

OUR FAVOURITE STOCK RIGHT NOW

Instrument (Inception)*	April 2015 Return	Year-to-Date Return	Compound Growth
Venator Founders Fund (March 2006)	-1.5%	1.9%	15.1%
Venator Partners Fund (July 2014)	-1.6%	1.6%	-
Venator Investment Trust (September 2007)	-1.6%	1.8%	11.5%
Venator Income Fund (August 2008)	0.4%	3.6%	14.9%
Venator Select Fund (September 2013)	-3.5%	-7.6%	26.8%
S&P/TSX Total Return (March 2006)	2.4%	5.1%	5.9%
Russell 2000 (March 2006)	-2.6%	1.7%	7.2%
S&P Toronto Small Cap (March 2006)	4.7%	4.5%	1.5%
S&P 500 (March 2006)	1.0%	1.9%	7.7%
Merrill Lynch High Yield Index (August 2008)	1.2%	3.8%	10.1%

Every now and then you spot an obvious opportunity. This doesn't guarantee that the stock is a sure thing, but it's just so good that the likelihood of being right is likely 75% or more. Plus you find you have that great "margin of safety" where the value is so deep and the upside so great that the risk/reward formula seems totally out of whack. There are lots of big winners in the market every year. Many of these are speculative, or momentum stocks, or corporate finance driven opportunities. To get the deep value you probably need to be a little contrarian, but that that doesn't preclude the obvious merits of the investment.

Enter Entercom, a plain old radio company, and one of our largest holdings. Entercom popped-up on both our equity and debt screens at the same time due to its strong free cash flow generation, its aggressive deleveraging of its balance sheet, and close to 15 years worth of tax shields. But again it's in the plain old radio business, which is supposedly on the decline which why the stock is so cheap, and had little sell-side analyst coverage. But therein lies the opportunity, for if the sector wasn't so out of favour, we never would have been able to steal 4% of the shares outstanding at current level.

In terms of the investment thesis there are just so many levers to pull beyond the cheap base business that we need to stack up the opportunity:

- **The Base Business:** Entercom is a stable no-growth business with tremendous free cash flow amounting to \$55MM per year, or \$1.45 per share, putting the stock at a cheap valuation of around 9x free cash flow.
- **The Refinancing:** Entercom got themselves in a little trouble not so long ago with a total debt burden of \$840MM, however it has paid down nearly half of that in the last seven years bringing its debt/EBITDA ratio down to about 4.5x. This balance sheet improvement should allow the company to refinance its debt in short order at significantly lower rates (we own the debt as well). Based on our assumed refinancing rates, we estimate that simply refinancing these existing bonds will create a \$0.25 - \$0.30 increase to cash flow per share to \$1.70 - \$1.75.
- **The Acquisition:** Entercom is currently in the process of closing the acquisition of Lincoln Financial (pay no attention to the name, it's a radio company). Management is being pretty cagey about the effect of this deal on the bottom line, but we are guessing (this is below the confidence level of estimating), that the deal will yield an incremental \$0.20 to free cash flow, bringing the total to \$1.90 - for a stock trading at \$12.00!

- **The Tax Assets:** Entercom will probably not pay any material taxes for the next fifteen-plus years. This is very important. When you won't pay taxes for three or four years, you probably need to value the company on a fully-taxed basis. But when you trade at 6x free cash flow and won't be paying taxes for over 15 years then you can pretty much value the business untaxed, which creates a lot of value versus a tax-adjusted P/E ratio (which is what the analyst estimates are based on). In fact, with their free cash flow they could possibly pay down all of their debt in around seven years, at which point (assuming no growth) they would have free cash flow of over \$2.50 (thanks to the elimination of the interest expense) and still have seven years of tax-free earnings available to them!

So why is this stock so cheap? Even a recent analyst initiation rated the company a "hold" despite projections similar to ours; the rationale was that the company was at the mid-point of its historical free cash flow range of 2x-12x (because 2x in 2008/9 with an over levered balance sheet wasn't considered an anomaly). Aside from neglect (other companies in this industry trade at around 11x free cash flow which would imply a \$20.00 target for Entercom), they are in the radio business, which investors appear to equate as like being in the black and white television business back in the 1950s. We think this characterization is somewhat unfair, and that radio isn't going away.

- Radio is the second most consumed media in America. At 2.8 hours per day, it trails only television at 5.0 hours and is ahead of the internet at 2.0 hours (much of which could be work use as the study didn't differentiate between business and casual use). Yet in terms of advertising spend radio ranks fourth behind newspapers (0.3 hours per day of consumption). That is quite the mismatch.
- Radio is the #1 medium from 5AM to 5PM. Interestingly online and mobile are fairly close suggesting that the Nielson research had difficulty differentiating between work and casual. 93% of Americans listen to radio on a weekly basis.
- Nielson also cited an average \$6 lift for every \$1 spent on radio ads, double that of other mediums such as television and digital.

So with these things going for the radio industry, what are the common perceptions and misperceptions that keeps this industry more or less ignored by general investing public? Firstly, as mentioned above, users and hours of consumption are actually pretty stable, but the perception of radio as a stale medium has shifted the ad dollars elsewhere to hotter properties such as digital and mobile. Perception becomes reality until the advertising spending finds its way back.

Radio is, for now, the superior listening service for local news, traffic, sports, weather and local tastes. Talk radio and sports radio are extremely localized and cannot yet be serviced by alternative "one size fits all" formats adequately. Spotify, Pandora and Slacker radio still haven't found a way to have engaging commentary over the Blue Jays mediocre start, or the Raptors playoff collapse, through interviews with their respective GMs and Coaches.

With regard to music, it's true that streaming services have stolen some share, but much of that share has been at the expense of the CD players (for the generation Xers out there; 8-tracks for you baby boomers). Some personalities still draw a crowd, otherwise Sirius wouldn't be paying millions to Howard Stern, and local giveaways are hard to facilitate on platforms targeted North America-wide.

So we aren't that bearish on the prospects for radio. If anything we think (pure speculation) that at some point advertisers might come back to radio beyond just local businesses. This would be beneficial relative to lower budget local small business ad dollars, which generally aren't very large.



I don't really like writing about/defending the industry. Frankly I think that management spends entirely too much time with investors defending an industry no one wants to hear defended, when they should be bludgeoning investors over the head with their free cash flow story which is among the best in the stock market (to be fair, they do talk about the free cash flow, it's just buried on page 23 of their slide presentation).

Finally, we don't tend to buy a lot of companies that have "catalysts" because usually those catalysts are built into the stock (even if they have a less than 50% chance of occurring). But in this case we have several that I believe have a high likelihood of happening:

- **The final announcement of the Lincoln acquisition:** They have announced the deal but not the financial impact. Industry scuttlebutt is that this deal was done on very favourable terms, but the Department of Justice has been holding up the deal because on closing Entercom will have over 30% of female listenership in Denver (yes that is as stupid as it sounds). The company has already agreed to sell off one station. I can't imagine this kills the deal, but radio is an old business regulated by people using rules drawn before the emergence of television so we have to be a little patient.
- **A dividend announcement:** Yeah, I know I *said* they could pay off all of their debt in around seven years but the reality is that it's highly unlikely they will. What they have already stated is their desire to pay a dividend with all that cash flow. \$2.00 of free cash flow and a stock trading at only 6x that numbers leaves the potential for a pretty juicy yield should they choose to do so.
- **The refinancing of the debt:** This will come later this year. The Company could do it today, but they are waiting (excitedly I might add) to announce what financial impact the acquisition will have on the business which could get them more favourable terms on the new debt.
- **The final impact:** The above should help, but it's possible that no one is really listening. That being said, the new numbers that will start in 2016 will be so impactful that I believe they will be impossible to ignore by the small handful of analysts following the stock, and will likely hit a number of "quant" screens along the way.

There are no sure things in the stock market before the fact. You can only maximize your likelihood of winning and minimize your chances of losing. Margin of safety literally means finding stocks with little downside first, and solid upside second. This is the hunting ground for doubles (the hunting ground for short term quintuples tends to carry much more risk at the outset; Boyd Group (up over 10x) looked more like a double when we first bought it, while Concordia (up over 10x) was far more speculative. While I am sure there are unforeseen events that can go wrong with the stock, some of which might cause us to abandon our position, I believe that risk-reward relationship to be firmly on our side here. On the one hand, I really like my chances with this one. On the other hand . . .

We reserve the right to change our mind!

A handwritten signature in black ink, appearing to read "BO", is positioned above the typed name of the CEO.

Brandon Osten, CFA
CEO, Venator Capital Management Ltd.

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