2nd Quarter 2014 Earnings Conference Call Transcript



Overview*:

BDC reported 2Q14 consolidated revenues of $605.1M, income from continuing operations of $46.5M and diluted EPS from continuing operations of $1.05. Belden expects FY14 revenue to be $2.30-2.35B and adjusted diluted EPS from continuing operations to be $4.10-4.30. Belden expects 3Q14 revenue to be $605-625M and adjusted diluted EPS from continuing operations to be $1.05-1.15.

*Adjusted results. See appendix for reconciliation to comparable GAAP results

BELDEN
. SENDING ALL THE RIGHT SIGNALS

CORPORATE PARTICIPANTS

John Stroup Belden, Inc. - President, CEO
Henk Derksen Belden, Inc. - CFO, SVP-Finance
Matt Tractenberg Belden, Inc. – VP, Investor Relations

PRESENTATION

Matt Tractenberg Belden, Inc. – VP, Investor Relations

Thank you, operator. Good morning, everyone, and thank you for joining us today for Belden's second quarter 2014 earnings conference call.

My name is Matt Tractenberg and I am Belden's Vice President of Investor Relations. With me here this morning are John Stroup, President and CEO, 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 question and answer.

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 and the presentation are available online at investor.belden.com.

Turning to slide two in the presentation. During this call management will make certain forward looking statements. I would like to remind you that any forward looking information we provide is given in reliance upon the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. The comments we will make today are management's best judgment based on information currently available. Actual results could differ materially from any forward looking statements that we make, and the Company disclaims any obligation to update this information to reflect future developments after this call. For a more complete discussion of factors that could have an impact on the company's actual results, 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, we have provided a reconciliation of the most closely associated GAAP financial information to the non-GAAP financial information we communicate. This reconciliation is in the appendix of the presentation and has been posted separately to the investor relations section of our Web site.

I will now turn the call over to our President and Chief Executive Officer, John Stroup.

John Stroup Belden, Inc. – President, CEO

Thank you, Matt, and good morning, everyone.

As a reminder, I'll be referring to adjusted results today. Following our remarks on the 2nd quarter's results, we'll share some thoughts with you on the most recent and exciting addition to the Belden portfolio…ProSoft.

Please turn to slide three in our presentation for a review of our second quarter highlights.

Revenues for the second quarter were $605.1 million dollars, an increase of 13.6% from the second quarter 2013. Although revenue was at the high end of our guidance, I suspect the configuration was slightly different than some may have expected. The intense focus on profit margin improvement within our Enterprise segment includes aggressive actions to improve product mix and allocate assets more wisely. As a result, our revenue declined year-over-year in a market where demand increased. As you expect, revenue declined in our low-margin cable products and increased in our high-margin connectivity products. This is a trend that we expect to continue. Although orders in our Industrial IT business were as planned, shipments fell short of our expectations. Conversely, our channel partners partially replenished inventory balances that declined in the first quarter. Both of these items are merely timing and have no effect on our full-year projections. Finally, our results included approximately $2.7 million dollars from ProSoft during the quarter. After adjusting for acquisitions and changes in copper and currency, revenues increased by 50 basis points from the year-ago period.

I'm proud of our record results, including earnings per share of $1.05 and gross margins of 37%, which continues to be best in class and highlights the opportunity that remains for improved profitability. Operating profit margin of 13.0% declined from the year-ago period. This decline is temporary as we integrate Grass Valley with Miranda. Given the progress made in the quarter with this integration and the productivity improvement plans shared with you last quarter, I'm extremely confident that margins will quickly return to our target range of 14% to 16%.

So far this year, we've deployed more than $340 million dollars to strategic initiatives, including the purchase of Grass Valley for $209 million, ProSoft for $103 million, and the repurchase of 424 thousand shares of Belden common stock for $31.2 million dollars. Additionally, we raised $200 million dollars of debt at an attractive interest rate, to provide the capacity for further execution of our strategic acquisition initiative.

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

Broadcast revenue in the quarter was $252.3 million dollars as compared to $169.7 million in the year ago period, an increase of almost 50% and attributable to both solid organic results and the addition of Grass Valley. Organic revenue growth was 6.6% during the period which is clearly in excess of market. Operating profit margins were 10.6%, decreasing 360 basis points year-over-year, mainly a result of the inorganic additions this quarter.

Revenue within our Enterprise platform was $121.3 million, down from $132.9 million in the second quarter of 2013, a decrease of 6.9% after adjusting for changes in copper and currency. Operating profit margins were 13.1% during the quarter, an increase of 200 basis points.

Industrial Connectivity had revenue for the quarter of $178.2 million, up $6.3 million from the year-ago period. After adjusting for copper and currency, revenues were up 5.7% year-over-year, also in excess of market growth. Operating profit margins were 15.2% for the second quarter, up 80 basis points year-over-year and well within our corporate goal.

Industrial IT revenue of $53.3 million decreased by $4.8 million from $58.1 million in the second quarter of 2013. While the revenue decline is disappointing, our book-to-bill in the second quarter was 1.15, so we enter the second half with stronger backlog and far less challenging year-over-year comparisons. As you would expect, operating profit margins for this platform were down from the prior year on the lower volume. Healthy investments in R&D continue, despite the temporary revenue reduction.

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 operations and 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 five for a detailed consolidated review…. Second quarter consolidated revenues were $605.1 million dollars. Compared to the second quarter 2013, revenues increased $72.5 million, or 13.6%, from $532.6 million. The year-over-year improvement includes the additions of both Grass Valley and ProSoft with an impact of $72.9 million dollars. Strength in our Broadcast and Industrial connectivity platforms more than offset declines in our Enterprise and Industrial IT platforms. After adjusting for changes in copper and currency, revenues increased organically 50 basis points year-over-year. As mentioned by John, we experienced a partial replenishment of inventory by our channel partners. After adjusting for this, revenues for the second quarter declined by 50 basis points.

Sequentially, revenues increased $116.8 million dollars from $488.3 million. After adjusting for changes in copper and currency, as well as inventory at our channel partners and customers, revenues increased organically by 4.8%, in line with typical seasonal patterns.

Gross margins were 37.0%, increasing 180 basis points year-over-year and 90 basis points sequentially. The additions of Grass Valley and ProSoft are accretive to gross margins with an impact of 160 basis points.

Second quarter SG&A expenses were $116.3 million dollars, or 19% of revenue. Excluding acquisitions, SG&A expenses as a percentage of revenue were 17.6%, flat on a year over year basis. Our productivity improvement programs are progressing according to plan, and we are committed to achieving SG&A costs of approximately $111 million, updated for the ProSoft acquisition, as we exit the year.

R&D expenses for the quarter were $30.3 million dollars, or 5% of revenue increasing $10.3 million dollars, or 120 basis points, year-over-year and illustrating the shift to more innovative products and services. SG&A and R&D expenses combined for the quarter were $146.6 million dollars, an increase of $32.8 million year-over-year, a direct result of the inorganic activities completed during the quarter.

Operating margins were 13.0%, down 120 basis points from the year-ago period and down 10 basis points sequentially. Excluding the impact of Grass Valley, margins were unchanged from the prior year quarter.

Net interest expense for the quarter was $18.1 million dollars, down slightly from the year-ago period and down $0.6 million sequentially. In June, we issued $200 million dollars of senior subordinated notes at 5.25% due in 2024. This is in support of our strategic plan. Going forward, we expect interest expense to be approximately $22.0 million dollars per quarter, an increase of $2.7 million from prior guidance.

Additionally, the effective tax rate for the second quarter was 23.0% compared to 23.4% in the year-ago period. For financial modeling purposes, we recommend using a 22% effective tax rate for the second half of 2014.

Income from continuing operations for the second quarter was $46.5 million dollars, up $2.3 million compared to the year-ago period and up $11.1 million sequentially.

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

Broadcast Solutions generated revenues of $252.3 million dollars during the second quarter. Compared to the year-ago period, revenues increased $82.6 million from $169.7 million. The acquisition of Grass Valley contributed $70.2 million dollars, ahead of expectations. Despite the strong start, we continue to believe that $225 million of revenue from Grass Valley is appropriate for 2014. Copper adjusted organic revenues increased 6.6% year-over-year and 9.2% sequentially. We're pleased with the performance of this segment during the quarter.

Operating profit margins within the Broadcast segment were 10.6% for the quarter, down 360 basis points from 14.2% in the year-ago period, and down 340 basis points sequentially. Both were primarily a result of the addition of Grass Valley, with an impact of 300 basis points. The integration of Grass Valley is progressing per our plan, and we expect Operating Profit margins for the segment to be within the corporate goal of 14-16% by year -end.

Our Enterprise Connectivity Segment generated revenues of $121.3 million dollars during the second quarter, decreasing $11.6 million compared to the year-ago period and increasing $12.9 million sequentially. After adjusting for changes in copper and currency, revenues decreased 6.9% year-over-year and increased 12.5% sequentially. This platform is continuing its transformation, with a shift in focus away from cable products and towards connectivity. This shift results in softer revenues but higher profitability, as evidenced by operating profit margins of 13.1%, increasing 200 basis points year-over-year and 340 basis points sequentially.

I'm encouraged by the year-over-year improvement, a result of productivity gains and favorable mix. This improvement in profitability is in line with our recently stated objective.

Our Industrial Connectivity Segment generated revenues of $178.2 million dollars during the second quarter. Revenues increased $6.3 million from $171.9 million in the second quarter 2013. After adjusting for copper and currency, revenues increased 5.7% compared to the second quarter 2013.

Sequentially, revenues increased by $18.9 million from $159.3 million, slightly stronger than the typical seasonality.

Operating profit margins were 15.2%, increasing 80 basis points from the year ago period and 180 basis points sequentially. Both the year-over-year and sequential improvements are primarily a result of leverage on volume.

The Industrial IT segment generated revenues of $53.3 million dollars during the second quarter, including a $2.7 million contribution from the newly acquired Prosoft. Revenues declined $4.8 million compared to the second quarter 2013 and $0.8 million sequentially. The $58.1 million of orders booked in the period, a book-to-bill of 1.15, supports our full-year projections.

Operating profit margins of 15.5% decreased 4 percentage points from the year-ago period and 1.2 percentage points sequentially, again, a function of the timing of shipments.

If you will please turn to Slide seven, I will discuss our balance sheet highlights.

Our cash and cash equivalents balance was $445.0 million dollars at the end of the second quarter, a decrease of $124.6 million dollars sequentially. We deployed $342 million dollars towards strategic initiatives which was offset by the $200 million of debt issued in June and $33 million of free cash flow generated in the quarter.

Inventory turnover was 6.9 turns, an improvement of 0.2 turns year-over-year and 1.2 turns sequentially.

Days sales outstanding was 63 days in the second quarter, an increase of 7 days year-over-year and 6 days sequentially. The increase is primarily a function of the longer customary terms

offered by Grass Valley, balanced by extended payable terms as well. This resulted in working capital turns of 7.9 at the consolidated level, an improvement of 1.1 turns year over year and 1.9 turns sequentially.

PP&E turnover was 7.3 turns, an improvement of 0.2 turns year-over-year and 0.8 turns sequentially.

Net leverage increased from 2.7 times net debt to EBITDA in Q1 2014 to 3.0 in the current quarter, a result of the investments made in the second quarter. We remain committed to a level of 2.5 over the next twelve months.

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

Cash flows provided by operating activities for the second quarter were $43.7 million dollars compared to $58.6 million dollars in the year-ago period. Net capital expenditures for the quarter totaled $10.6 million dollars compared to $11.8 million last year. Free cash flow, after capital expenditures, was $33.1 million dollars. We are on track to deliver our goal of free cash flow in excess of net income for the full year.

For the quarter, we purchased approximately 424 thousand shares of Belden common stock for $31.2 million dollars at an average price of $73.50 per share. On a combined program-to-date basis, we have repurchased a total of 5.8 million shares, or greater than 12% of the company, at an average price of $42.77 per share. We now have $100 million dollars remaining available under the current program. Dry powder at the close of Q2 was greater than $700 million dollars.

That completes my prepared remarks. I would now like to turn the call back to our CEO, John Stroup, for comments on the newly-acquired ProSoft and outlook. John?

John Stroup Belden, Inc. – President, CEO

Thank you, Henk.

Please turn to slide nine for a discussion of our most recent acquisition.

As we've discussed, during the quarter we acquired ProSoft, a leading supplier of industrial embedded gateway and wireless products, for $103 million in cash. The company generates approximately $50 million of revenue on a full year basis, so please include $25 million of revenue from them in the 2nd half of the year. Additionally, we anticipate $0.09 of EPS accretion in the current fiscal year, and an additional $0.11 in 2015, resulting in $0.20 on a full-year basis. Going forward, their results will be included in our Industrial IT platform.

ProSoft products include communication gateways that enable machine to machine communication, regardless of protocol. They benefit from the continued deployment of industrial automation systems, and provide a critical translation service required by complex communication devices. With gross margins above 50%, operating profit margins within the corporate range, a talented leadership team, and strong customer relationships, I'm confident ProSoft will be a wonderful addition to the portfolio.

Please turn to Slide 10 for our outlook regarding the third quarter and full year 2014 results.

Belden's outstanding business portfolio and improved organizational structure provide us with an opportunity to perform well in a variety of economic environments. We continue to emphasize our strategic initiatives, including our Market Delivery System and Lean Enterprise. We also remain confident in our ability to deliver consistent operating results as we continue through 2014.

We expect our third quarter 2014 revenues to be $605 – $625 million and adjusted income from continuing operations per diluted share to be $1.05 - $1.15.

For the full year, we continue to expect revenues of $2.30 - $2.35 billion and have narrowed the range for adjusted income from continuing operations per diluted share to $4.10 - $4.30.

These expected results now incorporate the addition of $25 million of revenue from ProSoft and $0.08 of EPS for the remainder of the year, and the additional interest expense from the recent bond issuance. It also assumes that inventory at our channel partners and customers returns to the level seen at the end of the first quarter, a decline of approximately $12 million in the second half of 2014.

Operator, please open the call to questions.