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MDCA.OQ - MDC Partners Inc and Stagwell Group LLC to Combine, Creating Transformative Global Marketing Network - M&A Call

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PRESENTATION

Operator

Good morning, and welcome to the MDC Partners Investor Conference Call. (Operator Instructions) Please note, this event is being recorded. I would now like to turn the conference over to Alexandra Delanghe, Chief Communications Officer; followed by Chairman and CEO of MDC Partners and Managing Partner of the Stagwell Group, Mark Penn. Please go ahead.

Alexandra Delanghe Ewing - *MDC Partners Inc. - Chief Communications Officer*

Good morning, and thank you, operator. Welcome to the MDC Partners Conference Call. Today, joining me are Mark Penn, Chairman and Chief Executive Officer of MDC Partners and Managing Partner of the Stagwell Group; and Frank Lanuto, Chief Financial Officer of MDC Partners.

Before we begin our prepared remarks, I'd like to remind you that the following discussion contains forward-looking statements and non-GAAP financial data. Forward-looking statements about the company, including those related to earnings guidance, are subject uncertainties referenced in the cautionary statements included in our press release and slide presentation and are further detailed in the company's Form 10-K and subsequent SEC filings. For your reference, we've posted an investor presentation to our website.

We also refer you to yesterday's slide presentation for definitions, explanations and reconciliations of non-GAAP financial data.

And now to start the call I'd like to turn it over to our Chairman and Chief Executive Officer, Mark Penn.

Mark J. Penn - *MDC Partners Inc. - Chairman & CEO*

Thank you, and good morning. We appreciate you joining on such short notice. It's a pleasure to be here with some clients, colleagues and shareholders to discuss the exciting next steps in the evolution of MDC and Stagwell. Joining me on the call today is Frank Lanuto, MDC's Chief Financial Officer.

I'd like to note up front that there's an investor presentation as well as an informative video available on our Investor Relations website that will supplement our discussion.

It's a new day for MDC and Stagwell. This morning, we announced that we entered into a definitive agreement for an all-stock combination of MDC Partners and The Stagwell Group, digital-first, technology-enabled marketing consultancy. By uniting the award-winning creative talent of our network with the advanced technology platform of Stagwell, we're unleashing the full power of talent and technology around the world.

This has been a multiyear journey for me coming from serving as Chief Strategy Officer at Microsoft to form and build Stagwell from the ground up, to managing MDC for almost 2 years, putting its financial house in order and steering it through the most difficult days of the pandemic. It's not every day a new marketing company is created with over $2 billion in expected revenue and built on a new generation of services. We're ready to take on the bloated and outdated marketing companies that have not adapted to change fast enough for today's marketplace.

Together, we offer the kind of scale, greater performance marketing that today's clients are seeking, the right combination of world class, award-winning talent and creativity and the kind of data and technology platform that can get the right ad to the right person at the right time. We'll create opportunity all around for employees, clients and investors.

At the core, these capabilities are built around creating one unified offering that has 4 best-in-class parts or, as our investor presentation notes, 4 layers of a delicious cake. First, there is second-to-none creativity and communications. We have some of the best-known names in creative advertising today, Anomaly, Forsman & Bodenfors, 72andSunny, precision, media and data capabilities. We'll start off with buying over $4 billion of media in a year, primarily online media.

Third, rigorous consumer insights and strategy. Our Harris poll this year was exceptionally accurate, right on target, and our sophisticated use of millions of consumer interviews we do each year will drive the strategy on targeting for the entire group.

And fourth, results-driven technology and digital transformation. With over 650 engineers, we will help remake the marketing world, helping companies to convert to new marketing flywheels. We have core agencies here, such as Code and Theory, Instrument and YML. These highly complementary combination built on these 4 layers means that the benefits here far exceed the individual qualities of each company. It enables us to complete a global network while expanding directly into new areas of technology.

We will triple the percentage of companies operating in the high-growth digital service areas, helping to springboard the company to significant growth. The combination also brings with it a host of financial benefits, which Frank will cover in detail, including lower leverage, expanded revenue growth opportunities, operational synergies and expanded pro forma cash generation.

Importantly, we will also be able to accelerate the company's growth over the coming 5 years. Together, we have a plan to grow to $3 billion in revenue in 2025, including acquisitions, organic growth and new products. We aim to transform the marketing services industry from the way we partner with clients to the business solutions that we provide.

We will grow the combined incredible blue-chip client base of both companies as they offer services to top technology, home product, automotive and Fortune 100 and 500 corporations in all verticals. We will offer expanded online marketing services and growing sophisticated and crisis communications areas and in the issues marketing space that is growing by leaps and bounds into the foreseeable future.

Marketing has changed, and this is the first company out there that can grow and expand to meet those challenges at -- here in the United States and in the rest of the world with just the right balance of talent and technology.

With this new model, we're able to capitalize on the proven strengths of each organization, add investment and development in our capabilities and talent and build an offering that can leapfrog to traditional holding companies and consultancies out there.

We won't just supply digital marketing services, but we will engineer digital marketing products that will provide unique platforms and growing SaaS revenue for the new company.

From a strategic standpoint, this combination offers several compelling advantages. As a combined entity with complementary assets offered as integrated services, it has the potential to produce 5% plus annual organic growth driven by 10% to 15% digital marketing growth and complementary capabilities and 9%-plus overall annual growth, including new products and acquisitions.

It also has the potential to generate over $200 million of pro forma cash generation in 2021, providing ample liquidity for reducing balance sheet liabilities and investing in growth. We also see incredible opportunities to drive scale from expanded digital and technology products. At MDC, we've long committed to being a digital-first organization with an eye towards creating data-powered media offerings that combine CRM, off-line media and performance marketing into a world-class digitally-focused platform. Together with Stagwell, we vastly accelerate this commitment, more than tripling MDC's high-growth digital offerings with 32% of the combined business in digital services. Combined, we will also have more than 2,000 media experts across 40 global offices, plus creating $4.4 billion spend in integrated media.

Stagwell also brings deep experience building and developing its own proprietary products to solve for gaps in the marketing ecosystem. Our Harris Compass product puts corporate reputation modeling at the fingertip of every marketer.

Our Profit product jointly developed between Stagwell and MDC uses AI to predict how releases will be covered in the media. Our Qualified platform runs influencer marketing for major brands. These are just growing out now and have significant future potential.

With a track record of collaboration across disciplines and dedicated engineering teams with growing marketing expertise, we anticipate building additional products that will bring the right technology solutions to our client challenges. That effort should generate meaningful top line growth over time. Specifically, we're targeting $75 million of new revenue from new products by 2025.

We expect our integrated services will also drive upwards of $30 million in annualized cost synergies, which does not include the cost to achieve, building on our efforts at MDC over the last 1.5 years. We'll continue to modernize internal workings of our network to drive shared efficiencies and long-term cost savings.

This includes continued integration and centralization of our back office services, more cost-efficient procurement, driven by enhanced scale and unified shared services. Having already delivered similar efficiencies at MDC, we expect it will take roughly 2 years to deliver 90% of these savings.

The organization will be led by an executive leadership team with strong experience in value creation and marketing services made up of leaders from both MDC and Stagwell. MDC and Stagwell's complementary capabilities will also allow for more collaborative global pitching than ever before as our reach expands from over 23 to 23 countries and 67 cities. We already have a record of joint wins, including with Doner and Code and Theory, pitched and 1 major creative client, unseating decades-long incumbents or recent media buys for hundreds of millions of dollars generated by some of the Stagwell companies.

We expect the combination to close in the first half of 2021. Until then, let me again express my excitement on how this will amplify the unique skill sets, capabilities, opportunities across our collective network and unlock phenomenal opportunities for creative collaboration, accelerated growth and investment opportunity.

With that, let me turn things over to Frank.

Frank P. Lanuto - *MDC Partners Inc. - CFO*

Thank you, Mark. This transaction will mark an inflection point for both organizations and gives us the means to accelerate innovation, creativity, growth and profitability that will deliver value to all company stakeholders.

From a financial standpoint, the combination brings a number of benefits, including expanded revenue growth opportunities, operational synergies, greater pro forma cash generation and lower leverage. Let me review each of these benefits.

This combination will create a platform to accelerate the company's revenue growth over the coming 5 years. As Mark mentioned, we have a plan to grow to $3 billion in revenue in 2025 driven by a combination of organic growth, new digital revenue streams and M&A.

Organic revenue has the potential to grow 5% plus, driven by 10% to 15% digital marketing growth and revenue synergies from the complementary, collaborative activities of MDC and Stagwell. New revenue streams from expanded digital and technology products have the potential to add $75 million annually over time. And lastly, we are targeting $325 million of revenue from acquisitions by 2025 from investments in additional services across global markets and in expanded digital marketing products.

Revenue growth from these targeted areas, though, is only part of the potential to be realized from the combination. We also expect to drive significant long-term operating efficiencies with an expected $30 million in annualized gross cost synergies. Combined with our earlier efforts to centralize many of the back-office functions, we expect to leverage air services and best practices to drive additional savings.

We believe we will incur onetime costs of approximately $24 million to fully achieve these synergies over the next 3 years, with 90% of the cost savings being realized in the first 24 months. From a cash flow perspective, we will have more than $200 million in pro forma cash generation in 2021, providing ample liquidity for reducing balance sheet liabilities and investing in high-growth digital assets. This metric is based on pro forma adjusted EBITDA, less CapEx, cash expense and -- cash interest and tax expenses and minority interest.

And to reemphasize Mark's earlier comments, this combination will significantly strengthen our balance sheet. Pro forma leverage will be lowered from 4.2 to 3.4x after giving full effect for run rate synergies.

Now turning to the financial outlook. We expect for 2020, MDC to deliver revenue of approximately $1.18 billion in line with our previous outlook of an organic revenue decline of approximately 10% to 15% but to also deliver adjusted EBITDA of $180 million to $185 million, ahead of the $174 million delivered in 2019. Stagwell's pro forma estimated revenue for 2020 is $890 million with adjusted EBITDA of $138 million. On a combined basis, we expect 2020 pro forma revenue of $2.065 billion to $2.075 billion and adjusted EBITDA of $345 million to $350 million, including the full effect of projected synergies. For 2021, we are targeting between $2.095 billion to $2.135 billion in pro forma projected revenue for the combined entity and $355 million to $370 million in combined adjusted EBITDA, again, including the full effect of projected synergies.

Moving to timing. We expect the transaction will close in the first half of 2021 subject to receipt of all regulatory approvals and other customary closing conditions.

In closing, we are thrilled to bring this combination to the market. This transaction will enable us to capitalize on the strengths of each organization and bring together a deep pool of creative talent and enhanced capabilities to deliver the best-in-class solutions modern marketers need. MDC and Stagwell together present an offering that can leapfrog what it will take the traditional holding companies and consultancies years to build. We look forward to sharing more information with you about this opportunity in the near future.

With that, let's please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) I do see that we have a question, and that question comes from Avi Steiner of JPMorgan.

Avi Steiner - *JPMorgan Chase & Co, Research Division - Executive Director and Senior Analyst*

Just on the 2025 guidance, I had a couple of questions, if I could. One, on the 5% annual organic revenue growth driven by the -- I think you said 10% to 15% digital. I guess, can you size that digital market opportunity, how big that pool of dollars you're going to play in now, really could be now that you're at this bigger combined or will be a bigger combined company, please?

Mark J. Penn - *MDC Partners Inc. - Chairman & CEO*

Well, I think as you point out, we're -- the high-growth digital services that we expect to grow 10% to 15% are roughly about 1/3 of the combined company. I think it's very hard to size that we believe that, that is hundreds of billions of dollars as a marketplace. And we believe that, that is a growing -- while the overall marketplace may be a slow grower, in fact, what's happening is that almost all advertising is becoming addressable.

And the more all advertising becomes addressable, the more you'll only be able to succeed with clients with the right combination of talent and technology.

So the real answer to your question is, the entire advertising marketplace. And what happens here is that, as you, I think, are rightly implying, the individual companies were not as strong together in terms of marketing up to larger and larger client assignments and greater stickiness by being integrated into larger client organizations with these more modern services. I hope that answers your question.

Avi Steiner - *JPMorgan Chase & Co, Research Division - Executive Director and Senior Analyst*

Okay. And then on the M&A component of that growth, should -- I guess, are you thinking about that as complementary to the combined company or perhaps moving into new areas? And then I think M&A historically has been funded with cash. And I guess, DAC, is that the rough plan going forward?

Mark J. Penn - *MDC Partners Inc. - Chairman & CEO*

I think that there are 2 areas that we would want to continue to invest in. One is making sure that we complete an adequate scale of global offering.

Second, to continue to bore into various digital spaces within the marketing community. So as AI becomes more important, as different areas, whether it's influencer marketing, whether it's how we buy media, whether it's around addressable TV, whether it is around digital signage, we will look on the -- in terms of acquisitions to invest in those 2 particular ways. And then in terms of your question, Stagwell's acquisition model has been less DAC, more direct, more direct purchasing. And so we generally -- while that, I think that's one of the tools, we generally don't emphasize that in the M&A work that we've done.

Avi Steiner - *JPMorgan Chase & Co, Research Division - Executive Director and Senior Analyst*

A couple more clarifications. I don't know, Frank, if you want to take them, but I didn't catch cost to achieve synergies.

Frank P. Lanuto - *MDC Partners Inc. - CFO*

Yes. We believe that we'll incur approximately $24 million of onetime costs in terms of expanding financial systems, rearranging contracts, making other certain investments to achieve that run rate of synergies.

Avi Steiner - *JPMorgan Chase & Co, Research Division - Executive Director and Senior Analyst*

Two more. Can you just repeat the use of free cash flow that you highlighted, the $200 million plus, where you think you'd apply that? You'd already talked about M&A, but anything you can help there would be great.

Frank P. Lanuto - *MDC Partners Inc. - CFO*

Mark, would you like me to take that one?

Mark J. Penn - *MDC Partners Inc. - Chairman & CEO*

Yes.

Frank P. Lanuto - *MDC Partners Inc. - CFO*

Sure. So I think it gives us options, Avi. So certainly, we have the opportunity to -- beyond making investments in either new products or new M&A opportunities, certainly an opportunity to reduce leverage further on the balance sheet and strengthen it further.

Avi Steiner - *JPMorgan Chase & Co, Research Division - Executive Director and Senior Analyst*

Okay. Great. Very last one, I think, pretty easy, but the preferred debt converting to sub debt here, the debt maturity, is that beyond the existing bonds?

Frank P. Lanuto - *MDC Partners Inc. - CFO*

So that's a small piece. We're converting $30 million of face at $25 million. So we're taking approximately a 17% discount on it. So it's advantageous from that standpoint, and that will be a subordinated note payable in 3 years. The rest of the security remains intact as permanent equity.

Operator

(Operator Instructions) Seeing no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to Mark Penn for any closing remarks. .

Mark J. Penn - *MDC Partners Inc. - Chairman & CEO*

Thank you for joining us today. As I said at the outset, it is a new day for both of these companies. It is, I hope, a new day for marketing itself as we combine talent and technology into the right kind of scale, creative performance that we think the marketplace is looking for.

This has advantages on the financial side in terms of the combination and then the opportunities for continued and strong growth. Thank you for your continued support of this new effort. We look forward to closing this in early '20 -- early or the first half of 2021. Thank you.

Operator

The conference has ended. You may now disconnect your line. Thank you for attending today's presentation.