Entravision Communications Corporation (EVC)

SEC Filings Show Steps to Clarity in Corporate Control and Detail on Digital Risks; Reaffirm Buy

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On Friday AMC, EVC filed its 1Q23 10-Q and an 8-K revealing a cooperation agreement with its largest shareholder. The agreement is in line with our basic expectations; recall that the family, trusts and estate of co-founder Walter Ulloa (the "Ulloa Family") own 18.1% of EVC's outstanding shares. The 10-Q has detail on risks of the media representation business. In particular, we infer that Meta has told EVC to expect leaner economics in 2H, and Meta is the dominant commercial partner of the Cisneros business in Latin America. The 10-Q states that the carrying value of the contingent consideration owed on the Cisneros acquisition fell 16% in 1Q23; this reflects downward revisions in outlook for the business. Recall that after 1Q results we reduced our margin estimates for EVC Latam, which was the main driver of our lower EVC EBITDA estimates and price target.

Key parts of the cooperation agreement give the Ulloa Family a board seat in exchange for the family's support—through the voting of its director representative—of the company's board proposals and the family's agreement not to support attempts to control EVC under various circumstances. More specifically, the provisions include: EVC's support of the nomination of a family representative as independent director, along with a right of the family to nominate a replacement director should that become necessary; the family's agreement not to acquire over 20% of shares or support a proxy contest or various attempts to influence management; and a term for key provisions lasting until the family no longer has an independent director on the board or its holdings fall below 12% of outstanding shares. Given that the Ulloa Family is EVC's largest shareholder, and its holdings likely represent a large share of the family's assets, we expected some arrangements to address the family's interest in EVC, as well as EVC's interest in setting a course for management now that there is no controlling shareholder. Our 1Q23 preview noted the prospect for a change of board composition to reflect representation of the family, for example.

EVC's commercial relationships with its key digital media platform partners are not memorialized in long-term contracts, and thus are subject to material changes on short notice --witness the detail in the 10-Q. The 10-Q discloses that "based on communications with our largest commercial partner, we anticipate receiving a lower rate of payment on our sales made on behalf of this company beginning in the second half of 2023, resulting in lower margins …." We infer that Meta is this partner; EVC discloses elsewhere that its largest partner represented 51% of EVC's revenue in 1Q23. The 10-Q also discloses that during 1Q23 the contingent consideration for the Cisneros acquisition declined 16%, to $34.9m from $41.4m, while that of the other components of EVC's contingent consideration, for the MediaDonuts and 365 Digital acquisitions, actually increased in value. All that said, not all changes in media partner relationships are likely to be negative for EVC. These partners (Facebook and TikTok, for example) are engaged in fairly vigorous competition, especially outside of the U.S. where EVC transacts with them, and attracting and maintaining quality vendors like EVC will likely be part of this competition.

Maintain $7 per share 12-month price target and Buy rating; risks on page 2. Our PT is supported by a DCF valuation based on explicit financial forecasts through 2028.

BUY			
Price at 5/8/23 (USD)			5.19
Price Target			7.00
52-week range			3.96 - 7.33
Performance (%)	1m	3m	12m
Absolute	-10	-23	19
S&P 500	1	0	0
Market Cap (USDm)			465.9
Shares outstanding (m)			89.8
Float (%)			89
Average volume			364,761
S&P 500			4,134.8
Forecasts and ratios			
Year ended 12/31	2022A	2023E	2024E
1Q EPS (USD)	0.02	0.02	0.09
2Q EPS (USD)	0.10	0.03	0.05
3Q EPS (USD)	0.11	0.06	0.17
4Q EPS (USD)	-0.02	0.18	0.15
FY EPS (USD)	0.21	0.29	0.46
% Change	-38%	40%	59%
P/E (x)	25.2	18.0	11.3
EV/EBITDA (x)	5.2	6.3	4.6
Revenue (USDm)	956.2	1,085.9	1,234.3
% Change	26%	14%	14%

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Investment Thesis and Valuation: Buy With $7.00 Price Target

Positives supporting our Buy rating include: 1) EVC's share price is not fully capturing the potential of digital media acquisitions because their higher growth and different business models are more difficult for investors to assess; 2) higher post-pandemic broadcast margins, stability of TV retransmission revenue (35% of 2022E EBITDA) and secular growth of political advertising revenue (31% of 2022E EBITDA), and potential monetization from future spectrum auction (as in 2017) substantially reduce the operating risk profile of overall business; 3) pro forma net debt leverage under 2x and double-digit free cash flow yield will give new senior management flexibility to increase returns of capital and continue accretive digital acquisitions; and 4) our DCF valuation supports substantial stock price upside over the next 12 months, particularly if there is no recession.

Our DCF-based 12-month price target is a weighted average of projected equity valuations at year-end 2023 and 2024; our PT assumes a 50% chance of a base case with ~$89m in 2023 EBITDA and a 50% chance of a recession with ~$83m in 2023 EBITDA, resulting in a target valuation range of $6-$7. In structuring our DCF, first we adjust the current net debt for the value of any estimated payments remaining on the acquisitions (e.g., earnouts) and noncontrolling interest. Second, we adjust the current net debt by the estimated free cash flow to be generated by each valuation date. Finally, we value EVC both using a weighted average cost of capital (WACC) reflecting its own stock price trading and using separate WACCs for its broadcast and digital media businesses based on sector comparables, applied to separate free cash flow forecasts for each of these businesses. The results of these two methods set the range for our valuation, with the EVC-specific method incorporating market data on EVC shares' actual volatility setting the upper bound, and the sector method relying on measures of risk of comparables setting the lower bound. Note that in our DCF, for our terminal value estimates, we assume that capex equals D&A, which results in a substantially higher capex estimate than in our financial statement forecasts because capex should be like D&A for a terminal value forecast, to support the need for an asset base in perpetuity.

Risks to our investment thesis include: 1) impact of upcoming management succession and change in voting control on company's strategy and pursuit of potential longer-term options, including sale of all or a portion of the company, 2) sensitivity of EVC's advertising-based businesses to macroeconomic shocks, such as a recession, 3) potential volatility of EVC's digital media business, given its increasing focus on emerging markets, its dependence on a small number of commercial relationships with media tech platforms, and increasing competition, 4) secular challenges and potentially increasing competition from TelevisaUnivision for EVC's broadcast media business, and 5) risk-off market sentiment as an overhang for valuation of EVC's fast-growing, less mature digital advertising businesses.

APPENDIX

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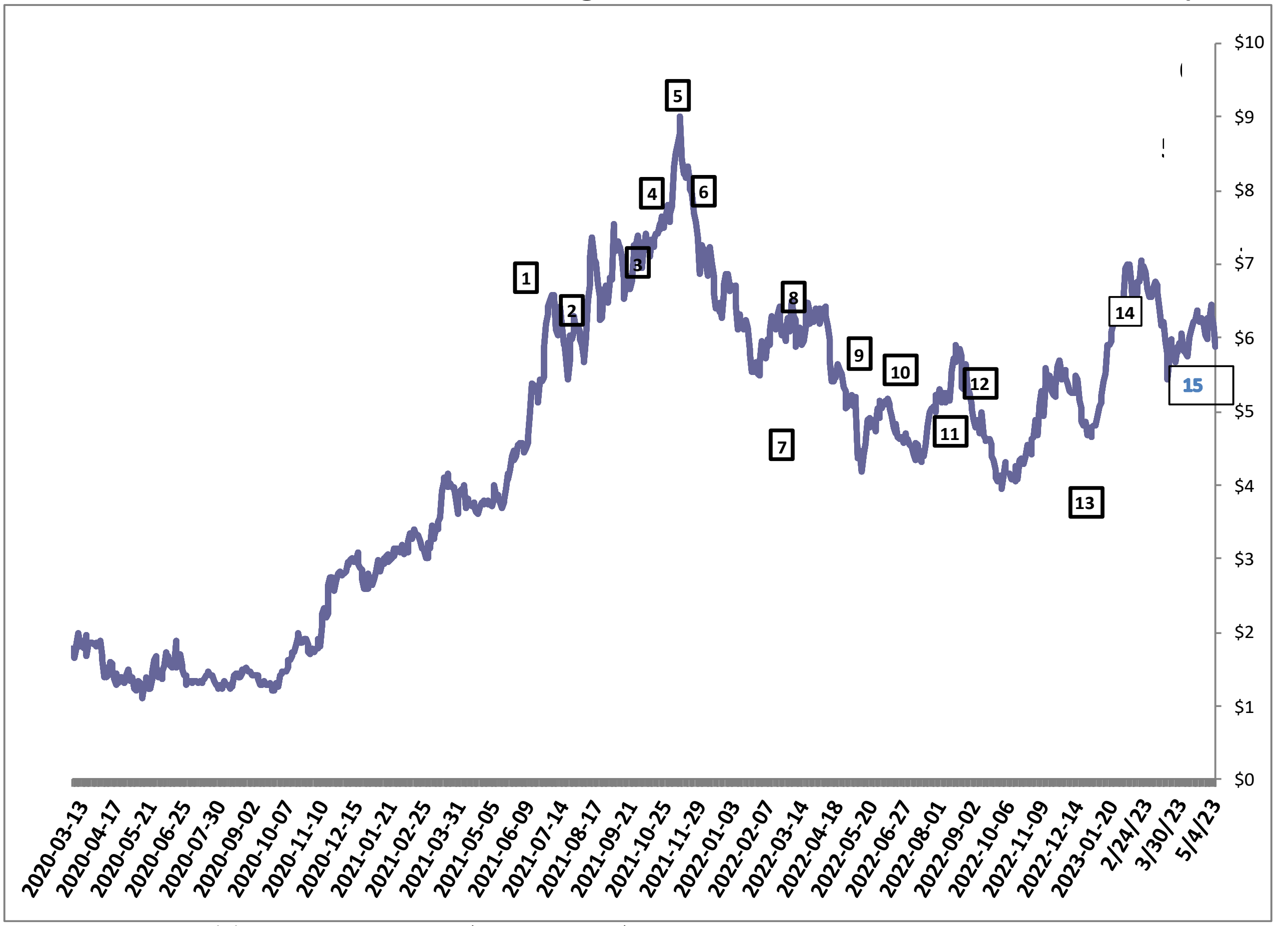
Historical Recommendations and Target Prices: Entravision Communications (ticker: EVC)



1	7/6/21	Initiated Buy @ $6.76, Target Price $9.00
2	8/6/21	Reaffirmed Buy @ $6.15, Target Price $9.00
3	9/2/21	Reaffirmed Buy @ $7.75, Target Price $10.00
4	10/5/21	Reaffirmed Buy @ $7.60, Target Price $10.00
5	11/5/21	Reaffirmed Buy @ $8.83, Target Price $10.50
6	12/20/21	Reaffirmed Buy @ $6.40, Target Price $10.00
7	2/2/22	Reaffirmed Buy @ $5.87, Target Price $8.00
8	3/4/22	Reaffirmed Buy @ $6.42, Target Price $8.50
9	4/15/22	Reaffirmed Buy @ $5.53, Target Price $8.50
10	5/6/22	Reaffirmed Buy @ $5.14, Target Price $8.00
11	6/9/22	Reaffirmed Buy @ $5.16, Target Price $8.00
12	8/25/22	Reaffirmed Buy @ $5.52, Target Price $7.50
13	11/3/22	Reaffirmed Buy @ $4.69, Target Price $7.00
14	1/27/23	Reaffirmed Buy @ $6.33, Target Price $7.50
15	5/5/23	Reaffirmed Buy @ $5.87, Target Price $7.00

Ratings Definitions

BUY: total return expected is >15% over a 12-month period
HOLD: total return expected is between 15% and -15% over a 12-month period
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The target prices of shares mentioned in the accompanying text are based on the assumed investment horizon of 12 months. If company notes are published on these shares in the future, the target prices mentioned in the subsequent notes will have priority.

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