

2nd Quarter 2021 Earnings Transcript

August 4, 2021

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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 second quarter 2021 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 and CEO Roel Vestjens, and Senior Vice President and CFO Jeremy Parks. Roel will provide a strategic overview of our business, and then Jeremy 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. 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 and CEO Roel Vestjens. Roel?

Roel Vestjens 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 second quarter highlights.

We performed well again this quarter, and I am pleased to report total revenues and EPS that exceeded the high end of our guidance ranges.

Our end markets continue to recover, and our global teams are meeting the robust demand levels and successfully navigating the inflationary environment. This resulted in meaningful growth and margin expansion during the quarter.

Second quarter revenues increased 42% year over year to $603 million, compared to our guidance range of $535 to $550 million. Organic growth is a key priority, and revenues increased 28% year over year on an organic basis.

The upside relative to our expectations was broad based, with contributions from both the Industrial Solutions and Enterprise Solutions segments.

Incoming order rates were strong during the quarter, increasing 74% year over year and 18% sequentially. This resulted in a healthy book to bill ratio of 1.19 times.

EBITDA increased 90% year over year to $93 million. EBITDA margins expanded 390 basis points, from 11.6% in the year-ago period to 15.5%.

EPS increased 163% year over year to $1.21, compared to $0.46 in the year-ago period and our guidance range of $0.88 to $0.98.

We are increasing our full year guidance to reflect the better than expected performance in the second quarter and an improved outlook for the second half of the year. For the full year 2021, we are increasing the high end of our revenue and EPS guidance ranges by $170 million and $0.77, respectively.

Turning now to our key strategic markets. We had another great quarter in industrial. Industrial Solutions revenues increased 32% organically, with broad based strength in each of our primary market verticals and regions.

Market conditions are clearly improving, and we continue to see a number of compelling longer-term demand drivers for automation solutions as industrial customers respond to increasing labor costs, increasing capacity requirements, the need to pandemic-proof operations, and other factors. Belden is extremely well-positioned and highly differentiated in the marketplace, and we expect to deliver solid growth in this market going forward.

As we shared with you previously, we are making targeted investments throughout the Company to support our customers by driving innovation and strengthening our product roadmap. As just one example of our recent innovations in industrial automation, we launched an expanded suite of advanced connectivity solutions during the second quarter, called LioN-X.

The LioN-X solutions provide manufacturers with a faster and more reliable approach to transmitting sensor and actuator data in automated production environments. This is a state-of-the-art, future-ready connectivity solution that is core to providing secure communication from the sensor to the cloud in industrial environments. These enhanced capabilities reflect our leadership position in this important growth market.

We are also sharpening our commercial excellence in a number of areas, such as solution selling. Beyond individual product sales, Belden is uniquely positioned to offer differentiated solutions to our customers, including cable, connectivity, networking, and software products and services.

I would like to highlight a recent success story in industrial automation that illustrates our capabilities in solution selling and resulted in a significant new business win.

During the second quarter, we received a $6 million award for a project with a large investor-owned utility in the United States for the implementation of a critical communications network.

This is an important strategic win. Over the course of the project, we will be providing an expanded solution from the combined Belden and OTN Systems, which we acquired in January, to a long-time Belden customer that previously purchased our industrial automation and cybersecurity offerings. It showcases our product and commercial synergies, and is a great example of the opportunities we are now positioned to secure in this market.

This is the first phase of the project, and significant future expansion is expected beyond this initial award.

Beyond this project, the continued upgrade of grid infrastructure by other utilities throughout the United States is expected to provide many other opportunities to deploy our technologies.

We also continue to make progress improving our portfolio and aligning with growth markets.

During the second quarter, we completed the divestiture of copper cable product lines serving the oil & gas market in Brazil, which we do not view as a strategic priority. These products previously contributed approximately $15 million in annual revenue, with an immaterial contribution to EBITDA and cash flow, and we were pleased with the $11 million sale price. I would like to thank the team in Brazil for their efforts and wish them all the best.

Turning now to Enterprise. Enterprise Solutions revenues increased 23% year-over-year on an organic basis in the second quarter.

Within the segment, revenues in Broadband and 5G increased 13% organically. We see strong secular trends in this market driven by the increasing demand for high-speed broadband and the desire to provide access to every household. Broadband networks will need to be upgraded continuously to support high definition video streaming, work from home, virtual learning, and many other applications. We have sustainable competitive advantages in this market, and we are ideally suited to support both MSO and Telco customers as they upgrade and expand their networks.

Broadband fiber revenues increased 28% organically year to date in 2021 after similar growth in 2020. We expect further robust growth going forward as we continue to strengthen our patent-protected fiber R&D capabilities, add engineering resources, and reduce our time to market for new offerings.

Revenues in Smart Buildings increased 36% year-over-year on an organic basis, substantially exceeding our expectations. We are very encouraged by the improvement we are seeing in this market and the strong execution by our teams. We entered the year with an expectation that smart buildings revenue would decline in 2021, but we now expect to deliver solid growth in this market.

We are benefitting from our commercial focus on growth verticals such as data centers and healthcare facilities. In addition, our improved operational performance and superior lead times are enabling continued share capture.

To summarize, we had a great second quarter and first half of the year. We are committed to driving robust organic growth in 2021 and beyond, and encouraged that our strategic initiatives are gaining traction.

I will now ask Jeremy to provide additional insight into our second quarter financial performance. Jeremy?

Jeremy Parks Belden, Inc. - CFO

Thank you, Roel.

Please turn to Slide 4 for a detailed consolidated review.

I will start my comments with results for the quarter, followed by a review of our segment results and a discussion of the balance sheet and cash flow performance. As a reminder, I will be referencing adjusted results today.

Revenues were $603 million in the quarter, increasing $178 million, or 42%, from $425 million in the second quarter of 2020.

Revenues increased 28% organically compared to the prior year and 9% sequentially. Importantly, we have not seen material restocking by our channel partners, and so we believe this revenue performance is consistent with improving end demand.

Incoming order rates were very strong during the quarter, increasing 74% year over year and 18% sequentially.

This resulted in a book to bill ratio of 1.19 times, including 1.22 in Industrial Solutions and 1.16 in Enterprise Solutions.

Gross profit margins in the quarter were 35.7%, increasing 30 basis points compared to 35.4% in the year-ago period. As a reminder, as copper costs increase we raise selling prices, resulting in higher revenue with minimal impact to gross profit dollars. As a result, gross profit margins decrease.

In the second quarter, the pass through of higher copper prices had an unfavorable impact of 320 basis points. Excluding the impact of this pass through, gross profit margins would have increased 350 basis points year over year. This exceeded our expectations for the quarter, and we are especially pleased with the performance given the current inflationary environment.

We expect that inflationary pressures will likely persist, and we are proactively addressing this through price recovery and productivity measures to support gross profit margins.

EBITDA was $93 million, increasing $44 million, or 90%, compared to $49 million in the prior-year period.

EBITDA margins were 15.5%, increasing 390 basis points compared to 11.6% in the year-ago period. Excluding the impact of higher copper pass through pricing, EBITDA margins would have increased 510 basis points year over year, demonstrating solid operating leverage on higher volumes.

Net interest expense was consistent with the year-ago period.

At current foreign exchange rates, we expect interest expense to be approximately $62 million in 2021.

Our effective tax rate was 18.2% in the second quarter, as we benefited from incremental discrete tax planning items. We expect an effective tax rate of approximately 19% in the third quarter and 19.5% for the full year 2021.

Net income in the quarter was $55 million, compared to $20 million in the prior-year period.

Earnings per share was $1.21, compared to $0.46 in the second quarter 2020.

We were very pleased to deliver such robust growth and margin expansion in the second quarter.

Turning now to slide 5 in the presentation for a review of our business segment results.

I will begin with our Industrial Solutions segment. 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.

The Industrial Solutions segment generated revenues of $335 million in the quarter, increasing 51% from $221 million in the second quarter of 2020. Segment revenues increased 32% organically.

Revenues in industrial automation, our largest market, increased 36% year over year on an organic basis, with broad based strength across each of our primary market verticals.

Revenues for our integrated cybersecurity solutions also increased year-over-year for the second straight quarter. We are pleased with the progress the team is making in advancing the product roadmap and identifying new commercial opportunities in industrial end markets. Non-renewal bookings increased 12% year over year in the first half of the year.

Industrial Solutions segment EBITDA margins were 16.9% in the quarter, increasing 500 basis points compared to 11.9% in the year-ago period. The year-over-year increase primarily reflects operating leverage on higher volumes.

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

The Enterprise Solutions segment generated revenues of $268 million during the quarter, increasing 32% from $203 million in the second quarter of 2020. Segment revenues increased 23% organically.

Revenues in Broadband and 5G increased 13% year-over-year on an organic basis. The ever-increasing demand for more bandwidth and faster speeds is driving increasing investments in network infrastructure by our customers. This supports continued robust growth in our fiber optic products, which increased 21% organically in the second quarter.

Revenues in the Smart Buildings market increased 36% year-over-year on an organic basis, substantially exceeding our expectations. Market conditions improved significantly in the quarter, and our commercial engagement and strong operational performance are driving notable share capture.

Enterprise Solutions segment EBITDA margins were 13.2% in the quarter, increasing 230 basis points compared to 10.9% in the prior year period.

If you will please turn to Slide 6, I will begin with our balance sheet highlights.

Our cash and cash equivalents balance at the end of the second quarter was $423 million compared to $371 million in the prior quarter and $360 million in the prior year period.

We are very comfortable with our current liquidity position.

Working capital turns were 7.6, compared to 6.7 in the prior quarter and 5.5 in the prior-year period.

Days sales outstanding of 53 days compared to 54 in the prior quarter and 60 in the prior-year period.

Inventory turns were 5.1, compared to 5.0 in the prior quarter and 4.5 in the prior year.

Our financial leverage improved significantly during the quarter. Net leverage was 3.3 times net debt to EBITDA at the end of the second quarter, compared to 4.0 times in the prior quarter. We now expect to trend back within the targeted range of 2 to 3 times by year-end 2021.

Turning now to slide 7. I will now discuss our pro forma debt maturity schedule.

As a reminder, our debt at the end of the second quarter was entirely fixed at attractive interest rates. We have no near-term maturities and no maintenance covenants on this debt.

Subsequent to quarter-end, we took steps to further strengthen the balance sheet and extend our maturities. Specifically, in July we issued 300 million Euros in new 10-year notes maturing in 2031. The interest rate on these notes is 3.375%, which matches the lowest interest rates on 10-year notes in the history of the Company. We were very pleased to complete this transaction.

We intend to use the proceeds during the third quarter to redeem the full 300 million Euros outstanding on our 2025 notes, so our total debt principal outstanding will be unchanged at the end of the third quarter.

Following the redemption, our debt maturities will range from 2026 to 2031, with an average interest rate of 3.6%. This provides significant financial flexibility as we execute our strategic plans.

Please turn to Slide 8 for a few cash flow highlights.

Cash flow from operations in the second quarter was $68 million, compared to $40 million in the prior-year period.

Net capital expenditures were $16 million for the quarter, compared to $20 million in the prior-year period.

And finally, free cash flow in the quarter was $52 million, compared to $20 million in the prior-year period.

We are pleased with the year to date free cash flow generation, which is approximately $50 million better than the first half of 2020.

That concludes my prepared remarks. I would now like to turn the call back to our President and CEO, Roel Vestjens, for the outlook. Roel?

Roel Vestjens Belden, Inc. – President & CEO

Thank you, Jeremy.

Please turn to Slide 9 for our outlook.

End market conditions continue to improve, and I am encouraged by our robust recent order rates and solid execution. We are increasing our full year 2021 guidance to reflect better than expected performance in the second quarter and an improved outlook for the remainder of the year, while considering the renewed uncertainty related to the global pandemic.

We anticipate third quarter 2021 revenues of $590 million to $605 million, and EPS of $1.11 to $1.21.

For the full year 2021, we now expect revenues of $2.320 billion to $2.350 billion, compared to prior guidance of $2.130 billion to $2.180 billion.

This $170 million increase to the high end of our guidance range includes approximately $140 million from improved operational performance and $30 million from higher copper prices and current foreign exchange rates. Our revised full year guidance implies consolidated organic growth of approximately 15% to 17%, compared to our prior expectation of 6% to 9%.

We now expect full year 2021 EPS to be $4.37 to $4.57, compared to prior guidance of $3.50 to $3.80.

Our revised guidance for the full year 2021 implies total revenue growth of 25% to 26%, and EPS growth of 59% to 66%.

We expect interest expense of approximately $62 million and an effective tax rate of 19.5% for the full year 2021.

Please turn to slide 10.

Before we conclude, I would like to reiterate our investment thesis. We are taking bold actions to drive substantially improved business performance, and you are seeing that in our much better than expected first half performance and increased full year outlook. This includes aligning around growth markets, developing innovative networking solutions, and enhancing our commercial capabilities.

Our financial leverage improved significantly during the quarter, and we intend to return to our targeted leverage range by year-end 2021.

I am confident that we have the management team, strategy, and business system to successfully execute our strategic plans and drive strong returns for our shareholders.

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