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OUTFRONT Media, Inc. (OUT)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the OUTFRONT Media Third Quarter 2015 Earnings Conference Call. At this time, I would like to turn the conference over to Mr. Greg Lundberg, Investor Relations. Please go ahead, sir.

Gregory Lundberg
Senior Vice President-Investor Relations

Hey. Good afternoon, everyone. Thanks for joining our 2015 third quarter earnings call. On the call today are Jeremy Male, Chairman and Chief Executive Officer and Donald Shassian, Executive Vice President and Chief Financial Officer. After a discussion of our financial results, we'll open up the lines for question-and-answer session. A slide presentation to accompany the call can be found in the Investor Relations section of our web site along with the earnings release and an audio webcast.

This conference call may include forward-looking statements. Relevant factors that could cause actual results to differ materially from these forward-looking statements are listed in our earnings materials and in our SEC filings, including our 2014 10-K.

We'll refer to certain non-GAAP financial measures on this call. Any references to OIBDA and AFFO made today will be on unadjusted and REIT comparable basis, respectively. Both of which are reconciled along with other non-GAAP financial measures in the appendix of the slide presentation, the earnings release and on our web site which is outfrontmedia.com.

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

Jeremy John Male
Chairman & Chief Executive Officer

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Thanks, Greg. Good afternoon, everyone, and thank you for joining our call today. It has been a busy summer here at OUTFRONT Media and I think we've made some good progress since we last spoke.

Slide four lays out some of the key highlights and I'll begin with the most important item, our revenue growth. Our third quarter revenues were up 2.5% organically, with continued robust growth in our Transit business and our Billboard business returning to positive growth. This is exactly what we described in our expectations back in August.

It's important to note that Transit strength was across the U.S. and not confined to any particular market. Our dedicated Transit sales teams are doing a great job. Our Billboards are also showing clear progress. The proactive measures we took in certain markets earlier this year are working and the Billboard business overall is improving. We are also pleased to note growth in both our national and local business in the U.S.

Looking forward to Q4, both our Transit and Billboard businesses in the U.S. are showing improved growth relative to the third quarter levels that we are reporting to you today. I'll give you more details later on the call.

I was also pleased to report earlier this week that we've entered into an agreement to sell our Latin American business. This is an important strategic milestone. Our focus as a company is on markets where we have a leadership position. For our Latin American business, collectively, this was not the case. This decision allows us to streamline our operations and focus on our North American market comprised of the U.S. and Canada.

Our technology platform was enhanced further during the quarter and you may have seen details on this from our release earlier this week. We are now branding our digital initiatives under the ON Smart Media banner.

As you'll recall, we are investing in new technologies to change how we operate. This includes new smart hardware displays, a data management platform for dynamic audience-based targeting and increased automation for our assets to connect, transact and interact with our advertising clients.

During the quarter, we moved ahead on certain elements, such as new display hardware deployed at Hudson Yards. As part of our ON Smart Media launch, we also introduced an exciting new product called OUTFRONT Mobile.

Growth in the advertising market is being driven by mobile, which combines exceptionally well with out-of-home almost by definition, because we match the advertisers one-to-one message with the physical location of the customer.

Location is becoming increasingly important in media. At an industry conference in New York this week, the chief strategist at a publicist group made a great comment that illustrates the saying, where you are is just as important as who you are.

What OUTFRONT Mobile means in practice is that we are now able to sell advertisers an integrated mobile campaign that delivers a mobile ad while the user is within a geofence that contains, for example, our billboard. OUTFRONT Mobile is live in test markets. We think it's an interesting initiative and will be watching this space closely.

Finally before I pass it to Don, I'm pleased to report that our board has declared the fourth quarter 2015 dividend of $0.34 a share payable December 31. A solid level of dividend income is central to our operating philosophy as a REIT and we look forward to updating you on this next February.

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So, I will now turn the call over to Don for a more in-depth look at our quarterly results.

Donald R. Shassian

Chief Financial Officer & Executive Vice President

Thank you, Jeremy, and good afternoon, everyone. Before we get into our third quarter results, I want to spend a moment on Monday's announcement regarding the sale of our Latin America business. This was a competitive bidding process and we are very pleased to have come to an agreement with JCDecaux. The purchase price is $82 million in cash, subject to working capital and indebtedness adjustments.

We do not currently anticipate any significant tax consequences from the sale and we are still exploring our use of the sale proceeds. As of December 31, 2014, this business represented 11,390 total displays across Mexico, Chile, Uruguay, Brazil and Argentina.

Revenues for the year ended December 31, 2014, were $72.5 million. As you know, we have never broken out adjusted OIBDA for Latin America, since it is not material to the business and is not a separate segment for reporting purposes. However, what I can tell you is that Canada represents the vast majority of international adjusted OIBDA and that on an LTM basis, the sales price for Latin America represents a higher multiple on EBITDA than our current public market trading level.

In addition, I do want you to know that for accounting purposes, Latin America does not qualify for discontinued operations treatment in our financial statements. However, we will find ways within our MD&A to inform you of the impact that the disposition of Latin America has on our revenue growth.

Please turn to slide six, which shows a summary of the year-over-year performance of some of our key financial metrics for the quarter and year to date. This table presents the results of the acquired Van Wagner assets only from the date of acquisition on October 1, 2014.

While it is not a pro forma view, I will note we lap the Van Wagner acquisition next quarter and the results you'll see in all of our financials going forward will be easier to compare on a year-over-year basis.

In addition to acquisitions, the primary differences between the two periods in this table are that Q3 2015 reflects the addition of interest expense incurred on the acquisition debt and tack-on financing. Q3 2014 is adjusted on a tax line to show the level we would have paid had we been operating as a REIT in the second quarter of last year; and third, restructuring and standalone costs.

While revenue and OIBDA are up, we experienced a decline in net income, FFO and AFFO during the period. I would like to go into the drivers of this beginning with revenues on slide seven.

Our total revenue growth was 14.9% on a reported basis and 2.5% on an organic basis. Please note that our definition of organic revenue excludes the acquisition of Van Wagner's billboard and transit assets. In the U.S., total organic revenues were up 2.8%.

Transit and Other delivered strong 8.5% organic growth, driven by both local and national. As Jeremy mentioned, this growth was across our entire portfolio and is due to the combination of a dedicated Transit sales force and advertisers continuing to target a mobile urban audience.

It's also very important to understand that the franchises in the portfolio are virtually the same as last year, so the increase in revenues is driven by our managing the assets through growing incremental yield.

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U.S. Billboard organic revenues were up 23%, significantly improved from a decline of 1.7% last quarter. Static billboard yields were flat in the third quarter compared to a decline during the second quarter. Same board digital yields were down at a much lower level than the second quarter.

We are encouraged to see Billboards improve during the third quarter. Continued improvements in sales performance have been supported by greater accountability within our markets, increase local and national marketing initiatives, process improvements and enhanced creative solutions. In the future, our on-spot media initiative should help us drive results even further.

An example of one of our marketing initiatives was the September launch of our OUTFRONT Prime, a new brand of premium out-of-home assets. We took our most highly trafficked and iconic billboard locations across the U.S. and rebranded them under this new name that represents the absolute top of our asset pyramid.

These displays are on spectacular locations and give advertisers an innovative tailored way to reach the best audiences. The initial advertisers on the Prime assets include Jimmy Choo, Calvin Klein, BMW, Gray Goose, Tiffany and David Yurman.

Internationally, organic revenues were essentially flat in Canada and Latin America where declines in certain markets offset strength in others.

Now, let's turn to expenses on slide eight. On a year-over-year basis, our total operating and SG&A expenses were up $44.2 million and a majority of this increase was driven by incremental costs associated with the Van Wagner acquisition.

Looking at the trend of expenses as a percent of revenue since the acquisition, we were flat or slightly improved on billboard lease costs, transit franchise expenses and posting and maintenance. The two areas where we saw upward pressure in the quarter were SG&A and corporate. Within SG&A, we saw higher compensation and benefit expense, some of which is linked to our higher revenues, but also reflect increased sales head count in selected U.S. markets where we needed increased feet on the street and where we believe we can grow even faster.

However the real driver of expense pressure this quarter was increased corporate overhead, which is up $5.9 million over last year. This included a $1.4 million increase in the standalone costs, increased strategic business development expenses of $600,000, and $3.2 million of legal expenses we incurred during the quarter. The vast majority of these legal expenses were project specific and are expected to be non-recurring, while some of the legal expenses will continue in the fourth quarter before trending out in the first quarter of 2016.

You can see how these expenses and our revenues translate into OIBDA on slide nine. Our total OIBDA of $113.9 million was up $7 million over last year. The OIBDA margin for the quarter was 29.5%. The non-recurring legal expenses that I just referred to represented 80 basis points of margin. Total OIBDA was therefore up based on the addition of Van Wagner and improved legacy performance, partially offset by these increased corporate costs.

Turning to slide 10, capital expenditures were $15.3 million, including $7.4 million of maintenance CapEx and $7.9 million of growth CapEx. Maintenance CapEx increased slightly relative to 2014 due to acquisitions and work we've completed subsequent to becoming a standalone company.

During the quarter, we added 22 digital billboards in total, including two internationally in Canada. Our 2015 guidance for total capital expenditures is being reduced by $5 million. Our new guidance is $65 million, including $25 million of maintenance, it was $30 million previously, and $40 million of growth. I remind you that our

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maintenance CapEx this year was targeted to be a bit higher than last year as we are refurbishing a number of our offices around the country and are making some investments in our IT applications.

We have built 73 digital billboards to date this year and are still targeting approximately 100 by year-end.

Please turn now to slide 11 for our cash flow for the quarter. This slide shows AFFO on a REIT-comparable basis to equalize the number of items you can see in the schedule in our press release, the largest of which are REIT taxes and interest expense on our formation borrowings.

Please note that Q3 2014 AFFO is not pro forma for the Van Wagner acquisition. The chart only includes Van Wagner as well as the interest expense related to the acquisition debt and tack-on financing as of Q4 2014. AFFO declined $5.4 million year-over-year.

As stated earlier, OIBDA was up $7 million year-over-year due to the addition of Van Wagner and stronger legacy results, partially offset by higher corporate expenses. Despite this overall lift in OIBDA, year-over-year AFFO was negatively impacted by $9.9 million of incremental interest on the Van Wagner initial acquisition financing and our tack-on financing this past March, $2.3 million of higher maintenance capital expenditures and $1.2 million of additional cash taxes.

As we have now lapped the one-year anniversary of the Van Wagner acquisition, it's an appropriate time to give you some color on the performance of the transaction. Revenues have come in slightly better than our expectations. And on an AFFO basis, the transaction has been nicely accretive, as expected. Therefore, when you look at AFFO on the chart on this page, keep in mind that it includes the headwind of legal expenses and maintenance CapEx this quarter, which we view as temporary.

Overall our AFFO is solid and provides good support of our dividends, which you can see on slide 12. Dividends were 69% AFFO and 88% of free cash flow on a trailing 12-month basis, as of September 2015. Last week, as Jeremy mentioned, our board declared another $0.34 per share dividend for Q4.

Slide 13 presents an overview of our balance sheet. At quarter end, the weighted average cost of debt was 4.7%. Our liquidity position was approximately $500 million at the end of the quarter, including $106 million of cash and an undrawn $394 million revolving credit facility, net of $31 million of letters of credit outstanding. Our net leverage ratio was 4.9 times as of September 30, 2015.

Subsequent to the end of the quarter, we did repay $50 million of our term loan with cash on hand. Our target range for net leverage is unchanged. We are committed to drive our capital structure to 3.5 times to 4.0 times, which is the appropriate leverage for this business.

We remain very comfortable with our balance sheet strength and liquidity, and expect to further delever into our target range through a combination growth of OIBDA and additional debt paydown while maintaining a competitive dividend.

I will now turn it back to Jeremy.

Jeremy John Male

Chairman & Chief Executive Officer

Thanks, Don, and please now turn to slide 15.

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Let's first talk about the fourth quarter outlook. At this point, we expect that revenue growth will continue to improve in the fourth quarter and we will be in the low possibly mid single-digit range. We expect continued outperformance in Transit and also expect to see Billboard once again to show solid improvement.

As usual, this outlook only represents our view at this point in time and it's on a constant dollar basis. Please also note that it also includes revenues attributable to the Van Wagner billboard business and transit assets for both periods, but excludes the phone, kiosk business.

Until we close on the Latin America sale, it also reflects our international reporting segments in its entirety.

As you heard this morning, the other large U.S. out-of-home company has once again reported positive organic revenue growth. They are also pacing up in the fourth quarter. This continues the trend we've been speaking about for several quarters. Out-of-home is one of the only media segments that is growing.

Interestingly, according to [ph] Cantor (18:20), in the first half of this year, Netflix spent 9% of their media dollars on out-of-home. Google spent 11% and Apple spent 13% of their total media budget on out-of-home in the U.S. These are all today's brands and they are also the brands of the future.

So, the out-of-home industry is in good shape and we think OUTFRONT Media in also in good shape for future growth. The work we are doing with sell-side leasing, OUTFRONT Mobile and most importantly, our data and analytics through ON Smart Media will help to drive incremental growth in 2016 and beyond.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And we'll go first to Marci Ryvicker of Wells Fargo.

Stephan E. Bisson
Wells Fargo Securities LLC

Q

Good afternoon. This is Stephan on behalf of Marci. You guys are looking for nice coloration based on the guidance in Q4. Can we get a little bit of color around that?

Jeremy John Male
Chairman & Chief Executive Officer

A

Yes. Thanks, Stephan. We've got very good visibility now. It will obviously improve. We've still got quite a bit of business left to write. It's not an exact science, but we're calling it pretty much as we see it right now. I can tell you that Billboards is certainly going to improve its growth rate from Q3. Transit is still strong. And I can also say that the U.S. is doing better than our international business. So that's kind of where we are right now, Stephan.

Stephan E. Bisson
Wells Fargo Securities LLC

Q

Great. Is there any break like local outperforming national vice versa, or any segments that are coming back? I know telco is something strong, some of the other [ph] outdoor players this morning (20:28)?

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Jeremy John Male
Chairman & Chief Executive Officer

A

Yes. To be honest, as we look at it right now, I think we're likely to see growth across both local and national. When we're thinking about sort of thinking about categories at the moment either for Q3, the largest sort of changes for us on a positive way were food and non-alcoholic beverages. Computers, Internet was strong. Entertainment was also top three for us. Also, good to see that autos was up in the quarter, and indeed some positive momentum in telecom. So overall, pretty good. Not doing so well, casinos and lottery, still difficult for us. Retail was a little bit off in Q3, and education was also down, but – yes, if that helps, Stephan.

Stephan E. Bisson
Wells Fargo Securities LLC

Q

That helps. Thanks so much.

Operator: And we'll go next to Ben Swinburne of Morgan Stanley.

Benjamin Daniel Swinburne
Morgan Stanley & Co. LLC

Q

Thanks. Good afternoon. Jeremy, can you talk about your remaining international business? I don't know if you could help us think about the organic growth rate historically for Canada versus Latin America? Any color there would be interesting. But are you considering selling that business if you can get it sold at an accretive multiple as well?

And related to the transaction you've announced, maybe for Don, what are the tax complications, if any, about repatriating the proceeds back to the U.S.? What can you do with the cash? If you have any restrictions at all, I'd be interested in some color there. Thanks.

Jeremy John Male
Chairman & Chief Executive Officer

A

Okay. So maybe if I take the first part of the question. I think just maybe to another couple of comments on LATAM. We think it's a very good deal for us. We think it's a very good deal for our clients down there and also our teams down there. And what I'm going to say, it's a good deal for JCDecaux as well. They've obviously got a decent size business down there and I'm sure that they'll be able to generate some cost and marketing synergies. So I think all-round, we feel very satisfied with the outcome of that process, and I'm sure that it wasn't a great surprise to any of you when we announced that – when we announced the deal.

So as we look to our business in Canada, if we go back sort of three or four years, the business took a step back with the loss of a couple of transit contracts out there, but since then the growth rates have been pretty consistent with the U.S. We have had the headwind there on ForEx. Right now, we like our business in Canada a lot. We think we've got a very good market position there. We think that we can be one of the drivers of future growth in Canada, and we'll be looking at smart ways that we can develop that business as we go forward.

Donald R. Shassian
Chief Financial Officer & Executive Vice President

A

Ben, my prepared comments where we don't expect any significant tax consequences on this transaction is both local taxes as well as being able to bring it back into the States. We do believe we can get it back in. Our tax

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structure as a REIT does gives us some opportunity to do so. It'll probably happen over a couple of years, not all at once, but we do think it will be minimal tax leakage to make that happen.

Benjamin Daniel Swinburne
Morgan Stanley & Co. LLC

Q

Great. Just one follow-up, Don, on costs. There has been some volatility to your fixed cost base since you guys have made some investments, as you mentioned, in salespeople, et cetera. Any way to tell us as we look into next year what the right expectation is for your SG&A or corporate growth to think about 2016? I know it's too early.

Donald R. Shassian
Chief Financial Officer & Executive Vice President

A

Well, corporate growth, there's no growth in corporate. We've had a couple of items that's non-recurring. Hopefully that's – we're not going to see that growing. The piece of corporate in SG&A that is a little bit variable is the salespeople. We talked about this a couple quarters, enhancing our salespeople, getting the right people in the right markets. We've also believed that if we get the right people in the right markets, they can pay back themselves pretty quickly, and it doesn't bring a big drag because we think they can cover the cost and grow the business pretty quickly if you get the right people in the right markets.

And the other one, we're investing for future. This world and this industry is changing. Digital data analytics is changing the way we are living today and continue to change, and we're making some investments in this business and that strategic business development cost that's averaging about $2 million a quarter that's – it's helping us drive a lot of things in the future.

I don't want to make any perspective of where that can go in the future, but we are really trying to lead this industry and not be a follower in these different areas. So corporate, I think hopefully will be flattish. SG&A I think will hopefully – the only increase you're going to see in the sales side of this thing is going to demonstrate with increased revenues.

And on the leasing and transit, leasing would be – on billboard side, would be minor increases and the transit will be a percentage of revenue. We'll grow with that revenue. So I think it's pretty easy to model, but also recognizing that we are making some investments for the future at that $2 million a quarter at least right now for future development. Coming out of those buckets, you see the cellular initiative, Jeremy mentioned, the mobile initiative that Jeremy mentioned, and the data analytics which we are really putting some attention to right now is the start of really trying to move that [ph] dime (26:29).

Benjamin Daniel Swinburne
Morgan Stanley & Co. LLC

Q

Thank you.

Operator: And we'll go next to Tracy Young of Evercore ISI.

Tracy Young
Evercore Group LLC

Q

Yes. I just wanted to follow up on your organic growth. Obviously, you had a nice little uptick on the Billboard business. Is there anything that you could particularly highlight as to that growth? And also, is there any way you can provide same-store billboard growth for the digital business?

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Jeremy John Male
Chairman & Chief Executive Officer

A

I'll take the first part of that, Tracy. When we look into the business, just to give a little more color, we've had some pretty good revenue growth in two of our key markets which is New York and LA. When we go into some of the other markets, as you know, we've got a basket of markets and we did call out the fact that we were making some changes in a number of those markets. And so far, I think the sort of proactive changes that we've made are starting to bear fruit. Those markets that were sort of underperforming were either less underperforming in Q3 or indeed some of them returned to growth. So that's all positive.

Donald R. Shassian
Chief Financial Officer & Executive Vice President

A

Same-store digital, Tracy, much better. It was a decline, not nearly as big as it was last quarter. Third quarter was slightly negative, very low single-digits, a nice improvement over prior quarter.

Tracy Young
Evercore Group LLC

Q

Okay. Thank you.

Operator: [Operator Instructions] And we'll go next to Jim Goss of Barrington Research.

James C. Goss
Barrington Research Associates, Inc.

Q

Thanks. The 8.5% organic Transit growth jumped out at me and I know in prior quarters, you mentioned that it's a lower margin business, so that growing could actually have compressed somewhat the overall margins. I was wondering, to the extent those are clearly being successful, is there some solution to the margin pressure through pricing upside that you might be able to push into that area to the extent that they are having results?

Donald R. Shassian
Chief Financial Officer & Executive Vice President

A

Jim, I think as I mentioned in my prepared remarks, I mean, our number of displays in the third quarter of this year are pretty much – pretty comparable to the third quarter of last year. When we look at it, it is incremental yield. It is significant demand and improved pricing, and our people are trying to sell these for the value we think they deserve, and it's a supply demand. People are really pushing for access to major metropolitan urban audiences and our folks are doing a nice job demonstrating the value by selling them for what they are worth. I think we are presently doing that and will continue to do so.

James C. Goss
Barrington Research Associates, Inc.

Q

Okay. And are there other categories, either existing or some of the new ones you are describing, that you think are going to be pretty important to the growth you are going to be developing? Whether it be getting into airports or street furniture, more than you have or are these other areas in mobile and digital, how should we look at the evolution upfront?

Jeremy John Male
Chairman & Chief Executive Officer

A

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As we look at our business going forward, we obviously have a very strong presence in the billboard market and we will continue to develop that, and we'll continue to digitize that. We are the leader in transit in the U.S. We don't currently operate in the airport advertising market. Never say never, but it's not something that's immediately on the cards right now. We continue to bid on bus shelter and street furniture franchises as and when they come up.

I think as we look forward, we are certainly going to be thinking about the screens business, as you know, we announced around about this time last year, the rights to the [ph] pitary (30:55) products which is sort of low-cost screens and cloud content at distribution. We think that there is some opportunities potentially in the screens business that may lead us into slightly different sectors, if that helps

James C. Goss
Barrington Research Associates, Inc.
Q

Okay. One other thing in terms of digital boards, have you seen some evolution in how they were intended to be used when they began to be implemented a decade or so ago? And what they are evolving into today in terms of just how you are dividing up the number of participants on a board, the time allocation, whether it has become more of a local advertising business than just national brand building business, that sort of thing? Are there changes you think are worth noticing and pointing out?

Jeremy John Male
Chairman & Chief Executive Officer
A

Digital certainly appeals to both local and national, that's for sure. I still think that in certain ways we probably don't harness all of the benefits creatively that digital has to offer. Too often we still see copy, where effectively it could be – it could equally as well be on one of our analog boards.

I think as we go forward, we are looking to actually upgrade the way that we reach out boards and it will also give us the ability to potentially load apps onto our billboards and this is where it gets to be very interesting because the apps then reach out for information, so they can do things like display a particular message dependent upon whether or not the Dow Jones has hit a particular mark, or whether or not the temperature in a particular area hits a particular point. So I think as we go forward, as we change the way that we are addressing our digital billboards, I think we will be able to capture that creativity in a much more dynamic way.

Donald R. Shassian
Chief Financial Officer & Executive Vice President
A

Enabling the advertisers to get their message out quicker, more timely, give them more flexibility to do things, and I think both we have provided better technology to do that and the advertisers are starting to realize how they can use these boards to really get their message out much more timely and focused to target their customers. So it's evolving.

James C. Goss
Barrington Research Associates, Inc.
Q

And your measurement efforts should be able to tie into that really well too then, I would imagine?

Donald R. Shassian
Chief Financial Officer & Executive Vice President
A

That's correct, absolutely correct.

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James C. Goss
Barrington Research Associates, Inc.

Q

All right. Thanks very much.

Jeremy John Male
Chairman & Chief Executive Officer

A

Thank, Jim.

Operator: There are no further questions...

Jeremy John Male
Chairman & Chief Executive Officer

Yes, I believe there are no further questions right now. So I'd like to thank you for your questions and your time today. And we look forward to seeing many of you at investor conferences over the next several weeks. Thank you very much, indeed.

Operator: And this does conclude today's conference. We thank you for your participation. You may now disconnect.

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