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Summary

- Entercom holds a dominant position in the terrestrial radio business, and radio is unlikely to go anywhere soon
- The company is led by the founder's son, a capable owner-operator who has grown the company with a disciplined acquisition strategy and long-term mindset
- Entercom was generating significant free cash flow from its legacy stations pre-CBS merger and will most likely bring acquired CBS stations up to same speed
- Shares have fallen substantially post-CBS merger over concerns regarding the profitability of CBS stations, the company's debt load, and overall opinion of the terrestrial radio business

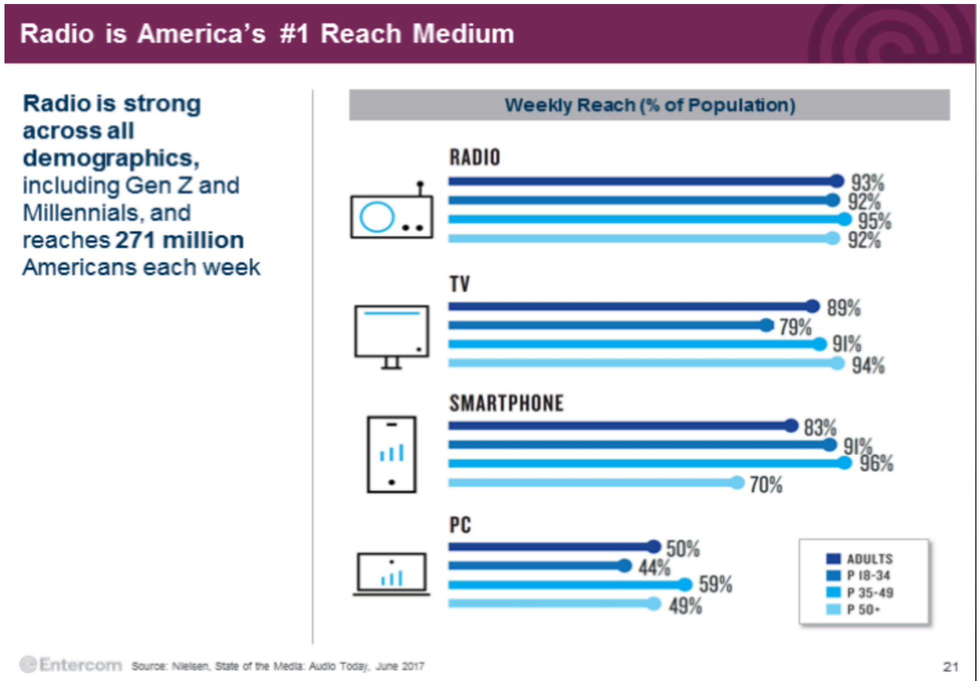
The Second Largest Radio Business

Entercom was founded in 1968 by Joseph Field with the belief that FM radio, not AM, would one day dominate the airwaves. The company grew through acquisitions and improvements to existing stations and listed its shares in an IPO in 1999. That same year, Entercom acquired 43 stations from Sinclair Broadcast Group and became the fifth-largest radio broadcaster in the country. At the end of November 2017, the company completed its massive merger with CBS' radio properties (net of a couple divestitures for regulatory clearance) via a Reverse Morris Trust transaction, continuing its growth trajectory. Now, with 112 million monthly listeners across 235 stations, Entercom has assumed the number-two broadcaster spot behind bankrupt competitor, iHeartMedia, Inc.

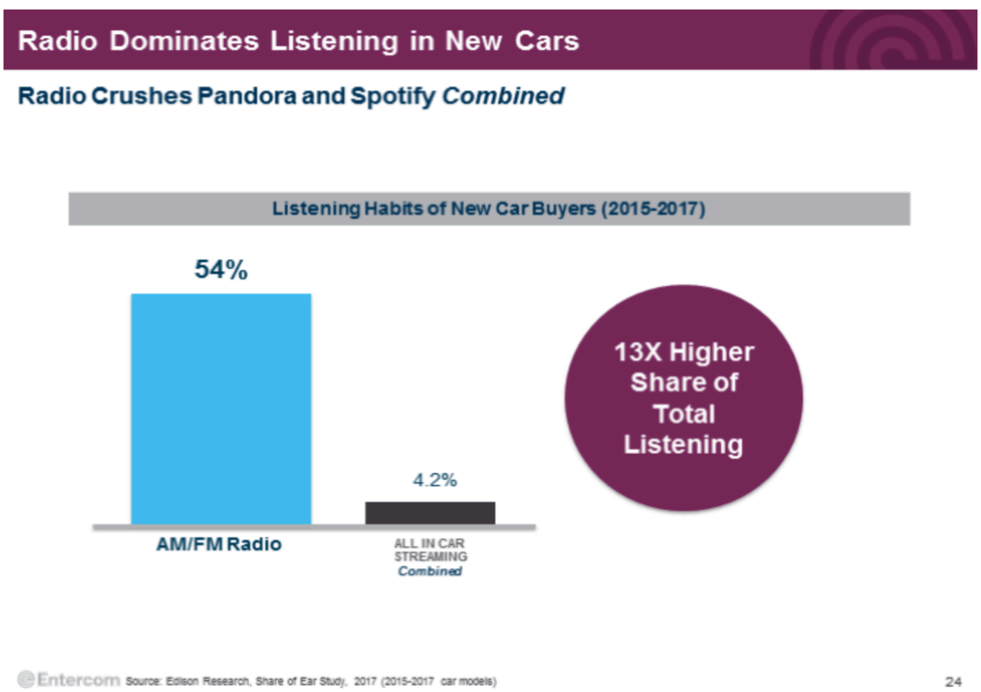
Entercom generates revenue almost entirely through advertising sales on its various radio stations. This is comprised of local radio advertising (the largest portion) and local-station digital products and advertising, both of which are handled directly through the local station-specific sales staff, and national advertising, handled by a national advertising firm. The company's advertising customers are a diverse group and no one customer makes up a large chunk of their revenue.

At first blush, an investor may want to steer clear of the radio business. After all, who wants to listen to radio when they can stream Spotify (SPOT) or Apple (AAPL) music or play their own downloaded library. But after digging a bit deeper, it becomes clear that radio is neither dead nor dying. At worst it is stagnant due to lack of attention from advertisers. However, this may be changing. Proctor and Gamble ventured back into the radio waters in late 2017 after declaring about $100 million in digital advertising ineffective (InsideRadio). They had previously written off the radio medium and instead focused on digital and other platforms. Management stated on their Q3 call that they are seeing renewed interest in the radio medium from other advertisers as well such as Amazon, Google, Uber, and Peloton.

The truth of radio as a medium can be found in the Nielsen and Edison Research data. Radio is unparalleled in its reach compared with other mediums, reaching over 92% of all demographics.



And, in the most technologically advanced cars we have ever made, many with streaming technologies made easily accessible, people still listen to radio. This further supports the Nielsen data that shows that radio has grown weekly listeners over the past 3 years in just about every age bracket. (Slides and Data From [Entercom's Presentation at the Wells Fargo Media & Telecom Conference].)



An investment thesis predicated on significant future increases in radio listeners and ad revenue would be speculative at best. However, Entercom shares are currently priced for a worst-case scenario: either Entercom bankruptcy or the rapid decline of the terrestrial radio business, neither of which are likely.

As the now-number-two radio operator, Entercom has a formidable position in the industry with an economies of scale advantage, especially when it comes to national advertisers. If a company wants advertising exposure to the radio medium, it's pretty difficult to avoid dealing with Entercom. To compound that, Entercom has made it its mission to compete and win primarily in the top-50 largest markets across the country. This goal has significantly increased the company's reach to the most valuable populations for national advertisers. The company owns 7 of the top 8 most-listened-to all-news stations as well as a top-three AM or FM station in Dallas, LA, New York City, San Francisco, and Chicago to name a few. Not to mention, after the CBS radio merger, Entercom is now the largest sports radio broadcast partner with 44 professional teams and numerous collegiate programs. Due to its concentration on the largest markets, Entercom has built-in efficiencies with roughly 63% higher average monthly listeners per station than iHeart across a portfolio of stations that's a quarter the size (as of year-end 2017).

That said, economies of scale by itself is not a strong enough competitive advantage to hold a company to strong returns in the future. Competition is fierce among FM stations, and Entercom is not immune to that competition. The company's real advantage is its highly-invested owner-operator management that is disciplined in both cost and long-term mindset.

Capable CEO & Acquisitive Founder

Entercom is led by David Field, son of founder, Joseph Field. David joined the company in 1987 after working as an investment banker at Goldman Sachs. He served in various positions within the company including COO and CFO before taking the spot as President in 1998 and assuming the role of CEO in 2002 (Entercom Leadership).

Mr. Field has shepherded the company through its grow-by-acquisition strategy focusing on both large transactions, such as the CBS merger and the acquisition of Lincoln Financial Media, as well as small purchases like WBEB-FM Philadelphia in 2018 and a four-station bundle in Charlotte at the end of 2016. Management seems to prefer to cherry-pick single stations or small station groups where significant synergies exist. The team also seems to look for stations and groups with underperforming margins. They are intelligent and disciplined in the pricing of their transactions, generally making year-one-accretive acquisitions. This frugality transfers into their operation of the business as well, exemplified by their sale of an unnecessary $46mm building in Chicago near O'Hare Airport, relocating the legacy CBS station operating there to a $2mm facility.

Mr. Field and the management team take a farsighted view of the business which creates value for shareholders. It is not uncommon for the company to initiate format changes at underperforming stations. Just after the CBS merger, the company initiated three major format changes in top-five markets. This move requires a revenue sacrifice up front as advertisers generally wait until the station's ratings are reassessed to commit ad dollars. This is an illustration of the management team's willingness to invest in the long-term success of the business – something that was lacking at legacy CBS Radio and in many other radio companies.

It's no wonder why Mr. Field is motivated to take this long-term view given his own personal equity stake of just over 3 million A-shares and 749,250 B-shares worth ~$26mm (Recent Form 4 & 2017 Annual Report). More interesting, however, is that Entercom's Chairman Emeritus, founder and David Field's father, Joseph Field, has been a voracious purchaser of shares at their recently depressed levels. As of November 19, Joseph Field owns or controls almost 9 million A-shares and just over 3 million B-shares, the total being worth ~$78mm. Joseph Field purchased almost half of his A-shares, just under 4 million of them, this year alone, showing his confidence in the undervaluation of his company.

What It's Worth

Entercom is a company whose value is masked by, among other things, the shadow of a truly enormous merger and accompanying debt load. CBS radio was roughly double the size of Entercom at the time the two merged, a large pill to swallow. Entercom issued stock and took on debt in order to make it happen. The idea behind the merger was simple: CBS Radio stations were severely neglected and underperforming. Entercom will increase the CBS stations' profitability via cost-cutting measures and synergies and pay down debt with the increased cash flow.

So far, the company is on track to do every part of that. As of Q3 this year, the company has realized $41mm in net synergies YTD and expect to exceed their $45mm target for the year by about $10mm. That's on top of $48mm realized in 2017 putting the company on track to hit their mark of $110mm of total synergies realized by the middle of next year.

For 2017, Entercom had FCF of $67.9mm after removing one-time merger and restructuring costs. CBS broke out the radio unit's FCF in their 2017 10-k, reporting $70mm in FCF. This was significantly lower than prior years, echoing Entercom management's statements on their Q4

’17 earnings call that CBS neglected their radio segment even more severely leading up to the closing of the merger.

Using the two figures for 2017, we estimated 2018 FCF to come in around the $130mm mark before one-time costs. Through Q3 of this year, Entercom has earned $94.2mm in FCF before $27mm in one-time merger-related costs incurred YTD, tracking fairly close to our estimate. It is reasonable to expect the company to generate $100mm - $110mmm in FCF for 2018 or 70¢ per share on the low end before one-time merger costs. With the recent price of $6.50, shares are trading at an implied FCF yield of 10.8%.

This estimate does not include lost revenue from the bankruptcy of US Traffic Network, a reseller of traffic-report ads that legacy CBS stations used. Entercom estimates the USTN bankruptcy has cost ~$30mm YTD through Q3, and that would have gone straight to the bottom line. The company has now brought the sales of USTN ad time in-house, cutting out a middleman unnecessary for a company of Entercom’s scale. Management has stated they expect significant growth from the traffic ad sales in 2019. Absent the lost USTN revenue, the company would be far exceeding our estimates for 2018 FCF.

It’s reasonable to expect annual run-rate FCF of $130mm given this year’s FCF will likely approximate $130mm - $140mm after adding back one-time merger costs and lost USTN revenue. Shares are currently trading at just 7.1x this normalized FCF figure. With an assumption of no growth at all in cash flow and a 10% discount, shares are worth $9.12, 40% above the recent quote. However, management has numerous levers to pull to increase the company’s FCF generation and drive value for shareholders such as improvement in performance and profitability of legacy CBS stations as well as station acquisitions or exchanges. If improved performance of CBS stations leads to just 2% growth in annual FCF, the shares are worth $11.63. With a lesser amount of merger and restructuring costs expected in the coming year, the company’s in-house sales of traffic ads ramping up, and the opportunity for improved profitability of legacy CBS stations, Entercom is set to have a very strong year in 2019 and should reach run-rate FCF in 2020.

Risks

An investment in Entercom is not without its risks, though investors have blown these risks out of proportion leading to the company’s depressed share price. Entercom, similar to its competitors in the radio business, is highly leveraged. As of September 30, 2018, the company had net debt of $1.65B, reflecting net leverage of 4.4x. With a weighted average cost of debt of 5.5%, the company’s expected annual interest expense is approximately $91mm (measured on net debt), covered 2.68x by LTM adjusted EBITDA. Compare that to bankrupt competitor iHeart, which operated with average interest coverage of a razor-like ~1.07x for the three years ended 2016 and Cumulus which had negative EBITDA for the past three years. Most of Entercom's debt does not come due until 2024 allowing for significant debt paydown or refinancing if the need arises.

Entercom does operate in an industry that's sensitive to the economic cycle, and this may have some effect on the company's ability to pay down its debt. However, it would be unlikely to push the company to the point of insolvency. Should we see another financial crisis akin to 2008 in the coming year, the company's EBITDA could decrease by ~20%, assuming constant margins. This is roughly the decrease in Entercom's revenues from peak to trough (2007 – 2009). Applying this scenario to the LTM adjusted EBITDA figure yields a tighter but still-acceptable interest coverage of 2.1x.

Entercom also faces the risk of not being able to increase the profitability of legacy CBS stations. Should the company's EBITDA margins drop to an industry average in the low to mid-teens, this will challenge the company's ability to return cash to shareholders and pay down debt.

Disclosures

I am/we are long ETM.

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