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TGNA - Q2 2018 TEGNA Inc. Earnings Call

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OVERVIEW:

Co. reported 2Q 2018 year-over-year reported total revenue growth of 7%; expects 3Q 2018 total revenue to increase mid-teens year-over-year.

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PRESENTATION

Operator

Good day, and welcome to the TEGNA Second Quarter 2018 Earnings Conference Call. This call is being recorded. Our speakers for today will be Dave Lougee, President and Chief Executive Officer; and Victoria Harker, Chief Financial Officer.

At this time, I'd like to turn the call over to Jeff Heinz, Vice President, Investor Relations. Please go ahead, sir.

Jeffrey R. Heinz - *TEGNA Inc. - VP of IR*

Thanks, Matt. Good morning, and welcome to our second quarter 2018 earnings call and webcast. Today, our President and CEO, Dave Lougee, and our CFO, Victoria Harker, will review TEGNA's financial performance and results. After that, we'll open the call for questions. Hopefully, you've had the opportunity to review this morning's press release. If you have not yet seen a copy of the release, it's available at tegna.com.

Before we get started, I'd like to remind you that this conference call and webcast includes forward-looking statements, and our actual results may differ. Factors that may cause them to differ are outlined in our SEC filings. This presentation also includes certain non-GAAP financial measures. We've provided reconciliation for those measures to the most directly comparable GAAP measures in the press release and on the Investor Relations portion of our website.

With that, let me turn the call over to Dave.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Thank you, Jeff, and good morning, everyone, and thanks for calling in wherever you may be this early August morning.

Today, I'll review our progress in the quarter that gives us further confidence that our growth strategy is on track and that we're well positioned to take advantage of the opportunities before us. I'll also briefly provide my view of how recent developments in our industry relate to TEGNA.

Total reported company revenue grew 7% year-over-year at the high end of guidance, driven by subscription revenue growth and higher political revenue. Even when you exclude political advertising and the impact of terminated digital businesses, our second quarter revenue was still up 5% year-over-year on a non-GAAP basis.

Subscription revenue was up 16% year-over-year, a $29 million increase, in line with and on target for full year forecast of mid-teens growth. Additionally, total paid subscribers are up organically year-over-year. Two months in a row, this has happened where they've been up year-over-year for the first time in recent years, so any lost traditional subs for TEGNA are being offset by new subscribers from OTT virtual MVPDs. This reflects strong consumer demand for our strong local broadcast content and our big markets on both the traditional MVPDs and new virtual MVPD services. While this trend may not persist in a straight line, this growing revenue stream is clearly stable.

Before I move away from subscriber trends, I want to reiterate a statement that I've made many times based on the data and trends we're seeing. The notion that TEGNA is, or may be, adversely impacted by consumers choosing to move to skinnier cable bundles for virtual MVPDs obviously is proving not to be the case. Our local network broadcast content is an integral component of even the most basic tiers of service as well as all the virtual MVPD packages.

As a result, we're largely insulated from this dynamic, which is creating a growing gap between our sub trends and those of many cable networks. And our net retransmission rates are essentially the same, if not better, on virtual MVPD services as they are on traditional, making us agnostic between the two.

Now turning to political advertising. Fundraising for these mid-term elections is unprecedented as we forecasted, and our record second quarter political revenue reflects that. So far, 2018 has been a record-breaking mid-term election cycle both in primary activity and early placements of ad revenue for the fall. We came into 2018 with a bullish outlook, and we're certainly seeing this play out.

TEGNA has a very strong footprint for this year's 2018 mid-term elections and has grown in strength over the year. With more competitive races than in prior cycles, several of these competitive races are in our largest markets and strongest stations.

For instance, in the U.S. House races, TEGNA currently has 25 competitive House seats for this year, the most we've seen this decade, with 17 of them in our top 25 markets, more than double what we had in '14 as an example. In the Senate, we have 16 races and 7 very competitive seats, including large markets where we have a large presence, like Florida, Arizona, Minnesota, Missouri, Ohio and Tennessee.

Gubernatorial elections will be the same, obviously, as four years ago in terms of the numbers. But it's a competitive footprint in some of our big markets. Currently, we have 7 competitive seats, including our Florida markets; Colorado, where we have the dominant station in the state; Ohio; and Minnesota. With winners of these races impacting the House redistricting that will take place in 2021, a lot is at stake, and a lot will be spent. These factors, in combination with state House and state Senate races and numerous state ballot issues, will produce spending from the top to the bottom of the ticket. Our strong local stations continue to provide one of the essential ways to broadly reach targeted constituents, especially voters. And that's clearly reflected again this year. Local TV is at the center of any local candidate's marketing strategy. As for third quarter, we now are comfortable forecasting that we will exceed our previous third quarter record in 2014.

Next, turning to recent developments in our industry as they relate to M&A. I'm sure you've all seen the SEC's decision a few weeks back regarding a large transaction in our industry. I want to highlight that this decision was specific to the structure and dynamics around that proposed transaction, and the concerns highlighted by the FCC are irrelevant to TEGNA's potential M&A opportunities. Additionally, as it relates to the household ownership cap, in late July, the Appeals Court of D.C. dismissed the challenge to the FCC's UHF discount. We believe this is positive for deregulation and for the industry. We have ample headroom around the current household ownership cap, but of course, a higher cap creates even more possible combinations.

Incremental regulatory clarity, along with the fact that additional assets have and are likely to come to market, should make the environment more conducive for vertical acquisitions. We remain focused on proactively evaluating all assets and all transaction structures and will continue to rely on our proven process. For instance, I'm happy to report that KFMB in San Diego is outperforming our initial expectations. With significant synergies specific to TEGNA, we purchased these assets at an average industry multiple and as Victoria will talk about in a little bit of detail later, we're well ahead of schedule on synergies, and our investment looks better today than when we made it in December.

This transaction, as well as our Belo acquisition in 2013, exemplifies our proven track record of meeting or exceeding our financial and strategic M&A requirements. As a result, all of our investments in broadcast assets have provided nearly immediate value to shareholders.

We will continue to proactively evaluate the expanded set of consolidation opportunities, but we'll remain patient and disciplined in evaluating these opportunities and will vigorously pursue the ones that are the right fit for us, both strategically and financially.

In the interim, we plan to pay down debt and opportunistically repurchase shares. Improving our balance sheet increases our capacity to grow after the growing pipeline of potential transactions that we expect to see.

Now moving to Premion, a great TEGNA success story of innovation and organic growth. As a reminder, Premion enables agencies and advertisers to seamlessly and transparently buy and deliver ads in live and on-demand longform TV programming across more than 125 branded OTT networks and across any geography in the U.S. As a first mover in this high-growth, over-the-top local and regional TV ad market, Premion has continued to advance its advertising business through the launch of a proprietary OTT data management platform, or DMP, that allows agencies and advertisers to more precisely target intended audience. Since its launch just 17 months ago, Premion has delivered thousands of campaigns, reaching markets now in every U.S. state. Our results serve as proof of our unmatched offering and high demand from advertisers.

The business continues to exceed our expectations. We began the year forecasting Premion revenue at $60 million, up from $30 million last year and today, we're raising that guidance to $75 million for the full year. Note, this projection excludes political revenue from Premion which is reported with our traditional political advertising revenue.

In the quarter, we also expanded Premion's new opportunities by enabling other local media broadcast groups to license its advertising and data solutions. This allows their sales force to sell premium OTT advertising in their markets. Our current focus is on actively reinvesting profits to grow the business and extend our first-mover advantage. The reception that Premion has received from customers is clear evidence that there is unmet demand in the market. And as a large local media company, we are uniquely positioned to serve this growing trend.

Now moving to the very important content side of our business. We continue to improve and grow our innovation efforts, shedding formats from the past on every platform. Our innovation approach is structured, data-driven and repeatable, and our efforts are being recognized. TEGNA just won 10 National Edward R. Murrow Awards for excellence in journalism, more than any other company this year. But notably, 9 of them are for excellence and innovation, 9 of them. Our content transformation efforts are having a measurable impact in the marketplace, where we're recapturing and increasing our share of local news viewers on all platforms. We're focused on creating exciting, shareable content across platforms, including a new digital-first series for Facebook Watch. The weekly series called "An Imperfect Union" travels across the country and offers a very unique storytelling perspective through the eyes of citizens on issues that everyday people are facing. This is just one of the many content initiatives that will help TEGNA stand out during the important election season.

We also recently launched the shopping e-commerce brand, DEALBOSS, a digital-first bargain-hunting product that allows us to reach entirely new audiences. And I could go on and on. Innovation in content is integral to our culture. Collectively, I expect these many innovative efforts to play an important role in driving even deeper connections with our consumers and increase market share. I look forward to providing regular updates on the fruits of these innovation projects going forward.

In summary, I'm thrilled with our progress during the quarter and our strategic focus and particularly, the good news about the recent paid subscriber trends. So as a result, we are seeing a greater proportion of recurring revenue and EBITDA in our portfolio, resulting in a much less cyclical business mix. With healthy EBITDA margins and strong free cash flow generation, we have ample opportunity to deploy capital. And all of this is supported by the strong balance sheet we maintain to support maximum optionality and returning value to our shareholders.

With that, I will pass the call to Victoria.

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

Thanks, Dave. Good morning, everyone, and thank you for joining us. As Dave mentioned, our second quarter results give us further confidence that our growth strategy is on track. Our diversified revenue streams, combined with operational effectiveness, are generating strong operating cash flow that will fuel future growth and deliver value to our shareholders.

Before I cover our consolidated financial results and capital allocation for the quarter, I'd like to review just a few special items with you.

During the quarter, we recorded special items of approximately $6 million, which include gains related to the sale of real estate in Houston and FCC spectrum repacking reimbursements. These gains were partially offset by an early lease termination charge. Special items impacting non-operating results reflected a gain of $11 million, comprised of equity earnings from CareerBuilder's sale of a business unit, partially offset by advisory fees and integration costs from earlier transactions and funding of the TEGNA Foundation. All in, special items for the quarter totaled $17.4 million or $0.07 a share.

Now turning to the second quarter consolidated financial results. Keep in mind, many of my comments today will be focused on our performance from continuing operations on a non-GAAP basis, in order to clearly provide financial insight into the drivers and results of our business. Also, as a reminder, our advertising and marketing services category excludes political advertising. You can find all of our reported data and prior period comparatives in the new key metric section of our press release and detailed in the rest of the text and tables contained there.

As Dave mentioned, on a reported basis, total company revenue was up 7% year-over-year...at the high end of the guidance range provided on our last earnings call. Excluding the impact of terminated digital marketing services and incremental political advertising, total revenue was up 5% over the second quarter of last year. As a reminder, due to the termination of our services agreement with Gannett last year, advertising and marketing revenue comparisons were again unfavorably impacted by $6.2 million this quarter. This is the final quarter of these negative comparisons since the agreement was terminated on June 1 of 2017.

Second quarter revenues grew primarily due to a substantial increase in subscription revenue of $29 million, coupled with an $18 million increase in political advertising during the quarter, driven by strong primary and early general election spending.

As Dave mentioned, subscription revenue growth for the quarter was 16% higher year-over-year, putting it well on pace to achieve our previous full year forecast of mid-teens. Growth was driven by contractual rate increases in our traditional MVPD agreements as well as revenue and subscription growth from new OTT agreements. Subscription revenue now comprises 40% of total revenue, up from 37% in the second quarter of 2017.

As a result of these trends, our net subscription revenue will continue to grow well into the future. To provide context, 15% of our MVPD subscription base is up for renewal at the end of this year and nearly half is up for renewal at the end of next year. To do the math, we'll be resetting the rates on nearly 65% of our subs in the next 17 months.

During second quarter, advertising and marketing services revenue, excluding political and discontinued digital marketing services revenue, was 3% lower year-over-year. On a reported basis, advertising and marketing services revenue was 5% lower year-over-year. More than one point of the decline was due to network programming changes in sporting events. This includes the NCAA Final Four, which moved from CBS to cable this year and the World Cup games, which aired on Fox stations this year, which we have very few of in our smallest markets.

Overall for the quarter, advertising category results were mixed, driven by events in specific sectors. The declines in automotive, restaurants and retail were partially offset by growth in services, medical and entertainment.

As Dave mentioned, political advertising in the second quarter was a record for the quarter and came in substantially higher compared to both 2016 and 2014.

Now moving to our third quarter revenue outlook. We expect total company revenue to increase in the mid-teens year-over-year, driven by both subscription and Premion revenue growth as well as substantially higher political revenue.

As you heard Dave say earlier, based on what we now know about the upcoming competitive races, some of our largest markets and strongest stations will see significant funding for the general election in November. Beyond this, our footprint benefits from state primaries in the third quarter in key states, such as Arizona, Florida, Michigan, Tennessee and Missouri, and spending for those primaries is robust.

Now turning back to second quarter results and a look at expenses. Non-GAAP operating expenses were up 12% for the quarter, in line with last quarter. Expense increases were primarily driven by higher programming fees and investments in Premion, including the new data management platform. As we previously discussed, programming expenses are growing, tied, in part, to subscription revenue increases and contractual escalators. Excluding programming, KFMB and Premion operating expenses were flat in the quarter. Premion expenses grew faster than expected in the quarter, well, because revenue grew faster than expected as well, a trend that will continue through the fourth quarter, as you saw from our increased revenue guidance.

As Dave mentioned, Premion has been a great success story, and we see significant opportunity for revenue growth. As a result, we're continuing to intentionally reinvest profits back into the business to drive revenue growth and to capitalize on our opportunities in the local and regional OTT ad space. As we previously mentioned, Premion remains on track to be profitable by year-end with a 10% margin. We are already well ahead of our competition in an area that is in high demand by local and regional advertisers.

During the second quarter, corporate expenses were $11 million, $3 million less than 2017, reflecting our ongoing continuing effort to right-size corporate functions as a pure-play broadcaster.

Adjusted EBITDA excluding corporate expense totaled $181 million in the quarter, producing a very strong margin of just over 34% from our business operations. Given the continued growth of Premion and upward revision of its revenue outlook to $75 million for the year, we expect our adjusted full year total company EBITDA margin to be between 36% and 38%, excluding corporate costs.

Now turning to our capital allocation priorities. As we've discussed before, TEGNA's disciplined capital allocation strategy is a key driver of our value proposition for shareholders. Our priorities continue to be: maintaining and operating a strong balance sheet, enabling organic growth, acquiring attractively priced strategic assets and returning capital to shareholders in the form of dividends and opportunistic share repurchases.

Our balance sheet is strong and provides consistent cash generation that will allow us to pursue the path that offers the most attractive return on capital at any given point in time.

The fact that we have a broad set of capital deployment opportunities further enhances our ability to continuously adjust to market conditions, as we seek to create shareholder value. The ongoing shift to a less cyclical, increasingly subscription-based revenue mix provides us with very good visibility into cash flow generation. As a result, we're quite comfortable that our balance sheet can support M&A and will allow us to continue paying down debt to create additional future flexibility.

I also want to reiterate that our M&A focus remains on the broadcast network ecosystem, including opportunities to acquire smaller tuck-in technology assets, which are complementary to our portfolio. I'd also like to emphasize that we vet all potential M&A targets against strict financial criteria as we always have and expect acquisitions to be EPS and free cash flow accretive within the first 12 to 18 months. From Belo to the London broadcast stations to KFMB in San Diego, we've consistently demonstrated our ability to meet and beat these hurdles.

In the case of KFMB, given our strong synergies there, EPS accretion will be achieved by the end of this year, a full quarter ahead of schedule, and free cash flow was immediately accretive.

Turning now to capital allocation during the second quarter. Capital expenditures were $10 million, reflecting investments in operating and efficiency-related projects as well as $1.5 million on the mandatory spectrum repacking for which we expect to be fully reimbursed over time. We continue to expect recurring capital expenditures of approximately $35 million to $40 million for the full year, in line with our prior projections. We expect roughly the same amount to be spent on nonrecurring items, including mandatory channel repacking, our upcoming headquarters relocation and a new facility in Houston.

During the quarter, we paid down $67 million in debt, resulting in $3.2 billion of debt outstanding, generating net leverage of approximately 4.3x.

Given that fully -- 85% of our debt has fixed interest rates, there is minimal impact from rising interest rates for us now and into the future.

We also extended our $1.5 billion revolving credit facility by 3 years this quarter to June of 2023, with existing favorable turns returns and financial covenants.

Finally, we repurchased 0.5 million shares for approximately $5.8 million in the quarter. We continue to believe our shares are undervalued by any measure and represent a very attractive investment opportunity. Given our balance sheet capacity and future cash flows, this does not preclude, in any way, our continuing commitment to both M&A and deleveraging over time. We will continue to analyze all opportunities to deploy capital in a manner that maximizes shareholder value, both in the near and long term.

Now let me turn the call back to Dave for some a summary or final remarks.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Thanks, Victoria. As you can see, we continue to make tangible progress through our culture and process of innovation. We are very well positioned for growth in both the short and long term and are uniquely well positioned to benefit from the changing regulatory landscape.

And with that, I'd like to open up the questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from John Janedis with Jefferies.

John Janedis - *Jefferies LLC, Research Division - MD & Equity Analyst*

Dave, maybe two for you. First, as you know, you've had an early call on the OTT subs, so as the impact increases, can you give us an update on what you're seeing on a regional basis, and to what extent the subs are cord nevers or subscribe to linear as well rather than trading down to the larger bundle? And then separately, on Premion, I think you were clear on the up revenue guidance excludes political, and I think you've been bullish on Premion, from a political perspective, so can you talk more about some of the growth drivers for Premion over the next couple of years broadly, and then to what extent political will be an opportunity this year?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, thanks, John. So on the OTT, you asked me about the regionals and yes, we still see a geographic difference, really, by market size. Although, notably the last 2 months, we have been up in total subs year-over-year. And that's really important as opposed to month-over-month, which we're up also, but it's really the year-over-year apples-to-apples comparison, given the seasonality. And I'll add -- you didn't ask, but we're up to 1.4 million OTT subs now for instance. But that does remain mostly a large to mid-market phenomena, and it has not gotten down as much to the smaller markets that I think DIRECTV NOW has. That said, yes, we continue to see, even with OTT, a decline in markets 100-plus. These last two months, everything from market, 0 to 50, in our portfolio are up. I mean, not every market, but as a grouping. All right? So and while negligible, the increase in April was even which was just over flat, is now around 0.5 point in May. As it relates to Premion political, we don't know what that'll be yet, because that is just new to the advertisers. So we don't have a lot on the books around Premion, but I think we're going to see when there's a lot of money on the table in those last few weeks, the people that are using it are liking it a lot. So I think it's a matter of adoption. But honestly, we don't have a good handle on what that number will be. As for the drivers in the next couple of years, John, just the organic demand. I mean, just from an inventory standpoint, our existing inventory partners, their inventory is growing dramatically. We'll be, I think, expanding the sales force, as I mentioned in my script. I also think the DMP that we're creating is going to create another revenue stream for us. So it's all good.

Operator

And we will now hear from Leo Kulp with RBC Capital Markets.

Leo J. Kulp - *RBC Capital Markets, LLC, Research Division - Associate*

So there's been several small and mid-sized affiliate groups recently announced they're looking to sell presumably due to the need for scale. Do you see an increasing need for scale? And if so, if you were going to do a bigger, larger deal, would solely focus on large markets? Or would you potentially move into some smaller and mid-size markets?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

The answer is yes. I think, we, obviously, have attractiveness to stations that are strong, that have a cultural fit with us i.e. the San Diego transaction that we did. But we are also in small markets now with the London transaction. We do know how to operate those businesses. So, we don't foreclose small markets if we see some unique opportunities or perhaps synergies because they're right next to our big boomer markets in a state where there are some regional synergies. So there's a lot of different criteria that we would look at.

Leo J. Kulp - *RBC Capital Markets, LLC, Research Division - Associate*

Got it. Dave, and then just one follow-up. Can you provide some color on what's driving the Premion upside? Is it the core product? Is it the DMP that you just started offering or some combination? And then does the revenue upside change your EBITDA target for the year?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Our EBITDA target, you mean for the company or for Premion?

Leo J. Kulp - *RBC Capital Markets, LLC, Research Division - Associate*

For Premion. I think it's slight profit.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, so -- slight profit but not -- it's de minimis relative to the overall total. The driver is the -- I'd use the word, core. Yes, if -- I guess we are -- I guess we use the word core business of Premion, and it is the core business of Premion. The DMP has not yet even been taken out to a market yet. It's just in the early stages of being created. So the DMP, I think, is more of a next year growth driver for us, but it's the core business of what Premion does, it's -- that's exclusively the driver right now.

Operator

And our next question will come from Barton Crockett with B. Riley FBR --

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Barton Evans Crockett - *B. Riley FBR, Inc., Research Division - Analyst*

I was wondering if you guys would have any ability to comment on some of the commentary that come out of the CBS earnings call where they're targeting very specifically that they are, kind of, average across their station footprint, they think, $3 in reach and $2 in reverse comp by 2020. I'm just wondering, if that seems, in any way, an approximation for what you guys see happening across your footprint, and if reverse comp is truly rising to the 2/3s at CBS? Do you guys you feel like you have an ability to grow net retrans as CBS and presumably the other networks kind of shoot for these kind of bogies?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, I'm not going to comment, Barton, on what CBS said. I just simply would say, I think, collectively, as I said in the past, I like to focus on the wholesale rate. Because I think we -- together, we have an undervalued wholesale rate before you start dividing the pie. And I think that wholesale rate continues to be undervalued relative to what our audience share of viewing is compared to what our share of subscriber revenues are, especially in the traditional MVPDs, but also on the skinny bundles. As it relates to the share of the pie, I understand that they've made those comments and have in the past. But I'm very comfortable about where our portfolio will be in terms of net retrans. As it relates to what the margin will be, as I said many times, I'd rather have 45% of $3.50 than 55% of $2.50.

Barton Evans Crockett - *B. Riley FBR, Inc., Research Division - Analyst*

Do you feel like your ability -- you still have an ability to grow your net retrans between now and 2020?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

We do. We do.

Barton Evans Crockett - *B. Riley FBR, Inc., Research Division - Analyst*

Okay. All right. And then switching gears a little bit, in terms of the M&A, kind of, environment with Cox announcing some sales and Tribune potentially in play, could you comment specifically on those two groups? Whether there's any specific things you can say about the potential appeal or parts of that? I know you can't get too specific. But just in general, are the things that are appealing those groups that might get you guys kind of looking?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes. I appreciate the question, Barton, but you can appreciate as a strategy, it does us no good to talk about specific companies. And we just never do. I mean, I appreciate the question. And I think those two companies, to your point, do provide -- there are potential more opportunities in the marketplace, as I said earlier. But we're just not going to speak to a specific interest in specific companies for just proprietary strategic reasons.

Barton Evans Crockett - *B. Riley FBR, Inc., Research Division - Analyst*

And then just one final thing. You guys are taking your margin guide now to like 36% to 38%, and you're saying that Premion's going to add about $15 million more in revenue than you thought. You said that was the driver. But it would seem that the margin reduction versus the loan what you gave before is larger than the revenue increment from Premion. So, I was wondering if you could talk about that?

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

Barton, the low end that we had given previously was given on Investor Day a year ago. So that was when Premion was a $30 million product. So, it really isn't apples-to-apples, but Premion is, as I said in my remarks, is profitable by year-end and is ramping into next year in terms of single -- double-digit profitability by the fourth quarter. So that amounts to what causes us to go down at the lower end. 36% to 38%, we're comfortable with. We have a number of additional cost measures in place outside of Premion, but we're reinvesting heavily to make sure we continue that growth there.

Operator

And our next question will come from Alexia Quadrani with JP Morgan.

David Karnovsky - *JP Morgan Chase & Co, Research Division - Analyst*

This is David on for Alexia. Is there any additional detail around core advertising performance in the quarter that you can provide or what you're seeing so far for Q3, including for auto or any other relevant verticals?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

No, we don't speak to core specifically, I guess, as we may have made on previous calls, but it's just not the way we're going to market now. So, reporting advertising and marketing services as a whole, because that's the way we do go to market. But, yes, I'd give you color on second quarter, as I think others have had, auto was soft. It was down just a little more than mid-single digits for us in the second quarter. Although the good news is, it does look significantly stronger for third quarter. I'm not saying robust in third quarter but significantly stronger. And retail was down as well, although not as much as I expected. And frankly; retail is a little stronger in the third quarter as well.

The flip side of that, services, medical/dental and optical and the entertainment business were nice up-categories for us in 2Q. And 3Q, we've got even a couple more up-categories. So, services, home improvement, entertainment are all positive in the third. Automotive is about flat right now for us and been improving, so we'll see how that ends up, and then we've got a political distillation factor that will come into play in the quarter. But hope that helps.

David Karnovsky - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. And then is there any update you can provide on the outlook, specifically for in-market M&A, and any holdups to that process? And at this point, do you continue to see the same opportunity you highlighted at your Investor Day in May last year?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, I do. I mean, I appreciate the question. The opportunity remains the same. The starting line has been pushed back. It's kind of, like, feels like a baseball game rain delay. I think the notable transaction I referred to earlier has sort of put a little bit of sand in the gears in the near short term relative to the DOJ, because the DOJ took a pretty aggressive stance in that particular transaction. So, I think the dust needs to settle a little bit on that. And probably the noise that came out about around that deal, I think, probably, scared off a lot of people in terms of engaging in that. And they also probably think that a lot of companies, given that the first major act was initiated by the discount, so the conversation all become around the cap, so I think a lot of companies have been focused on their vertical strategy, one way or the other. And I think as that dust settles out then horizontal M&A will become incredibly accretive in transactions for the entire industry, but I think probably, right now, in the near term, everybody is a little more focused on the vertical because of all the news you've seen.

Operator

We will now hear from Dan Kurnos with The Benchmark Company.

Daniel Louis Kurnos - *The Benchmark Company, LLC, Research Division - MD*

Dave, I just suspect you were being a little bit intentionally vague on the political numbers, other than just saying it was a record. But is there any chance you're willing to give us, percentage wise, like, the guys have started to do in this space up on Q3, and how we should think about full year political versus 2014?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes. --So, what I did say in the script is that we are guiding that we will be above 2014 third quarter, which was truly a record third quarter at the time, right, I believe. But the point -- and we were unwilling to do that before. Our challenge just to say, compared to other groups is, I'm not dealing with, say, a small-market portfolio of, say, 90 stations where it's a mutual fund with so much diversification, I can call it easily. We get big spending in big markets, right? And so a race could go cold, or a race could get hot. So, I've got more volatility in my projections. So, it's harder for me than, say, a large, small-market broadcaster to call the number, and no good deed would go unpunished on that. But we are confident saying that it will be higher than 2014, the third quarter. We're not saying that for the full year yet. But we are saying it for the third quarter.

Daniel Louis Kurnos - *The Benchmark Company, LLC, Research Division - MD*

Okay, fair enough. And then just any thoughts if the above or the record political spend is having an impact on the M&A environment? We've seen some smaller guys come to market, when they think cash flows are going to be higher. I don't know the mom and pops are unwilling to sell before, but maybe if they feel like they are going to get a better deal, they might come to market? Or is it just simply more the regulatory stuff that's just taken as much time to evolve to get there for the M&A to really pick up?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

I mean, sure, people like to show their numbers in M&A when they've got a good political year. But I think most companies bake that into their projections and look at it on a 2-year basis, if that's answering your question. So I think probably the mom and pops would like to hang in and collect their political revenues before they sell, my guess is. But -- and I don't mean mom and pop in a pejorative sense, but the smaller family groups, I think, probably want to take that cash. Probably.

Daniel Louis Kurnos - *The Benchmark Company, LLC, Research Division - MD*

Yes, I got it. That's what I was getting at. And then just lastly, in terms of Premion, I don't know if there are, sort of, too many external constraints on whether it's inventory or sort of, your ability to scale the tech stack, the offering, whatever it is, build out DMP. But I -- obviously, there's a competitor of yours that's spending a lot of money going after land grab. Now you guys have clearly started to build, at least theoretically, a moat in terms of being first mover and having a -- sort of a really qualified product. So what -- understanding that investors probably don't maybe like it as much to spend more money on it, why not throw a little bit more gas on that fire and get more aggressive, or are there too many external constraints to overspend now and then reap the rewards next year?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Well, first, I'm not sure if I know which competitor you're referring to. And remember, there's going to be more people selling. The MVPDs will be selling on their own TV everywhere and stuff. But there's a lot of room for us to play out there. I think there are competitors that are selling programmatic, right, which has none of the targeting capabilities that we do. What is unique about our proposition and so attractive to advertisers is that we can slice and dice in 2,000 audience segments and because of the tech stack we built. We really have no -- to your point, we've got no constraints, really. I mean, the inventory is growing daily. We're adding more content providers but we're scaling the expenses with the revenue. We're not overinvesting but I think I feel comfortable, and as I've signaled to the investor community from the beginning of this business, we have been plowing almost all of the profits back in the business to go get market share because it makes sense where we are, although as Victoria did indicate, we intend to be, and will be at a 10% margin by year-end.

Operator

And our next question will come from Kyle Evans with Stephens.

Kyle William Evans - *Stephens Inc., Research Division - MD*

Victoria, you gave us your sub count renewals, 15% into this year and 50% at the end of next year. Could you give us the network renewal schedule and also by percent of subs if you can?

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

Sure. So we've got -- yes, you want to start with NBC at 46%.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

But that's not up till 2021.

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

Not till 2021. Right. That's NBC. CBS is 32% of our subs, and it's 2019 and 2020, so the November of 2019 and December of 2020. Fox is only 1% expires June of 2019. And ABC at 20% of subs and expires the end of this year, 2018.

Kyle William Evans - *Stephens Inc., Research Division - MD*

Dave, you mentioned that the start for end market deals has been moved back. I understand that. But what kind of macro conditions do we need to see specifically before we get to that starting line? What's, kind of, the sequencing? I'm not even asking you for a time line, but what are the some of the landmarks or hurdles?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, so I think the dust needs to settle on that transaction, right? I think the cap needs to be clarified ideally. And I'm presuming that will happen before the election. I -- but I also...

Kyle William Evans - *Stephens Inc., Research Division - MD*

The cap raised?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

I would think the betting money would be that the cap would be raised. I've no inside information of course, but I think the betting money would be the cap raised. I think probably, my guess is, the FCC was concerned they were going to lose that UHF discount case based on the early political prognostications of the court case. So that may have some impact in a rethinking of what that cap number will be, compared to whatever they were thinking before. But I think the cap and vertical needs to get more clarity around it and then I think there needs to be more DOJ clarity. And by the way, as it relates -- I mean, the challenge is that the DOJ is still using a definition of the market that has not changed. They haven't really evolved that since almost the 1980s. The FCC, remember, has another quadrennial review next year. So, they will get a chance to redefine the market. So, at the outset, I'd think the quadrennial review can help provide the transparency on the market definition that would open the doors.

Kyle William Evans - *Stephens Inc., Research Division - MD*

Got you. Lastly, you guys have talked about vertical, horizontal, buying back stock, paying down debt, leverage - on a net basis of 4.3x in the quarter. What's the upper limit of where you go with that to do something strategic and maybe transformative?

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

Kyle, we really don't have a specific target. As we've talked to in the past, for the right transaction, we've been willing to flex up and we -- as we did with Belo and then pay down very quickly to get right back within the same ranges where we started. We've been very comfortable with that approach, and I think we continue be. We, obviously -- we have a very, very high amount of fixed debt in terms of interest rate, so we really have no risk relative to 85%...

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

85% is fixed.

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

So we have -- it's very forecastable. And we -- we're looking, at any given point in time whether we accelerate debt paydown versus use cash for transaction. So, I think for the right transaction, for the right EPS and free cash flow accretion, we could flex up significantly and get right back down to where we started.

Kyle William Evans - *Stephens Inc., Research Division - MD*

Great. Lastly, if you gave a 3Q 2014 pro forma political, I missed it. That's my last question.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

No, we didn't give a number. I'm sorry, 2014?

Kyle William Evans - *Stephens Inc., Research Division - MD*

I guess, I'm asking better than what?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

$40 million..

Operator

And we will now hear from Marci Ryvicker with Wells Fargo.

Marci Lynn Ryvicker - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

I have a couple questions. First, your EBITDA excluding corporate overhead, which I think is BCF guidance, seems to be coming down. It started at 39% to 42% on the Investor Day. Then you came to the low end of that on the fourth quarter call. Now it's a 36% to 38%, so we're getting a lot questions, where is the incremental expense coming from? I get Premion, but I don't think that, that's moving the needle.

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

Actually, it is significantly moving the needle. When we gave, on Investor Day, Premion was about a $30 million target by the end of 2017, and we're now at $75 million without counting political.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

And our target for this year was quite a bit less.

Marci Lynn Ryvicker - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Right, right.

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

So...

Marci Lynn Ryvicker - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Yes, but it's not contributing to EBITDA. So I -- where kind of -- where is the -- if you take Premion out since it's not contributing, the -- your whole guide is still trending downwards. I get the revenue guide, but I'm talking about the contribution to the bottom line is still de minimis. So if you're going from 39% to 42% to 36% to 38%, there's something in those numbers.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

But if you take $70 million, you take close to $70 million of expense out, Marci, that we wouldn't otherwise had. So I mean, we -- all right, it wouldn't be $70 million, but remember, we were not anticipating even doing $60 million on Premion or anything close to it at Investor Day.

Marci Lynn Ryvicker - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Okay. I'll take it offline because if you take that expense out, you take revenue out. Second, you mentioned and another one of your peers mentioned, auto is stronger in Q3. What is driving that? Because that's a big deal, and I think people are looking to figure out what 2019's going to be. So, can you talk to auto?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, I can. You know what, Marci? I wish I actually -- I'd love to be able to provide a brilliant answer to that. But I'm not sure we have it because the noise has been so choppy around that. I mean June SAAR was better, July SAAR was worse. There seems to be a lag, I think, on SAAR and behavior. So that may be one thing, right, because SAAR wasn't that bad during the quarter. But I think we all took a hit when Dodge Jeep Chrysler took a big piece of money, as you probably heard from others. But that remains out. But we've had some categories that -- foreign is actually driving the increase the most. And as a reminder, as to the tariff question, most of our foreign auto is Japan. It's not Germany. But the why I can't say. I just have -- we've been working hard at that and trying to get to it. But the data would say Tier 2 is back up, which is a good trend, especially when you take into consideration the Dodge Jeep. But that's what I got.

Marci Lynn Ryvicker - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Okay. And then my last question. It was in The Wall Street Journal, the DOJ is investigation ad pricing. Do you have any comment on that?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

We see the news reports about a DOJ investigation, and Marci, I don't have any comment about them. But I will say, you probably also saw that we and a number of other companies were named as a defendant in a class-action lawsuit filed the last week, and I will comment on that. So that was a lawsuit filed against several station owners and operators, including us, and the allegations of the complaint are completely meritless, and we will defend ourselves vigorously.

Operator

And our next question will come from Doug Arthur with Huber Research Partners.

Douglas Middleton Arthur - *Huber Research Partners, LLC - MD & Research Analyst*

Dave, just a point of clarification on top 4 in-market acquisition potential. When you talk about a 10% to 15% margin benefit, are you talking about between both stations or the acquired station? Just to clarify.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

No, no, just -- thanks for the clarification, Doug. No, just the acquired station.

Douglas Middleton Arthur - *Huber Research Partners, LLC - MD & Research Analyst*

Okay. And then lastly, obviously, a lot of discussion about Premion. Can you just put some color on your digital revenue growth in the quarter? It seems like it was strong. I'm just trying to get a sense of, kind of, dimensions here.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Well, we don't report out "digital" separately, because I mean, so many of our projects are digital now too, so it's almost a bit of a definitional issue for us. So, I mean, I'll just simply give you color. Premion is the belle of the ball. I think that social and sort of, core, we call them "digital core revenues" from your owned and operated stations. They don't grow as fast as they used to because there are secular issues relative to social referrals and stuff but Premion is the driver of it for us.

Operator

And we will now hear from Craig Huber with Huber Research Partners.

Craig Anthony Huber - *Huber Research Partners, LLC - CEO, MD, and Research Analyst*

A few questions. --

Can you just help us, what was auto in the second quarter. I mean, some of your peers were talking about being down as much as 15% year-over-year. How is it for you guys, please?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, as I mentioned earlier, you might have not been with us. It's down just over mid-single digits.

Craig Anthony Huber - *Huber Research Partners, LLC - CEO, MD, and Research Analyst*

Okay. Then you said, I think it's trending better in the third quarter. It's obviously early. Can you also comment on the retail category, how that did in the second quarter, please?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

I'm sorry, say that again, Craig?

Craig Anthony Huber - *Huber Research Partners, LLC - CEO, MD, and Research Analyst*

How did the retail advertising category do in the second quarter, and that's a big category, obviously?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, it was down less than auto. Kind of, low mid-single digits.

Craig Anthony Huber - *Huber Research Partners, LLC - CEO, MD, and Research Analyst*

Okay. And then also could you help us...

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

It's marginally better in the third quarter.

Craig Anthony Huber - *Huber Research Partners, LLC - CEO, MD, and Research Analyst*

Okay. And then also on the cost side, in the second quarter, if you strip out the acquisition, just curious why your overall costs were up, if you could help us with that?

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

We were up about 7%.

Craig Anthony Huber - *Huber Research Partners, LLC - CEO, MD, and Research Analyst*

Okay. Then my last question, this whole debate about if the FCC raises the 39% ownership cap and the debate if they actually, at the end the day, have this jurisdiction versus Congress. How do you come down on the debate right now? What are your thoughts, please?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

--So, that has evolved over time. I think the wildcard commissioner on that has been Commissioner O'Rielly who initially said he didn't think they had statutory authority and it sound like his position has changed too. While I am still not sure we will but I'll vote on it. And then we sort of, let the courts decided. I think the prevailing wisdom is, is that, they would move forward, pending -- even during an appeal on whatever they rule on.

Craig Anthony Huber - *Huber Research Partners, LLC - CEO, MD, and Research Analyst*

But then you thinking most likely somebody with (inaudible) would get tied up for courts for a long time? That's what you think?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

Yes, but I don't know, pending a stay. I don't know that, that would stop activity, Craig.

Operator

We will now hear from Michael Kupinski with NOBLE Capital Markets.

Michael A. Kupinski - *NOBLE Capital Markets, Inc., Research Division - Director of Research and Senior Media & Entertainment Analyst*

I just have a couple of quick ones. On the corporate expense side, I was wondering if you can give us little thoughts about how that line item looks? It looks coming in a little bit lower than I expected for the quarter. Is a good run rate, $11.5 million, or $12 million, or what do you see for the balance of the year on that line item?

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

The trend organically is about the same throughout the remainder for the year. We do have in the tail end of this year, we've got double rent expense here that we're paying in our existing building, we're transitioning to new headquarters in January of next year. So that'll be a one-time anomaly relative to that period of time, but the base trend is about what you've seen this quarter.

Michael A. Kupinski - *NOBLE Capital Markets, Inc., Research Division - Director of Research and Senior Media & Entertainment Analyst*

Got you. And then to be clear, the increase in revenue guidance for Premion does not include political, given that political is allocated to TV? Or are you allocating some of the political or thoughts on political in Premion and your expectations for the full year?

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

No, you had it right the first time. We are excluding political completely. So, any Premion political will be in the political category just for clarity's sake. Since that's not recurring next year, so the guidance, the $75 million is all nonpolitical dollars.

Operator

And our next question will come from, Davis Hebert with Wells Fargo Securities.

Davis Hebert - *Wells Fargo Securities - Analyst*

Just a quick balance sheet question. Victoria, you're facing some near-term maturities. I think, there's a draw on the revolver. And just curious, should we expect any debt capital markets activity out of TEGNA in the near term?

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

We don't currently have any plans. I think, we talked on our last earnings call, we had the opportunity to accelerate the 2019 in the latter part of October. We've looked at that as a use of capital depending on where we are with other uses of cash for transactions at the time but other than that, it's just business as usual in terms of our current maturities.

Michael A. Kupinski - *NOBLE Capital Markets, Inc., Research Division - Director of Research and Senior Media & Entertainment Analyst*

Okay. And then in terms of the construct of your capital structure. It's an all unsecured capital structure, any thoughts around adjusting that structure at all?

Victoria Dux Harker - *TEGNA Inc. - Executive VP & CFO*

No, not any current plan.

Operator

And with no further questions, I'd like to turn the call back over to management for any additional or closing remarks.

David T. Lougee - *TEGNA Inc. - President, CEO & Director*

All right. So, thank you, everyone, for joining us today. As you can see, we're excited about the opportunities in front of us and confident that we have the right plan to drive shareholder value. We look forward to speaking with you on our third quarter earnings call. And if you have any additional questions for any of us, please call Jeff Heinz at (703) 873-6917. Thank you, everyone.

Operator

And once again, that does conclude our call for today. Thank you for your participation. You may now disconnect.
