us build that brand, that ATS capability.

And so our funnel is very healthy. It's fairly large. It's very targeted in areas we want to expand. It's largely built around markets and technologies. And so we want to continue to expand our ability and capability. Think BioDot. A very attractive business to the add with ATS. And it's very specific around where we want to drive the portfolio.

One that we continue to talk about is life sciences. We really like the space. You're going to see a healthy mix in here around life sciences. You're going to see areas in the food technology space, regulated food, as well as products that support multiple areas. And there's a couple that we're also looking at from a new frontier perspective. And so all that to be said, the funnel is very healthy, we continue to focus on cultivation, whether it's my level or whether it's presidents of the division or even at times we engage our board to really help through that cultivation and with a focus on really adding value for the long term at ATS for our shareholders. And, as you're well aware, we're extremely disciplined in our approach and our process to deploying our capital.

Justin Keywood — Analyst, Stifel GMP

Understood and thank you for taking my questions.

Operator

Your next question comes from David Ocampo from Cormark Securities. Please go ahead.

David Ocampo — Analyst, Cormark Securities

Thanks. Good morning, everyone. I just had one follow-up question to Justin's line of questioning as it relates to acquisitions, but more so on the capital deployment here, especially in the context of all the free cash flow that you guys are generating. How should we square that up as it relates to deploying that capital and how much left over you have? Is there any more room there where we can finally start to see some shareholder distributions?

Ryan McLeod

So, David, when we look at capital allocation, we have a framework and a ranking of priority, and it's based on, ah, return on investment is a key criteria, and number one for us is internal investment. And Andrew talked about our disciplined approach on external capital. We have a similarly discipline approach on internal. But that is where we see the biggest, ah, the most beneficial return on investment is on internal investment, whether it's capacity expansion, innovation. We've invested in our sales group, building out capacity there. Number two is M&A and, as Andrew just talked about, we have a big funnel, and we really see that as the number-two lever in terms of creating shareholder value.

We don't have any intention at this point to implement a dividend or anything of that nature. It is something that we evaluate from time to time. In terms of return to shareholder, we have the NCIB in place, which we really view opportunistically. But like I said, at this time we don't have any plans to implement a dividend.

David Ocampo — Analyst, Cormark Securities

Okay. That's helpful. And then maybe just on the pipeline itself, as you guys get larger here, are you thinking about kind of doing larger, transformational acquisitions, or should we just think about the pipeline as kind of what we've seen in the past as kind of a good guidepost on what's to come?

Andrew Hider

So, David, our funnel has a healthy mix. There's large acquisitions, there's platform acquisitions within the targeted area that we're building out and cultivating and aligning to, and there's also tuck-ins

that are going to be meaningful value. And Ryan walked through it, but one of the four criteria that we look at on acquisitions is ROIC and ensuring that the value creation is there, but our funnel is a mix of both and we view both as a meaningful contributor to our shareholder value over the mid and long term.

David Ocampo — Analyst, Cormark Securities

Okay, that's my two. I'll hop back in the queue. Thanks, guys.

Andrew Hider

Thank you, David.

Operator

Ladies and gentlemen, as a reminder, should you have a question, please press the star followed by the one. Your next question comes from Maxim Sytchev from National Bank. Please go ahead.

Maxim Sytchev — Analyst, National Bank Financial

Hi. Good morning.

Ryan McLeod

Hi, Max. Good morning.

Andrew Hider

Good morning, Max.

Maxim Sytchev — Analyst, National Bank Financial

Andrew, maybe I wanted to ask your opinion around the red programs, because you did mention that you have less of those. Would you mind maybe kind of walking through structurally what's happening there? Is it how you approach the bidding process? Is it the execution? I presume it's a combination of the two but, yeah, do you mind providing any more colour on that?

Andrew Hider

Sure, Max. And when we look at our business, there's a couple key items here. We've implemented, call it, years ago, a real critical focus around the attributes of how to operate in the project environment, and these are called the critical rules to follow. And so we built that out and we've largely aligned around those and it has areas that are going to mitigate risk and/or have offshoots of risk.

So let's say it's a completely new operation, a completely new application. We're going to then do a conceptual design, ensure that we understand all the risk aspects of this, and then align around what that would then mean to the customer. So we're continuing to build out and look to mitigate risk. As you're well aware, many of our projects are things that have never been done and we're supporting and helping our customers through that. Think the EV shift and all the complexities that goes with a battery pack or a packout. We're able to really work with our customers through that.

Additionally, and I mentioned this in my opening remarks, but one of the things we've also implemented with the ABM is working at events with our customers. And this is a key area. And if you look at, not only does it help from a standpoint of relationship, because it brings you very close, it also

helps to get to what the critical must-haves are for any project. And if you think about our customers, they look at quality, they look at time to market, they look at times, the overall cost of the application, and so you're going to see all these areas are aligned to what we want to also drive within our business. And so when we work with our customers very closely around the critical areas to align around, it really does help in that full transition period.

And then lastly, one of the things we've implemented and continue to learn from is when we have a new project of any size, so think a larger-scale project, we do a full deep dive lessons learned on those projects and really understand, you know, even if you're on track, on schedule, on budget, on target, what did we learn through that that we can take into building out capability. And so that's built in then to our view on continuous improvement and how we want to implement that through the organization or through the area of impact.

Ryan, is there anything I missed that you'd want to add here?

Ryan McLeod

No, I think you covered the main points.

Maxim Sytchev — Analyst, National Bank Financial

Okay. That's helpful. Thank you so much. And then one of your suppliers, Rockwell was talking about pricing increases from their side. I'm just curious, how does it work from a client-facing perspective? I guess all that pricing is going to be passed through by you guys? Or how should we think just in terms of how the entire supply chain is reacting to inflationary pressures? Thanks.

Ryan McLeod

So, Max, I sort of answered this to Mark's earlier question, but specifically, in our fixed-price contracts, when we're going through the proposal phase and developing our concept that we're going to be presenting to our customers, we go through the supply chain at that point, and our supply chain folks will actually reach out to suppliers and lock in pricing at that time. And we do this for the majority of costs. We don't cover 100%, but we do cover the majority. And so that gives us cost certainty for the majority of our third-party costs on our projects. And it's a similar process with lead time and understanding what that means in terms of our project delivery schedule. So that's really how we're managing those cost increases, where we're seeing them. There are other things we do around looking at alternative suppliers and substituting components, things like that, but that's largely how we're mitigating.

Maxim Sytchev — Analyst, National Bank Financial

Right. And then maybe if you don't mind if I sneak in just one more on the inventory, because you said that sometimes you have to have a bit of a buffer. Are we talking about sort of material amounts for the kind of overall working capital or it still sort of ebbs and flows with kind of the historical trends we would have seen?

Ryan McLeod

Yeah, so the short answer is no, it would not have a material impact on our working capital percentage. And again, standardization, or progress in standardization is helping here. But where we have components or materials that get used and reused on projects or components where we know there's

longer lead times, we're able to pull ahead some of those purchases knowing that they're going to get consumed on projects. But it's not a material amount from a total working capital perspective.

Maxim Sytchev — Analyst, National Bank Financial

Okay, that's great. That's it for me. Thank you very much.

Operator

Ladies and gentlemen, as a reminder, should you have a question, please press star followed by the one.

Mr. Hider, there are no further questions at this time. You may proceed.

Andrew Hider

Thanks, operator. This was another strong quarter for ATS. I'd like to recognize the hard work and dedication of our teams across the company that made this possible. Like you, we are looking forward to putting the pandemic behind us, but in the meantime, we're moving forward together. Thank you for joining us. I look forward to speaking to you on our Q3 call in February. Stay safe and goodbye for now.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you very much for participating and ask that you please disconnect your lines.