31-Jul-2014

Curtiss-Wright Corp. (CW)

Q2 2014 Earnings Call

CORPORATE PARTICIPANTS

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Michael F. Ciarmoli
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to Curtiss-Wright's Second Quarter 2014 Financial Results Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer and instructions will be given at that time. [Operator Instructions] And as a reminder, this conference call is being recorded.

I would now like to hand the conference over to Mr. Jim Ryan, Director of Investor Relations. Sir, you may begin.

James Ryan
Director-Investor Relations, Curtiss-Wright Corp.

Thank you, Saeed, and good morning, everyone. Welcome to Curtiss-Wright's second quarter 2014 earnings conference call. Joining me on the call today are Dave Adams, our President and Chief Executive Officer; and Glenn Tynan, our Vice President and Chief Financial Officer.

Our call today is being webcast and the press release, as well as a copy of today's financial presentation are available for download through the Investor Relations section of our company website at www.curtisswright.com. A replay of this call also can be found on the website.

Please note today's discussion will include certain projections and statements that are forward-looking as defined in the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and are not guarantees of future performance.

Forward-looking statements always involve risks and uncertainties and we detail those risks and uncertainties in our public filings with the SEC. In addition, certain non-GAAP financial measures will be discussed on the call today. A reconciliation is available in the earnings release and at the end of this presentation and will be available on the company's website.

Now, I would like to turn the call over to Dave to get things started. Dave?

David Charles Adams

President, Chief Executive Officer & Director, Curtiss-Wright Corp.

Thank you, Jim, and good morning, everyone. For our agenda today, I will provide a brief update on recent events, followed by Glenn, who will review our second quarter financials and discuss the changes to our 2014 guidance. Then, I will return to provide some additional color on our margin expansion progress and opportunities before we wrap up and open the call for questions.

As you have seen by our press release, we reported strong second quarter results and increased several elements of our full year guidance. During the course of the second quarter, we took some actions to reposition the portfolio and improve Curtiss-Wright's overall profitability, which tracks with our stated intent to improve operating margins. This aligns with what we've been calling addition by subtraction.

First in April, we divested our 3d-Radar business in our ground defense -- in our defense segment, which was a smaller business focused on 3D ground penetrating radar and put this in the hands of a leader in that market space.

Second, we sold our HVAC Controls business in our defense segment as it never developed the critical mass we had expected to achieve. While this business has tremendous technologies, it was not in our mainstream, and achieving the desired results of solid margin and market position would have taken considerably longer than desired. This divestiture has resulted in improved margins for Curtiss-Wright and we also picked up some additional cash in the transaction.

Lastly, we classified our super vessels business within our oil and gas division in the Energy segment, as assets held for sale as we progressed through the sale process. Super vessels market demand has not materialized as expected and this operating unit has been a drag on the downstream oil and gas business over the past few years.

We are actively working with interested parties, which we feel would be a better strategic fit for the business and we will update you in the future on the status of this divestiture. The result of these portfolio rationalization actions is significant improvement in operating margins, EPS and ROIC for our ongoing results from continuing operations. These actions also reduce our volatility and will create more consistent results for Curtiss-Wright moving forward.

Now, I'd like to turn the call over to Glenn to provide a review of our quarterly performance and the financial details surrounding these actions.

Glenn E. Tynan

Chief Financial Officer & Vice President, Curtiss-Wright Corp.

Thank you, Dave and good morning everyone. Note that our discussions today of current and future results are on a continuing operations basis. We produced a solid second quarter with strong organic sales and operating income in our commercial, industrial and energy segments including solid contributions from our 2013 and 2014 acquisitions.

Operating income rose 27%, generating an operating margin of 11.7%, up 160 basis points. On an organic basis, which excludes acquisitions, divestitures and FX, operating income increased 22% producing organic operating margin of 11.9%, up 180 basis points from the prior year. We also produced diluted EPS from continuing operations of $0.93 in the second quarter. The divestitures resulted in a $0.10 benefit to our diluted EPS from continuing operations and our results were a few cents above our initial quarterly expectations, due primarily to margin improvement initiatives.

Overall, these results keep us on track for strong performance in 2014. In addition, free cash flow for the second quarter was very strong, rising more than 80% compared to 2013, driven primarily by the solid cash earnings performance and higher deferred revenues. Finally, we had solid new orders during the second quarter, most notably within the naval defense market for the Virginia-class submarine program, supporting Block III and Block IV ships, driving our book-to-bill to 1.15.

Moving to the end markets, our commercial market sales grew 12% overall during the second quarter, aided by our recent acquisitions and continue to outpace the defense markets as expected. In the commercial aerospace market, we experienced another solid quarter of organic sales growth, most notably for the Boeing 787 program. We remain well positioned for continued growth based on the multi-year production up cycle in this market.

In the oil and gas market, we generated solid organic sales across our diverse businesses, led by solid domestic demand for upstream, separation equipment and industrial MRO valves, as well as higher international sales of our coker equipment. Within the power generation market, we continue to experience lower revenues on both the U.S. and China AP1000 contracts. However, on a positive note, we experienced a rebound in sales to existing domestic operating reactors for plant upgrades, refurbishment projects, and obsolescence solutions. As expected, the second quarter performance included the shift in sales from the first quarter following weather-related delays. This end market also benefited from solid demand for coatings services for industrial gas turbines.

In the general industrial market, higher sales were primarily driven by our Arens Controls acquisition, serving the on-road and off-road trucks on specialty vehicles markets and a solid 11% organic growth.

Looking ahead, we continue to expect steady demand for our industrial vehicle products based on the solid growth outlook for OEMs and increasing global demand to reduce emissions, driving the need for enhanced electronics and power management products.

In the defense market, sales increased 2% overall following another strong performance in our naval defense market where we continue to receive funding for key US Navy shipbuilding programs. Sales in aerospace defense were lower, primarily due to timing on long-term production programs including military helicopters and the JSF and Predator programs, while ground defense continues to see lower demand. For the remainder of 2014, we expect growth to continue on our key defense platforms, particularly in the aerospace defense markets.

Now, I'd like to move on to our financial outlook beginning with our end markets, which as a reminder is based on continuing operations. For full year 2014, sales growth of 6% to 8% remains unchanged from our previous guidance. Total defense sales are expected to grow between 1% and 5% and total commercial sales are expected to grow between 7% and 11% from 2013, both unchanged from our previous guidance.

However, we made some modifications within the commercial end markets, as you can see herewith. In oil and gas, we removed the sales from the vessels business, although this change did not impact the guidance growth range.

In power generation, we lowered our sales growth, primarily based on the shift in timing of domestic AP1000 project milestones out of 2014.

In general industrial, we removed the sales from the Benshaw divestiture. As this business produced higher sales in 2013 than what we expected in 2014, the net effect is a higher end market growth rate for 2014. And finally, we removed the 3d-Radar divestiture, which did not have a material impact on our guidance.

Continuing with our financial outlook, I'll begin with the changes to segment sales, which tied to the end-market changes that I just previously discussed. The most significant change took place in the defense segment, which reflects the removal of the Benshaw business and the reductions to AP1000 revenues.

Next, I'll discuss our segment operating income and margin guidance, which reflects the benefits of our ongoing margin and operational improvement initiatives as well as the net positive full year impact of discontinued operations. These impacts were partially offset by lower sales volume, which I'll describe momentarily.

Starting with commercial industrial, our guidance remains unchanged from our prior outlook. As a reminder, we are projecting a 200 basis point increase in operating margin compared to our 2013 results.

Next to defense, in the latest forecast prior to its divestitures we'd expected Benshaw's operations to improve in the second half, which would have made it a net positive contributor to our operating income for the full year 2014, despite the first-half losses. Backing out this operation led to a reduction to our full year segment operating income from continuing operations. However, it provided a solid benefit to our margin guidance.

Our guidance change also reflects lower operating income due to the impact of reduced AP1000 revenues, which I noted earlier, and the benefit from our ongoing margin expansion and operational improvement initiatives. Overall, full-year defense segment operating income decreased by approximately $7 million, while segment margin guidance increased 50-basis points to a new range of 13.7% to 13.8%.

Moving to energy, the improvements in operating income and margin are two-fold. First, they reflect the benefit of removing the lower profitability vessels business, which following the move to discontinued operations, produced a robust contribution to our full year segment operating income and margin from continuing operations.

Second, they reflect our continued efforts to improve profitability in the oil and gas business through the implementation of operational improvement and margin expansion initiatives across our operations. Together, these improvements contributed to a significant increase in operating income and margin, which we now project in the range from 9.7% to 9.9%, up 250 basis points from our prior guidance.

Overall, Curtiss Wright's total operating income reflects a growth range of 17% to 21% in 2014, while our operating margin has expanded 80 basis points to a new range of 11.1% to 11.3%.As a result, we have increased our 2014 guidance for diluted earnings per share from continuing operations to a new range of $3.50 to $3.60, up $0.15 compared to our prior guidance.

And as highlighted in the earnings release, the breakdown of our diluted EPS guidance change is as follows: $0.10 contribution from the benefits of our ongoing operational margin improvements, $0.10 net positive impacts of moving certain businesses into discontinued operations and $0.05 decline based on the lower sales force -- forecast in our defense segment.

Looking ahead sequentially, we are expecting a decline in EPS from continuing operations in the third quarter with the fourth quarter being the highest as we have done historically.

Next to our cash flow, aided by the solid second quarter performance year-to-date, we have produced strong cash flow from operations of nearly $85 million, one of the strongest first half's in recent history. That led to $48 million in free cash flow during the first six months of 2014. Both the quarter and year-to-date performance was driven by higher cash earnings and higher deferred revenues. And following the strong first-half performance, we increased our full-year free cash flow guidance to a new range of $180 million to $200 million, based on expectations for working capital improvements in the latter half of the year. This also raised our expected free cash flow conversion rate to a range of 105% to 113%, which tracks to our goal to maintain a conversion rate of at least 100%.

And finally the divestiture actions taken this quarter have produced a 70-basis point improvement in our overall return on invested capital. Now, I'd like to turn the call back over to Dave to provide an update on our future outlook. Dave?

David Charles Adams

President, Chief Executive Officer & Director, Curtiss-Wright Corp.

Thank you, Glenn. We're very pleased to see the benefits of our margin expansion initiatives as they continue to manifest themselves by virtue of solid year-to-date results. We are well on our way to achieving the results we set out in December of last year becoming a top performer within our peer group. I'll now take a few minutes to provide some updates and then I'll open up the call to Q&A.

We remain on track thus far with most operating margin improvement initiatives performing at or close to plan. Our operating teams are focused and aligned with the goal of driving toward top quartile operating margin performance compared to the peer group. Clearly, the portfolio rationalization activities were a big highlight for this quarter. While we made some respectable changes over the past few months, we continue to review the entire portfolio for businesses or product lines, which may not be core to our future.

It's also worth noting that we have a few more irons in the fire, which could surface during the latter half of 2014. We also have various consolidation programs in the works beyond the aforementioned corporate realignment initiatives as we examine the global footprint for additional cost savings opportunities. As Glenn noted, our updated guidance reflects the benefits of some of these initiatives and thus far we are ahead of plan.

In addition, we continue to evaluate numerous segment focused opportunities where we are concentrating on our under-performing business units with the purpose of obtaining their full potential. We are devoting a considerable amount of attention to improving the operating performance of these businesses across each of our three segments.

Over time, these and other segment focused improvements will further contribute positively to our long-term performance. Although I've only highlighted a few of our key initiatives today, overall we maintain a high degree of confidence in achieving strong operating margin expansion. Some of these, you saw in our first half results and there's more to come in the future as we continue our drive to top quartile operating margin. To recap, we remain on track for a strong year in terms of operating income, operating margin expansion, EPS, free cash flow and ROIC. The benefits of our divestitures and ongoing margin improvement activities are measurable and contributing to our margin expansion. In addition, our continued efforts will drive strong double-digit increases in op income and earnings per share along with solid free cash flow.

Lastly, I wanted to highlight that we've repurchased $24 million in stock year-to-date through June 30 under our share buyback program and we'll remain active through the remainder of 2014. This Fall, we will re-evaluate our cash position heading into 2015 and formulate a plan for the allocation of our capital. We remain committed to our goal to have more balanced capital allocation between capital expenditures, returns to shareholders and strategic bolt-on acquisitions. Overall, we remain very confident that our continual efforts to improve margin expansion and free cash flow generation will produce long-term shareholder value.

At this time, I would like to open up today's conference call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Michael Ciarmoli from KeyBanc Capital. Your line is open. Please go ahead.

Michael F. Ciarmoli
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, good morning guys. Thanks for taking my questions. Nice quarter.

David Charles Adams
President, Chief Executive Officer & Director, Curtiss-Wright Corp.

A

Thank you, Mike.

Michael F. Ciarmoli
Analyst, KeyBanc Capital Markets, Inc.

Q

Just two, maybe Dave, the super vessel business, I mean as I understood it, that was started because it was a maybe there was one other large competitor out there and you guys were going to maybe take share on this side of the world. How -- are there a lot of buyers out there for that potential business? Maybe if you can just walk us through what kind of dialogs you're having or if maybe it's too early to discuss that. But I mean do you -- do you expect to find to sell -- a buyer for that business?

David Charles Adams
President, Chief Executive Officer & Director, Curtiss-Wright Corp.

A

Yeah. Mike, I'm very positive about this. We're very optimistic that we will do something in the near term and the outlook is good. So there are buyers out there very interested in this and I think that it is going to go as planned.

Michael F. Ciarmoli
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. And I'm assuming that obviously revenues were minimal there and we can clearly see the benefits flowing through on the margins in energy. I mean, should we think of energy at this 11% plus level as a new baseline going forward for this year and into next year? I mean, that -- it seems like you've created a step function increase in the earnings profile of that group.

David Charles Adams
President, Chief Executive Officer & Director, Curtiss-Wright Corp.

A

Anything, if going forward, as I said, we have several irons in the fire. And I think certainly going forward, obviously, we feel very good about where we're at today with the changes we've made and only to be further enhanced by the possibility of more that we're looking for. We do have several irons in the fire. So, yeah, I'm optimistic about the outlook in that regard as well. And I think that there are many opportunities for us.

Michael F. Ciarmoli
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay and then just last quick one here. Any progress on the domestic coker front? I know you talked about the international side, and it seemed like you were keeping your fingers crossed maybe last quarter, but anything you can speak of on that front?

David Charles Adams
President, Chief Executive Officer & Director, Curtiss-Wright Corp.

A

We've got a lot of interest in terms of quotations coming in with regard to cokers and I believe that, as I said last time, I was very, very cautiously optimistic. I still hold that and just by virtue of the opportunities that we see manifesting themselves, we think that there is some positive there. And so that's another area of interest that I think the market is certainly showing a change.

Michael F. Ciarmoli
Analyst, KeyBanc Capital Markets, Inc.

Q

Great, thanks a lot guys. I'll jump back in the queue here.

David Charles Adams
President, Chief Executive Officer & Director, Curtiss-Wright Corp.

A

Thanks, Mike.

Glenn E. Tynan
Chief Financial Officer & Vice President, Curtiss-Wright Corp.

A

Thanks, Mike.

Operator: [Operator Instructions] Gentlemen, I'm showing no one else in queue at this time.

David Charles Adams
President, Chief Executive Officer & Director, Curtiss-Wright Corp.

Thank you all for joining us today. We look forward to speaking with you again during our third quarter 2014 earnings call and have a great day. Bye-bye.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This concludes our program for today. You may all disconnect and have a wonderful day.