SAGA COMMUNICATIONS -CL A SGA

August 24, 2019 - 4:43am EST
by andreas947

			2019	2020
Price:	29.00	EPS	0	0
Shares Out. (in M):	6	P/E	0	0
Market Cap (in $M):	174	P/FCF	7	0
Net Debt (in $M):	0	EBIT	0	0
TEV ($):	145	TEV/EBIT	0	0

Description

Saga Communications (SGA)

Summary

We focus on smaller companies with “Ft. Knox” balance sheets and large & sustainable free cash flow yields and we are typically seeking a double-digit FCF yield or higher on an unleveraged basis. The objective is for the sustainable FCF to eventually drive up the share price to a more reasonable valuation, through share buybacks, debt reductions, dividends, or accretive acquisitions. Obviously, it is important we have a management team that cares about shareholder value. We focus on small-cap stocks because there is a much better chance to find an attractive investment opportunity which is under-followed or undiscovered.

Saga Communications (SGA) is an under-valued radio broadcaster which has one of the strongest balance sheets in the radio industry and trades at a large discount to our estimate of intrinsic value. SGA has only 6m shares outstanding and its trading volume is quite light, so this idea is likely appropriate for PA accounts or small- and micro-cap funds. However, several major investment firms have been able to assemble meaningful stakes over time, including Tower View (Tisch Family) and Fidelity Low Priced Stock (Joel Tillinghast).

SGA’s shares currently trade at about $29 per share with about 6m shares outstanding for a market cap of $174m. SGA has a “Ft. Knox” balance sheet with net cash position of about $30m as of 6/30/19 for a total enterprise value (EV) of about $145m. LTM EBITDA is about $30m (includes $2m in management comp expense). SGA is currently trading at about 5x LTM adjusted EBITDA. We think EBITDA can improve modestly in 2020 and SGA can achieve stable same station revenues. SGA is trading at multiples below most other public radio broadcasters, many of which are much more highly leveraged (4x to 7x net debt to LTM EBITDA). (See our Industry Comparable Companies comparison below).

We believe SGA can sustainably generate close to $20m of free cash flow p.a. with its current group of radio stations. SGA currently trades at a 13%+ unlevered free cash flow yield in a world with 10-year treasury rates of 2%. We believe this valuation is attractive, especially considering that SGA can likely use its strong free cash flow and “Ft. Knox” balance sheet to continue to add more small market radio stations at accretive multiples. SGA also has a $70m credit line which is largely unused. Importantly, we look at unleveraged free cash flow yields in our investments and on this basis SGA is even more attractive compared to other radio broadcasters who have very significant net debt positions relative to their cash from operations (generally the best indicator of their ability to pay their debt down).

We believe SGA’s “Ft. Knox” balance sheet and conservative, smart, and focused management team is a significant competitive advantage for investors. CEO Ed Christian and CFO Sam Bush are significant shareholders of SGA and we believe among the smartest investors in small market radio (or any size radio for that matter) today. We have followed them and invested in them for many years. We believe they are great partners for outside shareholders and will be prudent and smart with our capital. CEO Christian has voting control of SGA via super-voting Class B shares and we are fine with that based on his long-term track record.

We previously wrote up SGA in December 2010 on VIC and the investment performed well and we closed out the position at an 80%+ gain. Since then, SGA has paid down its net debt and sold the few TV stations it owned and built up a strong net cash position of close to $30m at 6/30/19 while continuing to generate strong and stable free cash flows. Over this period, SGA’s same station revenue has been relatively stable. While we certainly recognize radio is unlikely to achieve strong same station revenues we believe, especially in the local markets that SGA focuses on, radio has a viable long-term competitive position and can continue to generate strong cash flows well into the future.

We believe there is long-term value in the radio industry as a low-cost form source of advertising, particularly in the small markets where SGA’s radio stations are located. Several larger radio broadcasters are leveraged at 4x to 7x adjusted EBITDA while SGA trades with no debt at about 5x adjusted EBITDA. The bankruptcies of I-Heart (IHRT) and Cumulus (CMLS) are more related to over-leverage of good broadcasting assets than significant organic growth problems.

There appear to be some smart investors who see value in SGA’s small market radio broadcasting business. Tower View Capital (Dan Tisch) has been a long-time shareholder of SGA with a current position of about 1.1m shares or about 23% of total Class A shares outstanding. Fidelity Low Priced Stock (Joel Tillinghast) owns about 500,000 shares of SGA or about 10% of total Class A shares outstanding.

Based on 8x our estimate of adjusted EBITDA of $32m in 2020 (excluding acquisitions) plus $50m plus in estimated net cash by year end 2020, SGA would have a market cap of close to $300m or about $50 per share versus the current $29 share price (+72%).

Business Description

SGA is a radio broadcaster operating in smaller markets, whose business is devoted to acquiring, developing, and operating broadcast properties. SGA owns or operates broadcast properties in 27 markets, including 79 FM radio stations, 34 AM radio stations, and 77 metro signals. The Company’s radio stations employ a variety of programming formats including Classic Hits, Adult Hits, Top 40, Country, Country Legends, Mainstream Hot Contemporary, Pure Oldies, Classic Rock, and News/Talk. The Company serves various markets including Bellingham, Washington; Columbus, Ohio; Charleston, South Carolina; Asheville, North Carolina; Portland, Maine; Norfolk, Virginia; Milwaukee, Wisconsin; Manchester, New Hampshire; Des Moines, Iowa; and Ocala-Gainesville, Florida. SGA’s strategy is to operate the top ranked stations in mid-sized markets, which management defines as markets ranked from 20 to 200 based on Radio Market Report. SGA concentrates on development of strong, decentralized local management, which is responsible for the day to day operations of the stations it operates.

SGA sold its remaining TV stations in 2017 and is now a pure play small-market radio broadcaster. SGA was founded in 1986 and headquartered in Gross Pointe Farms, MI.

During 2018, radio stations in the company's five largest markets contributed the following percentages of total net operating revenues: Milwaukee, Wisconsin (12%); Manchester, New Hampshire (5%); Des Moines, Iowa (7%); Columbus, Ohio (11%); and Norfolk, Virginia (6%). SGA is a strong local operator in its markets with multiple stations in most of its major markets and generally a #1 or #2 consolidated ranking in those markets.

We think the radio broadcasting business will continue to be a pretty good business going forward. We especially like the local focus of SGA's business, with close to 87% of total revenues generated by local advertising. We believe in these smaller cities, the advertising reach of free radio is difficult to match, especially for small businesses which are trying to quickly reach their local market customers. We certainly recognize there are new technologies out there as well as Pandora, Spotify, and Sirius XM, etc. but SGA's radio stations are delivering as many listeners to their advertisers as ever.

Exceptional Management Team Oriented Towards Disciplined, Long-Term Value Creation

We like the management team at SGA which is led by CEO Ed Christian and CFO Sam Bush. Ed Christian is SGA's second largest shareholder and controls 60% of voting shares through his ownership of 100% of its Class B stock. These guys are conservative, disciplined, long-term operators who may not be flashy but are strong radio operators who take a low-risk approach that we like. Their balance sheet at $30m of net cash is much stronger than most other industry players, many of whom are leveraged 4x to 7x adjusted EBITDA.

Management's response to the sharp downturn in 2008-9 was very impressive as revenues fell from $140m in 2008 to $121m in 2009 while EBITDA only declined from $33m in 2008 to $28m in 2009. This was primarily due to aggressive reductions in operating expenses and corporate G&A expense which offset reduced ad revenues. Due to these expense reductions, SGA was able to generate cash from operations of $27m, $25m, and $26m in 2007, 2008, and 2009 and rapidly deleverage the balance sheet.

Attractive Valuation with Large and Sustainable Free Cash Flow Yield

SGA is currently trading at about 5x adjusted EBITDA, which is attractive for a business such as free radio that requires relatively little capital investment and produces large amounts of free cash flow. We believe SGA can sustainably generate free cash flow of close to $20m per year as compared to its current enterprise value (EV) of about $145m which results in an unleveraged FCF yield of 13%+. We believe this is highly attractive when compared to 10-year treasury rates near 2% and in a world that is contemplating negative interest rates. At this valuation, we believe there is a large amount of room for errors, uncertainties, and surprises, either in the economy or specific to SGA

Local Market Focus Provides a Strong Competitive Advantage

About 87% of SGA's gross revenues in 2018 were generated from local advertising in SGA's markets. We believe the Company is deeply entrenched in its local markets and has built hard to replicate relationships with local advertisers. Strong relationships exist with local listeners as the Company's stations emphasize local news and weather that is important to listeners in its markets. By focusing on information that is specific to its local markets and that is important to listeners, SGA creates a strong competitive advantage. SGA's management team is very selective in the local markets where it operates radio stations. They are also very effective at driving strong ratings through programming that resonates in these small markets and this translates into greater share of advertising dollars in these local markets. In general, SGA's revenues have held up better than other broadcasters during downturns due to this important local focus.

Radio Industry Consolidation Opportunity in Smaller Markets

We believe there will be consolidation in the small market radio industry as radio broadcasters seek to strengthen their local market positions for advertising customers. We believe the radio broadcasting industry has shown resilient results but the lack of strong same station revenue growth will tend to drive sales and consolidation in those smaller markets.

We believe SGA will use its "Ft. Knox" balance sheet and strong free cash flow generation to selectively acquire accretive small market radio properties that fit well with management's long-term operating philosophy. We think these key strengths provides it with a competitive advantage and could allow them to pick up some smaller, distressed properties at attractive prices.

In January 2017, the Company purchased a radio station in Charlottesville, Virginia for $1.7m; in May 2017, several radio stations in South Carolina were purchased for $23m; and in October 2018, several stations near Ocala, Florida were purchased for $9.3m.

Radio Advertising Markets Continue to Be Stable

The radio industry has produced stable revenues over the past few years despite predictions of its demise. The bankruptcies of I-Heart (IHRT) and Cumulus (CMLS) have tainted the radio broadcasting industry in general, but these were due to excessive leverage. The underlying same station revenue growth most radio broadcasters has been relatively stable and resilient in recent years.

"Ft. Knox" Balance Sheet Today; Rapid Deleveraging During 2008-9

SGA has a "Ft. Knox" balance sheet today with a strong net cash position of almost $30m and close to $70m in unused credit facilities. Most radio broadcasters are highly leveraged so this strong balance sheet should be a competitive advantage.

Further, SGA's management responded aggressively to the downturn in 2008-9 by rapidly deleveraging the balance sheet to reduce risk using its strong free cash flow. Net debt was close to $130m in early 2008 was reduced to $90m by year end 2010 and further to a net cash position of about $30m today.

Strong Cash Flow Generation, Even During 2008-9

SGA has consistently generated strong cash from operations and FCF. Cash from operations has averaged close to $25m in the last three years. Further, SGA's cash flow from operations for 2007, 2008, and 2009 were $27m, $25m, and $26m, respectively, which is very impressive considering this period represents one of the steepest declines in advertising expenditures in 40 years. SGA sharply reduced its expense structure in response to the downturn in 2008-9 and, as a result, despite a large decline in revenues from 2008 to 2009, SGA's free cash flow was $17m to $18m for 2008 and 2009.

Potential for Accretive Acquisitions, Share Repurchases, and Special Dividends.

SGA management has several tools at its disposal to drive long-term shareholder value and they have used all of them over the last several years. SGA has been focused on accretive acquisitions and special dividends in the last five years. The Company has paid cash dividends of $8.6m in 2018, and $11.8m in 2017, and $7.6m in 2016 including special dividends, or about a 5% cash dividend yield per year at current prices.

However, it is noteworthy that SGA bought back a large amount of stock in 2008, spending about $18m to repurchase a large portion of outstanding shares. We believe that management would consider another such repurchase as the balance sheet continues to deleverage if accretive acquisition opportunities are not available and its share price remains depressed.

Well Positioned for Long Term Growth in the U.S. Economy

We believe radio advertising is an important and very cost-effective medium for local businesses to reach potential customers, especially in the small markets in which SGA operates. In our view, SGA is essentially a bet on continued long-term economic growth in its key geographic markets such as Milwaukee, Wisconsin; Manchester, New Hampshire; Des Moines, Iowa; Bellingham, Washington; Columbus, Ohio; and Charleston, South Carolina. We are extremely confident in the long-term prospects for these markets.

Conclusion and Target Price

At 8x our estimate of EBITDA for 2020 of about $32m plus $50m of net cash at year-end 2020, SGA would have a market value of close to $300m or about $50 per share (+72%). If SGA's management team continues to execute and the radio broadcasting industry continues its stable performance, we think our target prices could be achieved.

Major shareholders (a)

Tower View LLC	1,170	23%
T. Rowe Price	629	13%
FMR (Fidelity Low Priced Stock Fund)	508	10%
Royce & Associates	502	10%
Dimensional Fund	422	8%
Edward Christian, CEO ****	922	%

*** CEO owns 100% of Class B stock

stock which has 10 votes as compared to one vote for Class A

SGA had 5.0m class A shares and 0.9m class B shares outstanding with class B shares having 10 votes per share

(a) Ownership of Class A shares

Price per share	$29		
Shares outstanding	6.0		**Average Daily Volume**
Market value	$175		8,000
52-week range	$28.00	$38.25	

Income statements FYE 12/31	2014	2015	2016	2017	2018	6mos 2018	6mos 2019
Sales	$134	$112	$119	$118	$125	$60	$60
Gross profit	$36	$29	$32	$30	$29	$	$
SG&A expense	$9	$10	$11	$12	$10	$5	$5
EBITDA	$34	$24	$27	$25	$27	$11	$12
EBIT (before items)	$27	$19	$21	$19	$20	$8	$9
Net income	$15	$13	$18	$55	$14	$6	$6
EPS	$2.55	$1.58	$2.20	$3.77		$1.03	$0.96

Cash flow stmts. (1) FYE 12/31	2014	2015	2016	2017	2018	6mos 2018	6mos 2019
Net income	$15	$13	$18	$55	($3)	$6	$6

Dep & amort	$7	$5	$6	$6	$9	$3	$3
Non cash adjust	$5	$2	($3)	($38)	$18		
Working capital chgs.	($2)	$1	$0	$0	$1		
Cash fr operations	**$25**	**$29**	**$22**	**$24**	**$26**	**$13**	**$13**
Capital expenditures	($6)	($4)	($4)	($6)	($6)	($3)	($3)
Dividends	($10)	($6)	($8)	($5)	($12)	$0	$0
Share repurchases	($12)	$0	$0	$0	($2)	$0	$0
Other	$1	($12)	($13)	$43	($9)	$0	$4
Est. free cash flow	**$19**	**$18**	**$18**	**$18**	**$**	**$**	**$**

Balance sheets

FYE 12/31	**2014**	**2015**	**2016**	**2017**	**2018**	**6/31/19**
Cash	$18	$18	$27	$27	$45	$39
Total assets	$192	$192	$196	$196	$248	$247
Total debt	$36	$36	$36	$36	$20	$10
Shareholder equity	$115	$115	$125	$125	$185	$189
Shares outstanding *		5.8	5.8	5.8	5.8	5.8

(1) Cont. ops.

Valuation & Valuation Ratios

Market value	$175	Enterprise value / EBITDA	5
Net cash	($30)	Enterprise value / EBIT	
Preferred stock	$0	Enterprise value / Cash fr Ops	6
Enterprise value	$145	Ent. value / Free cash flow	7
		Market value / Cash fr Ops	8
		Market value / Free Cash Flow	

Quarterly Consolidated Results

	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019
Net operating revenue	$31.5	$28.0	$32.2	$31.7	$32.9	$27.8	$32.2
Station operating expense	$23.2	$23.4	$23.1	$23.4	$23.8	$23.2	$22.9
Corp. G&A exp.							
Operating income ex items	$5.3	$2.0	$6.2	$5.3	$6.0	$2.0	$6.6
D&A expense	$1.8	$1.6	$1.7	$1.6	$1.8	$1.7	$1.7
EBITDA	$7.1	$3.6	$7.9	$6.9	$7.8	$3.7	$8.3

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Industry Comparable Public Companies

	Saga Com SGA (owns79 FM & 34 AM radio stats)	iHeartMedia, Inc. IHRT (owns and operates 854 stations in 160 markets)	Cumulus Media, Inc. CMLS (owns and operates 428 stations in 87 markets)	Entercom Comm ETM (operates 235 radio stat in 48 markets)
Cash	$39	$127	$21	$30
LTD	$10	$5.8b	$1.2b	$2b
Net Debt	$29	$5.7b	$1.1b	$2b
S/E	$247	$2.8b	$434	$1b
Price	$29	$13	$14.93	$3.70
Shares	5	64	17	143
Market Cap	$172	$831	$240	$527
Enter. Value (EV)	$145	$6.6b	$1.4b	$2.5b
Rev - LTM	$125	$3.6b	$1.1b	$1.5b
Adj EBITDA - LTM	$28	$1.0b	$233	$326
EV to Adj EBITDA	5.2x	6.6x	6.0x	7.7x
EV to LTM Revenues	1.2x	1.8x	1.3x	1.7x
Capex – LTM	$6	$100	$25	$52
Cash from ops – LTM	$25	$482	$84	$125
EV to OCF – LTM	6.0x	12.4x	16.7x	20x

Industry Comparable Public Companies

	Saga Com	Townsquare Media, Inc.	Beasley Broadcasting Group	Entravision Comm
	SGA (owns79 FM & 34 AM radio stats)	TSQ (owns 321 radio stats in 67 small to mid size mkts)	BBGI (owns 64 radio stats in 15 markets)	EVC (owns 55 TV stats & 49 radio stats incl 38 PM & 11 AM)
Cash	$39	$63	$12	$166
LTD	$10	$600	$280	$295
Net Debt	$29	$537	$268	$129
S/E	$247	$344	$279	$303
Price	$29	$6.10	$3.35	$3.08
Shares	5	19	28	85
Market Cap	$172	$116	$94	$262
Enter. Value (EV)	$145	$656	$356	$390
Rev - LTM	$125	$430	$264	$291
Adj EBITDA - LTM	$28	$102	$52	$58
EV to Adj EBITDA	5.2x	6.6x	6.9x	6.7x
EV to LTM Revenues	1.2x	1.5x	1.4x	1.3x
Capex – LTM	$6	$19	$7	$25
Cash from ops - LTM	$25	$39	$25	$37
EV to OCF - LTM	6.0x	16.8x	14.2x	10.5x

Catalysts

1. Strong free cash flow generation; net cash position should build by $20m+ per year, but more likely used to acquire additional small market radio stations.
2. Low valuation of 5x LTM EBITDA and 13%+ unleveraged FCF yield.
3. “Ft. Knox” balance sheet with net cash position of $50m by year-end 2020.
4. Major share re-purchase or large special dividends.
5. Possible acquisition of SGA by a strategic or financial purchaser.

Risks

1. Economy turns down sharply, especially in SGA’s small markets.
2. SGA misallocates capital into a poor acquisition.
3. New technologies or services materially impact the radio industry and SGA.

Disclaimer

Disclaimer: We own shares of SGA. We may buy or sell these shares at any time without notice. The information in the write-up is believed to be correct as of the date written but VIC members should do their own verification of this information and analysis of this potential investment. We undertake no obligation to update this write-up if new information arises at a future date.

I do not hold a position with the issuer such as employment, directorship, or consultancy.
I and/or others I advise do not hold a material investment in the issuer's securities.

Catalyst

See above

Messages

Subject questions
Entry 09/06/2019 10:27 AM
Member finn520

Thanks for the writeup. I get the appeal but wonder how fast the ice cube is melting.

1) What price do they pay for acquisitions?

They spent $57 million on acquisitions from 2015-2018 and EBITDA went from $24 million in 2014 to say $27 million in 2019. Say they paid 7x EBITDA, that means that organic EBITDA dropped from $24 million to $19 million in that period, or net income from $14m to $9m, which is not great and big trouble if declines accelerate.

2) You say that "SGA's radio stations are delivering as many listeners to their advertisers as ever". What do you base this on? I would be shocked if that listening hours was not declining. Anecdotally, I have two vehicles, one has the car-company installed screen/radio options and the other has that plus Apple Carplay. I can technically plug in my smartphone and access apps in both, but I find I use my phone and various apps (podcasts/audiobooks/Pandora) much more often in the latter because it's so much more seamless and has such a better interface, and conversely, I listen to the radio more often in the older one.

It's amazing to me that WPLJ in NYC is now kaput. Apparently, revenues from $27 million in 2010 to $10 million in 2017 (estimated from BIA).

https://radioink.com/2019/05/31/what-happened-to-wplj/

Subject Re: questions
Entry 09/09/2019 06:02 PM
Member andreas947

Hi Finn,

Thanks for the good questions.

On acquisitions, they likely paid a higher multiple than 7x before improvements. i don't think the organic EBITDA dropped nearly that much. but it will be important to watch that future acquisitions drive growth in adjusted EBITDA and are not just maintenance expenditures. they have told us they believe same station revenue can grow low single digits over next several years in these smaller markets. but you raise a fair point to watch and they need to grow adjusted EBITDA over next few years from acquisitions (although we are not looking for huge growth).

On listeners, they have told us their believe their listenership in these smaller markets has been stable over last several years. There is an even more intense focus on local events and news in these smaller towns.

We have a call next week with the CFO and we will forward any incremental info on these questions that we get. Hope this helps.

Best, Andreas

Subject Re: Re: questions
Entry 09/25/2020 03:31 PM
Member finn520

Andreas,

Any new thoughts on this one? Looks like the playbook hasn't changed, I imagine they will reinstate the dividend after things resume to some semblance of normalcy and expect they will keep trying to make acquisitions.

Thanks.

Subject Re: Re: Re: questions
Entry 09/25/2020 05:23 PM
Member andreas947

we think results will come back but likely takes a few quarters. as CEO said on Q2 call, the pandemic has been tougher on them than the GFC. their business model has not held up as well as we might have expected. these small businesses in these smaller communities have been hit really hard and pulled back on advertising. but we think both the communities and businesses will come back over time. maybe WFH in some of these smaller towns looks pretty good at this point. i think the playbook has not changed at all and this may create some acquisition opptys from more levered players. sorry for the disappointing results to date. we believe next year will be much better and balance sheet enables them to wait and we are still holding most of our position in this. hope that helps a bit. best, andreas