2nd 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 second 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 second quarter performance.

Second quarter revenues and EPS were above our guided ranges. I am extremely pleased to report record quarterly revenues that exceeded our long-term growth goal and our fourth consecutive quarter of double-digit EPS growth.

Revenues in the second quarter increased 10.0% to $671.4 million. On a constant currency basis, revenues grew 8.4%, above the high-end of our long-term financial goal of 5-7%.

EBITDA grew 9.6% year-over-year to $122.6 million, reflecting 18.3% EBITDA margins. Our proven Belden business system continues to drive sustainable productivity gains, offsetting the mix headwinds in the quarter.

EPS increased 17.8% in the second quarter, from $1.29 in the prior year period to $1.52.
We expect improved organic growth, solid EBITDA margin expansion, and continued double-digit EPS growth in the second half of the year.

We are tightening our full-year 2018 revenue and EPS guidance ranges to reflect our expectation of 11-12% revenue growth and robust 17-21% EPS growth.

We are also pleased to announce a favorable payment related to an IP dispute within our Broadband business. We received cash and recognized a pre-tax gain of approximately $62 million early in the third quarter, which will not be included in our adjusted EPS for 2018.

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

I will begin with our Enterprise Solutions segment. As a reminder, our Enterprise 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 14.6% year-over-year to $399.7 million, or 13.4% 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. Category 6A cable revenues increased 43% organically in the second quarter on a year-over-year basis.

Final mile broadband, which benefits from increasing broadband subscribers and network upgrades, rebounded as expected in the quarter. We continue to expect mid-single digit growth in this market for the full-year 2018.

We also expanded the fiber capabilities within our broadband business during the quarter with the acquisition of NT2, a fiber component supplier with approximately $15 million in annual revenues. NT2's complimentary products expand our fiber-to-the-home offering for broadband service providers, and bring our total annual fiber sales to approximately $100 million.

Further, we have a robust M&A pipeline, and we continue to actively pursue a number of attractive inorganic opportunities in this area.

Live media production is served by our combined Grass Valley and SAM businesses.

We completed the SAM acquisition during the first quarter, and the integration is progressing as planned. Revenue and EBITDA exceeded our expectations in the first full quarter of ownership, as we are efficiently combining these two leading companies and capturing the targeted synergies.

Revenues for the combined Grass Valley and SAM business were approximately flat on a year-over-year basis. We are encouraged that the combined EBITDA margin increased over 10 percentage points to 17% as a result of our successful integration and restructuring efforts.

Enterprise Solutions segment EBITDA margins were 17.6%, increasing 140 basis points from the prior-year period, primarily as a result of the acquisition integration.

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 3.8% year-over-year to $271.7 million, or 1.6% on a constant currency basis. This includes a headwind from the MCS divestiture, which closed at the end of 2017.

Cybersecurity revenues declined in the quarter, in part due to project timing, as two larger projects slipped into the second half of the year.

Importantly, our improved product roadmap is gaining traction with new and existing customers. We released a number of new Cloud-based products during the quarter that enable the installed base to purchase additional product categories. We also had a key win with a major pharmacy chain for a recently launched solution, which we expect to be well-received by other customers as well.

We continue to expand our reach into Industrial customers, as we now offer a comprehensive suite of capabilities tailored for this vertical. We expect to add to these capabilities in the coming quarters.

Discrete manufacturing, our largest vertical, grew 6.7% on an organic basis, driven by continued demand from machine builders and increasing investments in automation.

The process market grew 8.6% organically, with robust demand in chemical processing and water/wastewater applications.

Energy increased 3.7% in the quarter, driven by demand in electrical substation automation and alternative energy.

Finally, transportation, which predominately provides networking equipment for public transportation and infrastructure applications, expanded 1.3% organically in the quarter, with demand across a broad range of transportation markets, such as airports.

Importantly, end market demand remains very encouraging with healthy order rates and backlogs across our industrial markets.

Industrial Solutions segment EBITDA margins were 19.6% in the quarter, increasing 150 basis points sequentially and declining 110 basis points year-over-year due to the unfavorable mix headwinds.

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 were $671.4 million dollars in the quarter, increasing $60.8 million, or 10.0% from $610.6 million in the second quarter of 2017.

Revenues were favorably impacted by $9.7 million from currency translation, $9.7 million from higher copper prices, and a net $33.0 million from acquisitions and divestitures. After adjusting for these factors, revenues increased 1.4% organically from the prior-year period.

Importantly, all of the product held at 3PLs at the end of 2017 has been delivered to end customers. Through the end of Q2, we have recognized revenue on approximately $33 million of this product. The remaining $3 million will be recognized in future periods. We are glad to put this issue behind us.

Gross profit margins in the quarter were 40.0%, compared to 41.4% in the year-ago period. The year-over-year decrease was driven by unfavorable product mix and higher copper prices.

As a reminder, when copper costs increase and we successfully raise selling prices, this drives higher revenue with minimal impact to gross profit dollars. As a result, gross profit margins decrease.

Operating expenses were $158.1 million dollars, or 23.6% of revenues. After adjusting for the impact of currency translation and acquisitions, operating expenses decreased $14.6 million, driven by our restructuring actions and productivity initiatives.

EBITDA was $122.6 million dollars, increasing $10.7 million, or 9.6%, compared to the prior-year period. EBITDA margins of 18.3% were consistent with the year-ago period.

Net interest expense declined 36% year-over-year, from $23.5 million to $15.1 million, as a result of the debt refinancing actions completed over the last year. We were extremely pleased with these actions, which substantially lowered our pre-tax cost of debt and extended our maturities.

At current foreign exchange rates, we now expect interest expense of $61 million dollars for the full-year.

Following the implementation of the Tax Cuts and Jobs Act of 2017, our effective tax rate for the second quarter was 24.0%, compared to 16.6% in the prior year.

I am pleased to report that our team has identified incremental tax planning initiatives available to us under the new tax laws. For financial modeling purposes, we recommend using an effective tax rate of 22% for the third and fourth quarters of 2018.

Net income in the quarter was $72.6 million dollars, compared to $64.3 million in the prior-year period.

Earnings per share was $1.52 in the quarter, increasing 17.8% from $1.29 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 $399.7 million dollars during the quarter, increasing 14.6% from the prior-year period. Higher copper prices, currency translation, and acquisitions increased revenues by $49.2 million dollars. After adjusting for these factors, revenues increased 50 basis points organically year-over-year.

I am pleased with the success of our recent price actions, which increased revenues sequentially for the third consecutive quarter. We expect additional benefits from these actions in the second half of the year.

EBITDA margins were 17.6% in the quarter, increasing 140 basis points from the prior-year period and 120 basis points sequentially. The year-over-year increase was driven by successful acquisition integration and sustainable productivity improvements.

As a reminder, we completed the acquisition of Snell Advanced Media, or SAM, during the first quarter 2018. We are investing approximately $50 million dollars this year in integration and restructuring efforts to capture the value of the combined company and generate a compelling 13% return on the total invested capital. These strategic actions include substantial cost reduction and manufacturing footprint rationalization.

We are extremely pleased with the substantial progress made by the team in the first few months of ownership. Revenue and EBITDA exceeded our expectations in the second quarter, contributing to the solid Enterprise segment EBITDA margin performance.

The Industrial Solutions segment generated revenues of $271.7 million dollars in the quarter, an increase of 3.8% from $261.8 million in the prior-year period. Currency translation and higher copper prices had a favorable impact of $10.3 million dollars. The divestiture of MCS, completed at the end of 2017, resulted in $7.0 million lower revenues. After adjusting for these factors, revenues increased 2.5% organically.

EBITDA margins of 19.6% decreased 110 basis points year-over-year driven by unfavorable product mix and higher copper prices.

Again, when copper costs increase and we successfully raise selling prices, this drives higher revenue with minimal impact to EBITDA dollars. As a result, EBITDA margins decrease.

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 $261 million dollars compared to $363 million in the first quarter and $670 million in the prior year period. The year-over-year decrease reflects our capital deployments, net of cash flow generation.

Our industry-leading working capital turns were 6.4 turns, compared to 5.7 turns in the prior quarter and 7.0 turns in the prior-year.

Days sales outstanding and days payable outstanding were consistent with the year-ago period at 63 days and 87 days, respectively. Inventory turns showed meaningful sequential improvement, from 4.6 turns to 5.2 turns despite the inflationary environment and increased output, as inventory levels declined approximately $10 million dollars.

We are encouraged by this progress on inventory turns during the quarter, and expect further improvements going forward.

Our total debt principal at the end of the second quarter was $1.51 billion, compared to $1.69 billion in the first quarter 2018 and $1.70 billion in the year-ago period. The sequential decrease of $181 million dollars reflects favorable currency translation and $82 million of outstanding debt that was repaid in early April as part of our debt refinancing actions.

Net leverage was 2.7 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 second quarter was $54.5 million dollars compared to $47.0 million in the prior year, despite $15 million dollars of incremental restructuring cost.

Net capital expenditures were $22.1 million for the quarter, compared to $11.8 million in the prior-year period, as we increased our investments in organic growth initiatives. This included investments in new software products and a new manufacturing facility in India, which is scheduled to be operational by the fourth quarter.

As a result, free cash flow was $32.4 million in the second quarter 2018 compared to $35.2 million in the prior year period.

For the full-year 2018, we continue to expect free cash flow in the range of $210 to $230 million dollars. This represents approximately 15% growth at the midpoint, which is consistent with our long-term financial goal of 13-15%.

This outlook includes the benefit of a one-time favorable legal payment of approximately $62 million dollars, or $45 million net of tax, related to a previously-disclosed patent infringement case brought by our PPC broadband business against a competitor. The case was originally filed in 2011, and the cash payment in July relates to the willful infringement of PPC's patents in prior years. As a result, this payment will not be included in our adjusted EPS guidance for 2018.

This outlook also reflects our current view of EBITDA and the incremental investments being made by our live media business to support our customers as they transition from capex models to opex models. As a clear leader in this industry, we view this as an opportunity to further support our customers and capture incremental market share.

Finally, we allocated $25 million dollars towards our share repurchase program in the second quarter, repurchasing 388,000 shares. We repurchased 1.4 million shares for $100 million dollars in the first half of 2018, and we have $75 million remaining on our current authorization.

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 third quarter and full-year 2018.

We are on track to meet our 2018 commitments. For the full year, we expect record revenues and EBITDA margins. We also expect free cash flow growth of approximately 15%, in line with our long-term goal of 13-15%.

We anticipate third quarter 2018 revenues to be between $670 and $690 million, and EPS of $1.65 to $1.75.

For the full year 2018, we are tightening our revenue and EPS guidance ranges. We now expect revenues between $2.643 and $2.673 billion, compared to our prior guidance range of between $2.633 and $2.683 billion. This represents 11-12% growth, or 10-11% on constant currency basis, exceeding our 5-7% long-term financial goal. This also represents organic growth of 5-6% for the full year, and 8-10% in the second half.

We now expect full year EPS of $6.28 to $6.48, compared to prior guidance range of $6.23 to $6.48. This represents robust 17-21% growth.

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