ATS Automation Tooling Systems Inc.

Acquisition of SP Industries

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the ATS Automation Conference Call and Webcast. This call is being recorded on November 8, 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 any questions. If anyone has any difficulties hearing the conference, please press star zero for the operator.

I'll now turn the conference 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; Ryan McLeod, Chief Financial Officer; and Chris Hart, President, ATS Life Sciences. For those who joined us by phone, our remarks are accompanied by a slide deck, which is available at www.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 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 and thank you for joining us.

Today we are pleased to announce the acquisition of SP Industries, a leading supplier of lyophilisation equipment, aseptic fill-finish solutions, and consumable labware products used in pharmaceutical drug development and production process. The addition of SP expands our life sciences offerings in the attractive and high-growth lyo and fill-finish pharma markets and is aligned with our strategy of targeting acquisitions with proven technologies and strong market position.

From a financial perspective, the transaction offers robust synergies, earnings accretion, and a compelling return on invested capital. We're excited about the possibilities we're unlocking for ATS and SP through this transaction, including strengthening our capabilities in biopharma and life sciences, enabling us to offer integrated end-to-end solutions for our customers and expanding our recurring revenue streams while creating significant synergies and shareholder value.

In terms of the financial profile of the transaction, the total purchase price is US$445 million, or approximately C$550 million. This implies a transaction multiple of 11.9x SP's adjusted EBITDA after factoring in estimated year three synergies under ATS's ownership, making the transaction accretive to ATS. The acquisition is expected to close in calendar Q4 of this year pending the completion of customary regulatory filings.

During our extensive due diligence process we identified synergies that would allow us to realize additional financial upside from the acquisition. Over the next three years we anticipate cost synergies of approximately US$3.5 million resulting from material cost savings and operational efficiencies. We expect to generate another US$5 million of EBITDA through revenue synergies resulting from cross selling and joint innovation. The transaction will be accretive to ATS's earnings and cash flow per share metrics in our first year of ownership and we expect ROIC to reach double-digit return on invested capital by our fourth year of ownership.

SP offers a differentiated platform in life sciences given its scale, global footprint, and breadth of products and capabilities. The company is a leading designer and manufacturer high-grade biopharma processing equipment, laboratory benchtop equipment, and labware and glassware products. SP serves a diverse blue chip and long tenured customer base in pharmaceuticals, biotech, as well as academic, commercial, and environmental laboratories. Headquartered in Philadelphia, SP has a highly-skilled workforce of approximately 700 employees across nine facilities in the US, UK, and Spain.

SP's products are used throughout the lifecycle of pharmaceutical development and production, as well as in diagnostics, broader life sciences, and applied sciences applications. With a strong market

position in lab and pilot-scale lyophilizers, evaporators, and labware, and a fast-growing position within the lyo and fill-finish markets, SP enjoys solid brand recognition and is one of few companies globally capable of offering end-to-end aseptic fill-finish processing and lyo solutions.

The company generated US$179 million in revenues over the last 12 months. Biopharma processing equipment and systems can price 50% of sales with life sciences equipment making up another 14% and labware and aftermarket services contributing the balance. Over the last three years SP grew revenue by 9% CAGR with strong sales presence in the US and global sales coverage in over 150 countries.

Moving to the addressable market opportunity, SP's exposure spans a number of attractive areas. The largest is biopharma processing, a market that is projected to achieve low double digit CAGR over the next five years. Its life sciences equipment market is expected to grow in the mid to high single digit range and its labware market is forecasted to grow in the low single digit range. Growth in the industry is driven by strong trends, which we see continuing. These include lyo capacity gap coupled with a growing biologic pipeline and higher demand for small-batch therapeutics, customer shift towards integrate and complete fill-finish solutions, and growth of drug development applications, including new drug modularities which is expected to drive demand for benchtop instruments, including evaporators.

One space that we really like is lyo and fill-finish. This is a well-established market with growth driven by robust pharma drug pipeline, rising use of biologics, and increasing lyo of injectable drugs. The process of lyo helps improve shelf life, product stability, and makes it easier to transport products. Pharma customers see value in solution providers capable of delivering end-to-end lyo and fill-finish systems.

There's also an opportunity to add further differentiation in the level of automation around handling, inspection, and packaging, which strengthens the value proposition for the customer.

Turning to the strategic rationale, SP has established itself as a trusted partner capable of supporting biopharma customers from the lab bench all the way through full-scale production in the drug discovery and production process. The company has a long track record of innovation and product technology with a dedicated R&D team and numerous patents, including patent protection, for its line-of-sight suite of products, which reduces time to market and improves process yield. We also like recurring nature of SP's labware business and see opportunities to grow aftermarket services by leveraging our services platform.

In line with our M&A playbook, we see multiple avenues to create meaningful synergies by sharing technologies across the combined portfolio and utilizing the ATS business model to drive commercial and operational efficiencies. Some examples include leveraging our Comecer sales organization to generate incremental sales of fill-finish systems and providing additional value to customers by integrating ATS's capabilities in inspection, packaging, and assembly automation; deploying Illuminate, ATS's IoT platform, on SP products to enable continuous monitoring of process quality, to anticipate servicing needs, and to leverage the ATS service organization to expand after-sales support and service; and realizing cost reductions due to material cost savings and operational efficiencies.

This transaction meets our four key acquisition criteria: market, value, fit, and financial returns. SP operates in a large and growing market underpinned by strict industry and government regulations. It possesses several differentiated technologies and brands that are globally recognized and trusted in an

industry that gives high value to these attributes. It is a strong operational fit with an experienced and motivated management team and the potential to apply the ABM playbook to further improve operations and realize synergies. And it is a financially attractive acquisition, with strong profitability, high recurring revenue potential, EPS and cash flow accretion in year one, and attractive return on invested capital by year four.

The acquisition of SP is aligned with our strategy of evolving the ATS portfolio towards high-value and growth end markets. We remain focused on highly-regulated sectors where ATS can add substantial value to its customers through the application of automation technology. Since 2013, ATS has completed several acquisitions in these chosen markets and more than tripled its LS business. On a pro forma basis, our exposure to regulated markets, which includes life sciences but also food and nuclear, is now close to 80% of our revenue. Going forward, we'll continue to explore opportunities to acquire assets in key targeted areas, with our focus remaining on transactions that are strategic for ATS and provide a solid return on our investment.

In summary, we're excited about the addition of SP to the ATS family. SP operates in an industry with attractive fundamentals and holds a leading position in its key end markets. The transaction broadens ATS's life sciences offerings and grows our equipment portfolio. SP enjoys strong profitability and offers a compelling opportunity to grow our recurring revenue stream. This is an attractive transaction from a financial perspective that is accretive to our earnings and cash flow and generates a compelling return on our capital.

With that, I will turn the call over to the operator for questions. Operator, over to you.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star followed by one on your touchtone phone. You will hear a three-tone prompt acknowledging your request and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press star followed by two. If you are using a speakerphone, please lift your handset before pressing any keys.

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

David Ocampo — Analyst, Cormark Securities

Good morning, everyone. Andrew, I guess my first question here is kind of on your comments on your expectation to continue M&A. And when we think about your leverage, it's up to 3x on a pro forma basis and you guys have talked about a comfort level of 2x to 2.5x. So how should we think about the pace of acquisitions going forward? Is this something where you guys need to integrate SP and see where that goes before being comfortable deploying more capital or should we expect the pace to continue here?

Andrew Hider

Yeah, good morning. So, let me start by first stating that we're very excited to have SP as part of our team moving forward and the technology and focus on the spaces that they have been targeting are very attractive to ATS and our journey as we're targeting this area to expand.

So, first and foremost, we're going to be laser-focused on ensuring that we have an integration process that's successful and we maximize our value into the market and then ultimately for our shareholders. In addition to that, we have several areas within our funnel that we're continuing to look at from the standpoint of small, medium, and large, and we're going to continue to cultivate those, but we're going to be very focused on this acquisition to ensure that we deliver the value that we perceive in the market and then ultimately the return to our shareholders. Ryan, would there be anything you'd want to add on top of that?

Ryan McLeod

Yeah. Good morning, David. With respect to leverage, so we talked about this in the past, that we're comfortable to move into the 3x to 3.5x range for the right acquisitions, and SP certainly ticks that box. This is a good cash-generating company similar to ATS. And we will focus on deleveraging from here. We're typically going to de-lever about one turn per year, so that'll give you a bit of insight on timing into back down to the 2x to 2.5x range.

David Ocampo — Analyst, Cormark Securities

Okay. That's perfect. When we think about the growth opportunities that are ahead of you guys and I look at where SP's revenue is predominately coming from, which is North America, so is there any opportunities for you guys to expand more into other regions and would that require any additional CapEx or is there still unused capacity in some of the facilities that you guys are operating in?

Chris Hart

Good morning. It's Chris speaking. Certainly SP is strong in North America, but with the i-Dositecno offering in Europe, combined with ATS's presence in Europe, I think there's good opportunity to expand in that region, amongst others.

Ryan McLeod

And David, from a CapEx perspective, there's capacity within SP. From an ATS Life Sciences perspective, that is something that we continue to monitor. And I've talked in the past about how we manage capacity and some of it's through investment like we've done here in Cambridge over the last year, year and a half, and then there's other opportunities for temporary space. So we'll continue to monitor that and adjust as we go forward.

David Ocampo — Analyst, Cormark Securities

Okay. That's my two. I'll hop back in the queue. Thank you.

Operator

Your next question comes from Mark Neville with Scotiabank. Please go ahead.

Mark Neville — Analyst, Scotiabank

Good morning, guys. Congratulations. First, I mean, Andrew, this is a very large sort of products acquisition for ATS, and I don't want to call it new, for sure, but is this sort of the direction you want to go with future M&A?

Andrew Hider

Yeah. So, Mark, I guess I'll start and then certainly, if there's other areas, Chris can jump in to continue to add. But if I step back and look, this is right in line with our strategy. And it targets attractive markets with strong long-term trends around growth profile. Secondly, continues to diversify our capability. And when we look at the products and their technology and, you know, this is space that brand and experience really matter, SP has done an excellent job here. And when we think about what we can do from a full breadth of solution and really lay out from a standpoint of automation to Lyoscan, which we do here at ATS Life Sciences, to the Comecer, how they do isolation and capability within this, to even IWK around packaging, really starts to frame up a strong solution set to support this market growth. So we like the dynamics of this business. We like what it does from a financial return. We really like the long-term aspects of how this is going to position ATS to win. Chris, would there be anything you'd want to add on top of that?

Chris Hart

I think the only thing would be, you know, part of our due diligence was a very active voice-of-customer exercise and what we learned is SP is known as a very respected, credible partner to many of ATS's current customers, albeit in sometimes different areas. But those customers indicated they would like us to be in this space in a much more comprehensive way. So I think, in concert to what Andrew said that, yeah, this is where we want to be.

Mark Neville — Analyst, Scotiabank

Great. EBITDA margin looks strong, cash generation looks super healthy, I'm just curious, what is the gross margin in this type of business?

Ryan McLeod

Mark, so their gross margins, it's slightly accretive to where ATS is today. It's in the low 30s.

Mark Neville — Analyst, Scotiabank

Okay. And if can ask just one last one, could you maybe just talk about the opportunity to expand the service business sort of separate from the consumables?

Andrew Hider

Absolutely. And as you broke it down, it shows 9%, but if you take that as a total equipment it's, call it, mid-teens. We view this as right in line with our progression on ATS's service and when we look at the ATS service footprint as well as aligning this to Illuminate and our digital capability, we view that there is obvious opportunity to expand and grow this piece in line with what we're setting as a target for total ATS.

Mark Neville — Analyst, Scotiabank

Sorry, what was the 15, the mid-teens?

Andrew Hider

Yeah, if you break it down in their segment, you're going to look at their business as equipment-based services is roughly around, call it, mid-teens of that. When you look at the labware/glassware, it's obviously not going to have a services element to it, because that's more a recurring revenue stream. So we look at that equipment piece and say this is that opportunity and then how do we expand it.

Mark Neville — Analyst, Scotiabank

Right. So you said the target should be sort of roughly in line with ATS consolidated to 20%?

Andrew Hider

We would put this right in line with that target and look to drive that growth.

Mark Neville — Analyst, Scotiabank

Right. All right, thanks a lot. I'll get back in queue. Congrats.

Andrew Hider

Thank you.

Operator

Your next question comes from Maxim Sytchev with National Bank. Please go ahead.

Maxim Sytchev — Analyst, National Bank Financial

Hi. Good morning.

Andrew Hider

Good morning, Max.

Maxim Sytchev — Analyst, National Bank Financial

Andrew, maybe just from a strategic perspective question, in terms of the importance to have exposure to the biologics market, do you mind maybe going in a bit more detail sort of describing why that's the case and why pharma companies are moving in that direction? Thanks.

Andrew Hider

Max, just so we understand the nature of your question, you're just trying to understand the growth in this space, the new launches, the expansion, or the solution that SP offers and how we, ATS, can really maximize that return?

Maxim Sytchev — Analyst, National Bank Financial

Well, I guess it's a bit of both, because, you know, based on our understanding, biologics manufacturing is different relative to other verticals, and it feels like that's kind of where the future of the pharma industry is going to. So, I mean from my perspective, I mean that seems like a very critical piece of exposure from the end-market perspective and I'm just trying to see if you sort of see it the same way.

Andrew Hider

Yeah, so I guess I'll start and certainly I'll walk through it with Chris. So we do. And when you look, there is a couple key attributes that we really like about this business. First and foremost, the longer-term trends on lyo and what that enables drug manufacturers to do around this, you know, think stability, think length of time a product can last, and that really helps them go there. And then when you go down to this area as they're going into more the customized solutions for different markets, and we often talk about small- and mid-batch processing, this is right in line with that mid-batch processing, which allows them to have a certain threshold of production quantities that enables the solution set to meet multiple customer demands. And so when we shift and look at the growth profile of that, we really like that profile, call it mid and small, as the growth over the next three to five years we view as larger than the high production process. And so this business is right in line with that capability and we view that that is a growing area that customers are going to continue to expand on, especially as they go more and more custom-type of medicines. Chris, would there be anything you'd want to add on?

Chris Hart

Yeah. So, as Andrew mentioned, the personalized nature of medicine is changing. The pandemic, I think, and the response to it really highlighted the art of the possible in terms of taking a solution from the lab to full commercialization, so speed of delivery, time to market, and SP is recognized as a leader in supporting customers from that lab-to-commercialization phase. So, yeah, I think that's the key pieces.

Maxim Sytchev — Analyst, National Bank Financial

Right. Okay, no, we're super bullish on the space as well, so that's helpful. And then, Andrew, do you mind maybe providing any commentary in terms of the client overlap? Obviously, the revenue

synergies suggest that there's not a huge amount, or maybe there is, and it's all about sort of product extension into these clients, but maybe any colour you can provide on that point.

Andrew Hider

You know what? I'm going to have Chris walk through. And we've done, as he mentioned, a lot of insight around our customer overlap and/or areas we think we can expand. So, Chris, why don't you walk and then I'll add on if needed.

Chris Hart

Yeah. So I think mentioned earlier just a lot of voice-of-customer work that yielded great intel on SP from the customers' perspective but, throughout the due diligence, just understanding that many of the current customers of SP are current customers of ATS and sometimes in different areas. But I think there's, and Andrew touched a little bit on this in his opening comments, but really there's seven pieces here that provide just excellent linkage to ATS and it starts with Comecer through that sale of incremental fill-finish lines and the integration of their containment solutions to the fill-finish portfolio. It extends then into ATS Life Sciences through our pharma assembly automation, our SuperTrak pharma offering, lyo handling, lyo scan inspection solutions. Then to IWK through the integration of secondary packaging solutions to the lyo portfolio. And then we get into the ATS digital and global services where Illuminate provides the diagnostics tool and capabilities for that commercial lyo product and that then enhances the quality of the aftermarket sales and services offering. Then there's PA, and PA is involved in some of these customers from a pharma (inaudible), a recipe management infrastructure perspective, downstream to our previous acquisition in BioDot and the lyo bead processing, which utilizes a lot of the same processing

technologies. And then finally, just the discussions we had with SP from a leadership perspective, just the strong cultural alignment to ATS, to LS, and that's always keeping that ultimate customer, being the patient, at front and centre. So, strong alignment there from a meaning and purpose perspective.

Andrew Hider

So, Max, I think in simple terms there is some overlap. We view that there is a significant opportunity to expand. And even in the overlap, might have the same logo on the outside but different buying decisions, and this allows us to really bring that full breath of solution, as Chris outlined, to a customer. And I have firsthand experience around the opportunity there with customers wanting us to engage and move into this space.

Maxim Sytchev — Analyst, National Bank Financial

Yeah. Makes a lot of sense. And maybe just last question in terms of, ah, was this a competitive process? Maybe any colour on the deal?

Andrew Hider

Yeah, as you're well aware, we've targeted this area for growth and we really like the aseptic fill-finish area and market. We really like the lyo as well. And it's been an area we've targeted for some time. We engaged with SP, call it, nine months ago ish. It was a competitive process. We were able to build out a strong relationship with the team, the management team as well as the selling entity, and were able to move into the ability to execute is why we're here today.

Maxim Sytchev — Analyst, National Bank Financial

Okay. Wonderful. Thank you and congrats.

Andrew Hider

Thank you so much, Max.

Operator

Ladies and gentlemen, as a reminder, should you have any questions, please press star one. Your next question comes from Justin Keywood with Stifel GMP. Please go ahead.

Justin Keywood — Analyst, Stifel GMP

Hi. Good morning. Thanks for taking my call. I just had a question of clarification on the revenue makeup. Is the labware and glassware at 27%, is that all consumable in nature? And if it is, is it consumable over a year or a number of years? If you could provide an additional context on that it would be appreciated.

Ryan McLeod

Yeah, so a large portion of it would be. I would say half to maybe just over half would be consumable in nature. There is some reuse of some of those products within lab or research settings, but the majority, call it just over half, would be more consumable in nature.

Justin Keywood — Analyst, Stifel GMP

Okay. And then also, just on the aftermarket services, I'm just trying to clarify, I heard two different figures, 9% and 14%. If you could just clarify what that business segment is doing right now and then if the opportunity is to expand it to 20%, if I heard correctly.

Ryan McLeod

Yeah, so, Justin, it's 9% of total revenues, but that includes the labware/glassware business, which does not have a service component to it. So, as we look at the opportunity in the equipment business, it's mid-teens, call it 14%, of that business. And with the opportunity to, as you said, to expand to ATS, in line with ATS.

Justin Keywood — Analyst, Stifel GMP

Got it. And then just on the synergies, we saw the identified cost synergies, $3.5 million, and then the revenue synergies of $5 million. I'm wondering though if there's an opportunity to expand margins. Like at Comecer I believe the operating margins expanded by 300 basis points. Is that an opportunity at SP?

Ryan McLeod

So it is. The synergies we've laid out, I mean if you work through the model, that will result in margin expansion. As we talked about or as we announced, it's in the 16% range today, their EBITDA margin, and this would get it into the high teens.

Justin Keywood — Analyst, Stifel GMP

Okay. And then just on the broader margin expansion goals, I know there was 200 basis points identified just in the quarterly results last week. Does that goal change at all with SP?

Ryan McLeod

Well, yeah, this will change the overall mix. I'm not going to commit to a new goal at this point, but this certainly changes the overall mix.

Justin Keywood — Analyst, Stifel GMP

Okay. And if I could just slip in one more, the CapEx is relatively pretty small, if negligible, at SP, less than 2% of sales. Are you able just to explain that dynamic there and why that's lower than ATS's just broader working capital target of less than 15% of sales?

Ryan McLeod

So, to clarify, are you asking about CapEx intensity or working capital percent?

Justin Keywood — Analyst, Stifel GMP

Oh, sorry, yes, well, if you can comment on both. I guess the CapEx is less than 2% of sales. I didn't see a working capital, but I note the high free cash flow conversion of 90%.

Ryan McLeod

Yeah, yeah, that's right. So the CapEx is about 2% and the majority of that is maintenance. And, as I said earlier, they do have capacity within their operations to continue to grow and scale from a current

footprint perspective. Working capital is similar to ATS. It's a little bit higher than where we are today. They're in the low double digit range as a percentage of revenues.

Justin Keywood — Analyst, Stifel GMP

Okay. All right, that's helpful. Thank you very much.

Ryan McLeod

You're welcome.

Operator

Your next question is a follow-up from Mark Neville with Scotiabank. Please go ahead.

Mark Neville — Analyst, Scotiabank

Hey, guys. I'm just curious, does this business come with any backlog or is it more…?

Ryan McLeod

Yeah, it does have a backlog, but, as we talked about with the product revenue, it's a lower percentage of their annualized revenue. So it's been in the $70 million range over the last several months.

Mark Neville — Analyst, Scotiabank

Okay. And just in terms of the aftermarket, you mentioned Illuminate, but does SP have anything sort of similar on its equipment or is it sort of relying on the customer sort of calling SP for service or spare parts?

Chris Hart

SP has an offering. As we talked through with them during due diligence, I think we recognized that the ATS offering with Illuminate and surrounding plug-ins to Illuminate are quite attractive to SP. So I think that's an early quick strike opportunity.

Mark Neville — Analyst, Scotiabank

Okay. Maybe just one last one, Andrew, on the comments around M&A, I mean was the comment that you're sort of slowing down to focus on integration or, no, am I not reading that right?

Andrew Hider.

So, Mark, to be very specific, we're going to be laser-focused on ensuring the success of SP into the ATS organization. We have a healthy funnel. We're going to continue to cultivate that funnel.

Mark Neville — Analyst, Scotiabank

Thanks a lot. Thanks again. Appreciate it.

Operator

There are no further questions at this time. Mr. Hider, please proceed.

Andrew Hider

Great. Thanks, everyone, for attending today. We look forward to speaking to you on our Q3 earnings call in February. Stay safe and goodbye for now.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines. Have a great day.