

**Media Industry Update – August Media Topics****Christopher H. Ensley**  
**Director****August 3, 2009**

It has been 6 weeks since I made the transition from research analyst to investment banker, and after numerous meetings with media companies, commercial bankers, and private equity firms, I wanted to share a few broad observations.

**A Secular or Cyclical Slowdown? - Both, But Cyclical Slowdown Is Predominant**

The biggest issue that faces local media companies is an issue that faces many other industries: the disintermediation of their business by the internet. While this issue confronts numerous industries, few industries are being written off as quickly by the press as the local media industry. Press reports documenting the demise of local media cite year-to-date revenue declines of 15%-25% as evidence that secular hurdles are proving to be too challenging for local media to overcome. However, as I survey the public markets, I find companies in a variety of industries that are reporting revenue declines inline with those of local media companies (i.e., down 15%-25%), yet I don't see the press writing the obituary of those industries (except, to some extent, for the U.S. auto industry). One only has to look at the revenue declines of outdoor advertising industry (a medium that doesn't face the secular challenges of audience fragmentation and ad skipping technologies) to conclude that the overwhelming factor impacting the *magnitude* of revenue declines in local media are cyclical, not secular. Nevertheless, we are mindful that an advertising recovery from 2009's trough levels will likely be muted by secular issues that result in advertising share shifts as ad dollars migrate to digital, mobile and alternative out-of-home media.

**Leverage Issues and Balance Sheet Remedies - Not Unique to Local Media**

In discussions with several commercial bankers I have found that the issues that frame local media/lender discussions are the same issues that frame lender discussions with a variety of other industries. A possible difference appears to be how quickly other industries are remedying their problem balance sheet issues relative to those in local media. In the public markets, companies in the banking and real estate (REITs) industries face operating challenges but have quickly raised capital in order to not replicate the mistakes of past bubbles, such as Japan's "zombie banks" of the mid-1990s. However, only a few large local media companies (i.e., CBS, Lamar) have successfully accessed capital to extend debt maturities in recent months (a few newspaper companies have been modestly successful). Has anyone noticed that Lamar's stock price has tripled since it extended its debt maturities by refinancing its 2010 convertible notes?

I'm concerned that Japan's zombie banks of the 1990s could be replaced by the zombie media companies of the 2010s if bolder approaches are not taken to address a lack of capital spending by local media companies on digital initiatives. Companies appear to be taking small steps (such as addressing covenants) that provide a short term lifeline but do not provide the long-term financial flexibility that allows reinvestment in digital initiatives. I would like to see bolder steps taken (even if it requires equity dilution), provided it frees up cash that can be reinvested in initiatives that enable local media companies to capture ad dollars that are moving into online, mobile or alternative out-of-home platforms. Swapping debt for equity would free up capital to be deployed in digital media. Both banks and local media companies need to sacrifice a portion of their investments so that in five year's time they both preside

over healthy companies, not more irrelevant companies. I'm concerned that today's wait-and-see approach could become tomorrow's Hail Mary pass that inevitably falls incomplete in a futile attempt to preserve equity values.

### The M&A Market

In previous recessions, media companies rectified balance sheet issues by selling assets to quickly alleviate leverage issues: does anyone remember Spanish Broadcasting's sale of two class A radio stations (with \$1 million revenues) in Los Angeles for \$120 million in 2004? Contrast that with UBS' inability to sell Young Broadcasting's TV stations at auction last week. This suggests that asset sales will not serve to remedy balance sheets as they did in the past.

A great impasse has grown over the M&A market which we boil down to two factors:

1. acquisition multiples that have fallen below current or projected leverage ratios, in which case asset sales no longer become de-leveraging; and
2. the precipitous decline in asset values that is derived from the product of trough cash flows multiplied by trough multiples.

Unfortunately, current ad trends indicate an ad rebound is not yet here and that we remain in the "bouncing along the bottom" phase of recovery. We expect deal activity to improve once core advertising begins to rebound and visibility improves. These should also provide a corresponding lift to deal multiples, though likely not to historical levels.

### Future Equity Issuance

Coming out of the 2001 recession, several local media companies took advantage of recovering fundamentals and public market multiples to issue equity relatively early in the recovery (such as Gray Television, Lin Television, and Salem Communications). I am watching with great interest Westwood One's attempt to sell \$50 million of common stock following a potential 1-for-200 reverse-split. If Westwood One can raise new capital, it stands to reason that much healthier media companies ought to be able to do the same.

We expect public equity issuance for local media companies to be tepid in this economic recovery relative to the last economic recovery for the following reasons:

1. the slower revenue growth in the 5 years preceding this slowdown (2002-2006) relative to those preceding the last slowdown (1996-2000);
2. significant dilution given the magnitude of stock price declines between 2007-2009 relative to the stock price declines between 2000-2002; and
3. equity issuance runs counter to the desire of most senior executives to take their companies private.

### Go Where the Growth Is and Investors Will Respond

As always, the bias of public and private equity investors remains focused on growth companies. While our meetings with private equity companies reveal the occasional firm or fund interested in acquiring traditional media companies, the majority of equity investors with an interest in media exposure are

focused on areas where either the advertising dollars are migrating (online, digital out-of-home, and mobile media), or where technologies facilitate this shift to digital media.

As a result, we at Coady Diemar expect to spend a substantially greater amount of time in these newer arenas such as internet radio; technology or software companies serving online companies and audiences (i.e., online audience measurement or ad-insertion companies); alternative out-of-home; and mobile media or mobile marketing companies.

I have enjoyed catching up with many of you over the last several weeks, and appreciate that many of you have taken the time to meet with us. For those I haven't touched base with yet, you are still on our radar screen.

We are always interested in discussing how we can help your company grow or more quickly transition into more web-centric or mobile-centric company, and welcome the opportunity to share ideas in this regard.

Sincerely,

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