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That's showbiz

Evan Lorenz writes:

Like most Americans on the Tuesday before Thanksgiving, you probably abandoned your defrosting turkey to log on to Robinhood to buy some short-dated equity call options. We collectively bought 35.7 million of them, eclipsing the prior record of 23 million, set in 2010.

Speculation is the topic at hand, both in a general way and with regard to the example of Live Nation Entertainment, Inc. (LYV on the Big Board), on which we are bearish. Here's an analytical appetizer: "The stock market has become a derivative of the options market." Chris Cole, founder and CIO of Artemis Capital Management, L.P., spoke those striking words just the other day.

Grant's makes no moralistic case against speculation. It sharpens the judgment, quickens the heartbeat and furnishes—taking all speculators in the aggregate—valuable signals on market sentiment and positioning. Think of it as a day at the track without the risk of skin cancer.

Simply watching the speculators can tell you a lot. For example, on the same pre-Thanksgiving Tuesday, Nov. 24, the ratio of traded puts (bets to the downside) to traded calls (bets on the upside) registered 0.37:1, a marker of bullish intensity rarely seen since the dot-com bubble.

"What has changed and what is different from the 1990s," Cole elaborates, "is that the options market has become quite dominant. It is much bigger and more prevalent than it has ever been before. The volume in the options market is almost one-third the volume of the total market. That is incredible."

Another change from prior cycles is the vogue in ultra-short options, including the kind that expire in just one week. Such rolls of the dice contribute as much as a quarter of options trading volume these days compared to almost nothing during the tech and housing booms. Their extreme sensitivity to the movements of the relevant reference shares leads dealers to protect themselves by buying the very same underlying equities. And up goes the market.

"If you opened the newspaper at the time, it said that the Dow is up because it is looking at a Biden presidency or the Senate," Cole tells me. "It has nothing to do with who won the presidency and who won the Senate. It has everything to do with the fact that you had a massive amount of short-dated put exposure that suddenly rolled off after the election and had reset to a lower [volatility] level.

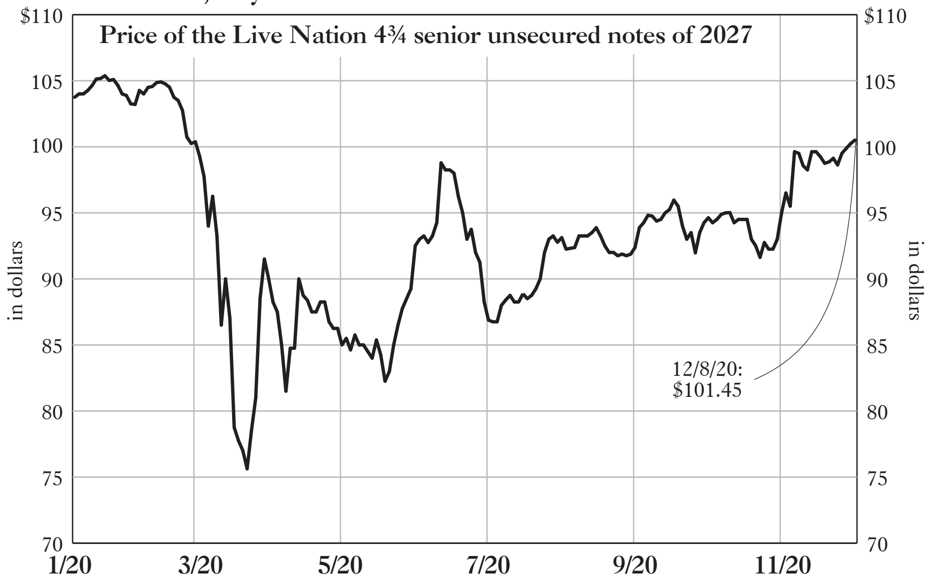
"Dealers were forced to hedge that by buying the market," Cole goes on. "It had nothing to do with any of the fundamentals and everything to do with a massive amount of short-dated optionality that was rolling off following the election."

This speculative ferment helped to write last month's returns into the history books. The Dow Jones Industrial Average returned 11.8% in

Betting on the roar of the crowd

source: The Bloomberg

All's well, says Mr. Market



source: The Bloomberg

November, its highest monthly leap since January 1987. The MSCI World Index beat the Dow with a 12.7% return, the best for global stocks since January 1975.

Perhaps the avatar of this year's rally is the special-purpose acquisition vehicle. A SPAC is a blind pool on the prowl for a profitable, fast-growing business. Naturally, in this singular year, such "blank check" companies have raised more than $65 billion—"approaching the total from all previous years combined," as Bloomberg reports.

Top-line growth is the name of the game for SPAC-borne companies. Consider Tattooed Chef, Inc., a maker of plant-based frozen foods. It went public on Oct. 15 via a SPAC called Forum Merger Corp. II.

"First of all, there is no question that there is an overwhelming demand for growth," Tattooed CEO Sam Galletti told a Nov. 23 Roth Capital Partners webinar. "I am hearing it loud and clear. When I was a privately held family business, I had to make money. I wasn't really as focused on selling as I was on just making sure that we were as profitable as possible. I've heard it loud and clear [now] from everybody that the most important thing for us is growth."

Finance companies, too, are signing on with SPACs. On Nov. 29, Bloomberg reported that boutique investment bank Perella Weinberg Partners is close to announcing a merger with FinTech Acquisition Corp. IV. On Dec. 2, Dyal Capital Partners, which buys general-partner stakes in private-equity firms, and Owl Rock Capital Partners, a credit-focused investment fund, disclosed that they would merge and go public via Altimar Acquisition Corp.

Recall that Goldman Sachs Group, Inc. went public in 1999; Fortress Investment Group, LLC and Blackstone Group, Inc., in 2007. Each was well-timed—for the sellers.

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Meanwhile, the forces of speculative anti-gravity have launched some stocks to such heights that not even great results can lift them higher. Take Peloton Interactive, Inc., the lockdown stationary-bike category killer, whose 232.4% year-over-year jump in sales during the September quarter, to $757.9 million, handily beat Street estimates but left Mr. Market cold. Since Oct. 15, the shares have tumbled by 13%. Zoom Video Communications, Inc., the ubiquitous videoconferencing stand-in for human connection, posted a 367% year-over-year vault in revenue, to $777.2 million, in its October quarter, again thumping estimates but failing to please investors. Since Oct. 19, Zoom's share price has zipped lower by 28%.

Now Mr. Market has turned his acquisitive eye on companies that the pandemic laid low but a vaccine could raise up. For example, Starbucks Corp., whose American same-store sales fell 9% in the third quarter but whose share price hit an all-time high last Friday, is priced at 19.1 times enterprise value to estimated 2022 Ebitda. Or consider airplane-parts maker Heico Corp., which suffered a 27% decline in third-quarter sales but trades at 30.7 times the 2022 Ebitda estimate.

Then there's Live Nation, the concert mega-company whose 95% collapse in third-quarter revenue from the year-earlier level could not deter investors from bidding the share price to $69.89, a 136.9% rebound from the March 18 nadir and just 2.2% lower than it was at the start of the year.

The 2010 merger of Live Nation, Inc. and Ticketmaster Entertainment, Inc. yielded the world's largest producer of live music concerts and leading ticketeer for live entertainment events. Live Nation produces and promotes LYV-sponsored events, sells tickets to Live Nation and third-party concerts and sells sponsorship and advertising.

Pre-pandemic, in 2019, the concert division generated $9.4 billion in revenue, or 81.5% of total sales, but nonetheless showed an operating loss of $53.5 million before corporate overhead. The smaller ticketing division ($1.5 billion in sales) and the sponsorship and advertising unit ($590 million) delivered operating income of $232 million and $330.3 million, respectively. Although Live Nation is active in 46 countries, the United States accounted for 66% of last year's revenues.

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Yes, bulls on the stock readily concede, events have been postponed, but, at the end of the third quarter, 83% of ticketholders for deferred concerts had not asked Live Nation for a refund. Here's proof, the argument goes, that America is champing at the bit to get out of the house and back to the amphitheater. While in-person events this year have been mainly confined to the fabulous, path-breaking, life-enhancing *Grant's* Fall Conference at the Javits Center in New York (—*advt.*), Live Nation has had some success selling tickets for online performances. "We expect that they will evolve into some hybrid model where there's some in-person, some virtual ticketing over time," David Katz, who rates LYV a hold for Jefferies, LLC, tells me. The sale of virtual tickets represents an incremental source of revenues.

Doug Arthur, who rates LYV a sell for Huber Research Partners, LLC, rounds out the bull case: "They've taken about $200 million in structural costs out of the business, by necessity, so they will be more profitable on the back end. A lot of their competition in the promotion business will have been hit, hurt or gone under. So, they'll be in a stronger bargaining position coming out of this with musicians and venues than they were before."

In consequence, the Street pencils in 2022 as a barnburner. Analysts project $11.6 billion in revenues and $1.1 billion in adjusted Ebitda, not far from the $11.5 billion in revenues and $997.5 million in adjusted Ebitda in 2019.

For a simple business, Live Nation presents a complicated balance sheet. The Sept. 30 statement shows $2.6 billion in cash, but most of that money doesn't belong to LYV. Thus, the liability side of the ledger lists deferred revenues (ticket sales for events that haven't yet happened) of $1.6 billion and an additional $103 million of deferred revenue hiding in the "other long-term liabilities" line item. Beyond this, there's $686.1 million in "accounts payable, client accounts," i.e., ticket sales collected on behalf of, but not yet remitted to, Ticketmaster clients. Netting these figures leaves $204.3 million in cash at LYV's full disposal.

Debt foots to $4.9 billion, up $1.6 billion over the past nine months, and operating leases to another $1.6 billion. Putting lease liabilities to one side, this means Live Nation's net debt sums to $4.7 billion, or 6.1 times 2019 Ebitda.

Even so, bond investors seem to like what they see in the B/B2-rated credit. The senior unsecured 4¾s of Oct. 15, 2027, which started the year at $103.50, sold off to $75.63 by March 23, the day the Federal Reserve threw its kitchen sink at the financial markets. Since then, the bonds have rallied back to 101.45 for a yield to maturity of 4.5%, or a spread of 411 basis points over Treasurys, well below the 429 basis-point yield premium of the average single-B-rated bond. No doubt, the creditors draw confidence from Liberty Media Corp.'s position as a 32.1% owner of Live Nation shares.

Of the 17 analysts on the case, nine say buy and only two say sell. In the past 12 months, insiders have sold a net 109,534 shares for net proceeds of $6.7 million, although the record also shows the purchase of 32,900 shares at prices below $43 per share in March and sales at prices above $50, including a pair of dispositions in June. Short interest amounts to a not-inconsiderable 10.4% of the float.

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While Live Nation's share price is down 2.2% since the start of the year, the bump in borrowings has lifted the company's enterprise value by 7.1% (EV being defined as equity market cap plus debt minus cash). On the Nov. 5 earnings call, the company's president, Joe Berchtold, told analysts that Live Nation burns $175 million of cash a month, or $525 million per quarter. Assuming two more quarters of losses on that scale and assuming, too, that Live Nation can return to breakeven by the second quarter of 2021—no sure thing—this would add $1.1 billion to LYV's enterprise value, making the company worth 12.9% more than it was on Dec. 31, 2019.

Of course, no one quite knows when Live Nation will be able to hold concerts with pre-Covid levels of attendance. The hope for next year is that limited-capacity performances will be feasible by the second or third quarters, with a return to shoulder-to-shoulder crowds by the fourth quarter of 2021 or the start of 2022.

"Put another way," Arthur wrote in a Dec. 2 note for Huber Research, "it took LYV 16 years to grow concert revenues from $2 billion to $9.4 billion in 2019; investors now assume this will transpire in 16 months." Even if the world is fully inoculated by 2022, Live Nation will still face "some degree of scheduling logjams for arena and stadium," and a potentially impaired consumer who may not be ready for "jam-packed" events—even if the event spaces and promoters are still in business to facilitate them.

"[A]cquisitions have been a critical component of growth accounting

Live Nation Entertainment, Inc. at a glance

all figures in $ millions

	TTM*	2019	2018	2017	2016
revenue	$4,513.2	$11,548.0	$10,787.8	$9,687.2	$7,826.3
operating income	-1,348.1	324.8	272.5	91.4	194.9
net income	-1,472.5	-4.9	-17.7	-97.6	-47.0
cash	2,625.1	2,470.4	2,371.5	1,825.3	1,526.6
debt	4,900.1	3,309.1	2,815.0	2,300.0	2,313.1
accounts payable, client accts.	686.1	1,005.9	1,037.2	948.6	726.5
deferred revenue	1,631.7	1,391.0	1,277.8	925.2	805.0
assets	10,885.4	10,975.6	8,496.9	7,504.3	6,764.3
cash flow from operations	-520.0	469.8	941.6	623.5	598.7
invest. in non-consolidated affiliates	-32.3	-57.3	-46.5	-25.2	-28.9
capital expenditures	-284.8	-323.6	-239.8	-238.4	-173.8
distributions to non-controlling int.	-65.8	-107.5	-59.2	-46.0	-55.1

* 12 months ended Sept. 30, 2020.

source: company reports

for over 30% of revenue and Ebitda growth in various segments in certain quarters," Arthur adds. LYV reported top-line growth of 7% in 2019; excluding the benefit of M&A, growth would have clocked in at 4.2%. High leverage may prevent Live Nation from acquiring competitors, thus tempering post-pandemic growth. Investors nowadays are willing to pay fancy multiples for rapidly growing businesses and not-so-fancy multiples for slower ones.

A more basic argument against today's elevated share price is that the company just isn't very profitable. After payouts to non-controlling interests (NCIs), the events behemoth generated a net loss of $4.9 million in 2019, $17.7 million in 2018 and $97.6 million in 2017. Free cash flow, adjusted for the payments to NCIs, averaged $297.1 million, or $1.40 per share, in the three years ended 2019. (We use the three-year average here as free cash flow was negative last year.) Putting a hefty 30-times multiple on the $1.40 figure would give a value of $41.93, a steep discount to the current share price of $69.89.

Liberty Media has not been the bulwark to Live Nation that investors might have hoped. At first, Liberty placed its LYV holdings in its tracking stock for Formula One Group. However, the leveraged auto-race company itself ran into trouble, so Liberty swapped its holdings to its SiriusXM satellite-radio subsidiary. Other financial machinations followed, including Liberty using a portion of its LYV stake as part of a convertible bond offering in November.

Covid-19 aside, the decade following the Live Nation–Ticketmaster merger has been a good one for concert promoters. According to industry trade magazine *Pollstar*, the average ticket price for the top-100 North American tours increased by 55% in the decade ended 2019, to $94.83, outpacing the 19% rise in the U.S. CPI over the same period. Pollstar found that nine of the 10 top-grossing concert tours last year had ticket prices in excess of $100.

Such success is a mixed blessing long-term, however, as the industry appears to have priced out younger, more budget-minded music fans. Only two of the bands in the 10, all-time highest-grossing tours were formed in the past 30 years: Ed Sheeran (2004) and Coldplay (1996). Top earners are primarily groups that came together between the 1960s and 1980s: e.g., U2, Guns N' Roses, the Rolling Stones. Like aging opera patrons, boomer rock 'n' roll audiences still pay their way, but you wonder who's going to replace them.

While bulls believe that Live Nation will be able to generate more revenue from selling tickets to virtual concerts, the viability of those very events means that artists can cut out middlemen like Live Nation. Last week, the rapper Travis Scott grossed $20 million by playing music in concert over the online videogame Fortnite.

A Dec. 2 Bloomberg dispatch featured three musicians who are using alternative streaming services to connect with fans. RAC, a Portland, Ore.-based remix artist, reaches listeners via Amazon.com, Inc.'s Twitch platform and gives special access to those who send funds via Patreon. RAC's sessions average 600,000 listeners per week. "Multiple cameras give RAC's fans an insight into his playing technique that they'd never get in a live concert," Bloomberg relates. "I can really bring it down and have some semblance of intimacy," RAC told the terminal. "It feels like a new medium."

The combination of the leading ticketing company and the largest concert promoter a decade ago led to obvious conflicts of interest—for example, the temptation before Live Nation to withhold events from amphitheaters that cut out Ticketmaster. To forestall such anti-competitive behavior, the Department of Justice imposed a 10-year consent decree in 2010 barring Live Nation from retaliating against venues that don't use Ticketmaster's services.

One year ago, the Department found that Live Nation had done exactly that and ordered an additional 5½ years of governmental scrutiny. Under president-elect Joe Biden and a rising tide of antitrust sentiment, Live Nation may face more restrictions on its world-dominating business.

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Of course, speculative manias eventually run out of euphoria. It may (or may not) be noteworthy that SoftBank Group Corp., dubbed the "Nasdaq Whale" for its outsized options positions this summer, announced last week that it's winding down its options book on that back of investor angst and a $2.7 billion loss on derivative bets in the September quarter.

Live Nation staunches its operating losses with new debt, which leads to a rising enterprise value. Thus, on Dec. 31, 2019, LYV traded at 18.3 times EV to trailing adjusted Ebitda. Today, it trades at 19.2 times EV to estimated 2022 adjusted Ebitda owing to an extra $1.6 billion of borrowing over the past nine months.

This leads to an arithmetic predicament: LYV will face several more loss-making quarters before a vaccine has been widely distributed, which will necessitate an even more leveraged balance sheet and a still higher EV. Recall that EV is equal to market cap plus net debt. Thus, for the share price to remain flat in the quarters ahead, its valuation must rise. In other words, Live Nation needs the kind of standing ovation from Wall Street that its audiences so lustily used to bestow on its rock stars.

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