4th Quarter 2016 Earnings Conference Call Transcript



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PRESENTATION

Kevin Maczka Belden, Inc. – Investor Relations

Thank you, Operator. Good morning, everyone, and thank you for joining us today for Belden's fourth quarter and full year, 2016 earnings conference call.

My name is Kevin Maczka, I'm Belden's Vice President of Investor Relations. With me this morning are John Stroup, President, CEO, and Chairman, 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 2 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, CEO, and Chairman, John Stroup. John?

John Stroup Belden, Inc. – President, CEO

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 for a review of our fourth quarter highlights.

We are pleased with our fourth quarter results, including organic revenue growth, EBITDA growth, and EBITDA margin expansion. I'd like to thank our associates for their commitment to aggressively executing our strategic plan.

On an organic basis, we grew revenues by 80 basis points to $608.2 million. We benefitted from another strong quarter of organic growth from both our Broadcast and Enterprise platforms.

EBITDA grew 6.9% year-over-year, from $114.6 million to $122.5 million. Furthermore, EBITDA margins expanded 110 basis points from 19.0% in the prior year period to 20.1%. I am extremely pleased with the record EBITDA margins. The margin expansion was broad-based across the majority of our platforms.

EPS in the fourth quarter was $1.42, compared to $1.63 in the prior year period. The fourth quarter of 2015 benefited from an effective tax rate of 9.6%, and the preferred equity issuance during 2016 provided further headwinds year-over-year. Earnings grew 16% excluding the impact of these two items.

We ended the quarter with a net debt to EBITDA ratio of 1.8x, down significantly from 3.6x in the year ago period. The improvement is due to EBITDA growth, record free cash flow, and the mandatory preferred equity issuance.

Please turn to slide 4 for a brief discussion of our full year 2016 results.

Revenues for the year were $2.36 billion. A stronger U.S. dollar and lower copper prices had an approximate $40 million unfavorable impact on revenues during the year. On an organic basis, revenues grew by 1.3% from the prior year, led by robust performances from our Enterprise and Broadcast platforms, with organic growth of 4.3% and 4.1%, respectively.

Our productivity initiatives drove EBITDA margins to a record 18.3%, up from 17.0% in 2015, an increase of 130 basis points. This puts our full year EBITDA margins within our long-term goal of 18-20%.

The 7.6% EBITDA growth, combined with lower interest expense due to our reduced debt balance, resulted in net income growth of 12.3% for the year. EPS increased from $4.98 in 2015 to $5.27 in 2016, up 5.8% and a company record for full year EPS.

We had robust free cash flow generation of $261 million in 2016, also a company record. Free cash flow increased by 40% from 2015, and once again exceeded net income. Our strong free cash flow is a testament to the quality of our earnings, and reflects our unwavering commitment to a Lean Enterprise, which leads to efficient use of working capital and fixed assets.

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

Broadcast revenues in the quarter were $208.8 million as compared to $201.8 million in the year ago period. On an organic basis, revenues increased 3.7%. We are especially pleased with 11% orders growth for Grass Valley, resulting in a healthy book to bill of 1.05. Grass Valley continues to generate positive market reaction with its new and innovative IP solutions. Fourth quarter orders included a significant multi-million dollar order with a major network for our open architecture IP infrastructure system. Our Broadband business had another strong quarter. Broadband revenues included the 2016 royalty payments related to its industry-leading intellectual property. This business will continue to benefit from royalties in 2017 and beyond.

EBITDA margins for the platform were 23.3%, increasing 340 basis points from the prior-year period. The platform benefited from favorable mix as well as its typical seasonal pattern.

Enterprise platform revenues were $150.2 million. On an organic basis, revenues increased 3.7% year over year, driven by strong end market demand. Most notably, end customer demand for our products in the U.S. accelerated throughout the quarter, reaching 18% year-over-year growth in December. Demand was driven by the increasing number of connections in new non-residential construction and smart buildings. Our innovative products deliver data in addition to power over Ethernet, meeting the higher performance requirements. Sales of Category 6A cable products, which deliver data and power over Ethernet, were up 48% year-over-year.

EBITDA margins of 13.8% were down from 16.8% in the prior year. Enterprise faced temporary margin headwinds this quarter, primarily due to the timing of rising copper prices, which increased from $2.18/pound at the beginning of the quarter to $2.50/pound at the end of the quarter. In periods of rapidly rising input costs, our industry leading inventory turns act as a temporary headwind, and Enterprise's EBITDA was negatively impacted by approximately $2 million. We have increased our prices and expect our margins to normalize by next quarter.

The Industrial Connectivity platform experienced a second consecutive quarter of organic growth. Revenues for the quarter were $146.7 million, up 50 basis points organically from the year-ago period. Discrete manufacturing end markets, which represent approximately 65% of our Industrial Connectivity business, continue to perform well and were up approximately 7% year-over-year.

EBITDA margins were 18.8% for the fourth quarter, an improvement of 200 basis points from the prior year. The margin expansion resulted from improved productivity.

Industrial IT generated revenues of $58.9 million, down 5% organically from the fourth quarter of 2015. From an end market perspective, oil and gas continues to be weak and our

transportation vertical, most notably in China, softened. EBITDA margins expanded by 30 basis points from the year-ago period, to 18.7%.

Finally, our Network Security platform generated revenues of $43.5 million. The platform experienced sequential revenue growth of 10.1%, in line with typical seasonality. On a year-over-year basis, total revenues for the quarter were down 11.4%. We made good progress under our new leadership in addressing the commercial challenges we discussed last quarter. We continue to believe these headwinds will be behind us by the second quarter. We were pleased with the continued momentum within our industrial vertical market. Fourth quarter non-renewal bookings in the industrial vertical were up 29% compared to the third quarter. Approximately 21% of our non-renewal bookings in 2016 were within the industrial vertical, up from 18% in 2015. EBITDA margins for the platform remained strong, at 34.6%.

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, 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 6 for a detailed consolidated review…. Revenues in the quarter were $608.2 million dollars, an increase of 90 basis points from $602.5 million in the fourth quarter 2015. Higher copper prices and a small bolt-on acquisition announced in the first quarter of 2016 favorably impacted revenues by $3.4 million and $2 million dollars, respectively. Currency translation reduced revenues by $4.5 million dollars. After adjusting for these factors, revenues increased 80 basis points organically from the prior-year period.

Sequentially, revenues increased 90 basis points from $602.5 million.

Gross profit margins for the quarter were 43.4%, increasing 30 basis points from the prior-year period, a result of productivity improvements. Sequentially, gross profit margins increased 180 basis points, due to seasonal mix and productivity.
Operating expenses for the quarter were $154.0 million dollars, or 25.3% of revenues. After adjusting for the impact of currency and acquisitions, operating expenses declined $700,000 dollars year-over-year.

EBITDA was $122.5 million dollars in the quarter. Compared to the prior-year period, EBITDA increased $7.9 million dollars, or 6.9%, driven by productivity improvements.

Sequentially, EBITDA increased $11.0 million dollars, or 9.8% from $111.5 million.

EBITDA margins were 20.1%, an increase of 110 basis points from the prior-year and 160 basis points sequentially.

As a result of this achievement, we're pleased to announce full-year EBITDA margins of 18.3%. This is a company record and within our long-term goal of 18 – 20%.

Net interest expense of $23.1 million dollars for the quarter decreased $3.5 million dollars from the prior year and $400,000 dollars sequentially. The year-over-year decrease was driven by a reduction of debt during the year and fewer days compared to the fourth quarter 2015. For the full-year 2017, we expect interest expense to be approximately $94 million.

The effective tax rate for the fourth quarter was 19.9%, compared to 9.6% in the prior year and 19.9% in the prior-quarter.

For financial modelling purposes, we recommend using a 20% effective tax rate for the first quarter and full year 2017.

Net income in the quarter was $70.3 million dollars, increasing $1.0 million dollars from the prior-year period and $8.9 million dollars sequentially.

Earnings per share was $1.42 in the quarter compared to $1.63 in the prior-year period. As a reminder, the prior year earnings per share included an incremental benefit from tax planning initiatives of 21 cents. In addition, the dilutive impact of the mandatory preferred equity instrument was 23 cents in the quarter.

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

Our Broadcast Solutions segment generated revenues of $208.8 million dollars in the fourth quarter. Revenues increased by 3.5% from $201.8 million in the prior-year period. Currency translation had an unfavorable impact of $2.5 million dollars, while acquisitions contributed $2 million. On an organic basis revenues increased 3.7% year-over-year, a result of solid execution in both our Grass Valley and Broadband businesses.

Sequentially revenues increased 6.4% from $196.2 million, reflecting accelerating demand for our Grass Valley products.

Broadcast EBITDA margins were 23.3% in the quarter, increasing 340 basis points from the prior-year and 470 basis points sequentially. Fourth quarter EBITDA benefitted from leverage on growth and favorable mix, and also included the full-year 2016 impact of incremental IP-related royalties.

Our Enterprise connectivity segment generated revenues of $150.2 million dollars during the quarter, growing 2% compared to the fourth quarter 2015. Higher copper prices increased

revenues by $1.8 million dollars, while currency translation reduced revenues by $1.1 million. On an organic basis, revenues increased 3.7% from the prior-year period.

Sequentially, Enterprise connectivity revenues declined 4.1% from $156.7 million dollars, in-line with typical seasonality.

EBITDA margins were 13.8% in the quarter, decreasing 300 basis points from the prior-year period and 360 basis points sequentially. The timing of rising copper prices had a temporary negative impact on margins in the quarter. We expect margins to normalize in the first quarter of 2017.

The Industrial Connectivity segment generated revenues of $146.7 million dollars in the quarter, increasing 3.5% from $141.8 million in the prior-year period. Copper had a favorable impact of $1.6 million, while currency translation reduced revenues by $300,000 dollars. On an organic basis the Industrial Connectivity segment grew 50 basis points, driven by continued strength with discrete manufacturers.

Sequentially, revenues decreased 2.1% from $149.8 million dollars, in-line with typical seasonality.

EBITDA margins of 18.8% increased 200 basis points year-over-year, a function of productivity improvements and product mix. On a sequential basis, margins increased 300 basis points.
The Industrial IT segment generated revenues of $58.9 million dollars, decreasing 6.2% from $62.8 million in the prior-year period. Currency translation had an unfavorable impact of $700,000 dollars in the quarter. On an organic basis, revenues declined 5.0% year-over-year. Sequentially, revenues decreased 2.2% from $60.2 million. The revenue performance was driven by weakness in Oil & Gas and Transportation end markets, particularly within China.

EBITDA margins of 18.7% increased 30 basis points from 18.4% in the prior-year period, but declined 250 basis points sequentially. Margins were impacted by the lower sales volume in the quarter.

Moving to our Network Security segment, revenues of $43.5 million dollars declined 11.4% on an organic basis from $48.9 million in the year-ago period. Revenues increased 10.1% sequentially, in-line with typical seasonality.

Network Security EBITDA margins of 34.6% increased 460 basis points compared to the prior-year period, and 510 basis points sequentially. For the full-year 2017, we expect margins to normalize at approximately 30% as we implement our new commercial programs and make investments in product innovation.

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 $848 million dollars compared to $748 million in the prior quarter and $217 million in the prior year.

The year-over-year increase reflects the improvements made to our balance sheet and record free cash flow generation.

Inventory turnover was 7.4 turns, an improvement of 0.1 turns sequentially and 0.3 turns from the prior-year period.

Days sales outstanding was 57 days in the fourth quarter, an improvement of 4 days sequentially and 5 days year-over-year, reflecting the timing of customer repayments.

PP&E turnover was 7.9 turns, improving 0.5 turns sequentially and 0.2 turns year-over-year.

Our total debt principal at the end of the quarter was $1.64 billion, compared to $1.71 billion in the third quarter and $1.75 billion in the prior-year period.

The year-over-year decrease reflects both the debt reduction in 2016 and the benefit of currency translation on our Euro-denominated debt.

In the quarter, we announced a private offering of 200 million euros of senior subordinated debt due in 2026 at rates of 4.125%. This was used to pay-off our term loan due in 2020. As a result, we have no significant maturities until 2022 and have more closely aligned our balance sheet with our cost structure.

Net leverage was 1.8 times net debt to EBITDA at the end of the fourth quarter, down from 2.2 times sequentially and 3.6 times year-over-year.

We are extremely pleased with the improvements made to our balance sheet during the year. We finished the year with approximately $550 million of dry powder available to invest in quality companies that meet our financial hurdles.

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

Cash flows from operating activities for the quarter were $167.4 million dollars compared to $144.4 million for the prior year-period.

Net capital expenditures were $17.8 million for the quarter, increasing $2.3 million year-over-year, as we increased our organic investments in growth initiatives.

Free cash flow in the quarter was $149.6 million dollars, increasing $20.7 million, or 16.1% compared to $128.9 million in the fourth quarter 2015.

For the full-year we achieved record free cash flow of $261.2 million dollars, increasing 40% from $187.0 million in the prior-year. In addition, free cash flow was 109% of net income, an outstanding performance.

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

Thank you, Henk.

Please turn to Slide 10 for our outlook regarding the first quarter and full-year 2017 results.

Our balanced portfolio and proven business system allow us to perform well under a variety of market situations. Consistent with our commitment to continuous improvement, we expect further EBITDA margin expansion across the organization in 2017 and another year of organic growth. When paired with our strong balance sheet and optimism around acquisition-related opportunities, we feel confident Belden is well-positioned for success.

We anticipate first quarter 2017 revenues to be between $540 and $560 million, and EPS is expected to be between $0.83 and $0.93.

For the full year, we continue to expect revenues to be between $2.355 and $2.405 billion, and we continue to expect EPS of $4.95 to $5.20.

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