Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

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www.btnresearch.com

Lamar Advertising (LAMR) EQ Update- 6/20 Qtr.

Current EQ Rating*	Previous EQ Rating
4-	4-

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "–" sign indicates deterioration

*For an explanation of the EQ Review Rating scale, please refer to the end of this report

We are maintaining our earnings quality rating of 4- (Acceptable)

LAMR reported AFFO of $0.95 in the 6/20 quarter which was 7 cps below consensus targets. We saw some minor red flags in the quarter but not enough to lower our rating yet.

- LAMR's AFFO (adjusted funds from operations) includes and add back of maintenance capital spending. We noted that the company's annual maintenance capex run rate at the time of about $45 million figure looked small when considering that real estate depreciation and amortization expense was well over $200 million. This concern was amplified by the fact that an increasing percentage of billboards are digital (some picked up in acquisitions) and will be expensive to replace. The company's total capex spend fell to $10.6 million in the 6/20 quarter from $25 million in the previous quarter. However, maintenance capex declined to $3.8 million versus $10.6 million in the previous quarter. For perspective, a $1 million decline in maintenance capex adds about a penny per share to AFFO. The company is forecasting maintenance capex expense of $10 million for the second half of the year which compares to $26 million in the second half of 2019. We believe maintenance spending will have to rebound rapidly to avoid problems with displays down the road which will be a drag on reported AFFO growth.

- We note that in 2019, the company was required to capitalize contract fulfillment costs after the mandatory adoption of ASC 606 for revenue recognition. These amounts include costs such as setting up new advertising displays. The company disclosed amounts capitalized and the associated amortization costs. In the 12/19 quarter, the company capitalized $5.6 million in fulfillment costs and recorded amortization expense for $6.4 million. However, this disclosure disappeared in the 3/20 10-Q which the company attributed to the fact that it was no longer material. COVID resulted in a sharp decline in fulfillment costs as few new contracts were being signed. Regardless, we hope to see this disclosure return when conditions normalize as the amounts in question are typically material and should be monitored for signs in changes in the rates of capitalization and amortization.

- Management stated in the conference call that it will recommend that the Board maintain the cash dividend at 50 cps in the third quarter, consistent with the second quarter and half the dividend from the first quarter. This represents an AFFO payout of 53%. The company has cut total capex spending for the second half by more than $67 million versus a year ago and it now expects $60 million in cost savings for the year, up from its original forecast of $50 million. After its recent redemption of $535 million of senior unsecured notes, the company has liquidity of approximately $10 million in cash, $50 million remaining on its receivables securitization facility, and $640 million on its revolver. Management touted in the call that June was very strong for signing up new deals although it saw some leveling off in July as COVID cases spiked. The company should be in a good position as conditions normalize as it is largely located in smaller markets which avoid delays in national advertising campaigns and also are signed over shorter time frames which make for less of a commitment for customers. All of this makes us believe the current dividend is safe for now and will likely be raised quickly as the market returns to normal.

Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

Disclosure

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