2nd Quarter 2017 Earnings Conference Call Transcript

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CORPORATE PARTICIPANTS
John Stroup Belden, Inc. - President, CEO, and Chairman
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Kevin Maczka Belden, Inc. – VP of Investor Relations

PRESENTATION

Kevin Maczka Belden, Inc. – VP of Investor Relations

Thank you, operator. Good morning, everyone, and thank you for joining us today for Belden's second quarter 2017 earnings conference call.

My name is Kevin Maczka, I'm Belden's Vice President of Investor Relations. With me this morning are John Stroup, President, CEO, and Chairman, and Henk Derksen, Belden's CFO. John will provide a strategic overview of our business, and then Henk will provide a detailed review of our financial and operating results, followed by Q&A.

We issued our earnings release earlier this morning, and we have prepared a slide presentation that we will reference on this call. The press release, presentation, and transcript of these prepared remarks are currently available online at **investor.belden.com.**

Turning to slide 2 in the presentation.

During this call management will make certain forward looking statements in reliance upon the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. For more information, please review today's press release and our annual report on Form 10-K.

Additionally, during today's call management will reference adjusted or non-GAAP financial information. In accordance with Regulation G, the appendix to our presentation and the investor relations section of our Web site contain a reconciliation of the most closely associated GAAP financial information to the non-GAAP financial information we communicate.

I will now turn the call over to our President, CEO, and Chairman, John Stroup. John?

John Stroup Belden, Inc. – President, CEO, and Chairman

Please turn to Slide-3 in our presentation for a review of our second quarter highlights.

Overall, the business performed in line with our expectations during the second quarter. We are pleased with our continued EBITDA margin expansion and the successful acquisition of Thinklogical.

On a constant currency basis, revenues increased 2.3% to $610.6 million. The demand environment in the quarter varied significantly by platform, with solid gains in our Industrial and Network Solutions platforms offset by pressures in Broadcast and Enterprise Solutions.

EBITDA grew 3.5% year-over-year, from $108.1 million to $111.8 million. EBITDA margins expanded 40 basis points from 17.9% in the prior year period to 18.3% as a result of our proven Lean enterprise system.

EPS in the second quarter was $1.29 compared to $1.54 in the prior year period. After adjusting for the impact of the preferred equity issuance in July 2016 and the tax rate differential, earnings per share grew 6%.

We completed the acquisition of Thinklogical during the quarter, and we are excited to welcome this talented team to the Belden family. This growing, highly profitable business enhances our Broadcast Solutions platform and we expect this acquisition to be accretive to EPS by $0.27 on a full-year basis and $0.17 in 2017.

Looking forward, we remain very well positioned with a number of other attractive M&A opportunities.

We were also extremely pleased with the timely execution of our recent debt refinancing at very favorable terms. By issuing 450 million euros of senior subordinated notes at 3.375%, the lowest long-term borrowing rate in the history of the company, we have lowered our cost of capital and extended our maturities. We expect our balance sheet actions to be accretive to EPS by $0.35 on a full-year basis and $0.18 in 2017.

To reflect this debt refinancing and the Thinklogical acquisition, we are increasing our full-year revenue and EPS guidance. We expect solid double-digit EPS growth in the second half.

I'd like to thank our associates for their hard work during the quarter and their commitment to aggressively executing our strategic plan.

Please turn to slide 4 for a review of our business segment results.

Broadcast revenues in the quarter were $188.1 million, compared to $193.5 million in the year ago period. Our Broadband business is now recovering nicely after experiencing a temporary pause isolated to two specific customers earlier in the year. We are encouraged by this improving trend.

Grass Valley, however, had a disappointing quarter, experiencing similar market pressures that impacted other broadcast technology peers during the quarter. As customers transition to IP-based infrastructure, spending patterns have become increasingly uneven with project timing more difficult to predict. That said, our opportunity funnel, a good leading indicator for this business, has increased significantly. As a reminder, Grass Valley now represents approximately 43% of Broadcast Solutions revenues and 14% of consolidated revenues.

We closed the Thinklogical acquisition on May 31st, so we thought it would be helpful to provide some additional commentary on this exciting new addition to our Broadcast Solutions platform. The company is a leading global provider of secure, high-performance Keyboard/Video/Mouse – or KVM - switching equipment. Its products are used for real time enterprise video management across a variety of end markets, including military, command and control, and broadcast. Thinklogical generated 2016 revenue, EBITDA, and net income of $51 million, $17 million, and $12 million, respectively. We expect this acquisition to be accretive to EPS by approximately $0.27 in the first full year of ownership and $0.17 in 2017.

Broadcast segment EBITDA margins were 15.7%, increasing 50 basis points from the prior-year period, as productivity gains and the contribution from Thinklogical offset the volume and mix-related pressures.

Enterprise revenues increased 1.5% on a constant currency basis to $160.7 million. Commentary from various customers, channel partners, and other industry participants suggests that demand has been negatively impacted by tight capacity in the construction labor markets. We continue to see healthy leading indicators for this business, such as the ABI, Dodge Momentum Index, and multi-year high construction backlogs, and we expect our business to improve as industry demand normalizes.

As a result of this temporary pause in spending, we have been unable to fully pass through the steadily rising copper costs this year. As such, EBITDA margins were 16.7% in the quarter, increasing 20 basis points sequentially but declining 170 basis points year-over-year.

Revenues in our Industrial Solutions platform increased a robust 8.8% on a constant currency basis to $159.3 million. Discrete manufacturing, our largest vertical, again experienced strong growth, expanding 10% with solid demand from machine builders. We are pleased with another quarter of growth in this vertical, driven by increasing investments in automation. Oil & gas stabilized in the quarter as expected, increasing 40% sequentially and 11% year-over-year.

Industrial Solutions orders remained robust in the quarter, increasing 10% year-over-year and driving a book-to-bill ratio of 1.03.

EBITDA margins increased 120 basis points from the year-ago period to 19.5% driven by solid volume leverage and mix.

On a constant currency basis, revenues in our Network Solutions segment increased 2.1% from the prior year period and 11.4% sequentially to $102.6 million, in line with our expectations. Importantly, the formerly known Industrial IT business continues to deliver solid growth, and Tripwire showed a notable sequential improvement. We are encouraged by the progress made in addressing the business challenges, including significantly improved sales force retention, a pipeline of quality projects, and a number of new product launches.

EBITDA margins increased 40 basis points year-over-year to 22.2%, largely related to productivity gains.

I will now ask Henk to provide additional insight into our second quarter financial performance. Henk?

Henk Derksen Belden, Inc. - CFO, SVP-Finance

Thank you, John. I will start my comments with results for the quarter, followed by a review of our segment results, a discussion of the balance sheet, and close with our cash flow performance. As a reminder, I will be referencing adjusted results today.

Please turn to Slide 5 for a detailed consolidated review.

Revenues in the quarter were $610.6 million dollars, increasing 1.2% from $603.4 million in the second quarter 2016. Currency translation reduced revenues by $6.6 million dollars. Higher copper prices and the acquisition of Thinklogical increased revenues by $8.2 and $10.2 million, respectively.

After adjusting for these factors, revenues decreased 80 basis points organically from the prior-year period.

Sequentially, revenues increased $59.2 million dollars from $551.4 million, in-line with typical seasonality.

Gross profit margins for the quarter were 41.3%, decreasing 50 basis points from the prior-year period due to higher copper prices. As a reminder, when copper costs increase we generally raise selling prices, resulting in higher revenue with minimal impact to gross profit dollars. As a result, gross profit margins decrease.

Sequentially, gross profit margins were in-line with the first quarter.

Operating expenses for the quarter were $153.8 million dollars, or 25.2% of revenues, decreasing $2.5 million from the prior-year period, driven by productivity initiatives.

Sequentially, operating expenses increased $3.9 million dollars, after adjusting for the impact of currency translation and Thinklogical.

EBITDA was $111.8 million dollars in the quarter. Compared to the prior-year period, EBITDA increased $3.7 million dollars, or 3.5%.

EBITDA margins were 18.3% in the quarter, increasing 40 basis points from the year-ago period and 140 basis points sequentially.

Net interest expense of $23.5 million dollars for the quarter decreased $500,000 dollars from the prior year and was in-line with the first quarter.

As a result of the timely execution of our recent debt refinancing, we expect our interest expense to be reduced by approximately $22 million annually.

We expect interest expense to be $19.5 million dollars in the third quarter, and $18.5 million in the fourth quarter.

The effective tax rate for the second quarter was 16.6%, compared to 9.5% in the prior year, which benefitted from incremental discrete tax planning initiatives.

For financial modelling purposes, we recommend using a 20% effective tax rate for the third and fourth quarter, resulting in a tax rate of approximately 19% for the full-year.

Net income in the quarter was $64.3 million dollars, decreasing $1.1 million from $65.4 million in the prior-year period.

Earnings per share was $1.29 in the quarter compared to $1.54 in the prior-year period. The dilutive impact of the preferred equity issuance in July 2016 was $0.20 in the quarter. After adjusting for this and the tax rate differential, earnings per share grew 6%.

We expect the acquisition of Thinklogical and the debt refinancing to add $0.35 to earnings per share in 2017. On a full-year basis, we expect these actions will add $0.62 to earnings per share.

Please turn to slide 6. I will now discuss revenues and operating results by business segment.

Our Broadcast Solutions segment generated revenues of $188.1 million dollars in the second quarter. Revenues decreased by 2.8% from $193.5 million in the prior-year period. Currency translation had an unfavorable impact of $1.8 million dollars, and Thinklogical contributed $10.2 million dollars. On an organic basis, revenues declined 6.5% year-over-year.

Broadcast EBITDA margins were 15.7% in the quarter, increasing 50 basis points as productivity gains and the contribution from Thinklogical offset the volume and mix-related pressures.

On a sequential basis, EBITDA margins increased 60 basis points.

Our Enterprise Solutions segment generated revenues of $160.7 million dollars during the quarter, in-line with the prior year. On an organic basis, adjusted for copper and currency translation, revenues decreased 2.2% from the prior-year period.

EBITDA margins were 16.7% in the quarter, decreasing 170 basis points from the prior-year and increasing 20 basis points sequentially.

The Industrial Solutions segment generated revenues of $159.3 million dollars in the quarter, an increase of 7.8% from $147.8 million in the prior-year period. Copper had a favorable impact of $3.5 million dollars, while currency translation reduced revenues by $1.5 million. On an organic basis, segment revenues grew 6.4% in the quarter. We are pleased with this result, and encouraged by robust order growth of 10% year-over-year.

EBITDA margins of 19.5% increased 120 basis points year-over-year and 190 basis points sequentially driven by leverage on volume and mix.

Our Network solutions segment generated revenues of $102.6 million dollars, growing 90 basis points from $101.7 million in the prior-year period. Currency translation had an unfavorable impact of $1.2 million dollars in the quarter. On an organic basis, revenues grew 2.1% year-over-year and 11.4% sequentially.

EBITDA margins of 22.2% increased 40 basis points from prior-year period, driven by productivity initiatives. Sequentially EBITDA margins expanded 250 basis points, driven by leverage on volume.

If you will please turn to Slide 7, I will begin with our balance sheet highlights.

Our cash and cash equivalents balance at the end of the second quarter was $670 million dollars compared to $816 million in the first quarter and $176 million in the prior year period. The sequential decrease reflects the acquisition of Thinklogical in the quarter, net of the cash flow generated in the second quarter.

Working capital turns were 7.0 turns, down 0.2 turns year-over-year.

Days sales outstanding was 63 days in the second quarter, up 3 days year-over-year and down 1 day from the first quarter.

PP&E turnover was 7.6 turns, in-line with prior year levels.

Our total debt principal at the end of the quarter was $1.70 billion, compared to $1.66 billion in the first quarter and $1.71 billion in the second quarter 2016. The sequential increase reflects the currency translation on our Euro-denominated debt.

Net leverage was 2.2 times net debt to EBITDA at the end of the second quarter, compared to 1.9 times in the prior quarter and a significant improvement from 3.6 times in the prior-year period.

We’re extremely pleased with our refinancing actions. We have extended our maturities and significantly lowered our cost of capital. In addition, our capacity for M&A in 2017 remains robust, with approximately $475 million available for deployment.

Please turn to Slide 8 for a few cash flow highlights.

Cash flow from operations in the second quarter was $47.0 million dollars compared to $48.0 million in the prior year.

Net capital expenditures were $11.8 million for the quarter, in-line with prior year levels.
As a result, free cash flow was $35.2 million in the second quarter 2017 compared to $36.3 million in the prior year period.

For the full-year 2017, we expect free cash flow to be approximately $270 million dollars.

That completes my prepared remarks. I would now like to turn this call back to our President, CEO, and Chairman, John Stroup, for the outlook. John?

John Stroup Belden, Inc. – President, CEO, and Chairman

Thank you, Henk.

Please turn to Slide 9 for our outlook regarding the third quarter and full-year 2017 results.

Our consolidated results for the second quarter were in line with our expectations, and we are increasing our full-year revenue and EPS guidance to reflect the Thinklogical acquisition and debt refinancing. Consistent with our commitment to continuous improvement, we expect further EBITDA margin expansion and double-digit EPS growth in the second half.

Further, we continue to actively pursue a number of attractive inorganic opportunities.

We anticipate third quarter 2017 revenues to be between $615 and $635 million, and EPS of $1.35 to $1.45.

For the full year, we expect revenues between $2.415 and $2.445 billion, relative to our prior guidance of between $2.355 and $2.405 billion. We now expect full year EPS of $5.35 to $5.55 compared to our prior guidance of $4.95 to $5.20. Thinklogical and the recent debt refinancing are expected to add a combined $0.35 per share in 2017.

That concludes our prepared remarks, operator please open the call to questions.