2nd Quarter 2015 Earnings Conference Call Transcript



July 29, 2015

Overview*:

BDC reported 2Q15 consolidated revenues of $598.5M, income from continuing operations of $52.2M and diluted EPS from continuing operations of $1.21. Belden expects FY15 revenue to be $2.360 - $2.390B and adjusted diluted EPS from continuing operations to be $4.70 – $4.90. Belden expects 3Q15 revenue to be $580 - $600M and adjusted diluted EPS from continuing operations to be $1.05 - $1.15.

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

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. 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, 2015 earnings conference call.

My name is Matt Tractenberg, I'm Belden's VP of Investor Relations, with me 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 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 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 CEO, John Stroup. John?

John Stroup Belden, Inc. – President, CEO

Thank you, Matt, and good morning, everyone.

As a reminder, I'll be referring to adjusted results today.

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

On our first quarter earnings call, I shared with you some concerns regarding customer demand in a few of our served markets. A strong U.S. dollar, the impact of lower energy prices, and a lackluster Chinese economy are impacting demand for our industrial segments. Furthermore, it's now clear that our broadcast customers will defer capital spending on traditional infrastructure equipment as they navigate through a number of important industry transitions. As a result, we believe it's prudent to adjust our revenue expectations for the remainder of the year and take swift action to align our cost structure and protect margins.

Before I proceed, please know that I am extremely disappointed to a make a mid-year revision to our full-year revenue and earnings guidance. As you know, we have a long track record of accurately predicting the economic environment, and we do not make it a habit to fall short of our commitments. It is important, however, for me to highlight that my team and I remain fully committed to delivering outstanding shareholder returns, and I am confident that we'll do just that.

For the full year, we now expect revenues between $2.360 and $2.390 billion. As a result of these changes, the expected range of adjusted income from continuing operations per diluted share is now $4.70 to $4.90, which represents earnings growth between 11% and 16%. As a reminder, if not for the impact of currency translation, earnings growth projections would have been 18% to 23%. This revised outlook includes the expected benefit of a cost reduction program within our Broadcast Platform to align our cost structure with the current demand environment. The program, which requires an investment of $30 million, will result in $30 million in annualized savings. Henk will provide more information on the specifics of the program and impact to our margin profile.

First, let's review the second quarter performance. Total revenue in the second quarter was $598.5 million, an increase of 5.2% on a constant currency basis. The stronger U.S. dollar had an approximate $38 million unfavorable impact on revenues, year-over-year. After adjusting for copper, currency, and acquisitions, revenue declined 2.6% from the year-ago period.

Record gross profit margins were 41.7% for the quarter, an increase of 470 basis points from the year-ago period and continue to be best in class.

EBITDA margins were 16.7%, an increase of 190 basis points from the year-ago period.

We generated earnings per diluted share of $1.21 in the second quarter, an increase of 15.2% from the year-ago period.

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

Broadcast revenue in the quarter was $219.4 million dollars as compared to $252.3 million in the year ago period, a decrease of 8.6% after adjusting for changes in currency rates. Strength in our Broadband and commercial audio/video businesses partially offset the weakness for Grass Valley products in the professional broadcast market. EBITDA margins were 14.4%, increasing 200 basis points year-over-year, a result of productivity gains.

Grass Valley demand has been impacted by a stronger U.S. dollar, and a number of important challenges facing our traditional customers. On a full-year basis, we now expect revenue outside the United States to be down 18%. This is notable, because these markets are currently not facing many of the industry-specific challenges that I'll address momentarily. For some of our customers, capital spending has been impacted by government austerity programs and in other areas, Russia as an example, they simply don't have sufficient purchasing power to make investments. In the United States, where we expect revenue will be down 8% on a full year basis, our customers are dealing with the reality of reduced advertising spending, fewer subscribers, and unbundling. As a result, many of our customers have re-directed their capital budgets to fund their own over-the-top platforms. Although a consumer trend that appears to be permanent, this has no impact on the long-term need to invest in high quality content. With nearly two-thirds of Grass Valley's revenue tied to the live production of sports, news, and live entertainment, we're confident this is a pause in spending rather than a permanent reduction. Moreover, project win rates are healthy and stable. And the funnel continues to build, albeit partially the result of fewer projects being awarded than typical.

It's important to note that while these new consumption models negatively impact Grass Valley in the short-term, our Broadband Connectivity business, PPC, sees continued growth ahead…from the increased need for higher bandwidth and more robust infrastructure. Our Broadband component of this platform grew revenues by 5.2% on a year-to-date basis.

Shifting business platforms, I'm very pleased with results from our Enterprise and Network Security segments, with organic revenue growth of 4.2% and 10.9% respectively, both on a year-over-year basis. Congratulations to both teams on a strong quarter.

The U.S non-residential recovery is having a favorable impact on our enterprise business, and the team is managing their resources well with solid execution. End customer demand remains robust, as evidenced by 6% sales growth though our distribution partners. Equally strong was revenue from connectivity solutions within the enterprise platform, growing by 12% during the quarter, highlighting the continued shift to a higher value portfolio.

The Network Security platform once again exceeded our expectations, providing revenue of $39.6 million and EBITDA margins of 22.1%. I'm particularly pleased with the opportunity within

the utility market, where the partnership between Tripwire and GarretCom is gaining traction. Here, Tripwire saw sales more than doubled, and our Industrial IT platform drove 18% revenue growth, both year-to-date. Customers are racing to comply with upcoming NERC standards, and we're very well positioned to help them protect their critical infrastructure.

Revenue within our Industrial platforms, on a combined basis, was up slightly during the period. Project revenue from customers within oil & gas applications represents approximately 8% of the two platforms combined, and declined by approximately 20%. Moreover, project win rates within our industrial connectivity platform have fallen as certain competitors, that are more exposed than us to the oil & gas market, have gotten more aggressive as they battle factory utilization challenges. The Industrial platforms also derive approximately 20% of their combined revenue from machine builders. Revenue declined here in the low single digits. These customers are impacted by a weak manufacturing sector, a strong U.S. dollar, and softer demand within China. We anticipate these issues to persist for the remainder of the year. A clear bright spot, however, is our MRO revenue, which represents approximately 25% of the combined platform's revenue, grew by 6% year-over-year. This is clearly faster than market and is an indication of outstanding execution by our industrial sales team.

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 five for a detailed consolidated review. Second quarter revenues were $598.5 million dollars, a decrease of $6.6 million or 1.1% from $605.1 million in the second quarter 2014. On a constant currency basis, revenues increased 5.2% with acquisitions contributing $53.3 million in the quarter. Currency headwinds of $38.2 million on a year-over-year basis offset much of this benefit. On an organic basis, revenues declined 2.6% from the year-ago period.

Sequentially, revenues increased $29.0 million dollars from $569.5 million, in line with typical seasonality.

Gross profit margins were at an all-time record of 41.7%, increasing 470 basis points from the year-ago period due to successful execution on our M&A strategy. Sequentially, gross profit margins increased 110 basis points due to the favorable impact of lower input costs.

Second quarter SG&A expenses were $125.2 million dollars, or 21% of revenue. After adjusting for the impacts of currency and acquisitions, SG&A expenses declined $3.3 million from the year-ago period, primarily a result of productivity initiatives implemented in prior year.

R&D expenses for the quarter were $36.2 million dollars, or 6% of revenue. This represents an increase of 100 basis points year-over-year as a percentage of revenues as we continue to invest in more innovative products and services for our customers.

Despite a challenging environment, the Company generated record EBITDA margins of 16.7%, up 190 basis points year-over-year and 120 basis points sequentially. The acquisition of Tripwire had a favorable impact of 60 basis points on a year-over-year basis, while the other platforms have been executing well on productivity initiatives allowing for an improvement of 90 basis points.

Net interest expense for the quarter was $24.8 million dollars, an increase of $6.7 million year-over-year, a result of the additional senior subordinated notes issued in June and November of 2014. Given current exchange rates, our capital structure provides for an expected interest expense of approximately $25.5 million dollars per quarter going forward.

The adjusted effective tax rate for the second quarter was 18.0% compared to 23.0% in the prior year. For financial modeling purposes, we continue to recommend using a 20% effective tax rate for the third and fourth quarters, resulting in a 19% tax rate for the full year 2015.

Income from continuing operations per diluted share was $1.21, a 15% increase from the year-ago period.

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

Broadcast Solutions generated revenues of $219.4 million dollars during the second quarter. Compared to the year-ago period, revenues decreased $32.9 million from $252.3 million. Organic revenues declined 8.6% on a year-over-year basis. Grass Valley is navigating both the impact of a stronger US dollar on international demand as well as an evolving consumption model and its near-term effect on the allocation of advertising budgets.

EBITDA margins of 14.4% within the Broadcast segment increased 200 basis points year-over-year and 70 basis points sequentially. The year-over-year improvement is a result of productivity improvements identified and executed following the addition of Grass Valley last year. After a thorough analysis, we've identified an additional $30 million in annual cost savings at Grass Valley, which provides for a more appropriate Broadcast platform margin in the current business environment. The areas of focus are within manufacturing overhead, general and administrative, and sales and marketing in specific regions. We expect a benefit of approximately $0.13 cents in EPS this year, with the majority occurring in the fourth quarter. The required investment will approximate $30 million, much of which will impact free cash flow

in the second half of this year. The Income statement impact of the required investment will be excluded from our adjusted results.

Our Enterprise Connectivity Segment generated revenues of $117.3 million dollars during the second quarter, a decrease of $4.0 million year-over-year from $121.3 million, and an increase of $12.6 million sequentially. Organic growth was 4.2% on a year over year basis and 12.0% sequentially. Please note that the year over year performance included headwinds from portfolio actions initiated last year.

The Enterprise segment generated record EBITDA margins of 18.0%, an increase of 180 basis points year-over-year and 470 basis points sequentially. The improvements, both year-over-year and sequential, are primarily the result of an improved portfolio and leverage on growth. In addition, margins were favorably impacted sequentially by the timing of lower input costs. We believe that EBITDA margins on a year-to-date basis of approximately 16.0% is representative of the platform's performance for the remainder of the year.

Revenues within our industrial platforms increased 30 basis points organically from the year-ago period, and EBITDA margins increased 100 basis points on a combined basis.

The Industrial Connectivity Segment generated revenues of $160.9 million dollars. Organic revenues declined 3.1% year-over-year, largely due to the decline in Oil and Gas markets.

EBITDA margins of 17.8% increased 130 basis points year-over-year and 200 basis points sequentially. The increases are a result of productivity improvements.

The Industrial IT segment generated revenues of $61.3 million dollars. Revenues increased $8.0 million year-over-year with acquisitions contributing $10.3 million. This was offset by $8.6 million of currency headwinds. Revenues increased 12.0% organically, a solid performance that benefitted from an easier comparison.

EBITDA margins of 16.6% were essentially flat year-over-year and declined 160 basis points sequentially. The sequential performance includes investments in customer facing resources as well as product innovation, allowing us to capture share on an ongoing basis.

Finally, our Network Security platform continues to perform well, generating revenues of $39.6 million dollars, up 11% on an organic basis. EBITDA margins were 22.1%, which included an incremental investment of $1.4M in product innovation allowing us to execute the strategy ahead. Tripwire is off to a solid start and is on track to meet expectations shared with you at the outset of the year.

In summary, I am pleased with our ability to expand EBITDA margins across all of our platforms, especially in this environment.

If you will please turn to slide seven, I will begin with our balance sheet highlights.

Our cash and cash equivalents balance at the end of the second quarter was $208 million dollars compared to $445 million in the prior year.

Inventory turnover was 6.0 turns, down 0.9 turns on a year-over-year basis driven primarily by the in-sourcing of manufacturing at Grass Valley.

Days sales outstanding was 64 days in the second quarter, an increase of 1 day year-over-year.

PP&E turnover was 7.3 turns, flat year-over-year.

Our debt balance increased $360 million dollars from $1.56 billion in the second quarter 2014 to $1.92 billion in 2015

Net leverage was 3.9 times net debt to EBITDA at the end of the quarter. Our goal of improving this metric to a level of approximately 3.0 in the near term remains intact.

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

Cash flows from operations were $53.3 million dollars compared to $43.7 million in the prior year period. Net capital expenditures for the quarter were $11.7 million, increasing $1.1 million compared to last year.

Free cash flow was $41.6 million in the second quarter 2015 compared to $33.1 million in the prior year period, an increase of 25%. We expect Free Cash Flow for fiscal 2015 to be approximately $180 million dollars. This includes the impact of the restructuring investment made at Grass Valley, and as a result we expect free cash flow to be 85% of net income for the full year.

That completes my prepared remarks. I would now like to turn this call back to our CEO, John Stroup, for the outlook. John?

John Stroup Belden, Inc. – President, CEO

Please turn to slide nine for our outlook regarding the third quarter and full year 2015 results, which have been updated to reflect the current revisions I discussed earlier.

We expect third quarter 2015 revenues to be between $580 and $600 million, and adjusted income from continuing operations per diluted share is expected to be between $1.05 and $1.15.

For the full year, we now expect revenues between $2.360 and $2.390 billion. Slightly more than half of the reduction in revenue can be attributed to the Broadcast Platform, with the remaining amount the Industrial Platforms.

The expected range of adjusted income from continuing operations per diluted share is now at $4.70 to $4.90, which represents earnings growth between 11% and 16%.

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