2nd Quarter 2016 Earnings Conference Call Transcript

July 19, 2016

Overview*:

BDC reported 2Q16 consolidated revenues of $603.4M. On a year-over-year basis, EBITDA margins of 17.9% increased 120 basis points and EPS grew 27% to $1.54. BDC also increased guidance for the full-year 2016. BDC now expects FY16 revenue to be $2.355 - $2.385B and EPS to be $5.50 – $5.70. BDC expects 3Q16 revenue to be $595 - $615M and EPS to be $1.35 - $1.45.

* Consolidated adjusted Results. See appendix for reconciliation to comparable GAAP results.

CORPORATE PARTICIPANTS

John Stroup Belden, Inc. - President, CEO
Henk Derksen Belden, Inc. - CFO, SVP-Finance
Tim Lenze Belden, Inc. – Investor Relations

PRESENTATION

Tim Lenze Belden, Inc. – Investor Relations

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

My name is Tim Lenze, I'm part of Belden's Investor Relations team. 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've prepared a slide presentation that we'll 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'd 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, Tim, 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.

After a solid first quarter, we are extremely pleased to report strong results for the second quarter. Revenue and earnings growth, margin expansion, and cash flow generation were all robust.

I'd like to thank our associates for their commitment to aggressively executing our strategic plan.

On an organic basis, we grew revenues by 2.6% to $603.4 million. We benefitted from a number of attractive secular trends and captured share in the majority of our businesses. In addition to continued success in our Enterprise platform, our Broadcast platform generated broad-based, double-digit revenue growth in the quarter, and we are beginning to see order stability within our Industrial markets.

EBITDA margins expanded 120 basis points from the prior year period to 17.9%. This is nearly within the range of our long-term goal of 18.0% to 20.0%. The improvement is a result of leverage on organic growth and strong productivity from the effective application of our Lean Enterprise System.

As a result of the solid revenue growth, margin expansion, and effective tax planning, EPS grew 27% to $1.54 compared to last year's $1.21. After adjusting for the tax rate differential, EPS grew 16% on a year-over year basis.

In the first half of the year, we have generated an additional $57.5 million in free-cash-flow compared to prior year, which is a testament to the quality of earnings, and the efficient use of working capital and fixed assets. We are on plan to deliver free cash flow in excess of net income for the full year, and we expect to exit 2016 with a net debt to EBITDA multiple of 3.0.

Finally, given our strong results, we are, once again, increasing our revenue and earnings outlook for the full year.

Please turn to slide 4 for a review of our business segment results.

Broadcast revenue in the quarter was $193.5 million as compared to $174.9 million in the year ago period. On an organic basis, revenues increased 10.0% year-over-year. Grass Valley generated substantial organic growth of 12%. This was due in part to a stable US dollar and increased domestic advertising spend. As a result, international growth was 16% and United States growth was 6%.

Additionally, our IP introduction continues to gain traction with leading broadcasters around the world, as we shipped 9 IP systems during the quarter. Our broadband business also continues to perform well with growth of 8.0%, as our customers invest heavily to keep up with the consumer demand for increased bandwidth.

EBITDA margins for the platform during the quarter were 15.2%, increasing 210 basis points from the prior-year period due to leverage on growth as well as the productivity initiatives implemented in the prior year. I am obviously pleased with these results, and I expect growth between 3 and 5% for the full year.

Enterprise platform revenues were $160.4 million. On an organic basis, revenues increased 4.8% year over year. June was a record order month, and orders for the quarter increased 8% year over year. This was a result of a strong project pipeline and healthy win rates. EBITDA margins of 18.4% were consistent with the prior year, and we are now within the range of our long term goal of 18 to 20%. We are on track for another strong year with mid-single digit revenue growth and solid margin expansion.

As expected, our Industrial platforms experienced soft market conditions in the second quarter. Combined revenues of $210 million were down 4.1% organically from the year-ago period. The organic decline was a result of weakness within the Oil and Gas market as well as Latin America broadly. However, orders were flat year-over-year and improved throughout the quarter. We expect that the combination of our two industrial platforms will experience organic growth in the second half of the year and generate attractive year over year margin expansion.

Industrial Connectivity had revenues for the quarter of $147.8 million, down 5.9% organically from the year-ago period. EBITDA margins were 18.3% for the second quarter, up 50 basis points, and a solid outcome given market headwinds.

Industrial IT had revenue of $62.5 million, an increase of 80 basis points organically from the second quarter of 2015. EBITDA margins of 20.3% increased 370 basis points from the year-ago period as we begin to realize the benefits of productivity initiatives announced last year.

And finally, our Network Security platform generated revenues of $39.1 million. Second quarter results included the impact of a few large projects that didn't close in the expected timeframe. Excluding the impact of these larger deals, non-renewal bookings increased 20% sequentially. We are confident in the strength of the underlying business drivers as well as the advanced solutions we continue to develop to address the sophisticated threats our customers face everyday.

During the quarter, Tripwire did win a multi-million dollar factory project with an existing Belden Industrial customer. We expect this trend to continue as Belden is uniquely positioned to address the critical security issues facing industrial facilities and critical infrastructure. Despite not having the benefit of revenue growth, EBITDA margins improved 220 basis points from the prior year to 24.3%.

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 5 for a detailed consolidated review.

Revenues in the quarter were $603.4 million dollars, an increase of 80 basis points from $598.5 million in the second quarter 2015. Lower copper prices and currency translation reduced revenues by $12.9 million dollars, while a small bolt-on acquisition announced in the first quarter increased revenues by $2.1 million dollars. After adjusting for these factors, revenues increased 2.6% organically from the year-ago period.

Sequentially, revenues increased $59.6 million dollars from $543.8 million, exceeding typical seasonality due to improving demand in our Broadcast end markets.

Gross profit margins for the quarter were 41.8%, increasing 10 basis points from the year-ago period. Sequentially, gross profit margins declined 50 basis points, both within the normal range of variation.

Second quarter SG&A expenses were $120.1 million dollars, or 19.9% of revenue. SG&A expenses declined $5.1 million dollars from the prior-year period, driven by the productivity programs announced in 2015.

R&D expenses were $36.2 million dollars in the quarter, consistent with the prior year and prior quarter.

EBITDA in the quarter was $108.1 million dollars, an increase of $8.0 million dollars from the prior-year period and $19.0 million sequentially. EBITDA margins were 17.9%, an increase of 120 basis points year-over-year and 150 basis points sequentially.

These significant improvements were broad-based, with margins expanding across our platforms. We are approaching our long term goal of 18 to 20% and expect to be within this range for the full year.

Net interest expense of $24.0 million dollars for the quarter was $700,000 dollars lower compared to the prior year-period and $350,000 dollars lower sequentially. This was a result of a debt pay-down of $200 million dollars in the first quarter 2016 and fourth quarter 2015. We expect interest expense to be approximately $23.5 million for the third quarter and $96.0 million for the full year.

The adjusted effective tax rate for the second quarter was 9.5% compared to 18.0% in the prior year, mainly a result of successful implementation of tax planning initiatives. Year-to-date the adjusted effective tax rate is 13.9%, compared to 18.4% in the first half of 2015.
For financial modeling purposes, we recommend using a 20% effective tax rate for the third and fourth quarter, resulting in a tax rate of 17.4% for the full year 2016.

Earnings per share was $1.54 in the quarter, an increase of 27% from $1.21 in the prior-year period. Sequentially, earnings per share grew 53% from $1.01. Compared to the prior year and prior quarter, our tax planning initiatives provided a benefit of 14 cents and 18 cents respectively.

Please turn to slide 6. I will now discuss revenues and operating results by business segment.

Our Broadcast Solutions segment generated revenues of $193.5 million dollars during the second quarter. Revenues increased by $18.6 million dollars from $174.9 million in the prior-year period. Copper and currency translation had an unfavorable impact of $1.1 million dollars, while a small bolt-on acquisition contributed $2.1 million. After adjusting for this, organic growth in the quarter was 10.0% year-over-year. Grass Valley increased revenues by 12.0% and our broadband business grew at 8.0% from the prior-year period on an organic basis.

On a sequential basis revenues increased $22.2 million dollars from $171.3 million.

Broadcast EBITDA margins were 15.2% in the quarter, increasing 160 basis points sequentially and 210 basis points from the prior-year period. The year-over-year improvement is a function of leverage on volume growth and improved productivity, partly offset by an unfavorable product mix.

Our Enterprise connectivity segment generated revenues of $160.4 million dollars during the quarter. This segment faced a $5.2 million dollar headwind from lower copper prices and currency translation. On an organic basis, revenues increased 4.8% from the prior-year period.
Sequentially, Enterprise connectivity revenues improved $24.5 million dollars from $135.9 million.

EBITDA margins were 18.4% in the quarter, consistent with the prior-year period and increasing 90 basis points sequentially.

The Industrial Connectivity segment generated revenues of $147.8 million dollars in the quarter, decreasing $13.1 million dollars from the prior-year period. Revenues were unfavorably impacted by $7.5 million dollars from currency translation and lower copper prices. In line with expectations, our revenues declined 5.9% organically year-over-year, a result of softness within Oil & Gas and other process applications as well as broad weakness in Latin America.

Sequentially, revenues increased $6.7 million dollars from $141.1 million dollars. After adjusting for a $2.5 million dollar benefit from currency translation and higher copper prices, revenues grew 3.0%, in-line with typical seasonal patterns.

EBITDA margins of 18.3% increased 50 basis points year-over-year and 200 basis points sequentially. In addition to an improved product mix, we are seeing the benefits of our productivity program announced in December of last year.

The Industrial IT segment generated revenues of $62.5 million dollars, an increase of $1.2 million from $61.3 million in the prior-year period. After adjusting for currency, revenues increased 80 basis points organically. We are pleased to see this platform return to growth after three quarters of challenging market conditions, and we expect growth to continue through the remainder of the year.

Sequentially, revenues increased $8.6 million dollars from $53.9 million.
EBITDA margins of 20.3% increased 370 basis points year-over-year and 430 basis points sequentially. These significant improvements are a function of productivity, year-over-year, and leverage on volume growth, sequentially.

Moving to our Network Security segment, revenues of $39.1 million dollars declined $500,000 dollars from the prior-year period and $2.6 million sequentially.

EBITDA margins of 24.3% increased 220 basis points compared to the prior-year period.

If you will please turn to Slide 7, I will begin with our balance sheet highlights.

Our cash and cash equivalents balance at the end of the second quarter was $176 million dollars compared to $146 million in the prior quarter, and $208 million in the prior year.

Our LEAN enterprise system continues to deliver improvements in our inventory turns and fixed asset efficiency.

Inventory turnover was 7.1 turns, an improvement of 1.2 turns sequentially and 1.1 turns from the prior-year period.

Days sales outstanding was 60 days in the second quarter, consistent with the prior quarter and an improvement of 4 days year-over-year.

PP&E turnover was 7.6 turns, improving 0.8 turns sequentially and 0.3 turns year-over-year.

Our total debt principal amount declined by $210 million dollars from the year-ago period. Consistent with our commitment to de-lever, we paid down $200 million dollars over the last 9 months.

Net leverage was 3.6 times net debt to EBITDA at the end of the second quarter. We are on track to achieve a net leverage ratio of approximately 3.0 times by the end of 2016.

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

Cash flows from operating activities for the quarter were $47.8 million dollars compared to $53.3 million for the prior year-period. On a year-to-date basis we generated $60.5 million dollars compared to $5.0 million for the prior-year period, an improvement of $55.5 million dollars.

Net capital expenditures were $11.7 million for the quarter consistent with last year's outflows. Year-to-date, net capital expenditures were $25.1 million, down from $27.1 million in the prior-year period.

As a result, for the first half-year, free cash flow increased by $57.5 million dollars from a use of $22.1 million to free cash flow generation of $35.4 million dollars. We are on track to achieve free cash flow of $235 - $245 million dollars for the full-year, an improvement of $53 - $63 million dollars from 2015.

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 9 for our outlook regarding the third quarter and full-year 2016 results.

Given our strong results, we are once again increasing our revenue and earnings outlook for the year. We expect the Broadcast, Enterprise, and Network Security platforms will continue to perform well and benefit from favorable end-market conditions. And although our industrial businesses are down year-over-year in the first half, sequential performance, backlog, and order rates suggest stability that will lead to growth in the second half. Therefore, we're expecting all five platforms will generate organic growth in the second half.

We anticipate third quarter 2016 revenues to be between $595 and $615 million, and EPS is expected to be between $1.35 and $1.45.

For the full year, we now expect revenues to be between $2.355 and $2.385 billion from prior guidance of $2.320 to $2.370 billion. The expected range of EPS is now $5.50 to $5.70 from prior guidance of $5.15 to $5.45.

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