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OUTFRONT Media, Inc. (OUT)

Q1 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the OUTFRONT Media First Quarter 2017 Earnings Conference.

At this time, I would like to turn the conference over to Mr. Greg Lundberg. Please go ahead, sir.

Gregory Lundberg
Senior Vice President-Investor Relations, OUTFRONT Media, Inc.

Good afternoon, everyone. Thank you for joining our 2017 first quarter earnings call. On the call today, as usual, 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 a question-and-answer session. You can find the slide presentation for today's call and the earnings release on the Investor Relations page of our website. And after today's call is concluded, an audio archive will be available.

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 2016 Form 10-K, which is also on our website.

We'll refer to certain non-GAAP financial measures on this call. Any references to OIBDA made today will be on an adjusted basis. And reconciliations of OIBDA and other non-GAAP financial measures are in the appendix of the slide presentation, the earnings release, and on our website, outfrontmedia.com.

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

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Jeremy John Male

Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

Thank you, Greg, and good afternoon, everyone. So, the first quarter came in as we guided last call, with organic revenues down 2.2%. While local revenues were positive, the decline was driven by national advertising softness across a small number of key categories and automotive, in particular.

Our performance may, to some extent, reflect what seems to be a generally weaker advertising market than many commentators expected. Given our high operating leverage, revenue movements, up or down, obviously, have a pronounced impact. While we managed our expense levels diligently with total operating and SG&A expense, excluding our divested operations in Latin America, up only 1%, this could only provide some offset to the adverse revenue flow-through to adjusted OIBDA, which was down 9%, and to AFFO, which was down 16.7%.

As usual, I'll come back later on the call with some color on our revenue outlook for this quarter. It is worth noting now, though, that there has not been any significant rebound in national advertising, in the second quarter, but we are seeing an improvement in the second half of the year.

I'll now hand the call over to Don for a more detailed review of our financial results.

Donald R. Shassian

Chief Financial Officer & Executive Vice President, OUTFRONT Media, Inc.

Good afternoon, everyone, and thank you for being on our call today. Please turn to slide 6, which shows a summary of the year-over-year performance of some of our key financial metrics for the quarter. With the exception of organic revenues, this table is not comparable year-over-year, since our Latin America business was sold on April 1, 2016. However, we provide some historical figures for Latin America to assist you in your analysis and modeling.

Reported revenues for the quarter were down 5% due to the impact of the sale of Latin America and the national advertising market that Jeremy mentioned. Organic revenues, which adjust for acquisitions and divestitures, fell 2.2%. Adjusted OIBDA for the quarter reflected the high fixed cost nature of our business and was down 9%. AFFO was down 16.7% in the quarter due to the lower OIBDA, as well as higher maintenance CapEx and seasonally higher lease acquisition costs, partially offset by lower cash taxes and interest expense and a small Latin America comparison benefit with last year.

Please turn now to slide 7 for a discussion of our revenues during the quarter. Latin America disposition drove $11.4 million, the majority of the reported decrease. Organic revenues, which neutralized the impact of M&A, fell 2.2% as a result of declines in both U.S. Media and Other. U.S. Media declined 1.8% on a reported basis and 1.9% organically. Although we had growth in local, national revenues declined.

Billboard organic revenues were down 1.4%. This was driven by national, while we saw increases in both local revenues and digital billboard revenues. The impact of national also caused overall billboard yields to fall in both static and digital. This was driven by lower occupancy, not lower rates. Transit and other in the U.S. was down 3.2% organically during the quarter, which is more than the decline of billboard due to the historically high mix of national advertising across our transit assets.

The three advertising categories with the strongest growth during the quarter across both billboard and transit were entertainment, technology, and professional services. Our bottom three categories were automotive, financial services, and travel and leisure. To put the decline in perspective, auto was 4.9% of our total revenues

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during the quarter compared to 6.8% in the first quarter of 2016 or a decline of $6 million, about half of our national decline.

In Other, organic revenues fell 5.2%, driven by lower performance in Canada, which also experienced weakness in national advertising and a flatter performance in our sports marketing operating segment.

Please turn to slide 8 for an overview of expenses this quarter. Our reported expenses, including stock-based compensation, were down 3.5% year-over-year. Excluding the $11.9 million of expenses from the Latin America business we sold in Q1 2016, our expenses were up just 1% or $2.6 million in the quarter. Looking at this increase more closely, again, excluding Latin America, billboard lease expense was flat, reflecting good work by our real estate team in lease negotiations. Transit franchise expenses were down $1.5 million or 2.9%, as these expenses are driven by revenue share.

SG&A expenses were down $1 million or 2%, excluding corporate and stock-based compensation. Posting maintenance and other expenses increased by $2.3 million, with more than half of that due to new sports marketing contracts. And corporate expenses were up $2.1 million, primarily reflecting fees related to our recent revolver and term loan extensions and compensation-related expenses related to our excess 401(k) plan performance.

We are well underway in implementing our cost savings program that began in the beginning of the year. These savings will come from wage and non-wage initiatives across sales, field operations, procurement and general and administrative functions. Our first quarter results reflect a restructuring charge of $1.8 million relating to these activities. The cost savings returns on this project will scale up throughout the year to achieve annual and non-wage cost savings above a $16 million run rate as we exit 2017 with additional opportunities in 2018 and beyond. While a portion of these will be reinvested in the business as we project expenses over the rest of the year, excluding transit franchise expenses, which are variable to revenues, we expect overall expenses to be essentially flat.

On slide 9, you can see that despite our cost control and the seasonally lightest revenue quarter of the year, the decline in revenue translated to a 9% decline in adjusted OIBDA and a contraction in the related margin by 1 point to 24.3%.

Turning to slide 10, capital expenditures were $16.6 million during the quarter or 5% of total revenues. Growth spending was 3.5% of total revenues, and maintenance was 1.5%. We built or converted 17 digital boards in the U.S. and six in Canada. For 2017, our guidance for capital expenditure remains $65 million to $70 million, including growth capital expenditures of $40 million to $45 million, and maintenance of $25 million. As we have done in previous years, we will update you on our CapEx spending as we move forward throughout the year.

Please turn now to slide 11 for a look at AFFO. We were down 16.7% during the quarter, primarily a as result of lower OIBDA, higher maintenance CapEx, and seasonally higher lease acquisition costs, offset partially by lower cash taxes and interest expense. On a trailing 12-month basis, AFFO was up 7.4%.

As a result of the weaker levels of national advertising we've seen in the first quarter and are seeing in the second quarter, it now appears unlikely that we'll be able to achieve our previously issued annual AFFO guidance of low to mid-single-digit growth in 2017. With the national weakness in the first six months of the year, particularly in billboard, at this point, our view is that AFFO is likely to be slightly down for 2017. We will update this view when we have even greater visibility on national spending for the second half of the year. With the flat expense base I talked about earlier on this call, improvements in national advertising will have a strong flow-through to AFFO.

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Slide 12 shows a 12-month trailing AFFO of $287 million and a dividend payout ratio of 67% compared to 64% for fiscal year 2016. Our 12-month trailing free cash flow was $224 million, and our dividend payout ratio on this metric was 86%, slightly higher than 83% for fiscal year 2016. As you know, our board recently confirmed the second quarter dividend of $0.36 per share, payable June 30.

Slide 13 shows the highlights of our balance sheet. It is important to point out that in March 2017, we extended the maturities of our term loan and revolving credit facility by three years. We now have no maturities until 2022. As of the end of the quarter, our liquidity position was $424.6 million, including $26.3 million of cash and $398.3 million of availability on revolving credit facility.

Due to the decline in OIBDA and a slight increase in net debt in connection with the credit facility extensions, our net leverage ratio has increased to 4.8 times. We remain focused and committed in our goal to reduce this to our long-standing target range of 3.5 times to 4 times, which will be achieved through growth in OIBDA and further debt paydown.

Let me now turn it back over to Jeremy.

Jeremy John Male

Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

Thank you, Don. So, looking forward on slide 15. Let me give you some further color on the second quarter. As we mentioned, national continues to be weak and particularly in billboard. However, solid growth in transit and good performance in local across both billboard and transit are driving our expectation of low single-digit growth in the second quarter. As usual, this outlook only represents our view at this point in time and is on a constant dollar basis.

While this is a definitive improvement in revenue trend relative to the first quarter, it's worth noting again that it is being driven by transit, where we get less flow-through to AFFO than billboard.

As you know, national advertising business comes in with a relatively shorter lead time compared to local. But looking forward, we see indications of a recovery in the second half of the year, but we still believe that at this time, it's better to be prudent with respect to our AFFO and cautious, once again, at this moment in time.

Forecasters remain bullish on the out-of-home industry, which grew revenue 3.1% overall in 2016 as, indeed, did OUTFRONT. To put this in context, our industry outperformed radio, print, and core TV, excluding elections and the Olympics. Only Internet advertising grew faster than out-of-home, and we're orienting our business to capture a greater share of those dollars as we move forward.

Out-of-home held its 4.2% share of total U.S. advertising spending last year. The top 100 advertisers spent just 1.8% on out-of-home, and we do see significant opportunity to increase their share. Already, some of the larger national companies grasp the benefit of out-of-home. The top 10 advertisers in the U.S. spent 2.8%, a full point higher than the top 100.

We're also encouraged that some of the most data-driven companies and well-known brands in the market-Google, Amazon, Netflix, Apple, Facebook, Snapchat and Spotify-spent a combined 7.2% of their ad dollars on out-of-home. We're working hard to show the rest of the national advertisers what these leading companies see. We still got a lot to do, but the size of the prize is significant.

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We're taking active steps internally to improve our sales process to drive growth, and our local business is doing just fine. We've already pushed ownership and accountability to regional and local general managers and made sure the right people are in the right places. We have also continued to emphasize yield and are in the process of driving new business by turning our local sales people into consultative sellers and moving our national sales people from a transactional focus to proactive idea generation across multiple markets, giving them new tools for prospecting and reducing administrative friction.

So, when you step back, everything in our business is going well, with the exception of national billboard advertising in these first few months of the year. Local is solid; expense control is good; the balance sheet is strengthened; and we're investing strategically in the right areas for future growth.

Before I turn this over to questions, I'd like to update you on the New York City transit renewal. As you know, our contracts for the subway, bus, and rail systems are currently set to terminate on June 30, 2017. While the RFP process continues to move forward, at this time, our understanding is that our contracts are likely to be further extended by the MTA.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we will take our first question from Marci Ryvicker with Wells Fargo. Please go ahead.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

Thanks. I guess, Jeremy, how much visibility do you actually have into the second half? How much inventory, I guess, can you tell us is booked? Because I think the problem is we keep hearing advertising weakness, and it's extending quarter-to-quarter-to-quarter. And we saw in the market today that nobody believes that there's going to be any recovery. And then the second question is, just can you give us a little more color on the AFFO outlook? And it looks like it is just revenue-related. Is that the case?

Jeremy John Male
Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

A

Okay. So, maybe let's hit that one first, Marci. Yeah, it is revenue-related. It's principally about national billboard in Q2. And also, about mix, our transit business is doing just fine in Q2, but we obviously get a different flow-through and a lower flow-through in transit relative to billboard. So, to give a somewhat more specific answer in terms of the back half of this year, when we look at our billboard business, we've got around about two-thirds of our business already laid down for the third quarter and about 50% for Q4.

So, you can look at that and say, well, it's a long way to go. Agreed there is, but within that, we can see national, certainly, its share of that mix is telling us that there is improvement in the second half. But as with all things, Marci, we have actually got to go out and sell the balance of it over the coming months.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

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And then for the New York City MTA, have they asked for any more documents? Are they still looking at what was submitted in October?

Jeremy John Male
Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

A

So, when we look at the MTA process, look, it's fair to say that it's a very complex process. As you know, it's not just about media, it's very much about a digital media upgrade and a communications systems upgrade. They've consistently been asking for incremental information, as we've moved through this process. We continue to feel good about where we sit in that process as always. We certainly don't wish to, in any way, overcook the pudding or be arrogant, but we feel good about where we are. It just seems that it's a long process. They're doing a very thoughtful job.

I guess the other point is that these incremental months that we're going to continue to enjoy our relationship with the MTA. We talked about transit in Q2, it's looking good. So, we're doing a great job for the MTA, and we'll continue to do so until such time, as we understand the exact timing. We don't control the timing on this, unfortunately. And we'll update further in due course.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

Thank you so much.

Operator: And we will take our next question from Alexia Quadrani with JPMorgan. Please go ahead.

Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. Just following up on Marci's question about the hopeful better ad trends in the back half of the year. I guess, you did mention positive indications in your opening remarks of better spending there. Is it the booking rates that you just referred to, or are you seeing a change in some of the categories, some of the verticals such as auto, where you've seen outsized weakness in the first half, maybe being more aggressive or spending in the back half?

Jeremy John Male
Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

A

Yeah. I mean, Don called out also, in particular, I mean, it's a significant delta for Q1 of around about $6 million. My feeling is that on a relative basis, auto is likely to be a little bit stronger in the second half of the year. So, yeah, that is, you'll say, one data point, once again, based on the fact that we were only two-thirds of the way down our sales road in Q3 and 50% in Q4. But it does, as I say, when we look at our business in total, the national advertising trends right now certainly seem to be pointing to an improved second half. And just a general level of RFP activity that we can see in the market at the moment give us some cause for optimism.

Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

And then just staying on the MTA for a second as well, too. Obviously, you're very close to them, and you have lived through deadlines that have come and gone in this process for a while now. Do you think that, it'll just sort of stay an evergreen contract as you sort of sail past the June 30, or do you think they'll officially put out a new sort of end date when we get to that point?

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Jeremy John Male
Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

A

Yeah, I mean, ultimately, that's going to be their decision. They could either just run it evergreen, or they could give another fixed period of time, Alexia. Right now, we're not exactly sure, but we're expecting something to be agreed in the coming days or short number of weeks.

Donald R. Shassian
Chief Financial Officer & Executive Vice President, OUTFRONT Media, Inc.

A

If I may just add, Alexia, the process is continuing. There is interaction, there's questions being submitted to us on things we've submitted, and there's been a lot of dialogue. And so, they're working this process and doing a very thoughtful job on this thing. So, I think, they're just going through their process and, and they're taking a little bit longer for whatever reasons, but we are anxious and confident that we're going to able to retain this and looking forward to moving this process along. But it is moving, and there's activity. They're asking us things, and they're investigating things, and looking into things, and asking all the right questions that one should be doing in this process. So, it's moving.

Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

Thank you very much.

Operator: Our next question will come from Ben Swinburne with Morgan Stanley. Please go ahead.

Benjamin Daniel Swinburne
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Good afternoon. Jeremy, why do you think national is softer than local sort of first half of the year? And what do you hear from agencies about where that national money is going? I realize it's not a huge business for you guys in terms of absolute dollars and in terms of volatility quarter-to-quarter. We know about the auto sector issues. But I'm just wondering if this is perhaps macro-related, the money is going back into the pockets of advertisers, or it's going to other media. And then just had a quick follow-up for Don.

Jeremy John Male
Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

A

Thanks, Ben. So, national is more important to us than our other peers in the industry. It's nigh on 50% of our business. So, I think it's fair to say that if national is weak, we're the company feels that most, and obviously, the reverse is true of that. In addition to auto, we did have two or three advertisers that were strong for us last year, but for their own marketing mix needs for the first few months of this year, it just didn't put any money into out-of-home.

Now, I'm sort of taking one step back from that. I think there's been very little reporting generally out there in the market that's suggesting that the total ad market is sort of more robust than anyone expected. So, I think, on that basis, you have to say, on balance, it's probably a little weaker than expected, in general. Obviously, there are still some important performance indicators and companies that still to report over this season, but that is our feeling.

Benjamin Daniel Swinburne
Analyst, Morgan Stanley & Co. LLC

Q

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Okay. Makes sense. And then, Don, just on the strategic investments. I'm wondering, you guys are obviously focused on cost incrementally more so today than maybe as of last quarterly results. What are you thinking around that spend this year? Are you considering pulling that back a bit if the top line continues to be tough, or sort of how committed are you to the capital you're putting into the strategic investments this year?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, OUTFRONT Media, Inc.
A

We're committed to making the right investments in both CapEx and operating expenses. We're trying to do it in the right way. We're not trying to whip saw and do the things in a huge way. We want to make sure that everything's done right. So, the amount of strategic development expenses in Q4, I think, it's pretty consistent on a quarterly basis with the prior quarters of last year. It may move up a little bit throughout the year, but we are going to continue with it.

It is the future of where this industry and this media is going to be, and so we need to continue to make those sort of investments to make it work. You may recall that the cost savings that I talked about, which we announced last quarter, part of that is used to fund that, if you would. So, those savings are real, both wage and non-wage, and that helps us continue that investment. But we need to continue moving down that path. We need to be smart about it and make sure we're making the right investments and not get out on a limb. But it's important for growing the revenue in this business in 2018, 2019, and beyond. So, we've got to find a way to do it right and continue on the course.

Benjamin Daniel Swinburne
Analyst, Morgan Stanley & Co. LLC
Q

Makes sense. Thank you.

Operator: Our next question will come from Jason Bazinet with Citi. Please go ahead.

Jason B. Bazinet
Analyst, Citigroup Global Markets, Inc.
Q

Thanks. Maybe you can give us a little bit of insight in terms of some of the discussions at the board level regarding your dividend. On slide 12, you show this roughly $32 million spread between LTM free cash and your dividend. Given the high operating leverage in the business, if I'm doing the math right even if you continue to contain costs, if we end up seeing a low single-digit decline in the top line, we could get to the point where your free cash generation is less than the dividend.

So, I assume the board has sort of at least thought about these scenarios. And I was just wondering if you could share a little bit of your philosophy before we get to that point. Is it something where you can moderate your CapEx, or you'll count on the working capital, or you're willing to pay out more free cash that you generate for a little bit of time or a temporary cut in the dividend? How should investors sort of frame that risk as we go forward?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, OUTFRONT Media, Inc.
A

Well, first of all, the guidance that Jeremy mentioned for Q2 of low-single-digit is revenue growth, not decline. It's revenue growth of low-single digit. It is primarily being driven by transit, and so national is not as strong and more of an impact on billboard.

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In terms of dividend coverage, we feel very comfortable. We certainly talk to the board about this. There are a number of discretionary matters we have here in terms of some things on our expense side and on discretionary CapEx. We spent $40 million to $45 million of discretionary CapEx. Some of that's really, really important for growth in the near term, some of it can certainly be deferred.

We see the trends in this business as it continue to grow, and we're managing very tightly to do so. And we don't think that this dividend is going to be tighter or at risk whatsoever. I think that you see that little bit of softening because of the quarter. It's important to note that Q1 is normally the softest and smallest quarter of free cash flow growth of all the four quarters, anywhere from $15 million to $20 million. So, it's a slight decline from where first quarter last year was.

So, we're feeling good about it. Important to maintain that dividend, important for sustainability, but we see this business continue to grow. We're managing our expenses tightly and investing for the future, and we'll continue to do so, knowing we have some levers to work with, primarily in the CapEx side and some expenses.

Jason B. Bazinet
Analyst, Citigroup Global Markets, Inc.

Q

Very helpful. Thank you.

Operator: Our next question comes from David Miller with Loop Capital Markets. Please go ahead.

David W. Miller
Analyst, Loop Capital Markets LLC

Q

Yeah. Hey, guys. I just want to make sure I understand, because the comments aren't completely clear to me. When you guys say that you expect the MTA to further extend beyond June 30, are you specifically saying that you expect them to kick the can down the road yet again, or are you saying that you think that you'll have improved economics in this contract beyond June 30? Please forgive the question. I just want to make sure that I'm clear.

Jeremy John Male
Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

A

The answer is to play your term back to you, the can is being kicked.

David W. Miller
Analyst, Loop Capital Markets LLC

Q

Okay, fair enough. And then, Don, on your previous comment about national advertising improving in the second half, should that imply to us that the auto category will see a resurrection in the second half, or are there other factors involved?

Donald R. Shassian
Chief Financial Officer & Executive Vice President, OUTFRONT Media, Inc.

A

David, I think it's premature to say that any one category's going to have major improvements. I think auto may have a slight improvement, but where I think we're seeing improvement, a variety of different categories. We don't rely on one category like auto through the rest of the year to grow this business, but I think we're seeing it across the board. And as Jeremy mentioned, it's both bookings and the activity levels we're seeing now for the second half. We've really seen a lot more activity, and we're expecting to see that translate even further.

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David W. Miller
Analyst, Loop Capital Markets LLC

Q

Okay. Fair enough. Thank you very much.

Operator: Our next question comes from Jim Goss with Barrington Research. Please go ahead.

James Charles Goss
Analyst, Barrington Research Associates, Inc.

Q

Thanks. Well, auto is not the only category. It does tend to be the largest category for a lot of advertisers. I'm wondering, and can I presume it's correct that it's manufacturers with brand building as either all or at least most of that advertising? And can you look back at the last cycle as SAAR has tended to peak to show us how things had worked out at that time, like if there's a leveling, or if there's any tendency to decline, or how that might have played out in the past? It might give us some history to instruct us for the current.

Jeremy John Male
Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

A

So, let me just take that. I think probably, it's very important to say that when you look at our national business and our revenue generally, it's very broadly spread. So, while auto is important for us, it only represents around about 5% of our revenue. And that's why, Don was saying, the second half isn't just about auto.

The first quarter, to some extent, was about auto, because we had that big delta, the $6 million delta from basically a couple of advertisers that were with us in Q1 of last year, weren't with us in Q1 of this year. But, as I say, one of the strengths of our business is just how broadly spread, okay, our revenue base is, which is why Don was right to point, just a more general positivity across sectors rather than specific. And we still got a way to go. So, it would be, I think, wrong to call it out individually by category definitively for the second half at this stage.

With regards to the cycle in more general terms, obviously, if you look at Media in general, to some extent or Other, it is a GDP plus or minus business. GDP for Q1 was actually a little bit lighter, I mean, it was the weakest quarter since 2010. I certainly wouldn't necessarily call it a direct correlation between that weakness now and the ad market in total.

I don't think we're there yet. I think we're looking at GDP growth for this year. I think the ad market's going to grow this year. We're going to grow low-single digits in Q2. So, as I say, I mean, I think it's not maybe quite the right timing to think about the history of the cycle.

Donald R. Shassian
Chief Financial Officer & Executive Vice President, OUTFRONT Media, Inc.

A

And local is very strong. We're seeing very strong in local, which is well more than 50% of our revenues.

James Charles Goss
Analyst, Barrington Research Associates, Inc.

Q

All right. Thanks very much.

Operator: There are no further questions at this time. I would like to turn the conference back over to the company for any additional or closing remarks.

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Jeremy John Male

Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

Well, thanks very much, everyone, for your questions and your time today. And we look forward to seeing many of you at investor events over the coming weeks. Many thanks again.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.

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