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ROG - Q4 2017 Rogers Corp Earnings Call

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PRESENTATION

Operator

Good afternoon. My name is Mike, and I will be your conference operator today. At this time, I would like to welcome everyone to the 2017 fourth quarter and full year conference call. (Operator Instructions)

I will now turn the call over to Jack Monti, Rogers Director and Head of Investor Relations. You may begin your conference.

Jack Monti - *Rogers Corporation - Director of IR*

Thank you, Mike, and thanks so much, everyone, for joining Rogers' Fourth Quarter and Full Year 2017 Earnings Call.

To follow along with the presentation, please see the investors section of our website.

Turning to Slide 2. We have a disclosure on forward-looking statements. During the call, we will be making certain forward-looking statements subject to a number of risks and uncertainties, which may cause actual results to differ materially versus today's outlook.

In addition, some of the metrics discussed will be on a non-GAAP basis, which management believes better reflects the underlying core operating performance of the business.

Turning to Slide 3. It's my pleasure to introduce Rogers' management team. Bruce Hoechner, President and CEO, is joined by Janice Stipp, SVP and CFO; and Bob Daigle, SVP and CTO. I will now turn it over to Bruce.

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

Thanks, Jack. Good afternoon, everyone, and thank you for joining us on today's call.

Please turn to Slide 4. I'm very pleased to report that in Q4 2017, Rogers achieved another quarter of double-digit sales growth to cap a record-setting year in both revenue and profitability. For the quarter, net sales were $209 million, an increase of 21% and at the high end of our previously announced guidance. Notably, we experienced healthy demand in nearly every one of our key markets across all 3 of our business segments.

In Q4, gross margin was 36.1%, a decline of 252 basis points from Q4 2016, due to several items that I will discuss shortly. Also, during the quarter, adjusted EBITDA was $38 million, an increase of 17% over Q4 2016. Adjusted EPS was $1.36, up 45% over Q4 2016, and within our guidance range. Rogers delivered exceptional full year results with net sales of $821 million, an increase of 25%. Gross margin was 38.8%, up 79 basis points over 2016.

Adjusted EBITDA was $190 million, up 46%, while adjusted earnings per share were $5.76, an increase of 55%. For the year, we achieved 13% organic growth, which is a clear indication that our strategy to target robust markets across all 3 businesses is paying off. In addition, our new acquisitions increased net sales by 12%. While we are very pleased with our top line growth, as I mentioned, we encountered several items that impacted operating performance in Q4. These were due primarily to initiatives focused on capacity optimization, new product scale-up costs, additional integration expenses and investments in strategic projects. Also affecting profitability in Q4 was the escalation of commodity prices and the time required to implement our cost recovery efforts. These challenges are being addressed.

We are optimistic about the outlook for 2018 given Rogers' strong leadership position in our core markets and our ability to execute.

Please turn to Slide 5. Last year, we announced our performance targets for 2020. In 2017, we made progress towards these goals by executing on the 4 pillars of our growth strategy, market-driven innovation leadership, synergistic M&A and operational excellence. We believe our ongoing commitment to this blueprint for success will enable us to meet our targets and continue to propel Rogers to a new level of value creation.

As we look at our 2020 financial performance objectives, we envision top line organic growth of our current businesses in the range of 7% to 10% per year over the next 3 years. In addition, our top of the pyramid M&A strategy will add 5% to 8% revenue growth per year over the period for overall top line growth of 15% per year. By the end of 2020, we expect Rogers to achieve roughly $1.2 billion in sales, with adjusted operating profit margin at 20%.

Turning to Slide 6. Since 2012, we have implemented our strategy amid varying market dynamics and slower global GDP growth to build top line sales from roughly $500 million to $821 million. This is an increase of 64% overall or a 10% compounded annual growth rate. At the same time, we've built a performance-driven culture improving adjusted operating margin from 10% in 2012 to 18.5% in 2017, an increase of 850 basis points. Our operational excellence initiatives have helped deliver a 700 basis point gross margin improvement. From a cash perspective, we grew free cash flow from $17 million to $112 million. This increase was driven by strong operating cash generation, improved profitability and disciplined working capital management, yielding a strong double-digit compounded annual growth rate above 45%.

Over the past 5 years, our strategic roadmap has enabled us to deliver significant value to our shareholders in the face of dynamic market conditions.

Please turn to Slide 7. We view advanced mobility and advanced connectivity as our 2 key growth drivers. This is where we are investing to support today's applications and to secure design wins in tomorrow's emerging opportunities. On the next few slides, I'd like to take a closer look at several particularly promising markets.

Please turn to Slide 8. In 2017, a number of automotive OEMs announced plans to accelerate the introduction of EV/HEV models. For instance, Mercedes-Benz stated it will have EV or HEV versions of all of its models by 2022. Volvo announced that by 2019, they will offer EVs or HEVs exclusively, and General Motors intends to introduce 20 new EV models over the next 6 years. The projections for EV and HEV powertrain sales also tell the story with compounded annual growth rates projected to be nearly 50% over the next 3 years. Another positive indicator for this market is the Chinese government's recent decision to extend its tax rebate on purchases of EVs and HEVs through 2020. All of this bodes well for Rogers, where our ceramic substrates are meeting the needs of this evolving market. We are seeing continued adoption of our silicon nitride substrates for wide band gap semiconductors. These products offer high thermal connectivity and reliability, which are essential for EV/HEV applications. In addition, our elastomer materials provide unique sealing and vibration management solutions to protect batteries from water, dust and other extreme environmental conditions, while also reducing noise for passengers.

Turning to Slide 9. The implementation of automotive radar-based safety sensors is accelerating faster than previous projections. Automotive radar is the most rapidly growing segment in our Advanced Connectivity Solutions business. Our portfolio addresses the full range of requirements for short-, mid- and long-range sensors. Although varied, industry projections show strong growth, and we are utilizing this data for capacity planning. There are 2 areas driving this growth: First, is the adoption of ADAS systems into more and more mass market models. What was once considered a luxury, blind spot detection, collision avoidance and so on, is becoming standard equipment. The second is the increased number of sensors per vehicle as we move towards higher degrees of autonomy. Radar sensors are a proven technology and a requirement for these applications.

Our teams continue to do a great job getting specified into these applications, putting us in a solid leadership position.

Turning to Slide 10. The proliferation of mobile video and social media are driving greater demand for data with Cisco projecting a 45% compounded annual growth rate in mobile data traffic through 2020. We expect to see growth coming from the 4.5G and 5G infrastructure buildout, where industry sources cite new developments on the horizon. For example, reports estimate that China will spend $170 billion to $180 billion on 5G systems from 2019 through 2025. When compared to 4G LTE, Rogers has significantly greater material content in these highly sophisticated 5G systems. In the meantime, we believe we will see continuing demand for 4G LTE applications with some fluctuation from quarter-to-quarter as the market transitions to 4.5G and 5G. This is a similar implementation pattern to what we've seen with 2G and 3G deployments.

Please turn to Slide 11. In Q4 2017, ACS achieved net sales of $76 million, a 5% increase over Q4 2016. These results were largely driven by growth in high-frequency circuit materials for ADAS and portable electronic applications, partially offset by a transitioning demand for wireless 4G LTE applications. For the year, ACS delivered net sales of $301 million, an 8% increase over full year 2016. As mentioned, higher demand for automotive safety applications, where sales increased 48% over 2016, was partially offset by lower demand for 4G LTE wireless telecom. This speaks to the diversity of the ACS product portfolio and the agility of this business in being on the forefront of market and technology trends. Also, in 2017, ACS introduced several well-received products, including antenna modules that provide superior performance from millimeter wave applications, such as automotive radar and 5G infrastructure.

Please turn to Slide 12. In Q4, EMS delivered all-time record sales of $76 million, a 34% increase over Q4 2016. Growth was driven by higher demand across all sectors with particularly strong results in portable electronics and automotive applications for EV/HEV. For the year, EMS achieved net sales of $313 million, an increase of 54%. Organically, sales grew 15% over 2016 on strong demand for applications in general industrial, mass transit, automotive and portable electronics. We continue to be pleased with the addition of the DeWAL and DSP product lines to Rogers.

We will continue to look for top of the pyramid companies that can strengthen our product portfolio and augment our organic growth.

Turning to Slide 13. In Q4, PES achieved net sales of $52 million, a remarkable organic increase of 33% over Q4 2016. This growth was due to broad-based demand across markets, including renewable energy, EV/HEV, variable frequency motor drives and laser diode coolers. For the full year, PES achieved net sales of $185 million, a 21% increase over full year 2016. Net sales combined with operational improvements such as manufacturing automation and footprint optimization helped drive segment adjusted operating margin expansion of 450 basis points over 2016. As we look ahead for PES, we are particularly excited about our growth opportunities. Strong demand is projected for applications in advanced mobility, including EV/HEV and vehicle electrification. In addition, we expect to see continued growth in our unique solutions for laser diode coolers.

Please turn to Slide 14. Looking at the macroeconomic environment, we are very encouraged by the positive growth forecast in many of our key markets. Based on recent reports, business confidence is gaining, and global GDP strong. There are some conditions that may impact global markets, and we will continually monitor those and respond as appropriate.

Turning to Slide 15. Again, we are very pleased with our record-setting 2017 net sales and earnings. In 2018, we will maintain focus on executing the 4 pillars of our proven growth strategy to continue on our trajectory towards our 2020 targets.

I'll now turn the call over to Janice.

Janice E. Stipp *- Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Thank you, Bruce. Good afternoon, everyone. 2007 (sic) [2017] marked a record year as we successfully executed upon key milestones. Highlights for the year included: record revenue of $821 million, growing 25.1% versus 2016; record gross margin at 38.8%; record net income; and record earnings, with adjusted earnings per share of $5.76. This past year's success is in large part of the result of the strong foundation that we've built around our leadership positions in technology, operational excellence and accretive acquisitions.

Turning to our fourth quarter, we had continued sales momentum, finishing the year with strong growth across all our business units, driven by our market focused strategy. However, it was a challenging quarter for earnings as we worked through operational issues, made strategic investments, experienced acquisition integration difficulties and managed through capacity balancing demand. Also in Q4, adjusted earnings benefited from a federal income tax provision, primarily driven by: reduced accruals for foreign taxes on undistributed foreign earnings, increased international tax benefits due to earnings mix and equity compensation excess tax deduction.

In today's presentation, I'll review our fourth quarter and full year results in more detail, followed by a discussion on operational excellence and conclude with our first quarter guidance forecast.

Now, please turn to Slide 17. Q4 2017 revenue, as previously noted, was $209 million, which was at the high end of our guidance and exceeded Q4 2016 by 20.8%. Our growth was primarily the result of strong volumes across all our business units and the recent acquisition. Adjusted operating income was $27.6 million in Q4 2017, increasing $1.9 million versus $25.7 million last year. Adjusted operating margin was down 160 basis points from 14.8% in Q4 2016 to 13.2% in Q4 2017. Adjusted EBITDA of $38.1 million improved $5.4 million or approximately 16.5% compared to the fourth quarter of 2016 at $32.7 million, primarily due to strong volumes mix and accretive acquisitions, partially offset by operational challenges, increased copper prices and higher SG&A expenses. Net income of $7 million in the fourth quarter of 2017 was down $4.9 million versus the prior year. In addition to the above items mentioned and EBITDA, net income was impacted by the use tax reform regulation, which resulted in Q4 charges of $13.7 million, primarily due to the transition tax on unremitted earnings. Fourth quarter adjusted earnings per share of $1.36 was up $0.42 versus the prior year and within our guidance range.

Turning to Slide 18, our Q4 revenue was up 20.8% on a year-over-year basis, and above the midpoint of our guidance resulting mainly from stronger-than-expected organic, inorganic growth and favorable exchange rates. The fourth quarter currency exchange rates favorably impacted revenues by $4.5 million, primarily due to depreciation of euro and renminbi. Adjusted for FX, our organic revenue was up $18 million or 10.4% with contributions from all of our strategic business units.

In addition, revenue increased by an additional $13.5 million or 7.8% versus last year due to the recent acquisitions.

Turning to our Q4 2017 adjusted EBITDA on Slide 19. Fourth quarter adjusted EBITDA of $38.1 million reflects an increase of $5.4 million compared to $32.7 million reported in the fourth quarter of 2016. The higher adjusted EBITDA is a result of strong sales and mix, and derivative contract gains for currency and commodity exposures. The increase in adjusted EBITDA was partially offset by higher copper prices, acquisition integration difficulties, higher freight costs due to customer demand surges, capacity balancing demand and increased SG&A expense due to incentive compensation, acquired SG&A, other strategic investment in sales and marketing and higher professional services.

Turning to Slide 20. We exceeded Q4 2016 adjusted earnings per share by $0.42 or 44.7%, resulting in an adjusted earnings per share of $1.36 for Q4 2017. As the slide depicts, the $0.42 increase was primarily due to: $0.36 of favorable volume and other, $0.27 of lower tax expense, primarily due to reduced accruals for foreign taxes on undistributed foreign earnings, increased international tax benefit due to earnings mix and equity compensation excess tax deduction. $0.09 favorable miscellaneous income expense from copper and FX derivatives, offset by $0.22 unfavorable SG&A, primarily due to incentive compensation, acquired SG&A, other strategic investments in the sales and marketing and professional services. $0.07 unfavorable performance, primarily due to acquisition integration difficulty, capacity balancing constraints, freight and higher copper cost.

Turning to Slide 21 for your review of our full year results. 2017 was a record by almost all financial metrics. Revenue was $821 million, an increase of 25.1% versus 2016 revenues of $656 million as a result of strong volumes across all of our strategic business units and the recent acquisitions. Adjusted 2017 operating income was $151.6 million, increasing $51.9 million versus $99.7 million last year. Adjusted operating margin was up 330 basis points from 15.2% in 2016 to 18.5% in 2017. Adjusted EBITDA of $189.7 million improved $59.6 million or approximately 45.8% compared to 2016, primarily due to: volume and mix, derivative contracts, accretive acquisitions, favorable operational performance driven by increased capacity utilization, operational process enhancements and automation, and conversion of fixed cost structure to variable where possible. Favorable performance was partially offset by higher freight due to customer sales demand and surges, acquisition integration difficulties, capacity balancing constraints and increased copper cost.

In addition, increased SG&A was mainly due to incentive compensation, acquired SG&A, strategic investment in sales and marketing and professional services. 2017 net income of $80.5 million was up $32.2 million versus the prior year or 240 basis points as a percent of revenue. 2017 adjusted earnings per share of $5.76 was up $2.04 versus the prior year or 54.8%.

Now let's move into the segments on Slide 22. Starting with segment revenues on the left side, you'll see ACS, EMS and PES segment revenues increased by 8.4%, 53.9% and 21.4%, or by $23.3 million, $109.5 million and $32.6 million, respectively. More specifically, our ACS segment revenue increased primarily due to ADAS, aerospace/ defense, partially offset by lower demand of 4G due to the 5G wireless infrastructure evolution. The EMS segment revenue increased 53.9% in 2017. Organic sales increased $30.6 million or 15.1% due to higher demand across all applications, including portable electronics, general industrial, automotive, including EV/HEV applications and mass transit.

Finally, our PES segment was the fastest organically growing segment with 21.4% organic growth due to broad-based demand across markets, including renewable energy, EV/HEV, variable frequency motor drives and laser diode coolers.

Turning to operating income on the right-hand side of the chart. ACS adjusted operating income was $60 million, up $12.6 million from 2016. This was primarily due to favorable impact of volume and mix and favorable operational results from performance, partially offset due to higher copper commodity prices, higher freight due to increased volumes demand surges, capacity balancing constraints, strategic investments in sales, marketing and R&D and incentive compensation.

EMS adjusted operating income of $64.2 million was up $29.2 million as compared with 2016. The EMS adjusted operating income increase was a result of: strong volume mix growth, favorable performance due to operational excellence initiatives and accretive acquisitions. Partially offsetting these positives were increased freight due to customer demand and surge sales, higher incentive compensation, sales, marketing investments and acquisition integration difficulty.

Lastly, PES adjusted operating income was $20.3 million, up $10.4 million from 2016. This increase was mainly due to favorable volume mix, improved productivity as a result of operational excellence initiatives, including leveraging our Eastern European footprint. Partially offsetting these favorable items are the higher commodity costs due to copper, strategic investments in sales and marketing, incentive compensation and capacity balancing demand.

In summary, our 2017 performance reflected strong execution by the entire Rogers team.

Turning to Slide 23, you will remember earlier in our presentation, we briefly touched upon our 4 strategic pillars. Rogers is a market-driven organization with innovation leadership, focused on M&A, while achieving operational excellence in everything we do. It is through these strategic initiatives that will continue to increase shareholder value. Over the last several years, Rogers has executed on significant margin expansion, and is focused on achieving a consistent growth margin target of 40%. We continue identifying initiatives to achieve this target, such as footprint optimization to increase our capacity utilization, process enhancements and automation, converting fixed cost structure to variable where possible, repurposing underutilized assets and back-office initiatives to increase utilization of shared services.

Turning to Slide 24, let's discuss some of our key operational excellence activities. Starting with footprint and asset optimization. Rogers is consolidating our Eastern European footprint in Belgium, and transferring some labor-intensive assembly processes to Hungary. These efforts will continue to improve our asset utilization and enhance gross margin. Completion is expected in Q4 of 2018. Also, we are expanding and refurbishing an underutilized China clean room to expand final inspection capacity to meet the growing Asian market. Rogers continues to execute on productivity and automation projects to eliminate human errors, improve yields and increase capacity. Some of the examples include: use of automated optical inspection machines. Investing in automated ceramic simulation process would increase global capacity by 20%. Upgraded ACS press automation, which increase machine capacity by approximately 35% to 40%. We are also investing in state-of-the-art technologies such as high-speed laser cutting and direct laser imaging machines. Rogers also remains focused on improving our direct labor cost structure by leveraging a blend of permanent skilled work force and temporary workers to increase labor flexibility to meet our customer demand. Shared service is another important initiative. An example is the enhanced China shared service model, which promotes efficiency and cost improvement such as the China cash pooling and Asia consolidation of the supporting functions. These process improvements were recognized by the China government in the form of a cash grant award.

Turning to Slide 25. Consistent with our focus on business and operational excellence, we view all costs and competitiveness. Therefore, we have commenced a pension termination process on our recently merged pension plan. The pension termination strategy was launched due to: the fact that the pension was already frozen. Pension is no longer considered a strategic benefit to our employees. Our actions de-risk the financial statement and it is in line with market competitive trends. This initial will avoid ongoing pension expense, including increased PBGC contributions and pension expense fluctuations related to actuarial functions such as interest rates, mortality tables, discount rates, investment trends or other regulatory and market changes.

Turning to Slide 26, you'll see we ended 2017 with a cash position of $181 million. Rogers continues to generate solid operating cash flow of $139 million for 2017, which represents an increase of $22 million versus 2016. The increase in cash flow is largely driven by 2017 improved profitability, partially offset by the net increase in working capital, primarily driven by our sales growth. Although, our working capital metrics have improved. We had strong 2017 adjusted EBITDA of $189.7 million, which helped fund our strategic priorities, including the acquisition of DSP as well as the debt paydown during the year.

Full year cash conversion is approximately 73% due to working capital requirements to fund growth, with our fourth quarter cash conversion approximately 103%. Year-to-date cash taxes paid are $36.9 million, which calculates to a cash tax rate of 27.8%. Lastly, we invested $27.2 million in capital expenditures during 2017 or 3.3% of revenue.

Turning to capital allocation on Slide 27. Our business model has enabled us to convert more income to cash and there's no shortage of attractive deployment opportunities. Rogers will continue to have a disciplined and well-balanced approach to capital allocation. First, we are focused on reinvesting in our business, both organically and inorganically. Approximately 24% of our historic operations cash flow has been allocated to capital investments. This enabled us to continue to support growth and deliver on operational excellence initiatives. On M&A, we've invested approximately 15% net. We remain focused on accretive acquisitions that provide attractive end-market diversification, sales and technology, where we have the opportunity to significantly accelerate commercialization. The M&A pipeline remains full, and we hope to share more with you over the course of the year.

Rogers has utilized approximately 50% of its historic operating cash flow to repay debt obligations, which allows us to maintain sufficient liquidity to assess our revolver as needed for strategic acquisition activity. To the extent we have excess cash we will return it to our shareholders, as evidenced by our share repurchase program. In summary, we believe effective capital deployment is an important part of an overall asset investment thesis.

Turning to Slide 28. We will now articulate our 2018 capital spending plan. Rogers plans to increase 2018 capital investment to $50 million to $60 million, which at the midpoint calculates to approximately 6.3% of 2018 consensus revenues of $880 million. The higher than historical capital spending in 2018 is required to meet growth in advanced connectivity and mobility, or more specifically, upcoming 5G wireless infrastructure deployments, ADAS and increased adoption of EV and HEV technology.

In 2018, Rogers plans to spend 76% of the capital investments in strategic and capacity expansion. This increase in investment will position Rogers to generate premium value for our customers, translating into improved shareholder value. Taking a look at our Q1 2018 guidance on Slide 29. Revenues are estimated to be in the range of $208 million to $218 million, with revenues in the range of $1.15 to $1.30 per diluted share. On an adjusted basis, we guide Q1 earnings in the range of $1.30 to $1.45 per diluted share.

At the midpoint, our Q1 2018 revenue guidance represents a year-over-year revenue increase of 4.1% compared to Q1 2017. This revenue guidance includes anticipated favorable currency fluctuations of 3.1% or $6.4 million. Guidance for earnings per share has a midpoint of $1.23 per diluted share. And in total reflects a decrease of $0.24 per diluted share compared to earnings of $1.47 in Q1 2017. On an adjusted earnings per share basis, guidance has a midpoint of $1.38 per diluted share, which is a $0.30 decrease from $1.68 in Q1 2017. This year-over-year decrease is primarily due to onetime favorable Q1 2017 events, higher commodity, raw material prices, additional investments in strategic sales and marketing, capacity balancing demand and professional services. We are addressing these challenges to improve our profitability with a continued focus on operational excellence, investments in capacity, technology and automation.

In addition, we are obtaining customer qualification for multiple plant locations to increase capacity flexibility, implementing pricing programs and cost performance initiatives to mitigate increasing commodity raw material costs. These initiatives will lead Rogers to a stronger, more agile, resilient company thereby enhancing shareholder value. Rogers is in the process of reviewing the full year impact of the U.S. tax reform and the impact it will have on the company's ongoing tax rate. Currently based on information available and analysis that have been to date, Rogers guides its normalized effective tax rate to be approximately 28% to 30% for Q1 2018.

I will now turn the call back over to Bruce.

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

Thanks, Janice. And now we'll open the line for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question is from Craig Ellis from B. Riley FBR.

Craig Andrew Ellis - *B. Riley FBR, Inc., Research Division - Senior MD & Director of Research*

To start off, just congratulations on all the financial performance records of 2017. First, just to clarify a couple of things in the middle of the income statement. Bruce, I think you mentioned about 5 items that were at play in gross margin. The clarification is, one, did they all contribute about equally to the 250 basis point year-on-year decline, or were some much more significant than others? And secondly, to what extent were some of those items more one-timers that just impacted the fourth quarter versus things that you'll be executing against as you go through either the first half of the year or the full year?

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

I'm going to ask Janice to give us an outline on -- to respond to that question.

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Yes, in the Q4, if just you go -- when we look at it, year-over-year, we had -- obviously, copper is consistent. I mean we don't see copper going down. As we talked about it, we're looking at different pricing programs, and also initiatives to offset some of our copper -- might be engineering changing and things like that, of our products. So we're looking at that. So we'll continue on that. The increased freight and some of our operational inefficiencies. We had a lot of demand surges with some of our customer, obviously with ADAS and 4G. We don't have that timed out perfectly. And some of our customers really have only presses approved on certain locations. So what we're trying to do is get our customers to qualify multiple presses so that we have the capacity flexibility to move things around the world. So right now as we did product launches, we put of them -- some of them on inefficient presses because the other presses were full due to customer qualification demands on certain presses. So that will go away. We just have to take time for engineering to get that approved with our customers along with the commodity pricing pass-through. So we'll see that going away shortly, but it will take a little bit of time. The SG&A, which was large, we had some one-timers, as we talk about -- one of our strategic pillars is M&A. Obviously, we're very active in the market, and we had some costs that came into Q4. Unfortunately, we were unable to close on some of our targets, but those were costs that were increased in other professional services that coincide with that. So those are onetime, although they might come back because obviously, we're active in the M&A market. And we, hopefully, will be able to tell you something in the future on some of those. So those will be off and on depending on what we're working on. And then the incentive compensation, obviously, it was Q4, last year was a record year so we paid very high bonuses. We are back to our target levels in 2018 at this point in time. Hopefully, we will increase it as the year progresses. But that's -- the profits there obviously will increase that. So we have a mix of items that we think that won't repeat in Q1, but some that might take a little bit longer than others to resolve and might fall into Q2.

Craig Andrew Ellis - *B. Riley FBR, Inc., Research Division - Senior MD & Director of Research*

A follow-up on the SG&A point, Janice. Of the -- I had SG&A about $6 million versus what I thought. So of the 2 items that you mentioned, some expenses related to the M&A strategy, and then incentive compensation. Can you break down the relative contribution to the sequential increase in OpEx between those 2?

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Yes, I will say the -- a large portion was due to M&A activity. That was a onetime for Q4. A larger portion was related to that.

Craig Andrew Ellis - *B. Riley FBR, Inc., Research Division - Senior MD & Director of Research*

Got it. And then following up on some end-market dynamics. As we talk here right now, we've got Mobile World Congress wrapping up over in Europe. And it seems like the data points on 5G are pretty encouraging, not dramatic pull-ins, but it seems like we've got a nice list of smartphone OEMs that will be launching 5G enabled product a year from now, more in the second half of the year. Bruce, I think you mentioned some longer-term 5G developments for ACS, but when do you think we'll start to see the material impact of the increased content that goes along with 5G in the Rogers business?

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

So our view is -- and I was just in China about a month ago talking with some of our key customers there. And their view that they shared with me was, certainly towards the -- in the second half of 2018, they're doing testing and so forth. And what we anticipate is, in the first half of 2019, we'll start seeing the real rollout of 5G. And so again this is -- I've read (inaudible) since I've returned, some people are saying it's being pulled in a little bit more, some people saying that it's pushed out another 6 months. But we believe that during 2019, we'll start seeing the real rollout here. In the meantime, just to address maybe some thoughts that people have, we are seeing the 4.5G continue some strong activity there with deployments in higher-traffic areas of the 4G networks. And also specifically, in China, NB-IoT, Narrowband Internet of Things, machine-to-machine buildout for 4.5G is also occurring. And some of the information that we have, 500 base stations of NB-IoT were built in 2017. Probably, somewhere around 750,000 will get constructed in 2018. So the bridging between the 4G and 5G is that 4.5G, Narrowband Internet of Things that we'll see during the year, which is going to cause I would think -- I think some noise and variability quarter-to-quarter in our telecom space.

Craig Andrew Ellis - *B. Riley FBR, Inc., Research Division - Senior MD & Director of Research*

That make sense, Bruce. And then following up within elastomeric. Part of the business has exposure to the smartphone market. We've had some mix dynamics there. China weak in 4Q, but it seems like it's coming back now, and some other things going on with Tier I smartphone programs. Can you give us your sense of what you're seeing in that market? And how you think we should be looking at that particular opportunity as we think about the full year 2018?

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

So we were very successful in 2017 in a number of new applications there. As we move into 2018, we've also seen a few new arrivals and new specs and so forth, that will work through as those products get introduced through the year. So we're anticipating another pretty good year, probably not as good as what we saw in 2017, but we still continue to see our design wins, and we'll move through. We're particularly pleased with some of the work that we have been doing with the local Chinese handheld folks. And so that's -- we should start seeing some of that as we move through the first half of the year.

Craig Andrew Ellis - *B. Riley FBR, Inc., Research Division - Senior MD & Director of Research*

Got it. And then lastly, Janice. Just on the tax rate guidance. Is your expectation to provide us with more quarterly guidance as we go through the year? Or would you expect the next time we meet sometime in the April or early May time frame to be able to provide us with full year guidance? And if you did that or on a quarterly basis, what are the prospects for the tax rate to settle in lower than the 28% to 30% we're looking at for the first quarter?

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Yes. We will -- we anticipate having the numbers in April or May. And we -- the problem that's going on with the tax rate reform as you know is there a lot of interpretations, there's switching back and forth. [Wills] came out and we're waiting for the final interpretations before we actually give our full guidance. And also -- so that's one of the reasons why we won't. But we will have it hopefully in the April, May time frame. And when we look at the guidance in 28%, 30%, we're hoping it might be a little bit lower, but you have to remember that 70% of our income is offshore, so we're not getting the total benefit from the U.S. And as we look at our investments, we're looking to see if they will actually help us lower some of our tax position or our assertions that we're taking of our offshore income. So with that we usually have a better indication in April or May and we'll let you know. But we're hoping that will be a little lower also.

Operator

Your next question comes from Daniel Moore with CJS Securities.

Daniel Joseph Moore - *CJS Securities, Inc. - Director of Research*

I wanted to start with just the outlook for growth. The guidance implied for Q1 low- to mid-single-digit growth, a little bit below the longer-term 7%-plus organic growth targets. And Bruce, it sounds like 2019 is when 5G kicks in earnest. Is that growth for Q1 kind of a good way to think about 2018? Or do you see some room for acceleration as we go out through the back half of the year?

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

Good. Great question. And thanks, Dan, good to hear from you. We view Q1 to be a little bit on the low side, but we will accelerate through the year. Couple of things going on. I referenced in the last question the variability in 4G as we go to 4.5G and so forth through the year. We think that will start building more momentum in 4.5G as we move through into second, third quarter. We also see, in the PES business, extremely robust sales moving through the year, particularly related to EV/HEV. And also, as I mentioned on the EMS side, we'll starting seeing some of the new design wins coming in second, third quarter. So that'll boost sales. And also, just generally in the general industrial side of the business, we're seeing continued strength there, a little bit of variability here in Q1. But again, we -- our outlook for the year is strong in the EMS, PES business. And also strong, I will mention also in the segment of ADAS, in the automotive segment in ACS. We will continue to see strength there. So we're looking -- I'm very optimistic about 2018. I think Q1 is, as you point out, a little bit lower than what we had -- what we have in our 2020 targets on a percentage basis. But we'll see this moving forward and recovering through second, third, fourth quarter.

Daniel Joseph Moore - *CJS Securities, Inc. - Director of Research*

Very helpful. And similarly, as it relates to the EBIT margin, we exited 2017, 18.5%. Your 2020 goals is 20%. Given some of the incremental costs that you went through in detail, do we anticipate taking a little bit of step back in '18? Or more kind of flat and then start to build toward that 20% level over the next 2 years?

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

We're reaffirming our 2020 targets. We'll recover here through this quarter probably into Q2. We have very clear programs in place. As Janice, I think did a great job in outlining the specifics here, some of them are operational. We know what the issues are. The good news for us is we control that. It's not like in some cases things that you don't control, we control our destiny here. So we've got teams working on it, and we have a very clear path. We're also working through on cost recovery on the commodity side, and working closely with customers on that as well and looking for efficiencies as we go forward. So again, I think we'll see a very good recovery as we move through the year.

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Yes, and as we don't give guidance for the full year, you obviously know the management team here, and we don't really look backwards ever, we always look going forward and improving. So that will be something we will be striving for always.

Daniel Joseph Moore - *CJS Securities, Inc. - Director of Research*

Got it. And then lastly, M&A, obviously, it sounds like you were down the path, in Q4. I won't ask you what that was, but maybe just talk about the environment in general? And if you're seeing -- is it going to be more likely to see smaller tuck-ins like DeWAL and DSP, or are there larger deals that you're out there looking at as well?

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

We're -- our strategy is clearly top of the pyramid. We like the DeWAL deal. We like DSP. So we continue to look for those kinds of opportunities. It is -- as I think you probably hear from other folks in the M&A market, it's a tough place. And we have targets we're going after. Obviously, we can't talk about what happened here in Q4, but we're very active out there.

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

And we have the liquidity to support any activity that we do.

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

Right, I mean again, I think Janice's point here is a good one. The liquidity is there. We are ready and able to go when the right opportunity comes. But I will also reinforce the point that we are disciplined. And that discipline also could have caused some problems in Q4 here, whereas as we looked at the target and came to a conclusion that maybe we were better off moving to others.

Operator

The next question comes from Sean Hannan with Needham & Company.

Sean Kilian Flanagan Hannan - *Needham & Company, LLC, Research Division - Senior Analyst of Smart Grid, Electronic Mfg Svcs, IT Components & Electronic Components*

So actually folks, kind of coming back to the guidance here. If I were to pull out the DSP deal you did last year, and certainly taking out the currency tailwind, it actually looks like your guide is going to be down year-on-year. So I want to check if that's correct? And if so, hoping to really understand a little bit better, what's getting us there? And I realize you don't necessarily guide on a segment basis, but some directional color for each of these segments would certainly be helpful to better understand the components that get you to that revenue guide?

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Yes, just -- I mean honestly was DSP was so small. It's not going to -- it's not really -- when you take it out, it's minimal for us. When we really look at from Q1 of last year to Q1 of this year, as we said ACS is somewhat the one that's really causing the deterioration due to the 4G transition moving into 5G. But it's the timing, because 4G we still believe there's a lot of sales growth. In the 4G market, it's just the timing. And I think a lot of people at Nokia and other people that had their earnings call talked about this short -- the Q1 downturn. And so that's kind of what we're seeing, the market kind of down-turning. But we do see a lot in the EV/HEV. We see an upturn on that, that's very strong. And EMS is strong. So really the markets, when we look at it for Q1 in our guidance, is really strong, except for that one market which is the 4G and it's the transition type of period. So we anticipate 2018 to be a very good year for us.

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

Yes, Sean, advanced connectivity, advanced mobility, those 2 core growth sectors for us. Those are the ones that are driving the company forward. And so a little bit of noise here and there with 4G. But certainly ADAS, as I mentioned previously, is a big growth driver in the ACS business, overcoming some of the weakness that we're seeing in 4G in the quarter. And again, EMS and PES in particular are on a good growth trajectory.

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Yes, and I also think that recent announcement from the China government spending $180 billion approximately into 5G is very encouraging for us. So if they move forward. It's just the timing, we know they will eventually want to take the lead, it's very encouraging for us, and we also know ADAS is growing between 30% and 70% from different kind of markets studies. So we're anticipating a lot of growth. It's just kind of a timing thing as we see in Q1 at this point of time.

Sean Kilian Flanagan Hannan - *Needham & Company, LLC, Research Division - Senior Analyst of Smart Grid, Electronic Mfg Svcs, IT Components & Electronic Components*

Okay. So EMS, PES some relatively quasi-repeatable growth as we go into this fourth quarter, offset then by ACS. And that's where we get to that range you've got?

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

Right.

Sean Kilian Flanagan Hannan - *Needham & Company, LLC, Research Division - Senior Analyst of Smart Grid, Electronic Mfg Svcs, IT Components & Electronic Components*

Okay. All right. And then also to follow up around thinking about the pace of SG&A investments here. And obviously, there's some other factors that have been in play that I think you're trying to get a little bit more efficient on. How do we think about the cadence of the dollar number from here moving forward? And what we should think about, specifically starting with that first quarter as we kind of move through the year then?

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Yes, I will say, obviously, our sales are growing. We're growing as a company. The markets are growing. We're going to have to put some investment in SG&A. We need sales and marketing expertise and other staff. So you're going to see the absolute dollar increasing a little bit, but our percent to sales you will see deteriorate as we move forward. Obviously, we'll get more efficient as we grow, but there will be some basic adds that we'll have to do. So you will see that really happening. And like we talked about, it depends on the M&A, if there's a target we're working on, we'll spend some money professional services and M&A activity, and other ones will be low. So that will depend on really what's out there and what we're working on. But really there is going to be a little bit of the SG&A growth as we're growing. But the absolute percent is going down.

Sean Kilian Flanagan Hannan - *Needham & Company, LLC, Research Division - Senior Analyst of Smart Grid, Electronic Mfg Svcs, IT Components & Electronic Components*

You're talking on a year-on-year basis, not coming off of a fourth quarter base, correct?

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Correct, yes.

Sean Kilian Flanagan Hannan - *Needham & Company, LLC, Research Division - Senior Analyst of Smart Grid, Electronic Mfg Svcs, IT Components & Electronic Components*

Okay. So we'll tick down before moving up?

Janice E. Stipp - *Rogers Corporation - CFO, Principal Accounting Officer, Senior VP of Finance and Treasurer*

Quite a bit. You'll see quite a bit of move there on a percentage basis from Q4.

Operator

There are no further questions at this time. I will turn the call back over to Bruce Hoechner, President and CEO.

Bruce D. Hoechner - *Rogers Corporation - CEO, President and Director*

Thanks. This concludes our call. Thanks everyone for joining us. Have a good evening.

Operator

This concludes today's conference call. You may now disconnect.
