Independent Credit Research

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Yellow Media

All Capital Structure is Attractive

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We think that both bonds and equity of Yellow Media ("YLO" or the company) are attractive both on relative and absolute value. Investors are creating the company's 9.25% 1st-lien notes at 1.24x multiple of the LTM EBITDA as of March 31, 2013 and at 1.43x multiple of our estimated 2013 EBITDA. Compare these multiples with 8.0% yield to 05/31/2017 call at 100.0, and you will see that the notes are attractive. Similarly, investors are creating the company's equity at 2.00x of the LTM EBITDA and at 2.31x of its estimated 2013 EBITDA. Compare these multiples with the estimated 2013 EBITDA 4.1x multiple of equity creation for Dex Media and average 2013 estimated 2.5x average Net Debt/EBITDA multiple of Dex Media's subsidiaries' bank debt, and you should realize that the stock of Yellow Media can actually triple through the next 12 months. Indeed, the triple of today's price will create the company at 3.75x of the company's 2013 EBITDA. And we actually believe that the company "deserves" higher valuation multiples, since the local advertising market is less fragmented and less competitive. We had discussed all pros and cons of the Canadian advertising business in the initiation report, and therefore, we spend most of the time in this document pinpointing your attention to the fact that the story has been forgotten without any merits and to some new qualitative considerations we have learned recently.

	Face Value	Market Price	Market Value	MV / LTM EBITDA	MV / 2013 est. EBITDA
Cash as of March 31, 2013	$164,658				
Senior 1st-lien Secured Notes due 11/30/2018	$800,000	*104.0%*	$832,000		
Total Secured debt	$800,000		$832,000		
Net Secured Debt	$635,342		$667,342	**1.24x**	**1.43x**
8.0% Senior Sub. Disc.due 12/20/2022	$107,500	*87.5%*	$94,063		
Total Debt	$907,500		$926,063	**1.35x**	**1.57x**
Total Net Debt	$742,842		$761,405		
Number of shares diluted	27,955,077	$11.97	$334,622	**2.00x**	**2.31x**
LTM EBITDA as of March 31, 2013	$540,061				
2013 est. EBITDA	$466,005				

- Both U.S. and Canadian yellow pages companies have been losing advertising sales, and the nature of these losses relates to three major factors:
    1. Lower advertising spending by existing customers - economy slowdown and poor access to capital – cyclical reason;
    2. Small number of new emerging business owners - economy slowdown and poor access to capital – cyclical reason;
    3. Digitalization of advertising is more capital efficient for small businesses, and therefore, advertising spending required to accomplish same goals are lower than before. As such, to offset this structural decline, advertising companies need to sign up new customers. This reason, along with the economy of scale and better technology, represents the most significant competitive advantage of yellow pages companies versus smaller competitors. Yellow pages companies have an army of salesmen with existing relationships.

The following chart shows sales decline rates at Yellow Media, compared to subsidiaries of Dex Media:

Sales Decline	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013
Yellow Media	*2.9%*	*-4.8%*	*-9.1%*	*-3.1%*	*-17.3%*	*-16.4%*	*-17.2%*	*-15.6%*	*-12.4%*
RHDI	*-13.3%*	*-13.2%*	*-11.8%*	*-12.6%*	*-9.1%*	*-7.3%*	*-8.4%*	*-13.4%*	*-14.5%*
Dex Media East	*-13.5%*	*-12.7%*	*-14.8%*	*-14.4%*	*-9.7%*	*-10.6%*	*-12.1%*	*-15.6%*	*-16.0%*
Dex Media West	*-17.8%*	*-17.0%*	*-19.7%*	*-16.4%*	*-14.6%*	*-15.3%*	*-12.0%*	*-18.2%*	*-19.2%*

We do not have information on the average sales per customer for Dex Media. However, if you compare the total sales decline at Yellow Media with the decline rate of sales per customer, you will see that Yellow Media has been generating higher rate of new business owners, compared to 2012. This phenomena, actually, is also applicable to Dex Media, based on our conversations with the management. However, we cannot quantify its as explicitly as in Yellow Media case:

	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013
Total Sales Decline	*-17.3%*	*-16.4%*	*-17.2%*	*-15.6%*	*-12.4%*
Sales per customer	*-11.0%*	*-9.2%*	*-9.7%*	*-7.1%*	*-2.7%*
Customer churn	*-6.2%*	*-7.2%*	*-7.5%*	*-8.5%*	*-9.7%*

Contrary to the U.S., Canadian small business owners have had lower reliability in regards to their financing needs on equity lines in their properties. In the U.S., access to capital for small businesses, those covered by yellow pages companies, has been limited, because of the crisis in the real estate mortgage business. The successful resolution of the "mortgage issue" in the U.S. should boost advertising needs of entrepreneurs higher, in direct correlation with the easier access to capital. Shortly, in Canada, existing customers are reducing their advertising spending less and less…Over the last 12 months, 19% of renewing advertisers spent less. These advertisers represent 43% of sales. Advertisers experiencing decline in spending are mainly large advertiser, according to the company.

The fact that Canadian advertising market is less fragmented, compared to the U.S. is the main explanation of higher EBITDA margins. Yellow Media on average generates EBITDA margins 8.0% - 9.0% higher than Dex Media. Additionally, the growth rate of online sales that became questionably low in 2012, has stared growing again. During Q4 2012 and Q1 2013, it has grown by 11.1% and 15.1%, respectively. Digital sales represent 39% of total sales, and their renewal and growth rate is more sustainable. As such, we believe that the future of Yellow Media is brighter, at least, in the near-tern, compared to the one of Dex Media.

We believe that Yellow Media stock is undervalued and recommend that you take advantage of it.

Yellow Media Inc.	**2010**	**Q1 2011**	**Q2 2011**	**Q3 2011**	**Q4 2011**	**2011**	**Q1 2012**	**Q2 2012**	**Q3 2012**	**Q4 2012**	**2012**	**Q1 2013**	**2013est.**	**2014est.**
Online Sales	$267,000	$83,200	$85,900	$87,300	$89,700	$346,100	$85,900	$89,700	$92,000	$99,700	$367,300	$98,900	$402,194	$440,402
change	*15.8%*	*39.0%*	*33.2%*	*26.4%*	*23.1%*	*29.6%*	*3.2%*	*4.4%*	*5.4%*	*11.1%*	*6.1%*	*15.1%*	*9.5%*	*9.5%*
Percentage of total sales	*19.1%*	*23.8%*	*25.1%*	*27.0%*	*28.6%*	*26.0%*	*29.7%*	*31.3%*	*34.4%*	*37.7%*	*33.2%*	*39.0%*	*41.0%*	*50.4%*
Total Sales	$1,401,129	$349,372	$342,738	$323,441	$313,315	$1,328,866	$289,073	$286,484	$267,711	$264,447	$1,107,715	$253,277	$980,328	$874,452
change	*-14.6%*	*2.9%*	*-4.8%*	*-9.1%*	*-3.1%*	*-5.2%*	*-17.3%*	*-16.4%*	*-17.2%*	*-15.6%*	*-16.6%*	*-12.4%*	***-11.5%***	***-10.8%***
Salaries, commissions	$293,609					$303,756					$273,740			
%-ge of sales	*21.0%*					*22.9%*					*24.7%*			
Supply chain & logistics	$138,325					$131,186					$110,191			
%-ge of sales	*9.9%*					*9.9%*					*9.9%*			
Other goods & services	$131,194					$129,564					$91,311			
%-ge of sales	*9.4%*					*9.7%*					*8.2%*			
IT services	$41,308					$45,255					$43,716			
Bad debt expense	$39,585					$39,398					$18,157			
%-ge of sales	*2.8%*					*3.0%*					*1.6%*			
Total Operating costs	$644,021	$159,337	$166,262	$157,443	$166,117	$649,159	$143,056	$141,240	$129,936	$122,883	$537,115	$137,799	$514,323	$464,825
COGS	$364,962	$97,543	$95,774	$95,230	$103,938	$392,485	$84,768	$89,353	$80,000	$84,653	$338,774	$78,933	$307,823	$279,825
%-ge of sales	*26.0%*	*27.9%*	*27.9%*	*29.4%*	*33.2%*	*29.5%*	*29.3%*	*31.2%*	*29.9%*	*32.0%*	*30.6%*	*31.2%*	***31.4%***	***32.0%***
SG&A	$279,056	$61,794	$70,488	$62,213	$62,179	$256,674	$58,288	$51,887	$49,936	$38,230	$198,341	$58,866	$206,500	$185,000
%-ge of sales	*19.9%*	*17.7%*	*20.6%*	*19.2%*	*19.8%*	*19.3%*	*20.2%*	*18.1%*	*18.7%*	*14.5%*	*17.9%*	*23.2%*	*21.1%*	*21.2%*
EBITDA	$757,108	$190,035	$176,476	$165,998	$147,198	$679,707	$146,017	$145,244	$137,775	$141,564	$570,600	$115,478	$466,005	$409,628
EBITDA Margin	*54.0%*	*54.4%*	*51.5%*	*51.3%*	*47.0%*	*51.1%*	*50.5%*	*50.7%*	*51.5%*	*53.5%*	*51.5%*	*45.6%*	*47.5%*	*46.8%*
D&A	$180,265	$52,368	$47,735	$37,800	$23,003	$160,906	$30,081	$24,220	$26,597	$23,003	$104,293	$13,690	$55,000	$50,000
Cash taxes	($33,903)	($214)	($34,579)	($34,129)	($36,281)	($105,203)	($29,823)	($13,908)	($12,218)	($7,507)	($63,456)	($16,042)	($76,000)	($68,000)
Cash interest expense	($137,871)	($41,807)	($29,521)	($49,226)	($21,001)	($141,555)	($32,936)	($26,969)	($35,065)	($54,451)	($149,421)	($13,978)	($82,600)	($82,600)
Capex	($13,699)	($5,036)	($11,907)	($5,559)	($38,897)	($61,399)	($4,401)	($10,905)	($8,435)	($16,494)	($40,235)	($18,910)	($45,000)	($50,000)
Acquisitions & Divestitures	($170,059)	($8,083)	($7,026)	($581,257)	$1,331,730	$735,364	($3,783)	$2,360	$350	$2,723	$1,650	$161	$0	$0
Changes in WC	$33,774	($29,931)	($19,091)	($17,038)	$23,423	($42,637)	($55,772)	$10,424	($14,585)	($59,217)	($119,150)	$1,130	$0	$0
FCF	$435,350	$104,964	$74,352	($521,211)	$1,406,172	$1,064,277	$19,302	$106,246	$67,822	$6,618	$199,988	$67,839	$262,405	$209,028
Debt	$2,218,203	$2,171,679	$2,282,391	$1,674,300	$1,613,231	$1,613,231	$1,826,685	$1,801,118	$1,775,546	$801,831	$801,831	$801,577	$801,577	$801,577
Cash	$69,325	$33,981	$70,867	$52,072	$84,186	$84,186	$310,148	$375,535	$380,916	$106,807	$106,807	$164,658	$359,224	$568,251
Net Debt	$2,148,878	$2,137,698	$2,211,524	$1,622,228	$1,529,045	$1,529,045	$1,516,537	$1,425,583	$1,394,630	$695,024	$695,024	$636,919	$442,353	$233,326
Cash flow from operations	$596,607	$111,701	$87,923	$43,985	$92,964	$336,573	$22,407	$104,777	$49,640	$61,749	$238,573	$86,588	$217,405	$159,028
Cash flow from investments	($183,758)	($13,119)	($18,933)	($586,816)	$1,292,833	$673,965	($8,184)	($8,545)	($8,085)	($13,771)	($38,585)	($18,749)	($45,000)	($50,000)
Cash flow from financials	($392,713)	($110,852)	($44,882)	($732,416)	($115,462)	($1,003,612)	$211,739	($30,845)	($36,174)	($322,087)	($177,367)	($9,988)	$0	$0
Total FCF	$20,136	($12,270)	$24,108	($1,275,247)	$1,270,335	$6,926	$225,962	$65,387	$5,381	($274,109)	$22,621	$57,851	$172,405	$109,028
Number of advertisers	365,000	358,000	354,000	348,000	340,000	340,000	333,000	326,000	319,000	309,000	309,000	300,000	282,500	270,000
Renewal rate	*88%*	*88%*	*88%*	*87%*	*87%*	*87%*	*87%*	*87%*	*86%*	*86%*	*86%*	*86%*	*86%*	*86%*
Average sales per advertiser	$3,444	$3,444	$3,445	$3,441	$3,429	$3,429	$3,367	$3,311	$3,273	$3,260	$3,260	$3,259		
%-ge of cust. both online & print	*65.2%*	*65.0%*	*65.0%*	*64.0%*	*63.0%*	*63.4%*	*63.0%*	*62.0%*	*61.0%*	*61.0%*	*61.8%*	*61.0%*		
Full average sales per customer	$3,839	$976	$968	$929	$922	$3,908	$868	$879	$839	$856	$3,585	$844	$3,470	$3,239
change	*-9.9%*					*1.8%*	*-11.0%*	*-9.2%*	*-9.7%*	*-7.1%*	*-8.3%*	*-2.7%*	*-3.2%*	*-6.7%*

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