1st Quarter 2018

Earnings Conference Call Transcript

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CORPORATE PARTICIPANTS

John Stroup Belden, Inc. - President, CEO, and Chairman
Henk Derksen Belden, Inc. - CFO, SVP-Finance
Kevin Maczka Belden, Inc. – VP, Treasury & Investor Relations

PRESENTATION

Kevin Maczka Belden, Inc. – VP, Treasury & Investor Relations

Thank you, operator. Good morning, everyone, and thank you for joining us today for Belden's first quarter 2018 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 first quarter performance.

I am pleased to start the year with 10% revenue growth and 26% adjusted earnings growth in the first quarter. During the quarter we also continued to execute our balanced capital deployment strategy, which included an attractive acquisition, debt refinancing at very favorable terms, and record quarterly share repurchases.

Revenues in the first quarter increased 10.2% to $607.4 million. On a constant currency basis, revenues grew 6.9%, at the high-end of our long-term financial goal of 5-7%.

EBITDA grew 11.1% year-over-year to $103.3 million, reflecting 17.0% EBITDA margins. Our proven Lean enterprise system continues to drive sustainable productivity gains, offsetting mix headwinds in the quarter.

EPS increased 26.1% in the first quarter, from $0.92 in the prior year period to $1.16.

In addition to this solid operating performance, the quarter was highlighted by balanced capital deployment.

We completed the acquisition of Snell Advanced Media, or SAM, during the first quarter for $94 million, and we are excited to welcome the SAM team to the Belden family. SAM is a leading provider of live media production equipment that compliments Grass Valley's existing product and geographic capabilities.

This transaction brings significant value to our customers and shareholders through scale and productivity. By combining these two leading companies and aligning the resources and strategies, we create a much larger and stronger business with leading offerings in live media production.

We intend to invest approximately $50 million dollars this year in integration and restructuring efforts to capture the value of the combined company. These strategic actions include substantial cost reduction and manufacturing footprint rationalization.

We expect this acquisition to be accretive to EPS by $0.33 over the next four quarters. This reflects a compelling 13% return on the $144 million of invested capital. As a reminder, our ROIC targets for acquisitions are 9% in the first year of ownership and 13-15% beyond year 3.

We were also extremely pleased with the timely execution of our recent debt refinancing at very favorable terms. By issuing 350 million euros of senior subordinated notes at 3.875%, we lowered our cost of debt to a fixed rate of 3.5% and extended our maturities to 2025 and beyond. We expect this refinancing to be accretive to EPS by $0.12 on a full-year basis and $0.08 in 2018.

Finally, we allocated a quarterly record $75 million towards our share repurchase program during the quarter.

We are increasing our full-year revenue and EPS guidance to reflect the accretive SAM acquisition, debt refinancing, and share repurchases.

As a result, we now expect double-digit revenue growth and robust 16-21% EPS growth in 2018.

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

As highlighted in our press release issued this morning, we made a change to our organizational structure in the first quarter to improve execution and commercial collaboration. In order to properly align our external reporting with the way the businesses are being managed, we are now reporting two segments: Enterprise Solutions and Industrial Solutions. The segments formerly known as Enterprise Solutions and Broadcast Solutions will now be presented as the Enterprise Solutions segment, and the segments formerly known as Industrial Solutions and Network Solutions will now be presented as the Industrial Solutions segment.

Segment information for the 2017 quarters has been revised to conform to this change and has been included as an appendix to the press release issued this morning.

In our Enterprise segment, our solutions allow customers to transmit and secure data, sound, and video across complex enterprise and media networks. Our key markets include smart buildings, final mile broadband, and live media production.

Revenues in this segment increased 11.7% year-over-year to $351.0 million, or 9.1% on a constant currency basis.

The smart building market continues to benefit from healthy non-residential construction in the United States, and increased needs for contractor productivity and building efficiency.

This trend is best reflected by our innovative Category 6A cable products, which deliver both data and power over Ethernet. Orders for Category 6A cable more than doubled in the first quarter on a year-over-year basis.

Final mile broadband, which benefits from increasing broadband subscribers and network upgrades, performed as expected in the quarter. We are encouraged by a book-to-bill of 1.06 and continue to expect mid-single digit organic growth in this market for the full-year 2018.

Live media production is served by our combined Grass Valley and SAM businesses. Customer sentiment is positive following the ratification of industry IP standards in December 2017, as evidenced by our increased project quoting activity and a quarterly record $9 million of IP sales.

Grass Valley and SAM offer complimentary IP solutions, and our combined product roadmap has been well-received. Grass Valley is a clear leader in the live media space, and customers appreciate the unmatched scale that will be achieved through this business combination. That said, conditions in the United States remain challenging as our customers invest in direct to consumer platforms to combat new entrants.

Enterprise Solutions segment EBITDA margins were 16.4%, increasing 60 basis points from the prior-year period, driven by sustainable productivity initiatives.

Turning to our Industrial segment.

Much like Enterprise, our Industrial solutions allow customers to transmit and secure data, sound, and video, but in this case in harsh industrial environments. Our key markets include discrete manufacturing, process facilities, energy, and transportation.

Revenues in this segment increased 8.1% year-over-year to $256.4 million, or 4.0% on a constant currency basis. This includes a headwind from the MCS divestiture, which closed at the end of 2017.

Discrete manufacturing, our largest vertical, grew 4.2% on an organic basis, driven by continued demand from machine-builders.

The process market grew 7.6% organically, with robust double-digit growth in Oil & Gas.

Energy markets also saw double-digit organic growth in the quarter, driven by major project wins as a result of our expanded industrial cybersecurity initiatives.

Finally, transportation, which predominately provides networking equipment for public transportation and infrastructure applications, expanded 4.6% organically in the quarter.

Importantly, end market demand remains very encouraging across all of our markets, with total Industrial Solutions orders increasing 11% year-over-year in the first quarter.

Industrial Solutions segment EBITDA margins were 18.1% in the quarter, moderating slightly from the year-ago period.

I will now ask Henk to provide additional insight into our first 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 were $607.4 million dollars in the quarter, increasing $56 million, or 10.2% from $551.4 million in the first quarter of 2017.

Revenues were favorably impacted by $17.9 million from currency translation, $7.5 million from higher copper prices, and $30.5 million from acquisitions. After adjusting for these factors, revenues increased 1.1% organically from the prior-year period.

Gross profit margins in the quarter were 39.9%, compared to 41.5% in the year-ago period. The year-over-year decrease was driven by unfavorable product mix.

Operating expenses were $150.9 million dollars, or 24.8% of revenues. After adjusting for the impact of currency translation and acquisitions, operating expenses decreased $13.4 million, driven by sustainable productivity initiatives.

EBITDA was $103.3 million dollars, increasing $10.3 million, or 11.1%, compared to the prior-year period. EBITDA margins increased modestly to 17.0%.

Net interest expense of $17.0 million dollars decreased $6.5 million year-over-year, driven by the debt refinancing actions completed in 2017.

As a result of further debt refinancing actions completed in April 2018, we now expect interest expense of $64 million for the full-year.

The effective tax rate for the first quarter was 22.8%, compared to 18.2% in the prior year.

For financial modeling purposes, we recommend using our jurisdictional tax rate of 24% for the remaining quarters of 2018.

Net income in the quarter was $57.5 million dollars, compared to $47.8 million in the prior-year period.

Earnings per share was $1.16 in the quarter, increasing 26.1% from $0.92 in the prior-year period.

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

Our Enterprise Solutions segment generated revenues of $351.0 million dollars during the quarter, increasing 11.7% from the prior-year period. Higher copper prices, currency translation, and acquisitions increased revenues by $42.0 million dollars. After adjusting for these factors, revenues decreased 1.7% organically year-over-year.

I am pleased with the success of our recent price actions, which increased revenues by $6.1 million sequentially in the quarter.

This is the second consecutive quarter of price improvements.

EBITDA margins were 16.4% in the quarter, increasing 60 basis points from the prior-year and 180 basis points sequentially. The year-over-year increase was driven by sustainable productivity improvements.

The Industrial Solutions segment generated revenues of $256.4 million dollars in the quarter, an increase of 8.1% from $237.1 million in the prior-year period. Currency translation and higher copper prices had a favorable impact of $13.9 million dollars. The divestiture of MCS, completed at the end of 2017, resulted in $6.0 million lower revenues. After adjusting for these factors, revenues grew 4.8% organically.

EBITDA margins of 18.1% decreased 40 basis points year-over-year driven by unfavorable product mix and increased investment in product innovation.

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 first quarter was $363 million dollars compared to $561 million in the prior quarter and $816 million in the prior year period. The year-over-year decrease reflects our capital deployments, net of cash flow generation.

Working capital turns were 5.7 turns, compared to 8.2 turns in the prior quarter and 8.1 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 first quarter was $1.69 billion, compared to $1.58 billion in the fourth quarter 2017 and $1.66 billion in the year-ago period. The sequential increase of $110 million reflects $30 million of currency translation and $80 million of outstanding debt that was repaid in early April as part of our first quarter debt refinancing actions.

We are extremely pleased with the improvements made to our balance sheet. We have lowered our pre-tax cost of debt to a fixed rate of 3.5% and extended our maturities to 2025 and beyond.

Net leverage was 2.9 times net debt to EBITDA at the end of the quarter, in-line with our target range of 2.5x – 3.0x.

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

Cash flow from operations in the first quarter was a use of $83.9 million dollars compared to a use of $12.3 million in the prior year.

The year-over-year decline was primarily due to payments to vendors to support the increased growth capex spending and the inventory build in the fourth quarter. We are holding more inventory than typical, reflecting higher copper prices, safety stock related to our manufacturing footprint consolidation, and expectations for improving demand going forward, as evidenced by our $68 million increase in backlog during the quarter.

With the manufacturing footprint consolidation now complete, we anticipate a $30 million dollar reduction in inventory in 2018.

Moving next to capital allocation.

Net capital expenditures were $15.9 million for the quarter, increasing $5.5 million from the prior-year period.

In the quarter, we completed the acquisition of SAM for a total cash investment of $94 million dollars. This includes $75 million plus $19 million in debt that we assumed and immediately paid off.

We expect to make an additional investment of approximately $50 million dollars this year in integration and restructuring efforts to capture the value of the combined company.

In 2018, we expect SAM to contribute approximately $105 million dollars of revenues, $15 million of EBITDA, and $0.20 of EPS accretion.

Over the next four quarters, we expect this acquisition to be accretive to EPS by $0.33. This reflects a compelling 13% return on the $144 million of invested capital.

We are updating our free cash flow guidance to reflect the SAM acquisition. We now expect 2018 free cash flow to be in the range of $210 - $230 million dollars, compared to the previously guided range of $250 - $270 million.

This updated range represents approximately 15% growth at the midpoint, which is consistent with our long-term financial goal of 13-15%.

Finally, we allocated a quarterly record of $75 million towards our share repurchase program in the first quarter, repurchasing 1.05 million shares. We continue to execute upon this program in the second quarter, and we have repurchased 1.3 million shares for $92 million year-to-date through April.

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 9 for our outlook regarding the second quarter and full-year 2018.

In 2018, we expect record revenues with growth in both of our segments. Consistent with our commitment to continuous improvement and high quality of earnings, we also expect record

EBITDA margins and free cash flow growth of approximately 15%, in line with our long-term goal of 13-15%.

We anticipate second quarter 2018 revenues to be between \$650 and \$670 million, and EPS of \$1.41 to \$1.51.

For the full year 2018, we are raising guidance to include the benefit of our SAM acquisition, debt refinancing, and share repurchases in the first quarter.

For the full year 2018, we now expect revenues between \$2.633 and \$2.683 billion, an increase of \$105 million compared to our prior guidance range of between \$2.528 and \$2.578 billion.

This represents 10-12% growth, or 9-11% on constant currency basis, exceeding our 5-7% long-term financial goal.

We now expect full year EPS of \$6.23 to \$6.48, compared to our prior guidance range of \$5.95 to \$6.20. This represents robust 16-21% growth.

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