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1st Quarter 2020 Earnings Transcript

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CORPORATE PARTICIPANTS

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Roel Vestjens Belden, Inc. – COO
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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 first quarter 2020 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 provide a detailed update on our operations and 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 we review our first quarter performance, I'd like to discuss the COVID-19 situation and how we are responding. This unprecedented pandemic is putting incredible stress on the global economy and financial markets, and our associates, customers, and suppliers are experiencing disruptions in their daily lives that were unimaginable just a short time ago. Belden is certainly not immune from these new challenges, but we have the solid financial foundation to weather these difficult times. We are committed to protecting our people and supporting our customers, and offering our expertise and resources to assist in combatting COVID-19.

The health and safety of our associates and their families remain our top priority, and we are following CDC and WHO guidelines to maintain safe working conditions. We rapidly scaled our work from home capabilities in our offices, enhanced the hygiene practices in our factories, and implemented social distancing standards across our organization. We are also providing flexible working arrangements to help employees and their families navigate the disruption.

I am extremely proud to report that our teams are rising to the occasion and finding creative ways to support local efforts to combat COVID-19. This includes donating cabling and connectivity products for ventilator production, and masks for medical centers and temporary hospitals in the United States, Wuhan and elsewhere. In addition, we are using our 3D printers to produce components for face shields for medical workers, and rapidly developing and testing designs for N95 masks.

Our valued customers are feeling the impact of this global pandemic as well, and we are focused on keeping them supplied while keeping our associates safe. The majority of our sites have qualified for essential business status and remain operational, albeit at reduced capacity in some cases. Roel will provide more details on our operations in his remarks.

We remain committed to our capital projects and R&D investments. These investments are important to our customers and will enable us to provide a high level of product innovation in the future.

We are also taking the opportunity to further optimize our business for the current environment and the eventual recovery. As you would expect, we are managing our expenses and deploying countermeasures to protect cash flows.

This includes upsizing our existing cost reduction program, harvesting working capital, and implementing compensation reductions for our senior leaders. Specifically, for the remainder of the year we are reducing base salaries by 50% for myself and 30% for our senior leadership team. We are also reducing cash retainer fees for our Board of Directors by 50%.

However, we intend to maintain our direct labor force in anticipation of improving demand trends later in the year. During this period of softer demand, our direct labor is allocating additional time to kaizens and other continuous improvement and preventative maintenance activities. This will allow our operations to emerge even stronger.

Please turn now to slide 4 in the presentation.

Next, I would like to update you on the three transformative actions we initiated last year following our comprehensive strategic portfolio review. These include the divestiture of Grass Valley, the $40 million cost reduction program, and the planned exit of approximately $250 million in undifferentiated copper cable product lines.

The Grass Valley divestiture remains on track. In February we announced a definitive agreement to sell 100% of Grass Valley to private equity firm Black Dragon Capital in a transaction that we expected to close in the first half of 2020. The teams are working diligently to satisfy any remaining closing conditions, and the transaction remains on track for closing in the second quarter.

As I mentioned, we are upsizing our $40 million SG&A cost reduction program. We previously communicated an expectation of delivering $20 million of these savings in 2020 and the full $40 million run rate in 2021. We made considerable progress on achieving the planned savings, and our teams have identified a number of incremental opportunities. Today we announced an increase in the program to $60 million. We now expect to deliver $40 million in savings in 2020 and the full $60 million run rate in 2021.

Finally, given current market conditions, we are delaying the planned exit of $250 million in copper cable product lines. We believe that we are unlikely to maximize the value of these product lines during a global pandemic, so we will revisit this process and engage with potential buyers when conditions normalize.

Turning now to slide 5 in the presentation.

I'd like to update you on our end markets. Recall that the strategic actions we are executing will result in an improved portfolio of businesses that is aligned with favorable secular trends in industrial automation, cybersecurity, broadband & 5G, and smart buildings.

We continue to believe that these are robust markets with compelling growth opportunities over the cycle. We are well positioned to participate in that growth as we execute our strategic plans.

Turning now to slide 6 in the presentation.

That said, the current situation is very dynamic and visibility remains limited, making it incredibly difficult to accurately forecast near-term trends. As such, we thought it would be helpful to share our view of the potential trends in our markets once conditions normalize. When the crisis passes and global economies reopen, we believe that many of our businesses could emerge stronger than ever.

The next three slides illustrate our view of market conditions in a post-crisis environment. Green represents markets that we believe could see an accelerated recovery. Yellow represents markets that will likely see a typical recovery, while red represents markets that could remain depressed for an extended period before recovering.

Broadband and 5G, which represents approximately 23% of total revenue, should be a clear beneficiary of the global pandemic and the associated social distancing and work from home practices. Broadband networks are being stressed like never before. We believe this will drive increasing investments in network infrastructure by our customers, supporting continued growth in our outside-the-home product revenues.

Further, our inside-the-home business recently secured several large orders for self-install kits as a result of social distancing and a reluctance to send technicians into consumers' homes. We are well positioned to benefit from increasing demand for broadband and 5G and the required investments in network infrastructure.

Turning now to Industrial Automation, which represents approximately 46% of total revenue. The global pandemic is clearly impacting end demand on a temporary basis, but we remain extremely optimistic about automation trends longer-term. We see a number of drivers of sustainable secular growth, including increasing labor costs and enhanced productivity and quality needs. Social distancing and other new practices in the post-crisis environment could represent yet another incremental demand driver for automation.

Within Industrial Automation, we serve customers in four market verticals, including discrete manufacturing, process facilities, energy, and mass transit.

Our discrete products reside in machines on factory floors in a number of industries. Not surprisingly, recent demand trends vary significantly by sub-vertical. We support customers in consumer products, material handling, medical and pharmaceutical products, and semiconductors. These are areas of relative strength that we expect to perform very well in the recovery.

The Energy market is all about electric utilities, producing and distributing electricity. This vertical includes conventional electricity generation along with newer alternatives such as wind and solar and smart grid installations. Energy is typically less cyclical than most industrial verticals, and we expect demand to remain relatively healthy.

Mass Transit is also typically less sensitive to economic conditions. Projects in this market are often state-funded, and infrastructure-related stimulus investments could be especially beneficial, particularly in the EMEA and Asia-Pacific regions.

Much like Industrial Automation, demand trends in Smart Buildings vary significantly by sub-vertical. We would also expect robust demand in some of our Smart Buildings markets. We serve government, healthcare, and data center customers. As the economy reopens, we would expect healthy demand from these customers to partially offset the headwinds in the other verticals within Smart Buildings.

Finally, Cybersecurity is about 6% of total revenue. We continue to see compelling secular growth opportunities in cybersecurity, especially in industrial applications. However, COVID-19 is impacting our near-term results. Our customers are temporarily shifting their IT priorities elsewhere and delaying planned projects. Importantly, however, we are not seeing large project cancellations, and we expect the projects to proceed as the crisis passes.

Turning now to slide 7 in the presentation.

This slide highlights our other verticals that we would expect to see a normal recovery once the global economies reopen.

In Process Facilities, we play in the water and wastewater, oil and gas, metals and mining, and chemicals markets. Process markets like water and wastewater tend to be much more stable even in recessionary environments. We would characterize our expectations for the recoveries in these markets as relatively normal.

Turning now to slide 8.

While we expect many of our markets to see accelerating demand trends as the global economies recover, some of our markets may be depressed for an extended period before recovering.

For instance, in Smart Buildings, our customers in the hospitality, retail, and commercial real estate markets are clearly facing fundamental changes in their businesses that will have implications for demand for our products. We would expect projects currently underway to proceed to completion, but new project starts in these markets could soften going forward.

Oil and gas is obviously challenged, and I would note that this market represents only approximately 5% of total revenues.

Similarly, demand from automotive factories is increasingly pressured, and it also represents only approximately 6% of total revenues.

In summary, we see many more opportunities than risks in our markets in the post-crisis environment.

Our portfolio of businesses will be impacted by COVID-19 to varying degrees, but we believe that many of our businesses, such as Broadband & 5G and Discrete Manufacturing, will emerge stronger than ever. We remain extremely excited about the opportunities for Belden going forward as we continue our transformation.

Please turn to slide 9 for a brief discussion of our first quarter results and balance sheet and liquidity position.

Revenues in first quarter declined 7% on a year over year basis to $463.5 million. End demand for our products exceeded our shipments in the first quarter, with incoming orders declining 2% to $489.0 million. EPS was $0.67, compared to $0.84 in the year-ago period.

Perhaps more importantly given the current environment, our balance sheet is strong and we are very comfortable with our liquidity position. In recent years we strengthened our balance sheet and secured sources of additional liquidity. These decisions are proving to be especially beneficial now, providing important financial flexibility to successfully navigate this difficult economic environment.

We exited the first quarter with cash on hand of $294 million. Subsequent to the end of the quarter and out of an abundance of caution, we proactively drew down $190 million under our revolving credit facility, resulting in ample liquidity of over $450 million.

Our financial leverage at the end of the quarter was 2.8 times net debt to EBITDA. This is within our stated range of 2 to 3 times. Importantly, our fixed interest rate debt has no maintenance covenants and no maturities until 2025 to 2028.

I will now ask Roel to provide an update on our operations and review of our business segment results. Roel?

Roel Vestjens Belden, Inc. -- COO

Thank you, John.

Before I review our business segment results, I'd like to provide a more detailed update on our operations.

As John mentioned, most of our U.S. and global facilities remained operational during the outbreak while implementing enhanced safety protocols designed to protect our associates. In most cases, we received exemptions to remain open because we qualified as an essential business based on the nature of our products. However, operations in countries with government-mandated shutdowns, such as India, were suspended in the first quarter and have not yet reopened.

In addition, some facilities that were closed temporarily have reopened, albeit under capacity restrictions in some cases. In China, our Suzhou facility was previously closed due to government mandate but is now open and operating at full capacity. In Mexico we are operating at limited capacity due to an agreement with the local government.

Importantly, we have effectively shifted production from closed or impaired facilities to other facilities with little or no customer disruption. For example, in January, our customers in China were benefitting from our manufacturing capacity in Europe and the United States. In April, the opposite is true.

We are extremely thankful that across our global operations, only a few Belden associates have tested positive for COVID-19 to date. In each case, we followed our pre-established processes for site sanitization and employee quarantines, which resulted in temporary disruptions.

We anticipate improving demand trends in the second half of the year, so we intend to maintain our direct labor force sized for normalized demand levels. During this temporary period of lower demand, our direct labor will allocate additional time to kaizens and preventative maintenance activities.

The majority of our office locations have implemented work-from-home protocols, with our remote connectivity systems functioning well.

From a supply chain perspective, we did experience some disruption with various suppliers in China and elsewhere, but we have been able to manage through these situations for the most part. We are benefitting from a decision made years ago to produce within close proximity to our demand whenever possible. As a result, we have minimized the potential supply-chain disruptions. At this point, almost all of our suppliers have recovered to normal capacity levels.

Now please turn to slide 10 for a review of our business segment results.

Beginning with our Industrial Solutions segment, I will be referring to adjusted results today.

As a reminder, our Industrial solutions allow customers to transmit and secure audio, video and data in harsh industrial environments. Our key markets include discrete manufacturing, process facilities, energy, and mass transit.

Revenues in this segment declined 9% on an organic basis after adjusting for changes in channel inventory levels to $251.3 million.

Industrial Automation revenues declined 6% year-over-year in the first quarter after adjusting for changes in channel inventory levels. Not surprisingly, the declines were broad-based with demand softening as the quarter progressed and our channel partners reduced inventory levels.

Revenues in our Cybersecurity business declined in the first quarter. We typically generate a significant portion of our quarterly bookings and revenues in the last few weeks of the quarter, and the last few weeks of March were significantly impacted by COVID-related shutdowns. As a result, many of our customers understandably delayed large IT projects, including Tripwire installations. We are not seeing project cancellations or market share loss, and we anticipate significantly improved demand trends later in the year.

Industrial Solutions segment EBITDA margins were 14.1%.

Turning now to our Enterprise segment. 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 2% year-over-year to $212.2 million, and declined 3% on an organic basis after adjusting for the contribution of our recent broadband fiber acquisitions and changes in channel inventory levels.

Revenues in the smart building market declined 6% on an organic basis, with trends decelerating in March.

Consistent with our expectations, our channel partners reduced inventory levels in this market during the quarter.

Revenues in Broadband & 5G were approximately flat in the quarter on an organic basis after adjusting for changes in customer inventory levels, with orders increasing by 4%. We experienced some disruption related to fiber suppliers in China, but these suppliers are now back to full production levels.

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. We are also capturing share with our inside the home products, as we secured a number of large orders for self-install kits.

Enterprise Solutions segment EBITDA margins were 11.6%.

Finally, I would like to discuss channel inventory levels. We entered 2020 with a planning assumption for the full year that our channel partners would pursue a reduction in channel inventory levels of approximately $50 million. Given the more challenging environment, we now expect a larger channel inventory reduction of approximately $70 million. Inventory levels declined by $20 million in the first quarter, consistent with our expectations, and most of the remaining reductions are likely to occur in the second quarter.

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

Henk Derksen Belden, Inc. - CFO

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 11 for a detailed consolidated review.

Revenues were $463.5 million dollars in the quarter, decreasing $36.6 million, or 7.3%, from $500.1 million in the first quarter of 2019.

Revenues decreased 9.1% organically from the prior-year period, as a $17.0 million favorable impact from acquisitions was partially offset by an $8.2 million negative impact from currency translation and lower copper prices. After further adjusting for changes in channel inventory, revenues decreased 6.4% organically from the prior-year.

End demand for our products exceeded our shipments in the first quarter. Incoming orders of $489.0 million dollars resulted in a book-to-bill ratio of 1.06.

Gross profit margins in the quarter were 36.9%, declining 50 basis points compared to 37.4% in the year-ago period. This decline was due to lower production volumes and unfavorable product mix.

EBITDA was $60.8 million dollars, compared to $76.4 million in the prior-year period.

EBITDA margins were 13.1%, decreasing 210 basis points from 15.3% in the first quarter 2019.

Our SG&A cost reduction program is ahead of schedule, as we delivered $5 million of savings in the first quarter relative to our original commitment of $2 million. We also continued to fund our growth initiatives and R&D investments, and we remain committed to these important projects.

Net interest expense was consistent with the year-ago period at $13.3 million dollars. At current foreign exchange rates, we expect interest expense in 2020 to be approximately $57 million dollars.

Our effective tax rate was 18.2% in the first quarter, as we benefitted from incremental discrete tax planning initiatives. We expect an effective tax rate of 20% for the remaining quarters in 2020 and 19% for the full year.

Net income in the quarter was $30.5 million dollars, compared to $42.0 million in the prior-year period.

Earnings per share was $0.67 in the quarter, compared to $0.84 in the year-ago period.

Please turn to slide 12. I will now discuss revenues and operating results by business segment.

In the first quarter 2020, we transferred certain cable businesses and product lines from the Enterprise Solutions segment to the Industrial Solutions segment. We have recast the prior period segment information to conform to the change in the composition of reportable segments. These realignments help simplify our operating structure and enable the restructuring actions related to our cost reduction initiatives, as well as potential divestitures.

The Industrial Solutions segment generated revenues of $251.3 million dollars in the quarter, decreasing 14% from the prior-year period. Currency translation and copper prices had a negative impact of $5.4 million dollars. After adjusting for these factors and changes in channel inventory, revenues decreased 9% organically on a year-over-year basis.

EBITDA margins were 14.1% in the quarter, declining 460 basis points year-over-year, primarily due to lower production volumes, growth investments and product mix.

Our Enterprise Solutions segment generated revenues of $212.2 million dollars during the quarter, increasing 2% from the prior-year period.

Revenues were favorably impacted by $17.0 million dollars from acquisitions. After adjusting for acquisitions and changes in channel inventory in the year-ago period, revenues declined 3% organically on a year-over-year basis.

EBITDA margins were 11.6% in the quarter, increasing 120 basis points from the prior year period, primarily due to improved productivity and our ongoing cost reduction programs.

If you will please turn to Slide 13, I will begin with our balance sheet highlights.

Our cash and cash equivalents balance at the end of the first quarter was $294 million dollars compared to $426 million in the fourth quarter and $339 million in the prior year period.

As John mentioned, subsequent to the end of the first quarter we proactively drew down $190 million under our $400 million revolving credit facility, resulting in ample liquidity of over $450 million. This was done out of an abundance of caution, and we have no immediate plans to deploy this capital.

Working capital turns were 6.8 turns, compared to 13.0 turns in the prior quarter and 5.7 turns in the prior-year.

Days sales outstanding of 59 days increased by 2 days sequentially and 6 days from the prior year.

Inventory turns were 4.6 turns, compared to 6.0 turns in the prior quarter and 4.5 turns in the prior year period.

Our total debt principal at the end of the first quarter was $1.40 billion, consistent with the prior quarter.

Net leverage was 2.8 times net debt to EBITDA at the end of the quarter, in-line with our target range of 2.0 to 3.0 times.

Turning now to slide 14. I will now discuss our debt maturities and covenants.

As a reminder, our debt is entirely fixed at an average interest rate of 3.5% with no maturities until 2025 to 2028. We have no maintenance covenants on our debt, so we are not at risk of an event of default caused by worsening economic conditions.

We are very comfortable with the quality of our balance sheet and our liquidity position at this point.

Please turn to Slide 15 for a few cash flow highlights.

Cash flow from operations in the first quarter was a use of $52.1 million dollars, compared to a use of $46.1 million in the prior year period.

Net capital expenditures were $18.8 million for the quarter, compared to $23.6 million from the prior-year period. The year-over-year difference is primarily related to project timing.

Free cash flow in the quarter was a use of $70.9 million dollars, consistent with $69.6 million in the prior-year period.

On a trailing twelve months basis at the end of the first quarter, free cash flow was $165.7 million dollars, compared to $166.9 million in 2019.

We are implementing countermeasures to protect cash flows, and we expect to remain solidly free cash flow positive even in a severe downside scenario, as we were during the financial crisis in 2008 and 2009.

This includes upsizing our existing cost reduction program from $40 million to $60 million, other expense control including executive compensation reductions, and harvesting working capital. Specifically, we expect to reduce working capital by approximately $75 million dollars during the remainder of the year as we reduce our inventory levels and manage accounts receivable and accounts payable.

Our capital deployment plans have changed in response to the global pandemic. We are committed to our growth capital investments, and we continue to expect capex of approximately $70 million dollars in 2020 for continuing operations.

However, we now expect less share repurchase and M&A activity this year. We deployed $21.2 million to repurchase 592,000 shares in the first quarter. Year-to-date, we deployed $35 million to repurchase 977,000 shares at an average price of $35.83. We are not planning to execute additional share repurchases until conditions normalize and visibility returns.

Similarly, we are unlikely to complete additional M&A in this uncertain environment.

That completes my prepared remarks. I would now like to turn this call back to our President, CEO, and Chairman, John Stroup. John?

John Stroup's Closing Remarks

Thank you, Henk.

The COVID-19 situation is very dynamic and visibility into the extent to which our global markets and manufacturing capacity will be impacted is limited. This makes it incredibly difficult to accurately forecast near-term trends. Given the wide range of potential outcomes, we are not providing specific revenue or EPS guidance for the second quarter or full year 2020 at this time.

That said, the typical seasonal patterns are unlikely to hold this year. We expect our revenues and EPS to be lower sequentially in the second quarter.

We are also anticipating significant reductions in channel inventory levels. Again, our prior planning assumption for the full year was a reduction of approximately $50 million, but we now expect approximately $70 million with the majority occurring in the second quarter.

While we are not able to accurately predict the timing and magnitude of the recovery, our current expectation is that business conditions will bottom in the second quarter and we will see sequential improvement in the second half.

We look forward to resuming our normal guidance practices once visibility returns.

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