2nd Quarter 2019 Earnings Transcript

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CORPORATE PARTICIPANTS

John Stroup Belden, Inc. – President, CEO, and Chairman
Henk Derksen Belden, Inc. – CFO, SVP-Finance
Roel Vestjens Belden, Inc. – COO, EVP-Industrial
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 second quarter 2019 earnings conference call.

My name is Kevin Maczka, I'm Belden's Vice President, Treasurer and Investor Relations. With me this morning are Belden's President, CEO, and Chairman John Stroup, CFO Henk Derksen, and Chief Operating Officer Roel Vestjens. 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 second quarter performance.

Revenues were consistent with our expectations across most of our portfolio in the second quarter. However, demand trends softened in some of our key Industrial markets, with orders declining in the last month of the quarter.

Trade disputes and uncertainty seem to have triggered this abrupt shift in industrial demand, and we now expect a more challenging demand environment in the second half. Therefore, we are reducing our revenue and EPS expectations for the remainder of the year. Despite this near-term outlook revision, we remain extremely well positioned to benefit from a number of long-term secular trends.

Now, let's review the second quarter performance. Revenues in the quarter declined 4.1% on an organic basis to $637.5 million. As a reminder, results in the second quarter 2018 benefitted from non-recurring revenue recognition timing. After adjusting for that impact, revenues declined 3.1% organically.

EBITDA was $101.2 million, reflecting 15.9% EBITDA margins.

EPS was $1.39, compared to the guidance range of $1.30 to $1.50.

I am pleased to report further significant improvements in free cash flow, which increased 25% year-over-year in the second quarter.

Further, free cash flow more than doubled on a trailing twelve month basis, from $112 million in the second quarter 2018 to $231 million in the second quarter 2019.

Consistent with our plans, capital deployment has been balanced in the areas of organic growth investments, strategic acquisitions, and share repurchases.

Year to date, we deployed $51 million in capital expenditures to fund a number of attractive organic initiatives.

As previously communicated, we completed two broadband fiber connectivity acquisitions in the second quarter for a combined purchase price of $51 million. These businesses complement our product roadmap and should enable growth and share capture in our PPC broadband business.

We also initiated the share repurchase activity under our $300 million authorization, deploying $50 million year to date through July, including $23 million in the second quarter.

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.

After adjusting for the non-recurring revenue recognition timing in the year-ago period, revenues in this segment declined 6.6% on an organic basis to $369.9 million, in line with our expectations.

Revenues in the smart building market were approximately flat on an organic basis, with a decline in the APAC region offsetting continued growth and share capture in the Americas.

Revenues in final mile broadband declined 14% in the second quarter, as we expected, against a very challenging year-over-year comparison.

We continue to see healthy demand with our fiber optic and outside-the-home products, which benefit from increasing broadband subscribers and network upgrades, but demand for products used inside-the-home remains weak.

Following the two acquisitions that we completed in April, our broadband fiber revenues more than doubled in the second quarter. Further, our product mix continues to improve, as the majority of our broadband revenues came from outside-the-home products for the first time in the second quarter.

We continue to pursue a number of other compelling inorganic opportunities that would allow us to further expand our fiber product offering and drive substantial growth.

Revenues in live media production declined in the quarter. The first half performance in this business is consistent with our expectations for the full year.

Enterprise Solutions segment EBITDA margins were 14.5%.

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 1.9% on an organic basis to $267.7 million.

We continue to benefit from a balanced portfolio of industrial businesses. Demand remains robust in our process, energy, and transportation markets, each of which increased at least 8% organically. However, growth rates reversed during the quarter in our largest industrial market, discrete manufacturing.

Revenues in the discrete market declined 2% in the second quarter, with order rates declining 7% in June. This was especially pronounced in Germany and in the semiconductor vertical. Given our recent order trends, the increased level of uncertainty in the global industrial economy and the lowest German PMI in seven years, we expect the pressures in discrete to persist in the second half.

Cybersecurity demand trends remain very encouraging. Non-renewal bookings, our best leading indicator of revenues, increased 11% overall and a very robust 37% in the Industrial vertical. This represents the fourth consecutive quarter of double-digit growth in total non-renewal bookings.

Our new Cloud-based solutions continue to gain traction with new and existing customers. We anticipate further solid growth in this business going forward as we continue to develop and launch new products to expand our comprehensive suite of solutions specifically designed for industrial and enterprise applications.

Industrial Solutions segment EBITDA margins were 17.7%.

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 $637.5 million in the quarter, decreasing $33.9 million, or 5.1%, from $671.4 million in the second quarter of 2018.

Revenues were favorably impacted by $9.4 million from acquisitions, and negatively impacted by $15.9 million from currency translation and lower copper prices. After adjusting for these factors, revenues decreased 4.1% organically from the prior-year period.

Please note that the prior-year period was favorably impacted by $7 million related to previously disclosed, non-recurring revenue recognition timing. After adjusting for this impact, revenues decreased 3.1% organically on a year-over-year basis.

Gross profit margins in the quarter were 38.2%, decreasing 180 basis points compared to 40.0% in the year-ago period, due to unfavorable product mix in our Enterprise and Industrial segments. We expect mix and gross profit margins to improve in the second half.

We were pleased with the expense control in the second quarter, as operating expenses of $154.9 million, or 24.3% of revenues, improved 170 basis points sequentially.

EBITDA was $101.2 million, decreasing $21.4 million, compared to $122.6 million in the prior-year period.

EBITDA margins were 15.9%, decreasing 240 basis points year-over-year.

Net interest expense declined 6% year-over-year to $14.2 million.

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 $57 million for the full year 2019, down from $62 million in 2018.

Our effective tax rate was 13.7% in the quarter, compared to 24% in the second quarter 2018, as we benefitted from a number of discrete tax planning initiatives.

For financial modeling purposes, we recommend using an effective tax rate of 19% for the third and fourth quarters and 18% for the full year 2019.

Net income was $64.4 million, compared to $72.6 million in the prior-year period.

Earnings per share was $1.39 in the quarter, compared to $1.52 in the year-ago period.

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

Our Enterprise Solutions segment generated revenues of $369.9 million during the quarter, decreasing 7.5% from the prior-year period.

Revenues were favorably impacted by $9.4 million from acquisitions, and negatively impacted by $6.7 million from currency translation and copper prices. After adjusting for these factors, revenues decreased 8.2% organically on a year-over-year basis.

Excluding the revenue recognition impact in the prior-year period that I mentioned previously, revenues decreased 6.6% organically, in line with our expectations.

EBITDA margins were 14.5% in the quarter, declining 310 basis points year-over-year but increasing 240 bps sequentially. The year-over-year decline resulted primarily from lower volumes and unfavorable product mix.

The Industrial Solutions segment generated revenues of $267.7 million in the quarter, decreasing 1.5% from the prior-year period. Currency translation and copper prices had a negative impact of $9.2 million. After adjusting for these factors, revenues increased 1.9% organically.

EBITDA margins were 17.7% in the quarter, declining 190 basis points from the prior year period due to unfavorable product mix. Revenues declined 2% in our discrete manufacturing market, which typically generates above-average margins.

We continue to make strategic investments in new products which are expected to drive growth in future periods. We are already seeing positive results from some of these important investments, such as our Cloud-based cybersecurity solutions. We are very encouraged by the strong momentum in our cybersecurity non-renewal bookings, which increased 11% in the second quarter. That marks the fourth consecutive quarter of double-digit non-renewal bookings growth.

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 $295 million compared to $261 million in the prior year period.

Working capital turns were 6.0 turns, compared to 5.8 turns in the prior quarter and 6.4 turns in the prior-year.

Days sales outstanding and inventory turns were consistent with the prior year period at 64 days and 5.1 turns, respectively.

Our total debt principal at the end of the second quarter was $1.48 billion, consistent with the prior quarter.

Net leverage was 2.6 times net debt to EBITDA at the end of the quarter, down from 2.7 times in the second quarter of 2018 and in-line with our target range of 2.0 – 3.0 times.

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

Cash flow from operations in the second quarter was $67.7 million, improving $13.2 million, or 24%, compared to $54.5 million in the prior year.

Net capital expenditures were $27.2 million for the quarter, compared to $22.1 million from the prior-year period, as we continued to invest in the development of new software products.

Free cash flow in the quarter was $40.5 million, improving $8.1 million, or 25%, compared to $32.4 million in the prior-year period.

Further, free cash flow more than doubled on a trailing twelve month basis, from $112 million in the second quarter 2018 to $231 million in the second quarter 2019. We are very pleased with these significant gains, which resulted from improvements in our working capital and capital structure.

As a result of our reduced EBITDA expectations, we expect free cash flow in the range of $200 to $220 million for the full-year 2019.

Finally, we are very pleased with our balanced capital deployment toward organic growth investments, strategic acquisitions, and share repurchases.

Year to date through July we have allocated $51 million for capital expenditures to fund our attractive growth initiatives, $51 million for acquisitions to advance our broadband fiber strategy, and $50 million for share repurchases at very attractive prices.

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.

As I mentioned previously, we are reducing our revenue and EPS expectations for the remainder of the year to reflect more challenging conditions in some of our key industrial markets and the likelihood that our channel partners will reduce inventory levels to meet lower demand.

We anticipate third quarter 2019 revenues to be between $620 and $645 million, and EPS of $1.32 to $1.52.

For the full year 2019, we now expect revenues to be between $2.485 billion and $2.535 billion, compared to our prior guidance range of between $2.520 billion and $2.595 billion. We now expect full year EPS of $5.38 to $5.78, compared to our prior guidance range of $5.65 to $6.15.

In addition, we are nearing the completion of a comprehensive review of our portfolio of businesses, and we are considering adjustments that will allow us to deliver on our long-term commitments to shareholders.

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