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OUTFRONT Media, Inc. (OUT)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the OUTFRONT Media, Incorporated Second Quarter 2018 Earnings Call.

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

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

Good afternoon. Thank you for joining our 2018 second quarter earnings call. On the call today are Jeremy Male, Chairman and Chief Executive Officer; and Matthew Siegel, 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 a slide presentation for today's call and the earnings release on the Investor Relations page of our website. After today's call has concluded, an audio archive will be available there as well.

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 2017 Form 10-K. We will 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'll turn the call over to Jeremy.

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

Thanks Greg. Good afternoon everyone. Before I begin, I'd like to introduce our new Executive Vice President and Chief Financial Officer, Matthew Siegel who joined us in June. A number of you may already know Matt, who

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brings a deep financial and media background, including a significant career at Time Warner Cable and Time Warner, Inc. This is great experience for his future at OUTFRONT. As you get to know Matt, I'm sure you'll appreciate his knowledge and his perspective.

Now, turning to the second quarter; total revenues increased 1.4% on a reported basis during the second quarter. We're pleased that the primary source of this growth was our billboard business where we saw the further improvements in growth rate we indicated. This billboard growth is being driven by many positive factors. Local advertising growth was solid, national advertising which have been declining reached breakeven, digital growth remained strong, and importantly both digital and static yields were up.

Our U.S. Media transit business did not perform as well during the second quarter and was down 3%. While local advertising was solid, national weighed on the overall result. As usual, I'll give more specific color on our third quarter outlook later on this call, but I can say now that we are seeing national results improving into the second half in both transit and billboard, a very encouraging trend. With the solid billboard results, adjusted OIBDA grew 2.6%. Due to the timing of tax payments and higher interest expense, we had a slight decline in AFFO.

Let me now hand the call over to Matt.

Matthew Siegel

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

Thanks, Jeremy and good afternoon. Let's begin with our top line on slide 6. Our reported revenues were up 1.4% and organic revenues were up very slightly. Looking at our segments in detail, U.S. Media was flat on both reported and organic basis. Billboard grew 1.3% during the quarter. Similar to last quarter, we had a low level of condemnations relative to last year, meaning that the underlying advertising growth on billboards was closer to 3%. Key growth drivers included digital billboard conversions and an increase in same board yields, including both digital and static.

Billboards saw a growth in local advertising with national advertising coming in essentially flat, which was a good improvement compared to the first quarter and an early indication of the momentum that Jeremy mentioned. Transit declined 3% due to national advertising with local advertising once again up solidly. Looking across our transit portfolio, weaker performance in a couple of key markets was partially offset by growth in other areas, including the Boston MBTA, which once again posted strong growth due to further digital deployment.

Turning to our other segment, which is essentially Canada and Sports Marketing, our reported revenue increase reflects our acquisition of a digital billboard portfolio in Canada in June 2017, and the impact of a new accounting standard in our Sports Marketing operating segment. Organic growth was 2.1% and was evenly balanced between Sports and Canada. While I'm on the subject of Canada, I'd like to discuss a goodwill impairment charge. Some of you may recall that performance in Canada has been somewhat challenging since before we went public. In the second quarter of 2018, the Canadian reporting unit did not meet revenue expectations, and we determined that there was a decline in its long-term business outlook. This required an interim goodwill impairment analysis, and we concluded that the carrying value of our Canadian reporting unit exceeded its fair value, resulting in a non-cash impairment charge of $42.9 million on the income statement.

Moving down the income statement, please turn to slide 7 for a look at our expenses. You can see that they were up less than 1% on a reported basis during the quarter, but down slightly when considering the Canada and Sports Marketing impacts I just mentioned. U.S. Media and corporate expenses were down year-over-year, while other expenses were up. Looking at the drivers, billboard lease expenses were up year-over-year in part due to the new MTA billboard portfolio, but still steady at 34% of billboard revenues. Transit franchise expenses were

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down principally due to the terms of the new MTA contract and lower transit revenues. Our transit franchise expenses in total were 60% of transit display revenues compared to 64% last year. Overall, we picked up over a point in gross margin.

Our SG&A increased during the quarter principally due to strategic business development expenses. Additionally, we are adding staff as we build out operational capabilities for a digital environment, both in transit and in billboard, an important driver of future growth. We're also investing in our sales operation both on a local level where we continue to see great results, and in our dedicated national client and agency team where we believe there is significant opportunity for us. As you can see on slide 8, our revenue increase and expense management generated adjusted OIBDA growth of 2.6% during the quarter to $125.2 million.

Moving on to cash flow, slide 9 lays out our capital expenditures. Note that growth CapEx accelerated in the second quarter as we continued rolling out new digital transit displays, especially in Boston where we had 413 deployed at the end of June. Our digital billboard conversion pace which was 26 for the quarter, is on par with the first quarter. We actively manage our capital spending and are comfortable where we are relative to our previously communicated annual guidance of $75 million in total. As you know, our capital expenditures do not reflect spending related to the New York MTA contract as these expenditures are subject to recoupment from the MTA over time.

For that, let's turn to slide 10. In the second quarter we spent $29.3 million on the MTA. Our cumulative spending since last November when the contract went into effect is $43.5 million. We successfully completed our initial test deployment of digital advertising displays in Williamsburg Brooklyn on the L and G subway lines. You can see three of these displays pictured here. And I can tell you that a PowerPoint slide doesn't do justice to how good these look with full motion video, as many of you have already seen. Our MTA team is in new shared office space downtown working side-by-side with teams from the MTA and our installation partners. Together, we are constantly evolving the rollout plan, which originally estimated 3,000 displays were to be deployed in 2018, weighted toward the end of the year. We also previously estimated deployment costs of $100 million for 2018.

We now believe a portion of these 3,000 screens for 2018 are likely to shift into 2019 depending on the station rollout schedule. Looking at where we are right now with regards to our start-up costs, lead times and how many displays we are preordering for next year, the overall 2018 spending will shift upwards by approximately $30 million. Importantly, this is a complex process, and we will give you updates as this exciting project rolls out. We know 2019 will be a busy year.

Turning to slide 11, our performance on AFFO reflects the improvement in OIBDA and this is offset by higher cash taxes and higher interest expense. In particular, our cash taxes were higher in the second quarter. I'd note that on a normalized basis, AFFO would have grown more in line with OIBDA. Our annual AFFO guidance for the year of low to mid single-digit growth is unchanged. AFFO's relation to dividends is illustrated on slide 12 with the last 12 months dividend payments representing 74% of the related AFFO. On an adjusted free cash flow basis, our dividend payout ratio was 102%. This reflects the impact of some items on our working capital and an increase in growth CapEx for digital transit displays in Boston and digital billboard conversions. Our next quarterly dividend was approved last month by our board of directors at $0.36 per share.

The increase in outstanding debt, shown on slide 13, was principally due to MTA spending and digital billboard conversions. This increase was partially offset by growth in OIBDA, and we had tick-up in our net leverage ratio to 5 times. Our next significant maturities are in 2022 and includes a revolver and our 5.25% senior notes. Our liquidity remains solid at $336.9 million, including cash and available revolving credit capacity. Another potential

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source of liquidity is our $300 million at-the-market, or ATM, equity offering program. I think it's well-positioned balance sheet that can comfortably support our growth initiatives.

Before I conclude my prepared remarks, I'd like to share some initial thoughts from my first two months here at OUTFRONT. This is an entrepreneurial environment with talented people focusing both on growing the existing business and on new exciting development opportunities. The management team has a great combination of industry experience, knowledge and vision, and I look forward to working together with everyone here at OUTFRONT, in particular the finance team which has been instrumental in my out of home education. I also look forward to working with all of you to enhance OUTFRONT's shareholders value.

With that let me now turn it back over to Jeremy.

Jeremy John Male

Chairman & Chief Executive Officer, OUTFRONT Media, Inc.

So thanks, Matt, and moving on to slide 15, at this point in time, we expect third quarter revenue growth to accelerate to the low to mid single-digit range driven in particular by significantly improved growth in our billboard business, reflecting continued strength in local and the improvement in national that I referred to earlier.

Looking at the movements of industry verticals over the last 12 months, our largest revenue growth has come from professional services, entertainment and technology. Interesting technology has moved up to 8% of our total U.S. revenues putting it into second position in terms of revenue contribution along with television and health and pharma.

The biggest headwinds have been in movies, food and beverage and retail. You'll note that the weaker categories are essentially all national in nature. When we say that we see national improving, it reflects improvements in these categories, as well as growth in others.

Another factor driving our positive outlook is the continued growth in our digital portfolio. As you can see on slide 16, we had strong double-digit revenue growth on both our billboard and transit assets. At 16.7% of total revenues, our digital exposure is up nearly 3 points from the second quarter of last year. We expect this growth to continue; and at this rate, it won't be too long before we're over 25% of our revenues are coming from digital.

In billboards, our digital billboard inventory was up 14% during the year through both conversions and acquisitions, with over a thousand displays at the end of the first quarter and revenue growth of 21%. This growth was driven both by new units, and more importantly through higher yield on a same board basis. In transit and other, which are small format digital displays, we ended the quarter at just under 1,500 units with revenue growth of 30%. The main driver of the growth was from the ongoing deployment of video live boards for the MBTA in Boston, our first deployment of Caltrain Station in San Francisco. And it's again worth noting that we are seeing Boston live board yields that bode extremely well for the New York MTA build out.

Our digital investments are producing great returns and this strong digital growth in both billboard and transit is certainly a tailwind into the second half of the year and beyond. I also feel good more generally about the solid footing and future of the out-of-home industry. It continues to grow revenues in the broader advertising market because of its traditional benefits: mass audience reach, huge brand impact and the inability to be skipped or missed. These key elements are being enriched by digitization, mobile and social integration, and increasingly enhanced with insight and data integration for better targeting and ROI attribution, a bright future indeed.

Operator, let's now open the line for questions please.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we'll go to Alexia Quadrani with JPMorgan.

Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. If you could give a bit more detail in your sort of positive outlook for national spending in the back half of the year that would be great. I think Lamar mentioned earlier this morning that they saw the telecom vertical coming back into the market. I wonder if you have any more color in terms of what verticals you're seeing and why, sort of what's driving a more optimistic outlook in the back half?

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

A

Yeah. Thanks, Alexia, for the question. It's interesting, when you look at the three sort of public companies reporting their results recently, I think it's important to remember actually that the footprints of all of the companies is actually somewhat different. And as such, it's quite usual, for example that the verticals that we're seeing growth from might not be the same verticals as some of our competitors.

But as we look forward to the second half right now, I guess, the first point is actually that local, which has been strong for us really now for the last five or six quarters, is also strong. I think our sales force is executing well. We put a lot of emphasis and effort into training, into comp programs and other incentives. I think when you consider that we've got sort of 500-plus people in this team, that's a lot of boots out on the street, and we've also augmented those boots out on the street to sort of further support that local growth.

National was difficult for a while, but we're certainly seeing signs of improvement in the second half. As we sort of look at that team as well there, we've also been investing in a sales team that's really directed now very much at this sort of going up the food chain into the strategic buying agencies and also client direct. I think we're at the early stage of seeing some benefits from that SWAT team. I think we'll see even greater benefit as we go forward into next year. So sort of broad brush improvement, Alexia, I'd say, but local continuing to perform extremely well and national certainly picking up.

Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

And just a follow up I guess to your point that you guys have different footprints and therefore different businesses and different outlooks. Am I remembering correctly that you have said previously, you do not benefit at all from political? You don't expect to see any political this year?

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

A

No, we really don't see any political, Alexia. But A, we can't take any political on any of our transit assets; and B, when you look at our billboard portfolio, it's much more directed at the sort of top 20 markets rather than the smaller markets that benefit from that political. I think Lamar have said it, but I think we've referred to it before, but probably the best example giving if you like, the differences in our portfolios is our largest client is Apple, and I believe Lamar's is, or was, certainly was, Cracker Barrel, both very, very different, very, very sort of different clients that maybe that's a good example of the difference in our asset bases.

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Alexia S. Quadrani
Analyst, JPMorgan Securities LLC

Q

All right. Thank you very much.

Operator: We'll now take a question from Marci Ryvicker with Wells Fargo.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

Thanks. Jeremy. You keep calling local solid or describing local as solid. Can you quantify local in the second quarter, what did it do and what it's pacing in Q3 because your definition of solid may be different than ours?

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

A

As we look back to the second quarter in our billboard business, in the billboard business our local was up around 2.5% and that was after condemnations. And in transit, our local revenues were up around 3.5%, something like that.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

And then, is that getting better in the third quarter or is it stable in the third quarter?

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

A

It's improving in the third quarter.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

Okay. You mentioned some big transit contracts which caused the negative 3% but you only mentioned the positive one in Boston. So which were the ones that were struggling that caused transit to be down?

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

A

When you look at the portfolio, the business in New York is a particularly competitive environment right now. There have been sort of two changes to the portfolio in New York, one, there's been quite a build-out of digital on the streets from two of our competitors. And as you know, we're rapidly going to be catching up through our sort of digital build-out in the subway system and then in Metro North, et cetera. But at the moment, New York for us has been a somewhat competitive environment in transit, and it's obviously it's a big market for us.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC

Q

Okay. And then, Matt, can you restate what is going on with the $30 million in expenses, what is that related to and it's going higher but not impacting AFFO?

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

A

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Sure. It's really just a shift of some of our spending that we anticipated in 2019 into 2018 where we're paying for and buying some screens so we have to be ready for early 2019 deployment. And of course we have some initial year start-up costs, which we don't anticipate feeling later in the project's lifetime.

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

I think, Marci, just...

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC
Q

[indiscernible] (00:20:47).

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

I was just going to say, Marci, this as you know, we're sort of nine months into it, sort of 15-year contract, we're very much feeling our way with the MTA in terms of that sort of that scheduling piece. And with sort of the benefit of a few months more knowledge, we think that as I say it's likely to be a sort of shift of screens into next year from this year, and also some one-off start-up costs associated with that we took in 2018.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC
Q

Is this CapEx, OpEx or a mixture?

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

As you know, we're separating – I mean it's like CapEx, rather than OpEx, but we have a new line item for it that we I think discussed in quite a bit of detail before, but it shows it separately on the balance sheet because of its recoupability from the MTA.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC
Q

Right. Okay, I understood it. It sounded like you are shifting OpEx or some sort of operating expense higher, so I didn't understand how it wasn't going to impact AFFO. But if it's in that new line item, then I understand it.

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

Yes. Sorry for any confusion.

Marci L. Ryvicker
Analyst, Wells Fargo Securities LLC
Q

That's okay. Thank you very much.

Operator: We will now take a question from Jim Goss with Barrington Research.

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James Charles Goss
Analyst, Barrington Research Associates, Inc.

Q

Thanks. First, I was wondering, with the write down in Canada, are you at all rethinking your position there? It seems like you added some properties, and you thought they were more similar to the U.S. type properties even though they were not obviously re-qualified. But where do you stand on that?

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

A

Thanks for the question, Jim. Yeah. Around about this time last year, we acquired a set of digital assets which we sort of overlaid on to our Canadian business up there. And they are a great set of assets and we expect them to continue to perform for many years in the future. It was more associated with our legacy business where we had a carrying value in the balance sheet that wasn't matched by the impairment test that we carried out. So no particular change in the strategy up there. And actually looking forward, it's fair to say that included within our sort of improved guidance, is a good performance from our Canadian business in the third quarter.

James Charles Goss
Analyst, Barrington Research Associates, Inc.

Q

Okay. And it also, I think you were touching on this before, but it does seem like the major out-of-home companies each have their own fiefdoms, like you and transit and some others and airlines [indiscernible] (23:56). Do you like the position you have in terms of the mix of properties and the REIT versus non-REIT assets? And if you are looking at development in the future, would you be more inclined to look for M&A activity or organic bids that would get you, say more entrenched in the transit systems, for example?

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

A

Jim, I mean, I guess the first point is that, yeah, we have a very big billboard business that is wholly reasonable. We are the number two billboard company by revenue in the U.S. And the fact is that, we continue to develop organically in our billboard business. We continue to convert to digital which will all be growth drivers. And it's really in the billboard business where there is the opportunity for growth through acquisition or inorganic growth. And because there are other smaller billboard portfolios out there that could be additive to our business.

When you look at transit, it's not quite, because you have the ability to win contracts, it can often be not as interesting to acquire those contracts through a purchase. Quite often you're better just to go out and win new contracts. Obviously, part of that transit business also is REIT-qualified. We think as the number one player in transit in the U.S. with a strong portfolio in Boston, in New York, Washington, Miami, Los Angeles and soon to be for the first time, San Francisco. We think that we are well placed to benefit from what will be I think growth in urbanization, growth in – and growth in transit in the future.

James Charles Goss
Analyst, Barrington Research Associates, Inc.

Q

Okay. And then so you could consider M&A but they would be primarily, or that activity would primarily be in the billboard space?

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

Exactly.

James Charles Goss
Analyst, Barrington Research Associates, Inc.
Q

Okay. Thanks very much.

Operator: [Operator Instructions] At this time we'll take a question from David Miller with Imperial Capital.

David W. Miller
Analyst, Imperial Capital LLC
Q

Yeah. Hi. First of all, Matt, welcome to the community. Nice to meet you. A couple of questions for you. On SG&A, the $70.1 million, you had mentioned that the increase there was due to mostly business development expenses. If you're willing to drill down on that and just give us some color on that, that'd be great. And then also on the impairment charge, and I don't mean to beat the dead horse, I just want to make sure I understand, is the impairment charge in Canada due to – you're impairing the value of the business, in other words you're taking a DCF of what the business is now worth versus where you are carrying the value of the business before, or is this just all due to goodwill? I just want to make sure I understand. Thanks very much.

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

Let me answer the second one first, the impairment analysis is looking at the long-term model, or as you said the DCF model of the Canadian business, and looking at the valuation of that as it's compared to the balance sheet value that we have for our Canadian business.

David W. Miller
Analyst, Imperial Capital LLC
Q

Right.

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

Once we trip the test, look at the numbers and see it's worth less, so we effectively mark-to-market the value of our Canadian assets as of June 30th.

David W. Miller
Analyst, Imperial Capital LLC
Q

And then on the SG&A?

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

SG&A is drilling down a little bit, primarily strategic expenses. We've been investing in our business development area for the technology platform. So we've been hiring some new people, working with some vendors, and we think that's an important driver of growth and necessary for our future.

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David W. Miller
Analyst, Imperial Capital LLC

Q

Got it.

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

A

Numerically, 2018, okay. Thanks, David.

David W. Miller
Analyst, Imperial Capital LLC

Q

I appreciate it. Thank you.

Operator: And it appears there are no further questions at this time. I'd like to turn the conference back to our speakers for any additional or closing remarks.

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

So thanks very much, everyone, for attending the call. I look forward to meeting many of you over the coming weeks at investor conferences. Good afternoon. Thanks again.

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