Value Investing 4443 Section 3 – Group 2

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Value Investing Initial Screening Analysis

Obscure: With the initial screen of Townsquare Media ("the Company" or "TSQ") as a value stock, we looked at market capitalization to be below $1.2bn for American small-cap equities with low analyst coverage. TSQ is below the threshold with only a market capitalization of $130mm but has medium analyst coverage.
Undesirable: TSQ has a P/E and P/B of 5.9x and 0.35x, both below the target of 13x and 1.2x respectively. Furthermore, TSQ filed for Chapter 11 bankruptcy in 2010, further highlight the undesirability of the business. Due to the relative obscurity of the company as well as its low trading multiples, we believe that TSQ is potentially undervalued and we will proceed with a valuation analysis.

Business Risk

Townsquare is a radio, entertainment, and digital marketing solutions company focused on local advertising and marketing solutions in small and mid-sized markets across the United States. The company has two operating main segments, local marketing solutions and entertainment:
Local Marketing Solutions (69% of Revenue): Although the business risk of media businesses is typically a medium-high, we believe that TSQ is insulated from the business cycle relative to the industry. Firstly, it holds the number one or number two market share position in 66 of its 67 markets. Since the business operates in small-medium markets, most of its customers in the radio business are small local businesses, providing it with pricing power over its customers. The company also deliberately assembled a portfolio of stable, locally significant institutions such as universities, military bases and regional medical centres, which further reduces the volatility of advertising spend in its markets. Additionally, the business's operating margin are over the last 6 years are relatively stable (Exhibit 1). Therefore, we believe the business is a *medium-low* business risk.
Entertainment (31% of Revenue): The majority of TSQ's volatility is driven by the entertainment/live events business, as shown by the historical operating margins segmented into local marketing solutions and entertainment (Exhibit 2). The live events business is characterised by strong growth but low margins and limited barriers to entry. Furthermore, the industry is largely driven by per capita disposable income. Therefore, we believe the entertainment business is a *medium-high* business risk.
With *medium-low* for radio and *medium-high* for entertainment, we business TSQ overall has a *medium* business risk.

Financial Risk and WACC

Financial Risk: With a business risk of *medium* the optimal capital structure for the business is 30-49%. Management has averaged a debt to capital ratio of 64% over the last 4 years (Exhibit 3), outside of the optimal capital structure; suggesting the company has a *high* financial risk.
WACC: With a M-H risk, the credit rating of the business is likely in the range of BBB-B (Exhibit 4). Further credit analysis would suggest a rating of BB, which we used to determine the K_d. With a M-H risk, an ERP of 5.9% of was used which resulted in a WACC of 6.52% (Exhibit 5). This compares to our first pass ROIC of 4.2%, which is lower than WACC, implying NAV > EPV (Exhibit 6).

Strategic Valuation

NAV/Share is $16.35 (Exhibit 7). The largest drivers to the NAV value is TSQ's Intangibles (FCC licences), Goodwill and PPE. Since Goodwill accounts for less than 25% of total assets, the book value of the asset was taken. Customer relationships was assigned a multiple of 1.75x due to radio advertising effectively being a commodity but adjusted upwards due to TSQ's power over their small business customers.
EPV/Share is $9.53 (Exhibit 8). We used an average operating margin over the last six years to arrive at an average margin of 15.34%. The second pass ROIC of 5.26% is lower than TSQ's WACC of 6.52% (Exhibit 9). This is consistent with our valuation of NAV > EPV. All additional valuation adjustments for the NAV and EPV can be found in Exhibits 10-16.

Valuation of Catalyst Realization

Management: TSQ's management has shown a poor ability to manage capital as they continue to allocate capital towards its poorly preforming live events business, a business with lower operating margins and limited barriers to entry. Exacerbating this challenge is the manager in charge of Live Events, Dhruv Prasad, who is operationally incompetent and having never worked in the media and/or entertainment space prior to his tenure at Townsquare.
Excess Capacity: The asset turnover in the industry is weak, particularly on a national level, driven by fragmented competition and capital intensity. Excess capacity exists in larger US markets. But on a local level, there is less competition and lower volatility in advertising spending, as a result, we don't think excess capacity is an issue in the local markets TSQ operates in.
Competitive Disadvantage: Given TSQ's local scale, national reach and recognizable radio stations, there is little evidence to suggest that a competitive disadvantage exists.

Probability of Catalyst – While divesting the entertainment business would be the best path forward, Madison Square Garden company executed a strategic investment in TSQ for 12% in 2016 specifically to gain exposure to its entertainment assets. Therefore, it is unlikely management pursues a divestment of the entertainment business because such a large shareholder has an explicit interest in that segment of the business. Additionally, current management, was hand-picked by Oaktree during bankruptcy; as a result, we believe there is a low probability (20%) that management is changed and the difference between NAV and EPV is realized.

Recommendation (Exhibit 17/18)

Value of Catalyst: $6.81	**Intrinsic Value: $10.89**	**Entry Price: $7.26**	**Current Price: $7.00**	**Decision: Buy**