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# 4th Quarter 2018 Earnings 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, Treasurer & Investor Relations

## PRESENTATION

**Kevin Maczka** Belden, Inc. – VP, Treasurer & Investor Relations

Thank you, operator. Good morning, everyone, and thank you for joining us today for Belden's fourth quarter 2018 earnings conference call.

My name is Kevin Maczka, I'm Belden's Vice President, Treasurer and 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 website 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.

Revenues in the fourth quarter increased 8.1% year-over-year and 6.8% organically to $654.1 million. When adjusted for unfavorable movements in foreign currency rates and copper prices, revenues were consistent with our expectations across most of our portfolio.

Recall that we entered the fourth quarter with the expectation that capacity constraints in our Industrial segment would continue through the end of the year.

I am pleased with the progress we are making on expanding manufacturing capacity and reducing lead times. We expect these efforts to drive significant improvements in customer service and inventory levels going forward.

EBITDA in the fourth quarter increased 10.4% year-over-year to $121.6 million. EBITDA margins expanded 40 basis points from 18.2% in the prior year period to 18.6%.

EPS increased 2.5% in the quarter, from $1.62 in the prior year period to $1.66. As a reminder, the fourth quarter 2017 benefitted from an unusually low tax rate.

Net leverage was reduced from 2.5x net debt to EBITDA in the third quarter to 2.2x at the end of the fourth quarter. This is near the low end of our target range of 2.0x – 3.0x.

We completed our $200 million share repurchase program by deploying the final $50 million in the fourth quarter. We also announced a new $300 million authorization, which we expect to begin executing in 2019.

**Please turn to Slide 4** for a brief discussion of our full year 2018 results.

In 2018 we generated record revenues, EBITDA, and EPS.

Full year revenues increased 8.5% to a record $2.592 billion. On a constant currency basis, revenues grew 7.9%, exceeding our long-term financial goal of 5-7%.

EBITDA increased 9.2% to a record $474.2 million, driven by robust 24% growth in the Enterprise Solutions segment. Enterprise Solutions benefitted from the successful integration of the SAM acquisition within our Live Media business.

EBITDA margins of 18.3% were consistent with the prior-year.

Lower interest expense and share count resulted in a 13.3% increase in EPS to a record $6.06.

Cash flow from operations also increased by 13.3% to $289.2 million.

2018 was also highlighted by balanced capital deployment toward organic growth investments, share repurchases, and acquisitions.

We increased net capital expenditures to $98 million to fund a number of attractive organic initiatives that are expected to drive meaningful growth in future periods. This included investments in new hardware and software products, such as our successful Cloud-based cybersecurity solutions, and a new manufacturing facility in India. This important facility made its first shipments during the fourth quarter.

We deployed a record $175 million toward share repurchases, and we also completed two strategic acquisitions for $103 million, and we are very pleased with the successful integrations.

The addition of Snell Advanced Media, or SAM, allowed us to significantly improve our Live Media business, and NT2 complemented the fiber offering in our Broadband business.

**Please turn to slide 5** 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 14.1% year-over-year to $379.4 million, or 7.4% on an organic basis.

End demand in the smart building market increased 2.8% year-over-year in the quarter.

This 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 23% organically in the fourth quarter and 28% for the full year.

Revenues in final mile broadband declined approximately 5% on a year-over-year basis relative to our expectation of flat.

Recall that broadband order growth slowed late in the third quarter due to customer inventory management, and as expected, that trend persisted in the fourth quarter.

We continue to drive robust growth with our fiber optic and our outside-the-home products, which benefit from increasing broadband subscribers and network upgrades, but we are seeing softer demand for products used inside-the-home. As a result, revenues declined modestly on a full year basis.

We expect these trends to continue, with growth in the outside network offset by softness in the home.

We also see a number of attractive inorganic opportunities in the fiber area that would allow us to further expand our outside-the-home product offering and drive substantial growth.

Revenues in live media production were approximately flat sequentially in the fourth quarter. Importantly, orders increased sequentially and exceeded our expectations.

Enterprise Solutions segment EBITDA margins were 17.8%, increasing 320 basis points from the prior-year period, primarily due to acquisition integration and improved pricing.

Pricing gains throughout the year allowed us to successfully offset input cost inflation.

Turning now 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 6.0% on an organic basis to $274.7 million, with strong growth in all key verticals.

Discrete manufacturing and process facilities, our largest verticals, grew 7.5% and 14.3% 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.

Cybersecurity demand trends remain very encouraging. Non-renewal bookings, our best leading indicator of revenues, increased a robust 17% year-over-year in the fourth quarter after increasing 18% in the third quarter. Our new Cloud-based solutions continue to gain traction with new and existing customers.

Importantly, non-renewal bookings increased 32% in Industrial end markets. We are further expanding our reach into this key vertical with the most comprehensive suite of products specifically designed for industrial applications.

Industrial Solutions segment EBITDA margins were 19.8% in the quarter.

I will now ask Henk to provide additional insight into our fourth quarter and full year 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 $654.1 million dollars in the quarter, increasing $49.2 million, or 8.1%, from $604.9 million in the fourth quarter of 2017.

Revenues were favorably impacted by a net $22.7 million from acquisitions and divestitures, and negatively impacted by $14.5 million from currency translation and lower copper prices. After adjusting for these factors, revenues increased 6.8% organically from the prior-year period.

Please note that the prior-year period was negatively impacted by $36 million related to previously disclosed revenue recognition timing. After adjusting for this impact, revenues increased 80 basis points from the prior-year period.

Gross profit margins in the quarter were 40.6%, increasing 130 basis points compared to 39.3% in the year-ago period.

Operating expenses were $156.2 million dollars, or 23.9% of revenues.

EBITDA was $121.6 million dollars, increasing $11.4 million, or 10.4%, compared to $110.2 million in the prior-year period.

EBITDA margins were 18.6%, increasing 40 basis points from 18.2% in the fourth quarter 2017.

Net interest expense declined $1.5 million dollars year-over-year to $15.0 million, as a result of the successful debt refinancing actions completed in early 2018.

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

At current foreign exchange rates, we expect interest expense of $59 million dollars for the full year 2019, down from $62 million in 2018.

Our effective tax rate was 17.8% in the quarter, compared to 4.6% in the fourth quarter 2017. The prior year period benefitted from a number of incremental discrete tax planning initiatives.

For the full-year, our effective tax rate was 20.7%, compared to 13.7% in 2017.

In 2019, we expect an effective tax rate of 21%.

As a result of the higher effective tax rate in the quarter, net income was $77.7 million dollars, compared to $79.0 million in the prior-year period.

Earnings per share was $1.66 in the quarter, increasing 2.5% from $1.62 in the prior-year period.

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

Our Enterprise Solutions segment generated revenues of $379.4 million dollars during the quarter, increasing 14.1% from the prior-year period.

Revenues were favorably impacted by $29.6 million from acquisitions, and negatively impacted by $7.2 million from currency translation and copper prices. After adjusting for these factors, revenues increased 7.4% organically on a year-over-year basis.

After adjusting for the revenue recognition impact in the prior-year period that I mentioned previously, revenues declined 3.1% year-over-year.

EBITDA margins were 17.8% in the quarter, increasing 320 basis points from the prior year period. The year-over-year increase was driven by successful acquisition integration and solid execution on our pricing initiatives.

The Industrial Solutions segment generated revenues of $274.7 million dollars in the quarter, increasing 80 basis points from the prior-year period. Currency translation and copper prices had a negative impact of $7.3 million dollars. The divestiture of MCS, completed at the end of 2017, resulted in $6.9 million lower revenues. After adjusting for these factors, revenues increased 6.0% organically.

Demand remains robust across our industrial markets, with orders increasing 6.4% year-over-year on an organic basis.

EBITDA margins were 19.8% in the quarter, declining 240 basis points year-over-year.

Volume and price benefits were offset by temporary inefficiencies related to extended lead times throughout the supply chain. We made significant progress during the quarter, but still incurred additional costs to support our customers and maintain our on-time delivery standards.

In addition, we continue to make strategic investments in new products, such as our Cloud-based cybersecurity solutions, which are expected to drive growth in future periods.

**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 $421 million dollars compared to $329 million in the third quarter and $561 million in the prior year period. The year-over-year decrease reflects our capital deployments, net of cash flow generation.

We are very pleased with our capital deployments in 2018. This included a significant increase in organic growth investments, record share repurchases, and two successful strategic acquisitions.

Working capital turns were 9.5 turns, compared to 6.2 turns in the prior quarter and 8.2 turns in the prior-year.

Days sales outstanding improved 6 days on a year-over-year basis, from 71 days in the prior year period to 65 days.

Inventory turns were 5.0 turns, consistent with the year-ago period.

Our total debt principal at the end of the fourth quarter was $1.49 billion, compared to $1.53 billion in the third quarter and $1.58 billion in the year-ago period.

Net leverage was 2.2 times net debt to EBITDA at the end of the quarter, down from 2.5 times in the third quarter and in-line with our target range of 2.0 – 3.0 times.

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

Cash flow from operations in the fourth quarter was $188.4 million dollars, increasing 24% compared to $151.7 million in the prior year as a result of increased EBITDA and improved working capital.

Net capital expenditures were $34.4 million for the quarter, compared to $29.8 million from the prior-year period.

For the full year, net capital expenditures increased from $63 million dollars to $96 million as we increased our investments in organic growth initiatives. This included investments in new hardware and software products and our new manufacturing facility in India.

Free cash flow in the quarter was $154.0 million dollars, increasing 26% compared to $121.9 million in the prior-year period.

We generated free cash flow of $193.0 million dollars in 2018, consistent with the prior year despite the increased capital investments.

Finally, I am extremely pleased to report that we have fully remediated the previously disclosed material weakness in financial reporting related to revenue recognition in our Grass Valley business. Our new internal controls are operating effectively, and we are glad to put this matter behind us.

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 2019 outlook.

We entered 2019 facing an increased level of global economic uncertainty and some secular headwinds in our Enterprise Segment. This will pressure our 2019 revenue and earnings growth rates.

We anticipate first quarter 2019 revenues to be between $564 and $594 million, and EPS of $0.80 to $1.00.

For the full year 2019, we expect revenues to be between $2.495 and $2.595 billion, and EPS of $5.50 to $6.15.

For financial modeling purposes, we recommend using interest expense of approximately $59 million and an effective tax rate of 21% for the full year 2019.

This guidance does not contemplate any benefit from potential M&A transactions or share repurchases in 2019.

**Please turn to slide 11** for a bridge that walks from our 2018 results to the high end of our 2019 guidance.

Our 2018 results included $34 million in revenue and $0.35 in EPS related to favorable revenue recognition timing in our Live Media business. This will not recur in 2019.

In 2019, we expect to realize an incremental $9 million in revenue and $0.28 in EPS from the full-year impact of our 2018 acquisitions.

At current foreign currency rates, we also expect 2019 revenues to be negatively impacted by approximately $22 million.

After adjusting for these items, we expect organic growth to be approximately -2% to +2%.

Looking out beyond this year, I am confident that we have the strategy, balance sheet, and proven Lean enterprise system to drive meaningful growth and margin expansion longer-term.

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