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CBS Outdoor Americas, Inc. (CBSO)

Q2 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Julie, and I will be your conference operator today. At this time, I would like to welcome everyone to the CBS Outdoor Second Quarter 2014 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

I would now like to turn the conference over to Mr. Gregory Lundberg, Investor Relations. Sir, you may begin your conference.

Gregory Lundberg
Senior Vice President of Investor Relations, CBS Outdoor Americas Inc.

Good morning, and thank you for joining our 2014 second quarter earnings call. On the call today are Jeremy Male, Chief Executive Officer; and Donald Shassian, Executive Vice President and Chief Financial Officer.

After today's prepared remarks, we'll open up the lines for a question-and-answer session. A slide presentation to accompany today's call can be found in the Investor Relations section of our website at cbsoutdoor.com along with the earnings release, and an audio webcast.

This conference call may include forward-looking statements, and relevant factors that could cause actual results to differ materially from those forward-looking statements, that are listed in the earnings release, in slide number two of the presentation and in our SEC filings.

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In addition, in this call, we'll refer to certain non-GAAP financial measures. Please refer to the appendix of the slide presentation and our earnings release for the reconciliations of non-GAAP financial measures to GAAP financial measures each of which can be found in the Investor Relations section of our website.

These documents also provide reconciliations of results on a comparable basis, which, we believe, present a more meaningful view of our business performance and progress by making certain adjustments to our reported results. We reflect the constant dollar basis. We include incremental standalone public company operating cost and interest expense at the same level incurred in the first quarter of 2014. We exclude a net gain and loss on disposition incurred in the first quarter and second quarter of 2013, and we reflect income tax expense as if we were a REIT in each of the periods presented.

With that, I will now turn the call over to Jeremy.

Jeremy John Male

Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

Thanks, Greg, and good morning, everyone. So since our last earnings call in May, we've been rather busy both in terms of running our business and making important changes that set the stage for future growth.

If you turn to slide four of the presentation, I'd like to walk you through some of the key highlights. First of all, total revenues for the second quarter increased 1.6%. This is in line with the expectations that we shared with you back in May for the second quarter revenues to grow in the low single-digit range. U.S. revenue growth was 1.8%, with Billboards growing 3.3%, its best level for the past four quarters.

This was offset by a 2% decline in Transit & Other revenues. While local revenues in the U.S. were very solid, national revenues were down year-over-year. Internationally, revenues were very slightly up, with solid performances in Canada and South America, both up mid single-digits, offset by a weaker quarter in Mexico.

In the second quarter, our total adjusted OIBDA was up 2.2% and our margins expanded to 33%. Don will go into our numbers in more detail. So I'd like to turn now to three very important things that we've been working on during the quarter. First of all, we completed our separation from CBS Corp. on July 16, and began operating as a REIT the next day. This capped off a very long and complicated process. With this behind us now, we are able to focus exclusively on strategies to drive future growth and profitability.

One of these strategies is growth through acquisitions. And our July 20 agreement to purchase outdoor assets from Van Wagner is a very important step in our transformation. As you know, this was a unique opportunity that fits extremely well with our top market growth strategy and allows us to improve the breadth and creativity of solutions that we bring to our advertising clients.

I'd also like to mention that we announced the resignation of Wally Kelly, who was a great support to me in my first months of the company, and we are delighted to have announced last week the appointment of Clive Punter to lead our sales team as Chief Revenue Officer and Andy Sriubas as Head of Strategic Planning and Development.

These are important roles that we expect to have a meaningful and positive impact throughout the organization. Clive brings a deep out-of-home background, as well as tremendous sales and marketing leadership in our industry and also in digital media having led the global marketing teams at LinkedIn. I've had the pleasure of working with Clive for five years in out-of-home in Europe and I'm confident that he'll develop and execute our strategies for growth and provide the structure and inspiration to make it happen.

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Andy will enhance our digital and technological capabilities to help us win new business and drive future revenue growth for us and our partners. This is a key area of focus for us as out-of-home continues to digitize providing increasing benefits for advertisers. We want to be at the forefront of solutions that give our clients the greatest returns and engage our audience with innovative messaging. We believe that these management changes together with our Van Wagner acquisition and our recent independence, enhance our platform for growth and considerably strengthen our business.

Now, I'd like to hand over to Don, who will take you through our financials.

Donald R. Shassian

Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

Thank you, Jeremy and good morning, everyone.

Slide six is a snapshot of our consolidated results. You can see the total revenues were up 1.6% with Billboard revenues up 2.7%, and Transit & Other revenues down 1.3%. Adjusted OIBDA was up 2.2% and our margins expanded slightly to 33%.

This growth adjusts for $5.2 million of incremental standalone costs that did not occur last year. This level is up from a $3.8 million we reported last quarter, and is now running close to the annualized level that we previously communicated will be necessary to run the business as a standalone public company independent from CBS. I do expect our third quarter incremental cost to increase slightly further, at which time we'll be at the expected ongoing run-rate.

Now, let's dig into the results by turning to slide seven, which is the U.S. segment that represents 87% of our revenues. In the U.S., total revenues grew 1.8%. Underlying this was solid 3.3% growth in Billboards, offset by 2% decline in Transit & Other. In Billboards on a same forward basis, we had rising yields in the second quarter across our total Billboard portfolio including both static and digital. Yield growth remains an absolute key focus for us, going to maximize the revenue of each display and make sure that the displays delivering the best audiences are marketed accordingly.

We also had good growth from converting static boards to digital. In terms of revenue mix, local advertising strength was offset by softness in national, as Jeremy mentioned. The decline in Transit & Other revenue reflects the softness in national advertising, while it's also impacted by our April 2014 non-renewal of an unprofitable contract and the November 2013 sale of our street furniture business in Los Angeles.

Adjusted OIBDA growth was 1.9% year-over-year and margins were essentially flat at 36.6%. We expect greater operating leverage as revenue growth increases and our focus on yield also has benefits from profitability as revenues rise and a potentially less profitable boards are rationalized.

International revenues shown on slide eight, were up very slightly on a constant dollar basis in the quarter with Billboards down around 1% and Transit & Other up 4.3%.

Looking at the regions in detail, Canada was up 4.7% on increased spending across several advertising verticals. And South America was also up mid single-digits offset by Billboard declines in Mexico from the reduced spending this quarter by a few large advertisers. We have several new digital boards coming online in the quarter in Mexico that will positively impact Mexico's results as we go forward. Increased expenses in South America due to incremental Transit and Billboard lease costs reduced our margin to 22%.

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Turning to slide nine, let me provide an overview of our capital expenditures. In the second quarter of 2014, total CapEx is $10.9 million or 3.3% of total revenues. This included $4.4 million of maintenance CapEx and $6.5 million of growth CapEx.

During the quarter, we added 40 digital boards in total, including 28 in the U.S., eight digital boards in Canada, and four digital boards in Chile. You recall that the 43 digital boards we added in the first quarter included many that were already well underway in the fourth quarter of last year. As the timing of approvals is a bit ahead of our expected pace, we are raising our annual deployment estimate to approximately 120 boards, from 100 boards previously. Importantly, however, we are not raising our total CapEx estimate of $65 million as we've been able to reprioritize some spending and deploy boards at a slightly lower cost than budgeted.

Please turn now to slide 10 for an analysis of our FFO and AFFO. I'd like to point out a slight enhancement to our presentation. Since we are now operating as a REIT, we believe that it is important to present the second quarter metrics consistent with how we'll be reporting our financial results in the third quarter of this year and beyond. Therefore, this slide shows both our FFO and AFFO on a reported basis and also shows them on a REIT comparable basis, which adjusts for three things.

One, we equalize the impact of incremental standalone costs for both years. Two, we equalize the impact of interest expense relating to our January debt offerings. And third, we exclude taxes that would not have been incurred if we had been operating as a REIT for all periods presented. When adjusting for these items, FFO in the second quarter was up approximately 1%, compared to last year's second quarter and AFFO was up 2.4% for the same period.

Our $44.4 million dividend payment in the second quarter of 2014 represents a 56% payout ratio of the $79.8 million of REIT comparable AFFO generated in the same quarter or 77% of reported AFFO.

This week, our board declared a $0.37 dividend for the third quarter, payable September 30. As we stated in the Van Wagner Acquisition Call, we do not expect any change to our anticipated 2014 dividend levels. We expect that we can continue to pay a healthy REIT dividend that can grow over time, with increased financial flexibility, while also deleveraging to our target zone of 3.5 times to 4 times.

You can see our current debt profile on slide 11. It reflects our balance sheet as of year-end at June 30, 2014. At quarter end, the weighted average cost of debt was 4.2% and our consolidated total leverage ratio was 3.9 times. Including a $123 million of cash on hand, the ratio was 3.6 times.

Our liquidity position is $548 million, including an undrawn $425 million revolving credit facility and $123 million of cash on hand. You'll also note that we have $100 million of net proceeds from the IPO, which we will use along with an estimated $400 million of stock as the required on-time dividend to our shareholders and what's known as an earnings and profits purge.

CBS will complete the calculation of the E&P purge with the finalization of their 2013 federal tax return in early September. We will then be able to make an announcement of the final amount and the anticipated timing of that payment.

In connection with our conversion for REIT, please note that our third quarter results will reflect a non-cash reversal into net income of substantially all of the deferred taxes that you see on a June 30, 2014 balance sheet.

Now, I'd like to give you a brief update on the recently announced Van Wagner acquisition. We're in process of pursuing all regulatory approvals and we expect to finance the purchase with additional long-term borrowings, to

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provide the seller with certainty of financing, we do have commitment from Wells Fargo and a syndicate of additional banks to finance the transaction. In addition to a commitment fee on this financing, we disclosed in the Acquisition Conference Call that we expect total fees and expenses relating to transaction of approximately $25 million. Our portion of those fees will be paid in the coming quarters for professional services and the commitment fee will impact the quarter results until we close the new financing.

In summary, we believe this is a very strong and efficient balance sheet with substantial financial flexibility. With additional revenue growth, we expect to see enhanced conversion to OIBDA and AFFO. And we expect to use this for investment in growth initiatives, dividends and debt reduction, all of which when combined with our REIT structure should result in growing AFFO per share, our key operating metric.

I'll now turn it back over to Jeremy on slide 13.

Jeremy John Male

Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

Well, thank you, Don. Looking forward, while national trends in the third quarter are a little better than we saw in the second quarter, we still see overall revenue growth in the third quarter to once again be in the low single-digit range. Additionally, we'll continue to have the comparison issues associated with the contract non-renewal and asset sale that Don mentioned.

That being said, we've already written 90% of the revenue we achieved in 2013 and remain confident in our ability to increase share and out-of-home's ability to grow its share of advertising as we look into the future. We're also still focused on growth through tuck-in acquisitions. We believe this is a very attractive model to utilize our existing infrastructure and REIT status to drive incremental returns for shareholders.

As I mentioned in my opening comments, we're in our first month as an independent company, and there's an incredible amount of energy being put into our sales process, how we market and position the company, and how we leverage our data and systems to manage our existing assets in the most profitable way. We're pleased to have some key new leadership to drive this, but it's also happening at every level of the organization.

When we report our third quarter results in November, we'll be doing so with a new corporate name, logo and marketing strategy that will clearly define who we are and where we're going in this exciting industry.

So with that, operator, let's open the lines for questions.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Ben Swinburne with Morgan Stanley.

Benjamin D. Swinburne
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Good morning. Jeremy, can you talk a little bit – or Don – about some of the categories in the quarter that were favorable or unfavorable and particularly, I know you guys have a lot of exposure to the entertainment segment. It's been a very tough summer for the box office, so maybe any color on how that looks for the rest of the summer, and then and maybe even into next year where I think the slate looks a lot better?

Jeremy John Male
Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

A

Yeah, thanks for the question, Ben. So looking just at the main categories, I'm actually thinking about over the six months really, because I think it's a little more meaningful than just the quarter. When we look at the categories, the down categories for us, beer was down, restaurants were down, financial services were down. And on the upside, healthcare was very strong for us and TV was strong for us and professional services strong.

In terms of movies, yes, you're right. Movies has been a little bit less good for us, and particularly, in Q2. As we look into next year, we think that could be quite a strong growth for that, because the movies sort of schedule for next year, actually, is really quite exciting. So we're looking forward to that.

Benjamin D. Swinburne
Analyst, Morgan Stanley & Co. LLC

Q

Great. And then I just wanted to ask Don any follow-up on the acquisition pipeline. I know you obviously have done the Van Wagner deal or in process, but is there other tuck-ins you see as possibilities in the next six months to 12 months or do you think you've largely spent your capacity in the near term?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

Van Wagner acquisition was a great opportunity, very unique set of assets. We're very, very excited to get that close and integrated. There are a number of smaller acquisitions, tuck-in acquisitions. We mentioned the Chicago Windsor several weeks ago, and we continue to look at other smaller opportunities if they meet our qualitative and quantitative in our top 25 markets. We'll continue to look at them.

We never can tell how many you might be able to get there. Everyone is unique, but we continue to have a pipeline and continue to analyze the due diligence and try to find the ones that make some sense. So we have not spent anything. These are small items that we'll be able to do with cash. We think that they are things that are smart for us and we'll continue to look for them and hope we'll be successful in finding them.

Benjamin D. Swinburne
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you very much.

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Operator: Your next question comes from the line of Marci Ryvicker with Wells Fargo.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

Thanks. Billboard revenue was relatively strong up 3%. Can you talk about what you're seeing in the local versus national there? And then just digging into Transit a little bit more since that was on the weaker side, how much of the decrease was due to national being soft versus the contract on the asset sales, trying to figure out organic trends?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

On the latter one, on the Transit side, Marci, the decline was we had a non-renewal of a unprofitable contract, GameStop, and we also had the sale of the Los Angeles area street furniture into the JV. The amounts for the quarter decline for those two items was $3.6 million and for six months, it was about $6.3 million.

Jeremy John Male
Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

A

Turning back to the first part of the question, Marci, local actually has been really pretty good for us throughout. So the declines in national, certainly, sort of pull back that performance by a point or two.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

Operator: Your next question comes from the line of Alexia Quadrani with JPMorgan.

Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

Thank you. Could you remind us just on the last question what the mix is of national, local in your Transit business? And then second question is, have you seen any signs of improvement in national, any reason to be encouraged about the national environment I guess going into the September quarter, you did from what your sales reps are saying or what you may be seeing early in the quarter?

Jeremy John Male
Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

A

So our total split, Alexia, is 60% local and 40% national. When you drill into it, the bias in national is much stronger than that, but it's not a number that we've -

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

[ph] By (22:05) Transit is much stronger.

Jeremy John Male
Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

A

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Transit is much stronger than that. So when we look forward, I think that other commentators have said that from September, it's looking a little bit better. Yes, our September numbers are certainly better than July and August. So we hope that as the ad markets generally improve, our assets will benefit from that.

Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

Okay. And just a follow-up on the, I guess, weaker profitability in international, any sign when that may level off a little bit?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

Well, I think things can sometimes be a little lumpy. Canada was very, very strong again. South America also very strong. Mexico, I think it's a little lumpy for the quarter. We had a couple of large advertisers that discontinued for the quarter. We got a number of activities that I think Mexico is going to prove in the coming quarter so. International, definitely, has turned the corner. We definitely have stabilized. We're seeing some very good things in all the countries. I think Mexico was a little bit of a blip for the quarter and we feel good that the activities going on by local management there are going to show very good strength in coming quarters.

Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

Thank you very much.

Operator: Your next question comes from the line of Jason Bazinet with Citi.

Jason Boisvert Bazinet
Analyst, Citigroup Global Markets Inc. (Broker)

Q

I've a slightly longer-term question. The ad market, people, I think, blamed the weather and the economy in the fourth quarter, and things seem sort of sluggish this quarter and so, my question is, if this is sort of the new run rate in terms of advertising, revenues in aggregate or for outdoor, how much top-line do you guys think you need to generate to not have margin compression in the business? Is there a magic number that you think we need to see to sort of sustain margins?

Jeremy John Male
Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

A

Thanks for that, Jason. I guess the first point is that it does seem to be that the whole industry has maybe been a little bit wrong-footed this year. I think the expectations of growth haven't been achieved and that's right the way across the board.

Jason Boisvert Bazinet
Analyst, Citigroup Global Markets Inc. (Broker)

Q

Right.

Jeremy John Male
Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

A

I don't think it necessarily – I mean if we think about the last couple of quarters, I don't think it necessarily reflects, if you like, any longer-term trends there. Maybe that's the first point. I think the second point is that we

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still believe that within that, the out-of-home can increase its share. I think that this year it's looking like – it's certainly not certain if that will be the case, but I think as we look forward and as forecasters look forward, that indeed is believed to be the case and I'm confident that we can do that.

Coming back more specifically to your question, I think we've said before that when you look at our business, we do have a very, relatively high fixed cost, but we do have some cost creep. We have some leases that have inflation kickers in there. We have, in our transport business, we have rents that are linked to revenue.

So taking other sort of inflation, REIT cost creep on wages, et cetera, what that means is that we start getting margin expansion, depending on where the growth comes from, if it's [ph] by local (25:38) Transit or Billboard, sort of between 1.5% and 2%, right.

Jason Boisvert Bazinet
Analyst, Citigroup Global Markets Inc. (Broker)

Q

Wow, that's pretty low. Okay. All right. Thank you very much.

Operator: [Operator Instructions] Your next question comes from the line of Jim Goss with Barrington Research.

James C. Goss
Analyst, Barrington Research Associates, Inc.

Q

Thank you. First, I'd like to ask just a detail about the earnings purge, when – what is the expected date of record for that sort of thing? How does that work and would it be bigger than normal this year, and then a repeating pattern in subsequent years as you try to true-up your dividends for the actual earnings you have figured out?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

Jim, let me make sure we're not confusing things. There is a earnings and profits purge, which is a one-time distribution cash and stock that is required to be done as a REIT. The determination of when that will be done has not been announced yet. We have not announced a record date nor payment date yet. It needs to be done by the end of January of next year.

Secondly, you have a dividend and distribution out of our current earnings on an annual basis, and there's a recurring dividend, our board announced earlier this week, third quarter dividend, shareholders of record September 9, payable on September 30. And we will look forward that the board would approve a dividend in the fourth quarter and that will do again in the first quarter with a top-up as well. So I'm not sure which of those two you're specifically trying to focus on or whether it's [indiscernible] (27:16) or the one-time purge.

James C. Goss
Analyst, Barrington Research Associates, Inc.

Q

Okay. And I wasn't entirely clear if they were linked or they were separate. So the first one relates just to the going public transaction, and the shift to the REIT, the second one will be the repeatable one and that will be a little bit later on that?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

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No. The first one is the purge to be announced, to be done one-time no later than January. Recurring dividends, we're already doing them, but we paid the dividend in the second quarter that was payable on June 30 and our board just earlier this week announced another dividend that's going to be paid in September and that's a separate dividend.

James C. Goss
Analyst, Barrington Research Associates, Inc.

Q

Okay. But the – don't you have a larger dividend at the beginning of the year that relates to the actual earnings adjustment?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

That would be the top-up transaction that will be paid in the first quarter. Once we know the actual QRS tax return taxable income and we've committed to pay 100% of that, when we finally know that number at the end of the year, that number compared to what we had paid in our recurring dividends during 2014 would be a top-up and that would be paid in the first quarter along with the new recurring dividend for the next year.

James C. Goss
Analyst, Barrington Research Associates, Inc.

Q

Okay. And then secondly, I was wondering if as you make acquisitions if you foresee any shift in the nature of the display types, you would have over time and sort of in a corollary basis, are you seeing any changes, or are you developing any changes in the usage of your digital boards with any potential impact on pricing opportunities, for example, day-parting or things of that nature that were envisioned as a means, a reason to go digital in the first place aside from changing the displays?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

Jim, your first question about change in the mix of our boards because of acquisitions, as a REIT and as we stated previously, our focus on acquisitions would primarily be in growing our QRS business, and therefore, acquiring – if we're going to make acquisitions, it's focusing on U.S. fixed structures, billboards.

Van Wagner is a perfect example. Substantially all their assets are fixed structures, billboards in the state. So I think you would probably see the mix of our business shifting and if you would, obviously, more and more towards billboards on some of these acquisitions. But obviously, the assets that are TRS are very, very important to us, and we think they're very good money maker businesses and we'll continue to focus on them.

Jeremy John Male
Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

A

Just going to the other part of your question, Jim, I think I should say it's a really good question. I refer to digital as an iceberg and that actually, in terms of the capability of our assets, we're just using that 25% piece that's above the waterline and 75% we're really not using as well as we could. And that includes areas such as day-parting or live feeds or whatever else.

I think it's fair to say that from a technology point of view, we're very, very involved and looking at ways of becoming much, much smarter in this area and just going back to my comment earlier in terms of us certainly taking on Andy Sriubas who has great experience in these areas, that's all focused on really improving our expertise in this area that will drive future enhanced revenues we believe.

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James C. Goss
Analyst, Barrington Research Associates, Inc.

Q

All right. Thank you very much.

Donald R. Shassian
Chief Financial Officer & Executive Vice President, CBS Outdoor Americas, Inc.

A

Thank you.

Operator: At this time, there are no further questions in queue.

Jeremy John Male
Chief Executive Officer & Director, CBS Outdoor Americas, Inc.

Thanks, Julie. So I think we'll sign off there. I'd like to thank you all for your questions today. We look forward to seeing many of you next month in New York and then at Investor Conference and expect to report our third quarter results to you in November. Thanks very much to everyone on the call.

Operator: Ladies and gentlemen, this does concludes today's CBS Outdoor second quarter 2014 earnings conference call. Thank you for your participation. You may now disconnect.

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