3rd Quarter 2018

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, 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 third 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 third quarter performance.

I am pleased to report strong year-over-year earnings growth in the third quarter. However, despite entering the quarter with record backlog, order softness in our Enterprise segment and capacity constraints in our Industrial segment prevented us from meeting our revenue guidance.

We expect these challenges will continue in the fourth quarter. As a result, we are reducing our revenue and EPS expectations for the remainder of the year. We are disappointed in this near-term outlook revision. As you know, we have a long track record of accurately predicting our results and delivering on our commitments to shareholders. My team and I remain fully committed to executing our strategic plan and delivering robust growth and margin expansion longer-term.

Our new full-year 2018 guidance ranges reflect our expectation of approximately 9% revenue growth and 12-14% EPS growth.

Now, let’s review the third quarter performance. Revenues in the quarter increased 6.0% year-over-year and 3.2% organically to $659.0 million. On a constant currency basis, revenues grew 6.8%, in line with our long-term financial goal of 5-7%.

EBITDA grew 6.3% year-over-year to a record $126.7 million, reflecting 19.2% EBITDA margins. Increasing volumes and pricing along with the continued successful integration of our SAM acquisition offset various cost headwinds in the quarter.

I am pleased with another quarter of strong earnings growth. EPS increased 15.4% in the third quarter, from $1.49 in the prior year period to $1.72. This represents our fifth consecutive quarter of double-digit EPS growth.

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 live media production, final mile broadband, and smart buildings.

Revenues in this segment increased 8.7% year-over-year to $392.1 million, or 1.1% on an organic basis.

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

This market has proven to be very difficult to forecast. Following a relatively flat revenue performance in the second quarter, we had anticipated flat revenues in the third quarter based on our strong funnel of project opportunities and the typical seasonality of the business.

However, third quarter revenues declined 8% year-over-year and 5% sequentially, driven by the continued significant disruptions within the media markets in North America.

Revenues in North America declined 19% year-over-year, compared to growth in EMEA and Asia-Pacific. We expect the challenges in North America will continue in the fourth quarter.

Importantly, the SAM acquisition increased our exposure to stronger international markets and provided meaningful synergy capture opportunities. The combined EBITDA margin exceeded 19% in the third quarter as a result of our successful integration efforts.

I'd like to thank the team for their hard work during the quarter and their impressive execution under some extremely challenging circumstances.

Final mile broadband, which benefits from increasing broadband subscribers and network upgrades, increased 8% in the quarter. However, order growth slowed later in the quarter due to customer inventory management. This pressure is likely to persist in the fourth quarter.

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 a robust 48% organically in the third quarter.

Enterprise Solutions segment EBITDA margins were 18.4%, increasing 120 basis points from the prior-year period, primarily as a result of the acquisition integration and improved pricing.

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 6.2% on an organic basis to $266.9 million.

Discrete manufacturing and process facilities, our largest verticals, grew 8.0% and 9.4% respectively on an organic basis. We continue to benefit from strong demand from machine builders and increasing investments in automation, and we expect these favorable trends to continue.

Overall, end market demand remains encouraging with 6% organic order growth in the quarter and healthy backlogs across our industrial markets.

Despite these solid growth rates, we did encounter some manufacturing capacity constraints during the quarter related to labor shortages and extended supplier lead times. The teams are working diligently to eliminate bottlenecks and secure additional sourcing to satisfy the robust demand trends in our markets.

Cybersecurity revenues rebounded in the quarter as expected, increasing 3% year-over-year and 15% sequentially.

Importantly, non-renewal bookings, our best leading indicator of revenues, increased a robust 18% year-over-year.

Our new Cloud-based products are gaining traction with new and existing customers. We booked three orders in excess of $1 million in the quarter, the most since the third quarter of 2016.

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

In addition, we recently announced two strategic partnerships. By partnering with ForeScout Technologies, a leading Internet of Things security company, and Claroty, a leader in cybersecurity for industrial control networks, we further strengthen our cybersecurity offering for industrial customers.

Industrial Solutions segment EBITDA margins were 20.1% in the quarter.

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

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

Thank you, John. I will start my comments with results for the third 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 $659.0 million dollars in the quarter, increasing $37.3 million, or 6.0% from $621.7 million in the third quarter of 2017.

Revenues were favorably impacted by a net $22.6 million from acquisitions and divestitures, and negatively impacted by $5.3 million from currency translation. After adjusting for these factors, revenues increased 3.2% organically from the prior-year period.

On a sequential basis, revenues declined $12.4 million dollars, or 1.8%. Revenues were negatively impacted by $9.4 million from currency translation and copper prices.

Gross profit margins in the quarter were 41.0%, consistent with the year-ago period. Higher volumes and favorable pricing offset higher input costs and unfavorable mix.

Operating expenses were $156.4 million dollars, or 23.7% of revenues.

EBITDA was $126.7 million dollars, increasing $7.5 million, or 6.3%, compared to the prior-year period. EBITDA margins of 19.2% were consistent with the year-ago period, and increased 90 basis points sequentially.

Net interest expense declined 25% year-over-year, from $19.4 million to $14.5 million, as a result of the debt refinancing actions completed in recent quarters. We are extremely pleased with these actions, which substantially lowered our cost of debt and extended our maturities.

As a reminder, our debt is entirely fixed at an average pre-tax interest rate of 3.5% with no maturities until 2025 to 2028.

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

Our effective tax rate for the third quarter was 18.6%, compared to 24.0% in the second quarter 2018.

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 19% for the fourth quarter and 21% for the full year. We also recommend using 21% on an annual basis going forward.

Net income in the quarter was $81.9 million dollars, compared to $73.9 million in the prior-year period.

Earnings-per-share was $1.72 in the quarter, increasing 15.4% from $1.49 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 $392.1 million dollars during the quarter, increasing 8.7% from the prior-year period. Revenues were favorably impacted by $30.4 million from acquisitions, and negatively impacted by $3.3 million from currency translation and copper prices. After adjusting for these factors, revenues increased 110 basis points organically year-over-year.

On a sequential basis, revenues declined $7.6 million dollars, or 1.9%. Revenues were negatively impacted by $4.6 million dollars from currency translation and copper prices.

EBITDA margins were 18.4% in the quarter, increasing 120 basis points from the prior-year period and 80 basis points sequentially. The year-over-year increase was driven by successful acquisition integration as well as solid execution on our pricing initiatives.

The Industrial Solutions segment generated revenues of $266.9 million dollars in the quarter, an increase of 2.3% from $260.9 million in the prior-year period. Currency translation and copper prices had a negative impact of $2.2 million dollars. The divestiture of MCS, completed at the end of 2017, resulted in $7.8 million lower revenues. After adjusting for these factors, revenues increased 6.2% organically.

Demand remains strong across our industrial markets, with orders increasing 6% year-over-year on an organic basis and total backlog increasing 18%.

EBITDA margins were 20.1% in the quarter, declining 130 basis points year-over-year but increasing 50 basis points sequentially. Volume, price and mix benefits were offset by temporary inefficiencies related to extended lead times throughout the supply chain.

Our customers remain our priority, so we are incurring additional costs to maintain our on-time delivery standards. We are working diligently through these headwinds, which we expect to continue for the next 1-2 quarters.

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 third quarter was $329 million dollars compared to $261 million in the second quarter and $461 million in the prior year period. The year-over-year decrease reflects our capital deployments, net of cash flow generation.

Our working capital turns were 6.2 turns, compared to 6.4 turns in the prior quarter and 7.1 turns in the prior-year.

Days sales outstanding and days payable outstanding each increased slightly from the year-ago period to 66 days and 93 days, respectively.

Inventory turns were 4.9 turns, compared to 5.2 turns in the second quarter. We continue to expect inventory levels to decline by approximately $30 million dollars in 2018, adjusted for the SAM acquisition. We therefore expect to exit 2018 at approximately 5.5 turns, compared to 5.1 turns at year-end 2017.

Our total debt principal at the end of the third quarter was consistent with the second quarter at $1.53 billion.

Net leverage was 2.5 times net debt to EBITDA at the end of the quarter, in-line with our target range of 2.0x – 3.0x. We expect our net leverage to trend lower in the fourth quarter.

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

Cash flow from operations in the quarter was $130.2 million dollars compared to $68.8 million in the prior year. The third quarter 2018 includes $47.2 million dollars related to a gain on patent litigation. Excluding this gain, cash flow from operations increased 21% year-over-year in the quarter.

Net capital expenditures were $23.9 million for the quarter, compared to $11.2 million in the prior-year period, as we increased our investments in organic growth initiatives. This included investments in new products and a new manufacturing facility in India, which made its first shipments in the fourth quarter.

As a result, free cash flow was $106.3 million in the third quarter 2018 compared to $57.6 million in the prior year period.

For the full-year 2018, we now expect free cash flow in the range of $190 to $210 million dollars. This outlook reflects our revised view of EBITDA for the year.

Finally, we allocated $25 million dollars towards our share repurchase program in the third quarter, repurchasing 344,000 shares. We repurchased 1.8 million shares for $125 million dollars YTD in 2018. We have $50 million remaining on our current authorization, which we are planning to deploy in the fourth quarter.

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 fourth quarter and full-year 2018.

We anticipate fourth quarter 2018 revenues to be between $657 and $677 million, and EPS of $1.60 to $1.70.

For the full year 2018, we continue to expect record revenues and EPS, but we are lowering our guidance ranges. We now expect revenues between $2.595 and $2.615 billion, compared to our prior guidance range of between $2.643 and $2.673 billion. This represents approximately 9% growth, or 8% on constant currency basis, exceeding our 5-7% long-term financial goal.

We now expect full year EPS of $6.00 to $6.10, compared to prior guidance range of $6.28 to $6.48. This represents 12-14% growth.

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