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4th Quarter 2019 Earnings Transcript

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CORPORATE PARTICIPANTS

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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 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 a strategic overview of our business, 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.

Please turn to Slide 3 in our presentation.

Before I review our fourth quarter performance, I'd like to discuss the announcement we made this morning regarding the divestiture of Grass Valley.

As we reported last quarter, we completed a rigorous strategic review of our portfolio of businesses and concluded that it was in the best interests of our shareholders, customers, and employees to separate

Grass Valley from Belden. Today, we announced that we reached a definitive agreement to sell 100% of Grass Valley to private equity firm Black Dragon Capital. The transaction is expected to close in the first half of 2020.

Black Dragon's deep broadcast industry experience will enable Grass Valley to more effectively execute its strategic plan and pursue growth opportunities. We look forward to supporting the Black Dragon and Grass Valley teams during the transition.

The transaction consideration includes an upfront cash payment of $140 million plus various forms of deferred consideration, including a $213 million five-year seller's note, subject to certain adjustments, up to $130 million in PIK interest on the seller's note over its five-year term, and $150 million in potential earn-out payments. These earn-out payments are based on certain performance thresholds, but the seller's note and the interest on the seller's note are not.

We are pleased to announce this definitive agreement and extremely excited about the opportunities for Belden going forward as we continue our transformation.

Now, let's review our fourth quarter performance.

Revenues in the fourth quarter of $549.7 million exceeded the high end of our guidance range. Importantly, we delivered healthy organic growth of 2.7% after adjusting for changes in channel inventory levels in the fourth quarter of 2018. This demonstrates the enhanced growth potential of our improved portfolio of businesses.

We did not see the reduction in channel inventory levels that we anticipated in the fourth quarter 2019, so we are reflecting that expectation in our guidance for the first quarter.

EPS of $1.20 also exceeded the high end of our guidance range of $1.00 to $1.15.

Consistent with our M&A strategy, in the fourth quarter we completed another bolt-on acquisition of a broadband fiber related business called Special Product Company, or SPC, for $23 million. SPC is a supplier of enclosure systems for fiber and 5G applications with annual revenues of approximately $32 million.

SPC's products complement our broadband fiber portfolio, with many of our current outside-the-home products already being utilized in conjunction with SPC products. We see significant opportunities to leverage our global customer base and accelerate SPC's growth.

In addition, we continue to pursue a number of compelling inorganic opportunities in this robust market that would further enhance our product offering and growth potential.

Please turn to slide 4 for a brief discussion of our full year 2019 results.

2019 was highlighted by the significant actions we initiated following our comprehensive strategic portfolio review. These include the divestiture of Grass Valley, the ongoing $40 million cost reduction program, and our planned exit of approximately $250 million in undifferentiated copper cable product lines. These actions will result in an improved portfolio of businesses that is aligned with favorable secular trends in industrial automation, cybersecurity, broadband & 5G, and smart buildings.

Full year revenues were $2.131 billion. Despite the headwinds from global trade policies, end demand for our products increased during the year.

2019 was another year of disciplined and balanced capital deployment toward organic growth investments, acquisitions, and share repurchases.

Net capital expenditures of $80 million funded a number of attractive organic initiatives that are expected to drive meaningful growth in future periods. This included investments in new software solutions for both cybersecurity and industrial automation, and targeted capacity additions to support our customers by shortening our lead times and expanding our fiber capabilities.

We completed three strategic broadband fiber acquisitions in 2019 for a combined purchase price of $74 million. These included Opterna and the FutureLink product line in the second quarter and SPC in the fourth quarter.

Importantly, our product mix continues to improve, as the majority of our broadband revenues came from higher-growth outside-the-home products for the first time in 2019.

During the year, we also deployed $50 million toward share repurchases. All of this was accomplished with year-end financial leverage of 2.5 times net debt to EBITDA. This is well within our stated range of 2 to 3 times. Moreover, our net interest coverage ratio exceeds 7 times.

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 today.

As a reminder, our Enterprise solutions allow customers to transmit and secure audio, video and data across complex enterprise networks. Our key markets include smart buildings and broadband and 5G.

Revenues in this segment increased 1.0% year-over-year to $280.2 million, or 2.7% on an organic basis after adjusting for changes in channel inventory levels.

Revenues in the smart building market increased 2% on an organic basis when adjusted for changes in channel inventory, with growth in all regions and continued solid share capture in the Americas.

Revenues in Broadband & 5G increased 3% year-over-year on an organic basis.

We continue to see robust demand for our fiber optic products. Following the successful integration of our broadband fiber acquisitions, we are significantly expanding our product offering and capturing additional share. As a result, our fiber growth was strong throughout 2019, with revenues more than doubling on a full year basis.

Enterprise Solutions segment EBITDA margins were 15.3%.

Turning now to our Industrial segment. Much like Enterprise, our Industrial solutions allow customers to transmit and secure audio, video and data, but in this case in harsh industrial environments. Our key markets include discrete manufacturing, process facilities, mass transit, and energy.

Revenues in this segment also increased 2.7% on an organic basis after adjusting for changes in channel inventory levels to $269.5 million.

We continue to benefit from a balanced portfolio of industrial businesses. Demand remained soft during the quarter as expected in our largest industrial market, discrete manufacturing. Revenues in the discrete market declined 4% in the fourth quarter, with continued softness in Germany. Given our recent order trends, the continued uncertainty in the global industrial economy, and the soft manufacturing PMI readings in the United States and Europe, we expect the pressures in discrete to persist into 2020.

However, we continue to see growth in our other industrial markets, led by our process end market, which increased 6% organically in the fourth quarter.

Performance in our Cybersecurity business improved in the fourth quarter. Non-renewal bookings, our best leading indicator of revenues, increased 4% year-over-year.

We continue to make significant progress with our strategic priorities in cybersecurity. We expanded our software-as-a-service solutions, with SAAS revenues doubling in 2019 as a result.
Industrial Solutions segment EBITDA margins were 18.8%.

Finally, I would like to discuss the progress we are making on reducing our inventory levels. Our fourth quarter inventory balance declined $15 million sequentially and $34 million year-over-year, despite the addition of $9 million from the broadband fiber acquistions completed during the year. As a result, inventory turns improved to 6.0 turns in the fourth quarter from 5.1 turns in the year ago period. As we continue to execute our proven Lean enterprise principles, we would expect further improvements and an increase of approximately one half turn in 2020.

I will now ask Henk to provide additional insight into our fourth 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.

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

Revenues were $549.7 million dollars in the quarter, decreasing $2.4 million, or 40 basis points, from $552.1 million in the fourth quarter of 2018.

Revenues decreased 1.7% organically from the prior-year period, as a $10.5 million favorable impact from acquisitions was partially offset by a $3.6 million negative impact from currency translation and lower copper prices. After further adjusting for changes in channel inventory, revenues increased 2.7% organically from the prior-year.

Gross profit margins in the quarter were 37.4%, declining 230 basis points compared to 39.7% in the year-ago period. This decline was due to lower production volumes related to higher channel inventory levels in the year ago period and reductions in our own inventory balance, as well as unfavorable product mix.

EBITDA was $92.9 million dollars, decreasing $10.3 million, or 10.0%, compared to $103.2 million in the prior-year period.

EBITDA margins were 16.9%, decreasing 180 basis points from 18.7% in the fourth quarter 2018.
Net interest expense was consistent with the year-ago period at $13.9 million dollars.

At current foreign exchange rates, we expect interest expense in 2020 to be consistent with 2019 at approximately $56 million dollars.

Our effective tax rate was 19.8% in the fourth quarter and 17.5% for the full year 2019, as we benefitted from a number of incremental discrete tax planning initiatives.

For financial modeling purposes, we recommend using an effective tax rate of 20% throughout 2020.

Net income in the quarter was $54.9 million dollars, compared to $59.0 million in the prior-year period.

Earnings per share was $1.20 in the quarter, compared to $1.26 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 $280.2 million dollars during the quarter, increasing 1.0% from the prior-year period.

Revenues were favorably impacted by $10.5 million dollars from acquisitions. After adjusting for acquisitions and changes in changes in channel inventory in the year-ago period, revenues increased 2.7% organically on a year-over-year basis.

EBITDA margins were 15.3% in the quarter, decreasing 270 basis points from the prior year period. Lower production volumes related to higher channel inventory levels in the year ago period and unfavorable product mix contributed to the year-over-year decline.

The Industrial Solutions segment generated revenues of $269.5 million dollars in the quarter, decreasing 1.9% from the prior-year period. Currency translation and copper prices had a negative impact of $3.5 million dollars. After adjusting for these factors and changes in channel inventory in the year-ago period, revenues increased 2.7% organically on a year-over-year basis.

EBITDA margins were 18.8% in the quarter, declining 70 basis points year-over-year and increasing 100 basis points sequentially.

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 $426 million dollars compared to $297 million in the third quarter and $421 million in the prior year period.

Working capital turns were 13.0 turns, compared to 6.0 turns in the prior quarter and 10.8 turns in the prior-year.

Days sales outstanding were consistent with the year-ago period at 57 days and improved 4 days sequentially.

Inventory turns were 6.0 turns, compared to 5.4 turns in the prior quarter and 5.1 turns in the prior year period.

Our total debt principal at the end of the fourth quarter was $1.46 billion, in line with the year-ago period.

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

As a reminder, our debt is entirely fixed at an average interest rate of 3.5% with no maturities until 2025 to 2028. We are very pleased with the quality of our balance sheet.

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

Cash flow from operations in the fourth quarter was $187.4 million dollars, consistent with the prior year period.

Net capital expenditures were $35.9 million for the quarter, compared to $34.4 million from the prior-year period.

Free cash flow in the quarter was $151.4 million dollars, compared to $154.0 million in the prior-year period.

For the full year 2019, we generated cash flow from operations of $276.9 million dollars, compared to $289.2 million in 2018. As a reminder, 2018 benefitted from a non-recurring gain of $47 million related to patent litigation. Excluding this item, cash flow from operations increased 14% in 2019.

For the full year, net capital expenditures increased from $96 million dollars to $110 million as we increased our investments in organic growth initiatives. This included investments in new software solutions and targeted capacity additions to support our fiber growth initiatives.

As a result, we generated free cash flow of $166.9 million dollars in 2019, compared to $193.0 million in 2018.

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 2020 outlook.

2020 will be a year of continued transformation for Belden. Near-term demand trends are challenging, but we are taking appropriate and significant actions to position the Company for meaningful growth and margin expansion. I am very optimistic about our ability to achieve our financial goals and drive superior returns for our shareholders going forward.

We anticipate first quarter 2020 revenues to be between $485 and $505 million, and EPS of $0.70 to $0.85.

For the full year 2020, we expect revenues to be between $2.06 and $2.14 billion, and EPS of $4.25 to $4.75.

For financial modeling purposes, we recommend using interest expense of approximately $56 million and an effective tax rate of 20% for the full year 2020.

This guidance does not contemplate any benefit from potential M&A transactions or share repurchases in 2020. However, we will continue to include the contribution of the $250 million in undifferentiated copper cable product lines until we formally exit those products.

Please turn to slide 11 for a bridge that walks from our 2019 results to the high end of our 2020 guidance.

In 2020, we expect to realize an incremental $44 million in revenue from the acquisitions completed in 2019, including SPC.

As I mentioned previously, we did not see the reduction in channel inventory levels in the fourth quarter that we expected, so we are reflecting that expectation in our guidance for 2020. Our planning assumption for the full year is that our channel partners will pursue as much as a 1 turn improvement in inventory turns, which represents a reduction in channel inventory levels of approximately $50 million.

After adjusting for these items, we expect organic growth to be approximately 1% at the high end of our guidance range.

We are on track to realize at least $20 million in savings under our $40 million SG&A cost reduction program. These savings represent an incremental $0.38 in EPS.

In addition, we expect another $0.12 EPS benefit from our productivity initiatives and improved mix.

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