3rd Quarter 2019 Earnings Transcript

October 30, 2019

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 third quarter 2019 earnings conference call.

My name is Kevin Maczka, I'm Belden's Vice President of Investor Relations and Treasurer. With me this morning are Belden's President, CEO, and Chairman John Stroup, Chief Operating Officer Roel Vestjens, and CFO Henk Derksen. John will provide an overview of our third quarter performance and two other significant announcements that we made today, Roel will review our segment results, 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 excluding Grass Valley.

Please turn to Slide 3 in our presentation for a review of our third quarter performance and two other significant announcements that we made today regarding our intent to divest Grass Valley and a new cost reduction program.

We completed a rigorous strategic review of our portfolio of businesses and our cost structure, and today's announcement marks an important outcome. We concluded that it is in the best interests of our shareholders, customers, and employees to separate Grass Valley from Belden.

As a result, we are pursuing a divestiture of Grass Valley. With the support of JP Morgan, we are engaged with interested parties with significant experience in the broadcast industry. Based on the approval of Belden's Board of Directors to divest this business and the probability of completion, Grass Valley's financial results will be presented as discontinued operations going forward.

This strategic action also provides an opportunity for a broad-based organizational recalibration. As a result, we are announcing a cost reduction program that is designed to improve performance, delivering $40 million in annualized SG&A savings and enhancing our EBITDA margins by approximately 200 basis points.

We intend to deliver these improvements by streamlining the organization and investing in technology to drive productivity. This includes consolidating our internal business unit reporting structure, realigning our sales and marketing organization, and optimizing other functional areas such as Finance, Procurement, IT and HR.

These actions will begin immediately, with some benefit in 2020, and the full benefit realized in 2021.

Belden has a long track record of substantial growth, margin expansion, and shareholder value creation, but we are not satisfied with our recent performance. We are reaffirming our commitment to our stated financial goals, including a total revenue CAGR of 5-7% and EBITDA margins of 20-22%. We will be well-positioned to achieve our goals after executing these actions. Importantly, the expected cost savings will more than offset the free cash flow dilution associated with a divestiture of Grass Valley.

Now, turning to the third quarter results. Revenues of $533.1 million were near the midpoint of our expected range for the quarter excluding Grass Valley. Consistent with our expectations, demand trends remained softer in some of our key Industrial markets in the third quarter, but we are encouraged by the improving trends in our Broadband business.

EPS of $1.18 was also consistent with our expectations for the quarter excluding Grass Valley.

Finally, we are updating our expectations of revenue and EPS from continuing operations for 2019 since Grass Valley will be presented as discontinued operations for the full year.

Please turn to slide 4 for a review of the impact of today's announcements on our portfolio.

Following a Grass Valley divestiture, the remaining Belden portfolio will consist of strong businesses in attractive Industrial and Enterprise markets, each aligned with powerful secular trends. These include industrial automation, cybersecurity, broadband & 5G, and smart buildings. This portfolio, while smaller, offers improved revenue predictability and multiple platforms for accelerating organic growth. In addition, we continue to see numerous opportunities to invest in compelling inorganic opportunities in these robust markets.

The business will also be more profitable after the implementation of our $40 million cost program. We expect the planned savings to be accretive to EBITDA margins and EPS by approximately 200 basis points and $0.70, respectively.

In summary, we are taking significant actions that will result in a more balanced and profitable portfolio of growing businesses. We expect these improvements, in turn, to drive meaningful shareholder value creation.

I will now ask Roel to provide a review of our business segment results. Roel?

Roel Vestjens Belden, Inc. -- COO, EVP-Industrial

Thank you, John.

Please turn to slide 5 for a review of our business segment results.

Beginning with our Enterprise Solutions segment, I will be referring to adjusted results excluding Grass Valley.

As a reminder, our Enterprise solutions allow customers to transmit and secure data, sound, and video across complex enterprise networks. Our key markets include smart buildings and final mile broadband.

Consistent with our expectations, revenues in this segment declined 4.4% on an organic basis to $280.9 million.

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

Revenues in final mile broadband declined 7% on a year-over-year basis and increased 7% sequentially as expected. Demand trends improved during the quarter and we expect that momentum to continue.

Importantly, we continue to see robust demand for our fiber optic products, with fiber revenues more than doubling in the third quarter. Following the successful integration of two broadband fiber acquisitions earlier this year, we are significantly expanding our product offering and capturing additional share. Specifically, in the third quarter our enhanced capabilities resulted in our first multi-million dollar order from a large telecom operator related to 5G infrastructure.

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.

Enterprise Solutions segment EBITDA margins were 16.0%.

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, mass transit, and energy.

Revenues in this segment declined 3.1% on an organic basis to $252.2 million. Consistent with our expectations, revenues were approximately flat excluding changes in channel inventory levels.

We continue to benefit from a balanced portfolio of industrial businesses. Demand remains robust in our process, mass transit, and energy markets, each of which increased at least 9% organically. However, growth rates remained soft during the quarter in our largest industrial market, discrete manufacturing.

Revenues in the discrete market declined 9% in the third quarter, with continued softness in Germany. Given our recent order trends, the increased level of uncertainty in the global industrial economy and the weak manufacturing PMI readings in the United States and Europe, we expect the pressures in discrete to persist in the fourth quarter.

In our Cybersecurity business, we continue to make significant progress with industrial customers. Non-renewal bookings, our best leading indicator of revenues, increased a very robust 42% in the industrial vertical. However, total non-renewal bookings declined after four consecutive quarters of double-digit growth due to project timing and sales execution. We are aggressively implementing the appropriate corrective actions and expect performance to improve in the fourth quarter.

Industrial Solutions segment EBITDA margins were 17.8%.

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, Roel. 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 excluding Grass Valley.

Please turn to Slide 6 for a detailed consolidated review….

Revenues were $533.1 million dollars in the quarter, decreasing $20.9 million, or 3.8%, from $554.0 million in the third quarter of 2018.

Revenues also decreased 3.8% organically from the prior-year period, as a $10.5 million favorable impact from acquisitions was offset by a $10.5 million negative impact from currency translation and lower copper prices. Adjusted for changes in channel inventory, revenues decreased 1.7% organically from the prior-year.

Gross profit margins in the quarter were 37.4%, decreasing 210 basis points compared to 39.5% in the year-ago period, due to lower volumes and inventory levels. Our inventory balance declined during the quarter as planned, which unfavorably impacted gross profit margins by approximately 60 basis points. We expect gross profit margins to improve sequentially in the fourth quarter.

EBITDA was $89.3 million dollars, decreasing $13.1 million, compared to $102.4 million in the prior-year period.

EBITDA margins were 16.8%, decreasing 170 basis points year-over-year.

Net interest expense was consistent with the year-ago period at $14.2 million dollars.

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 $56 million dollars for the full year 2019, down from $61 million in 2018.

Our effective tax rate was 17.7% in the quarter, compared to 21.6% in the third quarter 2018.

For financial modeling purposes, we recommend using an effective tax rate of 20% for the fourth quarter and 17.5% for the full year 2019.

Net income was $53.8 million dollars, compared to $61.6 million in the prior-year period.

Earnings per share was $1.18 in the quarter, compared to $1.29 in the year-ago period.

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

Our Enterprise Solutions segment generated revenues of $280.9 million dollars during the quarter, decreasing 2.2% from the prior-year period.

Revenues were favorably impacted by $10.5 million dollars from acquisitions, and negatively impacted by $4.1 million from currency translation and copper prices. After adjusting for these factors, revenues decreased 4.4% organically on a year-over-year basis.

EBITDA margins were 16.0% in the quarter, declining 180 basis points year-over-year and increasing 30 basis points sequentially. The year-over-year decline resulted primarily from lower volumes.

The Industrial Solutions segment generated revenues of $252.2 million dollars in the quarter, decreasing 5.5% from the prior-year period. Currency translation and copper prices had a negative impact of $6.4 million dollars. After adjusting for these factors, revenues decreased 3.1% organically.

Adjusted for changes in inventory levels at our channel partners, segment revenues were approximately flat organically.

EBITDA margins were 17.8% in the quarter, declining 180 basis points from the prior year period and approximately flat sequentially. The year-over-year decline resulted primarily from lower volumes and unfavorable product mix.

If you will please turn to Slide 8, I will begin with our as reported balance sheet highlights.

Our cash and cash equivalents balance at the end of the third quarter was $297 million dollars, consistent with the prior quarter and down from $329 million in the prior year period.

Working capital turns were consistent with the prior quarter at 5.9 turns.

Days sales outstanding was 68 days, compared to 64 days in the prior quarter and 66 days in the prior year period.

Inventory turns were 5.3 turns, compared to 5.1 turns in the prior quarter and 4.9 turns in the prior year period.

Our total debt principal at the end of the third quarter was $1.42 billion, down from $1.48 billion in the prior quarter and $1.53 billion in the third quarter of 2018.

Net leverage was 2.6 times net debt to EBITDA at the end of the quarter, consistent with the prior 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 third quarter was $67.9 million dollars, compared to $130.2 million in the prior year. The prior year benefitted from a non-recurring gain of $47 million related to patent litigation.

On a trailing twelve month basis, cash flow from operations increased by 10%, from $252.5 million in the third quarter 2018 to $277.9 million in the third quarter 2019.
Net capital expenditures were $23.3 million for the quarter, consistent with the prior-year period.

Free cash flow in the quarter was $44.6 million dollars, compared to $106.3 million in the prior-year period.

On a trailing twelve month basis, free cash flow increased by 5%, from $160.8 million in the third quarter 2018 to $169.5 million in the third quarter 2019.

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 outlook.

As mentioned previously, we are updating our revenue and EPS expectations for the year, and our new fourth quarter and full year 2019 guidance from continuing operations excludes the results from Grass Valley from all periods.

We anticipate fourth quarter 2019 revenues to be between $510 and $530 million, and EPS of $1.00 to $1.15.

For the full year 2019, we now expect revenues to be between $2.092 billion and $2.112 billion.

We now expect full year EPS of $4.32 to $4.47.

This EPS range does not include any benefit from our cost reduction plans, which are expected to be accretive to EPS by approximately $0.70 once fully implemented.

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