4th 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 fourth 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

Thank you, Kevin, and good morning, everyone.

As a reminder, I'll be referring to adjusted results today.

Please turn to Slide-3 in our presentation for a review of our fourth quarter performance.

Most of our businesses performed in line with our expectations during the fourth quarter, with the exception of an isolated situation in our Broadcast Solutions segment.

We had expected to recognize revenue on $36 million of product that was shipped in 2017, but we were unable to do so as a result of technical U.S. GAAP revenue recognition requirements that our team identified during the year-end closing process.

We now expect these 2017 shipments to be recognized as $36 million in revenue and $22 million in EBITDA in 2018, and this will be additive to the revenue and EBITDA that we otherwise would have anticipated.

As a result, revenues in the fourth quarter decreased 50 basis points to $604.9 million. Our Enterprise, Industrial, and Network Solutions segments performed in-line with our expectations, growing 8% on a combined basis from the prior-year period.

EBITDA in the fourth quarter was $110.2 million, or 18.2% of revenue. Our proven Lean enterprise system continues to drive sustainable productivity gains, with year-over-year EBITDA margin expansion in our Enterprise, Industrial and Network Solutions segments.

EPS increased 14.1% in the fourth quarter, from $1.42 in the prior year period to $1.62.

Looking to 2018, we raised our full-year revenue guidance range by $36 million to reflect the 2017 shipments that will now be recognized as revenue in 2018.

We expect improved organic growth in 2018, and are encouraged by the robust 5% organic order growth in January.

We also maintained our full-year earnings per share guidance range of $5.95 to $6.20. This guidance reflects an increase related to the delayed revenue and EBITDA recognition that I just discussed, offset by a higher effective tax rate.

Under the new U.S. tax legislation, we now anticipate an adjusted effective tax rate of approximately 24% compared to the prior guidance of 20% before the impact of the new legislation.

Henk will provide further details of our expectations relating to tax later on this call.

Please turn to slide 4 for a brief discussion of our full year 2017 results.

Revenues for the year increased 1.3% to a record $2.389 billion, led by solid growth in our Industrial and Enterprise Solutions platforms of 7.3% and 4.6%, respectively.

EBITDA increased 70 basis points to a record $434.3 million, with robust 18% growth in Industrial Solutions offset by the shortfall in Broadcast Solutions. EBITDA margins of 18.2% were consistent with the prior-year period.

Lower interest expense and a tax rate of 13.7% resulted in net income growth of 10.4% for the year. EPS increased from $5.27 in 2016 to $5.35 in 2017, a company record for full-year EPS.
2017 was also highlighted by significant improvements to our balance sheet and disciplined capital deployment.

During the year we issued 450 million euros of senior subordinated notes at 3.375% and 300 million euros at 2.875%, the lowest long-term borrowing rates in the history of the company.
These actions allowed us to further lower our cost of capital, extend our maturities, and increase our annualized earnings per share by $0.47.

We also completed the acquisition of Thinklogical during the year. This highly profitable business continues to perform well as part of the Belden family.

Finally, we increased our investments in attractive organic initiatives, which we expect to drive meaningful growth in future periods. Notably, in the fourth quarter we increased net capital expenditures by $12 million year-over-year. This included investments in a new manufacturing facility in India and investments in new software products.

Please turn to slide 5 for a review of our business segment results.

Broadcast segment revenues in the fourth quarter were $174.7 million, compared to $208.8 million in the year ago period. Our Broadband business recovered nicely as expected in the quarter, increasing 10% year-over-year and 21% sequentially.

In our Broadcast IT business, orders in the fourth quarter were in-line with our expectations.

However, as I mentioned before, $36 million in revenue and $22 million in EBITDA related to 2017 shipments will now be recognized in 2018.

Largely a result of the deferral of these revenues, Broadcast EBITDA margins in the fourth quarter were 12.7%, compared to 23.3% in the prior-year period.

I am pleased that our Enterprise, Industrial, and Network Solutions platforms performed in-line with our expectations.

Enterprise revenues increased 5.0% to $157.7 million driven by our successful share capture programs, notably within the Asia-Pacific region. Organic growth in the region was 12%, the sixth consecutive quarter of double-digit growth in that region.

Order rates were strong in January, increasing double-digits and benefitting from a number of large projects moving from our sales funnel and into our backlog. Notably, this included two significant project wins that are larger than any opportunity shipped in the past two years.

EBITDA margins improved in the quarter, as expected, increasing a robust 290 basis points year-over-year to 16.7%.

Revenues in our Industrial Solutions platform increased 10.8% to $162.6 million, with continued strength in Discrete Manufacturing, our largest vertical. End market demand remains very encouraging, with orders increasing 10% year-over-year in the fourth quarter, resulting in double-digit year-over-year order growth in every quarter of 2017.

EBITDA margins increased 110 basis points from the year-ago period to 19.9%, driven by solid volume leverage and productivity gains.

Network Solutions revenues increased 7.4% from the prior year period to $110.0 million. Our industrial end markets continue to perform very well, with revenues increasing 17% from the prior-year period.

EBITDA margins were 25.8% in the quarter, increasing 40 basis points from the prior-year period.

I will now ask Henk to provide additional insight into our fourth 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 6 for a detailed consolidated review….

Revenues were $604.9 million in the quarter, down from $608.2 million in the fourth quarter of 2016 and short of our guidance.

Importantly, orders were in line with expectations, as we booked $659.2 million of orders in the fourth quarter 2017, up $44.8 million, or 7.3%, from $614.4 million in the prior-year period.
We had expected to recognize revenue on $36 million of orders in our Broadcast segment that shipped prior to the end of 2017. However, we were unable to do so as a result of technical U.S. GAAP revenue recognition requirements.

Per the terms of certain transactions, our Broadcast IT business shipped products through third party logistics providers or 3PLs. On all of these shipments, legal title and the risk of loss transferred to the customers at the time of shipment, and we were entitled to receive payment. However, we did not meet all of the technical delivery criteria for revenue recognition under US GAAP.

Clearly, we are disappointed with this outcome. That said, we are pleased that we identified this matter as part of our year-end closing process.

Ultimately, we view this issue as a delay and have increased our 2018 guidance accordingly to reflect an incremental $36 million in revenue and $22 million in EBITDA.

For the fourth quarter, currency translation, higher copper prices and acquisitions increased revenues by $26.5 million dollars, and revenues decreased 4.9% organically from the prior-year period.

Sequentially, revenues decreased $16.8 million dollars from $621.7 million.

Gross profit for the quarter was 39.3% of revenues compared to 43.4% in the year-ago period and 41.1% in the third quarter.

Operating expenses were $140.2 million dollars, or 23.2% of revenues. Compared to the prior year, operating expenses declined $13.8 million, driven by significant productivity improvements.

EBITDA was $110.2 million dollars compared to $122.5 million in the prior-year period and $119.2 million in the prior-quarter.

EBITDA margins were 18.2%, decreasing 190 basis points from 20.1% in the fourth quarter 2016.

Net interest expense of $16.5 million dollars decreased $6.6 million dollars year-over-year, driven by the successful execution of our debt refinancing actions earlier in the year. For the full-year 2018, we expect interest expense to be approximately $68 million.

We significantly outperformed on tax in the quarter, with an effective tax rate of 4.6%, compared to 19.9% in the prior year. The current quarter benefitted from a number of incremental discrete tax planning initiatives.

On a GAAP basis, the company incurred a one-time charge of $28.4 million in the fourth quarter, resulting from the enactment of the Tax Cuts and Jobs Act. However, as a result of successful tax planning strategies in 2017, we do not expect a material cash impact from the deemed repatriation of foreign earnings.

For the full-year, our adjusted effective tax rate was very favorable at 13.7%, compared to 17.3% in the prior year and a jurisdictional rate of 28%.

In 2018, we expect an effective tax rate of 24%, compared to our prior guidance of 20%. The Tax Cut and Jobs Act lowered our jurisdictional tax rate from 28% to 24%. However, many of the tax planning strategies that we previously deployed are no longer available to us. Our team is working hard to evaluate the new legislation and identify incremental opportunities.

Importantly, we expect our cash tax rate to continue to be approximately 10%.

Net income in the quarter was $79.0 million dollars, increasing $8.7 million, or 12.4%, from $70.3 million in the prior-year period.

Earnings per share was $1.62 in the quarter, increasing 14.1% from $1.42 in the prior-year period.

Please turn to slide 7. I will now discuss revenues and operating results by business segment.

Our Broadcast Solutions segment generated orders of $221.0 million in the fourth quarter 2017, growing $13.9 million, or 6.7%, compared to $207.1 million in the prior-year period.

Broadcast revenues of $174.7 million dollars declined 16.3% from $208.8 million in the prior-year period.

As a reminder, the 2017 shipments in our Broadcast segment that were not recognized under U.S. GAAP had a revenue and EBITDA impact of $36 million and $22 million, respectively.

As a result, Broadcast EBITDA margins were 12.7% in the quarter, down from 23.3% in the prior year period and 18.4% in the third quarter.

Our Enterprise Solutions segment generated revenues of $157.7 million dollars during the quarter, increasing 5.0% from the prior-year period. On an organic basis, revenues increased 1.7% year-over-year.

EBITDA margins were 16.7% in the quarter, increasing 290 basis points from the prior-year and 90 basis points sequentially, driven by productivity improvements.

The Industrial Solutions segment generated revenues of $162.6 million dollars in the quarter, an increase of 10.8% from $146.7 million in the prior-year period. Currency translation and higher copper prices had a favorable impact of $7.7 million dollars. Adjusting for these factors, revenues grew 5.6% organically.

EBITDA margins of 19.9% increased 110 basis points year-over-year driven by solid leverage on volume and productivity gains.

Our Network Solutions segment generated revenues of $110.0 million dollars, growing 7.4% from the prior-year period. Currency translation had a favorable impact of $4.0 million dollars in the quarter. On an organic basis, revenues increased 3.4%.

EBITDA margins of 25.8% increased 40 basis points from the prior-year and 100 basis points sequentially.

If you will please turn to Slide 8, I will begin with our balance sheet highlights.

Our cash and cash equivalents balance at the end of the fourth quarter was $561 million dollars compared to $461 million in the prior quarter and $848 million in the prior year period. The year-over-year decrease reflects our disciplined capital deployment, net of cash flow generation.

Working capital turns were 8.6 turns, compared to 7.1 turns in the prior quarter and 15.4 turns in the prior-year. The year-over-year decrease is mainly a result of increased inventory levels.

Our total debt principal at the end of the fourth quarter was $1.58 billion, compared to $1.55 billion in the third quarter and $1.64 billion in the year-ago period. The year-over-year decrease reflects the debt repayment completed during the year, slightly offset by currency translation on our euro-denominated debt.

We are extremely pleased with the improvements made to our balance sheet during 2017. We lowered our pre-tax cost of debt to 3.9%, compared to 5.3% at the end of 2016.

Net leverage was a robust 2.3 times net debt to EBITDA at the end of the quarter, in-line with the prior quarter and below our target range of 2.5x – 3.0x.

Please turn to Slide 9 for a few cash flow highlights.

Cash flow from operations in the fourth quarter was $151.7 million dollars compared to $167.4 million in the prior year. As a reminder, fourth quarter 2016 benefitted from customer prepayments and a $10 million patent settlement.

Net capital expenditures were $29.8 million for the quarter, increasing $12.0 million from the prior-year period. This included investments in a new manufacturing facility in India and investments in new software products.

Free cash flow in the quarter was $121.9 million dollars, decreasing $27.7 million compared to $149.6 million in the prior-year period.

For the full-year 2017 we generated free cash flow of $192.1 million dollars, compared to $261.2 million in the prior-year period.

The year-over-year decline of $69 million was due primarily to higher inventory levels. Compared to the prior-year, copper inflation has increased the value of our inventory by $40 million dollars. In addition, our inventory is temporarily elevated by $30 million as a result of holding safety stock for our ongoing manufacturing footprint consolidation, and the timing of shipments.

In addition to robust EBITDA growth, we expect our inventory levels to normalize in 2018. As a result, we anticipate free cash flow to be in the range of $250 - $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's Guidance Remarks

Thank you, Henk.

Please turn to Slide 10 for our outlook regarding the first quarter and full-year 2018.

In 2018, we expect record revenues with growth across all our platforms. Consistent with our commitment to continuous improvement and high quality of earnings, we also expect record EBITDA margins and robust free cash flow growth.

We anticipate first quarter 2018 revenues to be between $575 and $595 million, and EPS of $1.05 to $1.15.

For the full year 2018, we now expect revenues between $2.528 and $2.578 billion, an increase of $36 million compared to our prior guidance range of between $2.492 and $2.542 billion. We continue to expect full year EPS of $5.95 to $6.20, representing an increase of 11-16%.

This guidance includes an increase in EPS related to the delayed revenue recognition and an offsetting impact of a higher effective tax rate due to the new tax legislation.

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