CORPORATE PARTICIPANTS

Grant S. Moise  A.H. Belo Corporation - President & Publisher of The Dallas Morning News
Mary Kathryn Murray  A.H. Belo Corporation - Senior VP, CFO & Treasurer
Robert W. Decherd  A.H. Belo Corporation - Chairman, CEO & President
Timothy Michael Storer  Distribution, Inc. - Co-Founder, CEO and President

CONFERENCE CALL PARTICIPANTS

Chris Mooney

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Third Quarter 2018 A. H. Belo financial results.

As a reminder, this conference is being recorded.

I will now turn the call over to your host, Ms. Katy Murray. Please go ahead, ma'am.

Mary Kathryn Murray  A.H. Belo Corporation - Senior VP, CFO & Treasurer

Good morning, everyone. This is Katy Murray, Chief Financial Officer of A. H. Belo Corporation. Welcome to our third quarter 2018 conference call.

I am joined by Robert Decherd, Chairman, President and Chief Executive Officer of A. H. Belo Corporation; Grant Moise, Publisher and President of The Dallas Morning News; and Tim Storer, President of Belo and Company, who are all available for Q&A.

Yesterday morning, we issued a press release announcing our third quarter 2018 results. We have posted this release on our website under the Investor Relations section. Unless otherwise specified, comparisons used on today's call measure third quarter 2018 performance from continuing operations against third quarter 2017 performance from continuing operations.

Our discussion today will include forward-looking statements. Forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those statements. The company assumes no obligation to update the information in this communication, except as otherwise required by law. Additional information about these factors is detailed in the company's press releases and publicly available filings with the SEC.

Finally, today's discussion will include non-GAAP financial measures. We believe that non-GAAP financial measures provide useful supplemental information to assist investors in determining performance comparisons to our peers. Reconciliations to the most directly comparable financial measures, based on our segment reporting, presented in accordance with GAAP, are provided on our website under the Investor Relations section.

Before I review the quarter, I want to remind everyone, we adopted 2 new accounting pronouncements effective January 1 of this year. Detailed information is available in our GAAP to non-GAAP reconciliation provided on our website under the Investor Relations section.

For the third quarter of 2018, we reported a net loss attributable to A. H. Belo Corporation of $1 million for a loss of $0.05 per share compared to net income of $2.6 million or $0.12 per fully diluted share in the third quarter of last year.

As a reminder, in the third quarter of 2017, the company sold a real estate parcel in downtown Dallas that generated capital gains of approximately $5 million. For the third quarter of 2018, we reported adjusted operating income for A. H. Belo Corporation of $2.6 million compared to adjusted operating income of $4.2 million in the third quarter of 2017.

Today's discussion will address the financial performance of The Dallas Morning News and Belo and Company separately.
For The Dallas Morning News, in the third quarter, we reported total revenue of $43.7 million, a decrease of $8.9 million or 16.9% when compared to the $52.6 million reported in the third quarter of last year.

Approximately $2.3 million of this decline is attributable to the new revenue standard requiring certain transactions to be reported net versus gross.

Adjusted for this change, total revenue declined by $6.6 million or 12.6%. Print and digital advertising revenue of $19.9 million in the third quarter of 2018 is down $7 million or 26% when compared to the $26.9 million reported last year. $2 million of the decline is due to the new revenue standard. Excluding the impact of the new revenue guidance, print revenue decreased $5 million or 18.5% when compared to the prior-year period. In addition, $800,000 of the year-over-year decline is related to revenue of The Denton Record-Chronicle, which was sold in the fourth quarter of 2017.

Circulation revenue of $17.9 million in the third quarter of 2018 is a decline of $900,000 or 5% when compared to the third quarter of last year. Approximately $300,000 of the decline is the result of the new revenue guidance.

Excluding the effect of the new revenue guidance, home delivery revenue declined by $600,000 or 3.5% net of an increase in digital-only subscription revenue of $317,000 and single-copy revenue declined by $100,000 or 4.6% from the third quarter of last year.

The decline is primarily due to lower home delivery and single-copy volumes, partially offset by single-copy rate increases.

Approximately $300,000 of the home delivery revenue decline is related to the sale of The Denton Record-Chronicle in the fourth quarter of last year.

As we have stated before, one of our highest priorities is to grow The Dallas Morning News paid digital subscriber base and digital subscription revenue.

In the third quarter, we reported approximately $1 million of digital-only subscription revenue, an increase of $317,000 or 45.2% over the same period last year.

Other revenue at The Dallas Morning News decreased $900,000 or 13.8% to $5.9 million for the third quarter of 2018. $400,000 of the decline is due to a decrease in commercial printing revenue and $200,000 is related to a discontinued product line.

Total consolidated operating expense for The Dallas Morning News for the third quarter was $45.3 million, a decrease of $8.2 million or 15.3% compared to the prior year.

Excluding the $2.3 million decrease related to the adoption of the new revenue guidance, consolidated operating expense decreased $5.9 million or 11% when compared to the prior-year period. The decline is primarily due to improvements of $3 million in employee compensation and benefits expense, $1.8 million in distribution expense, $400,000 in advertising and promotion expense and $200,000 in professional fees.

Adjusted operating expense, which adjusts total operating expense for the new revenue standard, pension benefit, severance expense, depreciation and amortization expense and asset impairments, was $44 million for the third quarter, a decrease of $5.5 million or 11.1% compared to $49.5 million in the third quarter of last year.

The significant year-over-year improvement in adjusted operating expense is a result of cost-reduction initiatives enacted early in 2017 that are now being fully realized.

Adjusted operating income for The Dallas Morning News was $2 million in the third quarter of 2018, a decrease of $1.1 million or 35.1% when compared to the $3.1 million reported in the third quarter of last year.
Turning now to financial highlights for Belo and Company. First, I’m going to review GAAP and non-GAAP results. Then, I will provide some additional operational metrics on how Belo and Company is reviewed internally. For the third quarter, we reported total revenue of $5.3 million for Belo and Company, a decrease of $2.6 million or 33% when compared to the third quarter of last year. Approximately $1 million of this decline is attributable to the new revenue standard requiring certain transactions to be reported net versus gross.

Adjusting for this change, total revenue declined by $1.6 million or 20.3%. Total consolidated operating expense at Belo and Company for the third quarter was $5.1 million, a decrease of $2 million or 28.6% compared to the prior year.

Excluding the $1 million decrease related to the adoption of the new revenue guidance, consolidated operating expense decreased $1 million or 14.5% when compared to the prior-year period.

The decline is primarily due to improvements of $0.5 million in employee compensation and benefit expense and $1.1 million in digital cost of goods as a result of the lower revenue.

Adjusted operating expense, which adjusts total operating expense for the new revenue standard, severance, depreciation and amortization expense, was $5.8 million for the third quarter, a decrease of $1.1 million or 15.7% compared to the third quarter of last year.

The year-over-year reduction in adjusted operating expense is a result of lower digital cost of sales due to lower revenue.

Adjusted operating income for Belo and Company for the third quarter of 2018 was $537,000, a decline of $541,000 from the $1.1 million reported last year.

As mentioned at the start of the call, we have updated our GAAP to non-GAAP reconciliation, which is posted on our website under the Investor Relations section, to include a reconciliation of segment reporting, in addition to the consolidated reconciliation.

To provide more clarity with regards to the operational performance of Belo and Company, we have provided unaudited 2017 and 2018 quarterly operational metrics that reconcile revenue and expense per the 10-Q with an adjusted internal operating income metric.

This internal operating view includes 2 items in the reconciliation: First, beginning in 2018, Belo and Company's compensation and benefit expense increased as a result of the additional headcount being transferred from The Dallas Morning News to Belo and Company and an increase in healthcare cost. We moved all A. H. Belo employees into a single fully insured benefit plan this year to lower A. H. Belo's overall cost of healthcare. However, for Belo and Company, this results in an increase in benefit burden since Belo and Company had a self-insured plan in 2017. Second, we have included what the gross-down for revenue and expense would have been in accordance with the new revenue guidance had it been adopted in 2017. The year-over-year decline in internally reported revenue of $1.1 million included in the reconciliation is predominantly attributable to the attrition of 6 accounts in late Q4 2017 and early Q1 of this year. These accounts would have generated quarterly pass-through revenue in 2018 of approximately $800,000 and quarterly revenue of $500,000.

We have experienced slower than anticipated replacement of these accounts, but feel that Belo and Company’s sales teams are now making measurable headway in doing so.

As a result, Belo and Company is on track to achieve year-over-year improvement in revenue and EBITDA in the fourth quarter of this year.

Internally reported operating expenses in Q3 declined by $900,000, with the majority of that improvement related to pass-through expense and the balance being a decrease in compensation expense on a year-over-year basis. Internally reported operating income of $537,000 reflects a $161,000 decline from the $698,000 reported in the third quarter of last year. Internally reported operating margin for the third quarter was 10.1%, a slight decline from the 10.9% reported in the third quarter of last year.

Looking to the fourth quarter, we are confident that we will see substantial improvement in the adjusted operating income reported in the fourth quarter of 2018 compared to the fourth quarter of last year.
Turning again now to A. H. Belo consolidated, as of September 30, headcount was 978, a decrease of 129 or 11.7% from September 30 of last year. Most of this decrease is due to job eliminations in 2017. As of September 30, the company had approximately $58.5 million of cash and no debt. As of October 29, we had approximately $61 million in cash and cash equivalents.

For the balance of the year, we expect capital expenditures to be approximately $1 million. On Monday, we filed a Form 8-K, disclosing that we have entered into an agreement to sell the company's former headquarters at 508 Young Street in downtown Dallas for $33 million. This transaction is referenced in our earnings release that was issued prior to the market opening yesterday morning.

We expect this transaction to close on December 28. And while the transaction will generate a capital gain of approximately $23 million for federal tax purposes, net operating losses will fully offset the capital gain.

After fees and expenses, net cash proceeds to A. H. Belo will be approximately $32 million. In regards to taxes for the third quarter, the company reported tax expense of $596,000. We expect that cash taxes this year will be approximately $1.2 million with the majority related to the Texas margin tax.

So Wanda, we are now ready for questions

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from the line of Chris Mooney with Wedbush Securities.

Chris Mooney

Congratulations on the contracting of the headquarters.

Mary Kathryn Murray A.H. Belo Corporation - Senior VP, CFO & Treasurer

Thank you very much. We are very excited about the opportunity.

Chris Mooney

Yes. On that -- and just one minor question. The acreage quoted in the press release was 7.2 acres? And the Dallas County Appraisal District shows it is being a little over 8 acres. Is there -- is that the easement difference? Or what is?

Mary Kathryn Murray A.H. Belo Corporation - Senior VP, CFO & Treasurer

Chris, it's correct that's the -- it is the difference of the lot that sits behind WFAA. And so that was called out.

Chris Mooney

Okay. So you still own that? Or had you -- are you giving it up to the broadcast station?

Mary Kathryn Murray A.H. Belo Corporation - Senior VP, CFO & Treasurer

No. The potential new owners will step into our role on that, so they will own that.

Chris Mooney

Okay, okay. Great. The question I've been asked multiple times in the last -- since you all reported and made the announcement is what are they going to do with the cash. So how would you like to address that on this call, at least?

Robert W. Decherd A.H. Belo Corporation - Chairman, CEO & President

Chris, it's Robert Decherd. We have said -- good morning, we said consistently, as you know, that the board is -- has a strong belief about doing things in the proper sequence. This deal hasn't closed. As Katy said, we're very excited about the idea of having this resolved. It's an asset that's underutilized from our standpoint. So once we have closed at the end of the year, the board will deliberate as it has in the past as to what our resource allocation should be in 2019 and beyond. We have a number of investments we've talked to you about. They
certainly don't add up to the sum of $60 million and $32 million. So we're going to look hard what those options are and have advisors regularly advising us, both internally and externally.

Chris Mooney

Okay. I will stand by. Robert, in the press release, you seem to give the impression that you are more optimistic about the outlook for the paper in 2019 or the overall business of the news. Can you reflect on that somewhat?

Robert W. Decherd A.H. Belo Corporation - Chairman, CEO & President

Well, I certainly can. And both Katy and Grant can comment as well. We'll have some comparisons next year that are favorable. So that's one factor. The most important factor, though, is that Grant and his team, together with Katy and our corporate team, have spent a substantial part of the last 6 months thinking about how the newspaper will look in the future, and that doesn't mean 2019 necessarily. But what is the investment, which translates to our ongoing expense structure that yields a proprietary advantage in journalism, local news and information that also reflect the realities of the patterns we're seeing in print in terms of both advertising and subscriptions and the promise of the digital side of the business. Grant can comment on the work he is doing in both sides of the circulation equation. We actually think there is some potential in print that we have not realized in recent years. And certainly, there is tremendous upside on the digital subscription front. So we're seeing things as we go through this process that together with the comparisons I mentioned and some revenue opportunities make us feel pretty optimistic about moving in the right direction. We are not going to resolve anything in 2019, but moving in the right direction, so that we can not only propose this structure to our board, we can implement in a way that's successful over time. Grant, you want to elaborate on that?

Grant S. Moise A.H. Belo Corporation - President & Publisher of The Dallas Morning News

Yes. Chris, I mean, part of what -- just to expand a little bit on what Robert is talking about is the optimism that I see is predominantly on the subscription side, both in digital and print right now. As we announced last quarter, we hired Sue Kerr from Tribune, which -- she had led all of customer service at Tribune and had been very successful. And her print, circulation and subscription revenue initiatives, specifically in Hartford, where we saw someone who knew the fundamentals of the business that we could change in order to go see the print line of subscriptions improve. And Dan Sherlock, who we brought on almost a year ago, now has continued to show outstanding work in his leadership of digital subscriptions, as we just announced, obviously, a 45% digital subscription growth.

I'm very -- I really like the trends we're seeing. Print -- sorry, digital subscriptions remaining consistent in that 40% growth range now 2 quarters consistently. And we're already starting to see some early signs of -- even early work on the print side of subscriptions improving due to a lot of the fundamental changes that Sue is leading for the company. So a lot of optimism there and obviously, I'd be remiss to say that the print challenges that the whole industry have seen and advertising have been challenging, but I also have a little bit of optimism there of seeing, especially in the area of ROP, some improvement, as this year goes along. But obviously, with the types of declines that we're talking about in print advertising, we still have work yet to do.

Chris Mooney

Okay. On the Belo and Company side, there was -- the second quarter conference call, there was a fair amount of optimism that the second half or the back half of the year would show significant improvement, and now Katy seemed to be indicating that profitability in the fourth quarter, which would show improvement. But the revenue side is still a relative drag. Is there optimism that, that's going to change in this quarter?

Robert W. Decherd A.H. Belo Corporation - Chairman, CEO & President

Chris, I think it is in the fourth quarter. We're talking about this quarter defined as the fourth. The third quarter was bumpy. There is no question about that. Tim will comment in a minute on the efforts he's made to get passed that and ensure that the fourth quarter is an improvement, a noticeable improvement over 2017. The most important thing to reinforce from my standpoint is this is a real business. Digital marketing is a fast-growing, yes, complicated business, but there is great opportunity to serve a very large number of companies in this $5 million to $100 million revenue range. Who, frankly, can't do this themselves. They really don't have the horsepower in terms of talent or bandwidth, and they're looking for the kind of expertise that Tim has established and nurtured at what is now Belo and Company. So we -- we're not taking lightly the underperformance in the third quarter, but we think we now have smoothed things out, and we're looking at a good fourth quarter and a promising 2019.
Tim, you want to elaborate on some of the accounts we're bringing in?

**Timothy Michael Storer - Co-Founder, CEO and President**

Yes, absolutely. Good morning, Chris. As Robert said and as Katy mentioned as well, certainly, Q3 did not meet our expectations. Replacing revenue from some of those contracts that we lost last year, did not materialize and happen as quick as we would've liked in Q3. That said, we are very confident. We're moving in the right direction. We remain, as Robert said, very excited about the opportunity in front of us and our ability to deliver better results in subsequent quarters. I do feel that the summer months contributed a bit more than usual to delays in larger contracts we sold in Q2 getting fully implemented and ramped up in combination with new contracts getting executed. That said, we have certainly seen a nice uptick in activity and things getting back on track, certainly starting in September and that trend has definitely continued in the fourth quarter where we remain optimistic in regards to our fourth quarter results. So I definitely do believe that we are heading in the right direction and certainly, remain very optimistic. And as Robert alluded to, we are certainly in a target-rich environment. There is a massive amount of demand for what we are doing, the space we operate in and again, we remain very excited about the opportunity.

**Chris Mooney**

And Tim, could you reflect on who your competition is for those contracts?

**Timothy Michael Storer - Co-Founder, CEO and President**

Yes, I'll tell you. We are, as Robert alluded to, we are very focused, Chris, in the midmarket space. Midmarket is really defined as $10 million to $1 billion range. I will tell you that's a very underserved market. Businesses that are larger than $1 billion typically are going to be leveraging a lot of large external agency type relationships. And then you've got businesses that are smaller than $10 million that are going to be being serviced by smaller agencies, which really leaves this midmarket an underserved market from the digital marketing solution space. So if you're a $10 million to $1 billion organization, I will say that it's been from a competitive set perspective, because there are just not that many businesses that are really focused in that space. So we are very excited about the opportunity that remains in front of us. I would say that our biggest competition, Chris, in that space is more insourcing than outsourcing. Organizations are trying to develop or bring those types of teams in-house. But I will tell you in these kinds of economic environments, it's very difficult to do right now. So it remains a strong demand for our services.

**Chris Mooney**

Thank you. If I may, Katy, could I ask 2 sort of housekeeping questions to you?

**Mary Kathryn Murray - Senior VP, CFO & Treasurer**

Absolutely, Chris.

**Chris Mooney**

One, who's going to pay the property taxes on the headquarters for 2018?

**Mary Kathryn Murray - Senior VP, CFO & Treasurer**

Well. Yes, for 2018, Chris, that would be, based on the closing date, those property taxes are our responsibility with the exception of the handful of days at the end.

**Chris Mooney**

Okay. And second, could you just reflect on the status of the pension plan? And where we are? It seems to be declining every quarter.

**Mary Kathryn Murray - Senior VP, CFO & Treasurer**

So the pension plan, we actually will be having an update in this next month that we have a regular update with our advisors. The last update we had at this point, still do not expect any mandatory cash contributions in the next 10 years. I don't anticipate that to change. And from an overall funded percentage, I'm not able to give an updated number right now, but where we have been, historically, was around the 89% to 90% funded rate. So I still feel like even though we've seen some market volatility, we've also seen the interest rate side on the other side. So I think, from an overall perspective on the pension, I'm seeing some headwinds but also seeing some
favorability and look forward to the update that we'll be getting. But I don't expect to see any significant or material changes to our position.

Operator

(Operator Instructions) There currently are no questions in queue.

Mary Kathryn Murray A.H. Belo Corporation - Senior VP, CFO & Treasurer

Okay. So Wanda, thank you. Thank you everybody for joining our third quarter financials. We look forward to updating everybody after the close of 2018 next year. Have a great day and happy Halloween. Goodbye.

Operator

Ladies and gentleman, this conference will be available for replay after 11 a.m. today through November 7, 2018 at midnight. You may access the AT&T Teleconference replay system at any time by dialing 1 (800) 475-6701 and entering the access code 455876. International participants may dial (320) 365-3844. That does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.