

3rd Quarter 2021 Earnings Transcript

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CORPORATE PARTICIPANTS

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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 third 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 most recent quarterly report on Form 10-Q. 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 summary of the third quarter takeaways.

We delivered another outstanding quarter, with total revenues and EPS that exceeded the high end of our guidance ranges. I'd like to thank our global teams for diligently executing our strategic plans to accelerate growth and expand margins.

Demand trends remain robust, and I am encouraged by our order rates. We continue to strengthen our relationships with customers and capitalize on opportunities across our business. We are increasingly benefitting from our focus on solution selling and new product innovation. Our strong financial performance demonstrates that our initiatives are gaining momentum with customers, who recognize us for our design, engineering, and service capabilities.

We are successfully navigating the challenging operating environment. Our teams are supporting our customers and taking proactive steps to expand margins despite the significant inflationary pressures and supply chain challenges in our industry.

During the quarter we further strengthened our balance sheet. As we increased EBITDA and generated free cash flow, net leverage declined to 2.8 times at the end of the third quarter. We are pleased to report that this is back within our targeted range of 2 to 3 times for the first time since the outbreak of the pandemic.

Finally, we are increasing our full year 2021 revenue and EPS guidance once again to reflect better than expected performance in the quarter and an improved outlook for the remainder of the year.

In summary, this was another excellent quarter for Belden, and I am very proud of the achievements of our global teams.

Now, before we review our third quarter performance in more detail, I would like to update you on some important strategic initiatives.

Please turn to Slide 4.

As you know, Belden's senior leadership team and I have been pursuing a number of compelling strategic initiatives to drive solid and sustainable organic growth.

One key initiative is to enhance our value-added solution selling capabilities. Beyond individual product sales, Belden is uniquely positioned to offer complete and differentiated solutions, including cable, connectivity, networking, and software products and services. Given our product breadth and application expertise, customers are increasingly turning to Belden to solve their complex networking issues and enable them to collect and analyze vast amounts of data. Our sales and engineering teams are engaging with customers to optimize their operations, increase productivity, and improve safety.

I would like to highlight two recent project wins in industrial automation that illustrate our solution selling capabilities.

First, in the logistics area, we recently engaged with a world leader in warehouse automation systems that provides conveyors, material handling racks, and other equipment to large warehouse operators.

This is a long-time Belden customer that recently expanded our engagement to include a complete factory floor network assessment.

As a result of this milestone award, we expect to deploy a comprehensive networking solution across more than 20 facilities for this customer.

In a second recent project, we engaged with a rapidly growing provider of robotic supply chain systems that utilizes automated guided vehicles, or AGVs, in large-scale warehouses.

This application will include the design and implementation of next-generation wireless AGV communication networks, optimizing the operation for hundreds of AGVs at each site. This represents a significant new revenue opportunity with this customer.

These are just two examples of recent customer engagements that illustrate how Belden is transitioning from a product supplier to a value-added partner in the design and implementation of advanced solutions. We are very excited about the progress we are making on this important growth initiative.

Please turn now to Slide 5 for a review of an innovative new product.

We are making targeted investments throughout the Company to develop new and innovative products that support our value-added solutions strategy.

One new product that I'd like to highlight in the industrial automation market is a new cellular communications gateway called ProLinx Edge.

This product is designed to help customers establish remote connection to their machines and monitor data via a secure cloud-based network. Customers will now be able to use this single integrated device, whereas multiple components were previously required to provide the same functionality.

We expect to continue developing innovative new products and complete networking solutions to support our customers and increase our growth opportunities.

Now please turn to Slide 6 in our presentation for a review of the third quarter highlights.

As I mentioned, we delivered meaningful growth and margin expansion again this quarter, with total revenues and EPS that exceeded our expectations.

Third quarter revenues increased 33% year over year to $631 million, compared to our guidance range of $590 to $605 million. Organic growth is a key priority, and revenues increased 24% year over year on an organic basis.

The better than expected performance was broad based, with contributions from both the Industrial Solutions and Enterprise Solutions segments.

EBITDA increased 54% year over year to $101 million. EBITDA margins expanded 230 basis points, from 13.7% in the year-ago period to 16.0%.

EPS increased 82% year over year to $1.31, compared to $0.72 in the year-ago period and our guidance range of $1.11 to $1.21.

We are increasing our guidance once again. For the full year 2021, we are increasing the high end of our revenue and EPS guidance ranges by $50 million and $0.20, respectively.

Turning now to our key strategic markets. We had another great quarter in industrial. Industrial Solutions revenues increased 30% organically in the third quarter.

Market conditions remain very healthy, 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 and productivity requirements, and other factors. Belden is highly differentiated in the marketplace, and we expect to deliver solid growth in this market going forward.

Turning now to Enterprise. Enterprise Solutions revenues increased 18% year-over-year on an organic basis in the third quarter, driven by improving end market trends and significant share capture in Broadband, 5G and Smart Buildings.

Within the segment, revenues in Broadband and 5G increased 6% organically. We see strong secular trends in this market driven by the ever-increasing demand for high-speed broadband and the desire to provide greater access. We have sustainable competitive advantages in this market, and we are ideally suited to support both MSO and Telco customers as they continuously upgrade and expand their networks.

Revenues in Smart Buildings increased 32% year-over-year and 13% sequentially 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 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 another great quarter. We are committed to driving robust organic growth, and are encouraged that our strategic initiatives are gaining traction.

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

Jeremy Parks Belden, Inc. - CFO

Thank you, Roel.

Please turn to Slide 7 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 $631 million dollars in the quarter, increasing $155 million, or 33%, from $476 million in the third quarter of 2020.

Revenues increased 24% year over year and 6% sequentially on an organic basis. We have not seen significant restocking by our channel partners, and we believe this revenue performance is consistent with robust end demand.

Incoming order rates remained strong during the quarter, increasing 48% year over year and approximately flat sequentially compared to the very strong orders in the second quarter.

This resulted in a book to bill ratio of 1.13 times, including 1.20 in Industrial Solutions and 1.05 in Enterprise Solutions.

Gross profit margins in the quarter were 36.1%, increasing 80 basis points compared to 35.3% 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 third quarter, the pass through of higher copper prices had an unfavorable impact of 210 basis points. Excluding the impact of this pass through, gross profit margins would have increased 290 basis points year over year. 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 additional price recovery and productivity measures to support gross profit margins.

EBITDA was $101 million dollars, increasing $36 million, or 54%, compared to $65 million in the prior-year period.

EBITDA margins were 16.0%, increasing 230 basis points compared to 13.7% in the year-ago period. Excluding the impact of higher copper pass through pricing, EBITDA margins would have increased 310 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 18.5% in the third quarter, as we benefited from incremental discrete tax planning items. We expect an effective tax rate of approximately 20% in the fourth quarter and 19.1% for the full year 2021.

Net income in the quarter was $60 million dollars, compared to $32 million in the prior-year period.

Earnings per share was $1.31, increasing 82% compared to $0.72 in the third quarter 2020.

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

Turning now to slide 8 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 $345 million dollars in the quarter, increasing 40% from $247 million in the third quarter of 2020. Segment revenues increased 30% organically, with broad based strength across each of our primary market verticals.

Non-renewal bookings for our integrated cybersecurity solutions increased 10% year to date in industrial markets.

Industrial Solutions segment EBITDA margins were 17.3% in the quarter, increasing 170 basis points compared to 15.6% 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 $286 million dollars during the quarter, increasing 25% from $229 million in the third quarter of 2020. Segment revenues increased 18% organically.

Revenues in Broadband and 5G increased 6% year-over-year on an organic basis due to healthy end market demand and solid share capture. As a reminder, Broadband and 5G revenues increased in the third quarter 2020, and revenues are up double-digits compared to the pre-Covid period.

Demand for our broadband fiber products remains strong, with orders increasing 28% year to date.

Revenues in the Smart Buildings market increased 32% year-over-year and 13% sequentially on an organic basis, substantially exceeding our expectations. Improving market conditions and strong operational performance resulted in further share capture during the quarter.

Enterprise Solutions segment EBITDA margins were 14.0% in the quarter, increasing 250 basis points compared to 11.5% in the prior year period.

If you will please turn to Slide 9, I will begin with our balance sheet highlights.

Our cash and cash equivalents balance at the end of the third quarter was $458 million dollars compared to $423 million in the second quarter and $391 million in the prior year period.

We are very comfortable with our current liquidity position.

Working capital turns were 7.8, compared to 7.6 in the prior quarter and 6.6 in the prior-year period.

Days sales outstanding of 56 days compared to 53 in the prior quarter and 58 in the prior-year period.

Inventory turns were 5.2, compared to 5.1 in the prior quarter and 5.0 in the prior year.

Our financial leverage improved significantly again this quarter. Net leverage of 2.8 times net debt to EBITDA at the end of the third quarter is back within our targeted range of 2-3 times. This compares to 3.3 times in the second quarter and 4.0 times in the first quarter. We expect net leverage to trend even lower in the fourth quarter, which is seasonally the strongest quarter of the year for free cash flow generation.

Turning now to slide 10. I will now discuss our debt maturity schedule.

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

During the quarter, 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%. We were very pleased with the transaction.

We used the proceeds from this transaction during the third quarter to redeem the full 300 million Euros outstanding on our 2025 notes.

As a result, our debt maturities now 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 11 for a few cash flow highlights.

Cash flow from operations in the third quarter was $75 million dollars, increasing 47% compared to $51 million in the prior-year period.

Net capital expenditures were $25 million for the quarter, compared to $15 million in the prior-year period. The year over year change primarily reflects the timing of capital projects.

And finally, free cash flow in the quarter was $50 million dollars, increasing 41% compared to $36 million in the prior-year period.

We are pleased with the year to date free cash flow generation of $50 million dollars, which is approximately $65 million better than the year-ago period.

We now expect free cash flow of approximately $175 million for the full year 2021, compared to $86 million in 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 12 for our outlook.

Demand trends remain encouraging, and our global teams are executing at a high level. We are increasing our full year 2021 guidance to reflect better than expected performance in the third quarter and an improved outlook for fourth quarter, while considering the challenging operating and supply chain environment.

We anticipate fourth quarter 2021 revenues of $615 million to $630 million, and EPS of $1.21 to $1.31.

For the full year 2021, we are increasing the high end of our revenue guidance range by $50 million. We now expect full year revenues of $2.385 billion to $2.4 billion, compared to prior guidance of $2.32 billion to $2.35 billion.

Our revised full year guidance implies consolidated organic growth of approximately 19% to 20%, compared to our prior expectation of 15% to 17%.

We now expect full year 2021 EPS to be $4.67 to $4.77, compared to prior guidance of $4.37 to $4.57.

Our revised guidance for the full year implies total revenue growth of 28% to 29%, and EPS growth of 70% to 73%.

Please turn to slide 13.

Before we conclude, I would like to reiterate that I am optimistic about our future. As we align our business around secular growth markets, we are taking bold actions to drive substantially improved business performance. Our much better than expected results this year show the benefits of our investments in solution selling and new product innovation.

I am confident that our team will continue to execute our strategic plan to deliver robust organic growth and margin expansion, driving significant value for our shareholders.

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