BEHIND
THE NUMBERS
Quality of Earnings Analysis

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Live Nation Entertainment, Inc. (LYV)
Earnings Quality Review

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are initiating earnings quality coverage of LYV with a 4- (Acceptable) rating

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

In many ways, LVY has conservative accounting in that it does not recognize revenue and many expenses related to an event until the event occurs. However, the time between when an event is planned, booked, and ticketed and the time it occurs is 4-8 months on average. That means the income statement can appear lumpy and seasonal, despite working year-round. Plus, the balance sheet can bloat up with deferred revenues and prepaid expenses which also show some odd flows. Much of this may create a different picture than what a simple ratio analysis may indicate.

LVY was hit very hard by Covid lockdowns which cancelled many shows in 2020 and early 2021 before bouncing back very strongly in 2022 and 2023. Many may question if it is possible to sustain this growth after the strong pent-up demand may be sated. There is still growth, especially in foreign markets, but we can see some operating costs rising now.

From an accounting perspective, we are assigning an initial rating of 4- (Acceptable). While the balance sheet is not as strong as it looks at first glance, the headwinds we identified are relatively minor and the bigger risks relating to required cash outflows and potential squeezes for concert revenues will take longer to develop – if they do at all.

What to Watch

- The balance sheet appears more liquid than it really is. LVY sells tickets months ahead of events and does promotions and advertising for shows. It receives cash in the door that becomes deferred revenue until the event occurs. After 2Q23, cash was $7.1 billion against $6.6 billion in long-term debt.

- The company notes that a large percentage of cash is actually due to clients as it collects the face amount of tickets sold, even though LVY will only earn a processing fee. A larger percentage of cash is held overseas and LVY does not repatriate those funds. LVY has conservative policies in describing what is available cash, but we estimate available cash at closer to $1 billion than $7 billion. ***(See below for details)***

- LVY deals with numerous ventures that are not 100% owned by the company. It reports 100% of revenue and expenses but subtracts the share of net income due to minority owners at the end. There are also frequent cash payments to these ventures for additional investment. ***(See below for details)***

- Many of these noncontrolling interests can put their ownership stakes to LVY in the future as the company grows. LVY has to account for these put-rights by accreting the future value of these potential payments. The payment amount rises over time tied to growth of the company and LYV estimated this is over $1.1 billion in cash payments for 2023-27. This is already an annual hit to cash flow in several areas and the earnings are penalized by 40 cents per quarter from these arrangements. ***(See below for details)***

- Debt and cash flow have some risks that are worth noting. LVY recently had its debt rating raised to BB-. Debt in that area is still trading above 7% while LVY has debt maturing with coupons of 2%-5%. It also has 18% of its debt that has floating rates. We don't see covenant issues. Convertible debt is raising the effective share count while adding back low amounts of interest expense. Capital spending and acquisitions seem likely to rise. ***(See below for details)***

- LVY gets higher marks for earnings quality for not adjusting out the amortization of intangibles or stock compensation in its non-GAAP results. The amortization of intangibles occurs over a short 3-10 years as well. All of that eliminates some common EPS adjustments we see at other companies which ignore both recurring costs and favors acquisitions that appear to have zero cost vs. building in-house.

- We will note that a huge portion of acquisition prices are still listed as goodwill and not expensed. At $2.6 billion, if this was being expensed over 20-40 years, it would cost LVY 7-14 cents in quarterly EPS. Given that revenues and profits are still rising y/y – we're not concerned about an impairment, but this is worth watching if growth levels off.

- Treat the Adjusted Operating Income (AOI) as EBITDA. It adds back depreciation, amortization, gains/losses, and acquisition-related charges, which is standard for EBITDA. It further adds back stock compensation and amortization of non-recoupable advanced contract fees. We have a small problem adding back stock compensation as employees would want cash wages without stock. We would also note that advanced contract fees are a normal recurring cost of doing business for concerts. Stock compensation is about $110 million and amortization of nonrecoupable advance contract fees is about $89-$90 million. So when AOI was $732 million in 2022 and is $976 million on the trailing 12-months, about $200 million is due to these two costs being removed.

- Deferred Revenue Days Outstanding are still rising from 2019 and 2022 levels. The seasonality of revenues impacts this figure, so it needs to be compared y/y. It appears at this time, LVY still has room to grow revenues going forward:

Def. Rev DSOs	4Q	3Q	2Q	1Q
2023			81.2	146.9
2022	67.2	34.0	77.3	202.2
2019	44.3	27.2	54.5	107.8

- An area where earnings growth could come from is improving concert income. Often LVY still loses money in the concert division even though it is a larger part of revenues. That is not overly surprising as concerts have more labor, venue costs, planning, and deals with talent, while the ticketing unit often collects a very high margin commission on selling tickets. But we are seeing losses for concerts decline as revenue improves:

Concerts	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Revenue	$4,633	$2,281	$3,396	$5,293	$3,598	$1,208
Adj. Op Income	$168	$1	-$185	$281	$123	-$49
Op. Profit (GAAP)	$78	-$83	-$290	$243	$38	-$150

- The other reason to watch concert profitability is several operating risks would show up here. It likely costs more to build a new concert arena now after so much inflation. That may allow existing arenas to raise prices as deals with LVY renew. Plus, competition focuses on revenue guarantee levels to acts, and that could rise or fall – changing profitability. Advertising may rise as well and capital spending already is. ***(See below for details)***

The Balance Sheet Looks Better Than It Really Is

Most screens for LVY will show investors a very liquid company with minimal working capital items and zero inventory:

Bal Sheet Items	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Cash	$7,129	$6,992	$5,606	$4,951	$5,860	$5,872
Receivables	$1,890	$1,657	$1,465	$1,990	$1,456	$1,210
DSOs	30.5	47.7	31.4	29.7	29.9	60.4
Accts Payable	$294	$173	$180	$195	$220	$67
DSPs	6.4	7.4	5.0	3.8	6.1	5.6
Long-Term Debt	$6,606	$6,612	$5,904	$5,740	$5,747	$5,758

It's obvious that there is some seasonality as receivable days and payable days move up and down in particular quarters. However, it also looks like cash normally exceeds or equals total long-term debt. There are several other balance sheet items to watch and LVY redefines actual cash in its footnotes because much of the cash on hand on the balance sheet is not available: The company stated in its 10-K/10-Q Liquidity and Capital Resources discussion: *"We view our available cash as cash and cash equivalents, less ticketing-related client cash, less event-related deferred revenue, less accrued expenses due to artists and cash collected on behalf of others, plus event-related prepaid expenses."*

Not all these items are available quarterly from LVY. Let's define some of this and focus on where it is located on the balance sheet.

- Ticketing-related client cash arises when LVY sells tickets and collects the full-face amount of the ticket, even though LVY may only earn a servicing fee. This item is disclosed in the 10-K and 10-Q every quarter in the Liquidity and Capital Resources section. LVY has a separate accounts payable liability on the balance sheet called Accounts Payable, Client Accounts where this is located.

- Event-related deferred revenue comes from cash paid to LVY for tickets, promotion, and advertising for various shows. Because LVY only recognizes revenue and expenses AFTER an event occurs, there is a sizeable deferred revenue account. Deferred Revenue that will be realized after more than 12 months is located in "Other Long-term Liabilities." These two accounts are available every quarter. However, neither is broken down to reflect only Event-related Deferred Revenue. LVY does have a non-GAAP supplement showing trends for the business that breaks out current Event-related Deferred Revenue. Investors would need to estimate amounts in Other Long-Term Liabilities.

- Accrued expenses due to artists and cash collected on behalf of others are both found in Accrued Expenses. These are broken down in the 10-K, but not quarterly. We would focus on three of these items: accrued event expenses, collections on behalf of others, and accrued ticket refunds. Refunds occur if a show is canceled and the tickets in deferred revenue transfer to accrued expenses.

- Event-related prepaid expenses are not broken out either, but LVY has a sizeable prepaid expense account on the balance sheet. This would be advertising and promotion ahead of an event, but LVY also pays the radio stations and pays for t-shirts and souvenirs, beer, and soda before the event

LVY has one other note about cash concerning cash held in overseas subsidiaries. The company notes that it does not repatriate any of this cash. This is disclosed every quarter in the 10-K/10-Q Liquidity and Capital Resources discussion. We would caution here because the operating model overseas should be similar to domestic operations where tickets are sold, contracts with talent, and agreements with arenas are all made in advance of the event with revenue and expenses recognized after the event occurs.

Bal Sheet Items	**2Q23**	**1Q23**	**4Q22**	**3Q22**	**2Q22**	**1Q22**	**4Q21**
Cash	$7,129	$6,992	$5,606	$4,951	$5,860	$5,872	$4,885
less Client Cash	$1,400	$1,400	$1,500	$1,300	$1,400	$1,500	$1,300
less Def. Rev.	$5,026	$5,103	$3,135	$2,269	$3,766	$4,050	$2,775
less 35% Acc. Exp.	$973	$701	$887	$967	$768	$529	$587
Plus Prepaid Exp	$1,629	$1,323	$950	$909	$1,154	$963	$655
Est. Real Cash	$1,359	$1,111	$1,034	$1,324	$1,080	$756	$878
Foreign Cash	$2,600	$2,600	$2,100	$1,700	$1,800	$1,800	$1,500

- It is likely overly aggressive to assume that 100% of deferred revenues should be subtracted as well as 100% of prepaid expenses should be added back. We know in the last two quarters, the spread between total deferred revenues and event-driven deferred revenues was $700 million and during 2022, it was about $400 million. That would add to the estimated real cash. The 100% of prepaid expenses is likely too large of an addback still.

- On the higher cash balance in 2Q23, note that LVY recently retired a $550 million convertible bond by issuing a new $1 billion bond and other L-T debt also rose by $275 million since the start of 2023.

- The 35% of accrued expenses is the actual accruals for event expenses, collections on behalf of others, and refunds for the 4Q22 and 4Q21. That is how we came to use a 35% of the total figure when we did not have an itemized breakdown in other periods.

- We did not subtract the foreign cash as we believe that is already counted in deferred revenue and accrued expenses. However, we are listing it to show that if cash at LVY is really closer to $1 billion, much of that is likely overseas and not readily available to the company.

- Putting the two tables together – we would conclude that LVY really has net debt of above $6.5 billion (assuming some of the $1.3 billion above is located overseas) vs. net cash of $0.5 billion that initial screens would indicate.

Back-Loaded Income Recognition Is Conservative – but Leads to a Wide Difference between Income and Cash Flow – Noncontrolling Interests Impact Both

We've said before, the nature of how LVY recognized income is conservative in our opinion. LYV accrues expenses, gets its sales, promotion, and prep work done before the event and then recognizes all the revenue, expenses, and income after the event. Historically 1Q is weaker overall due to fewer events in the late winter. But, as we have seen in looking at the cash situation – cash is coming in before the event occurs. That causes lumpy income and cash flow that often looks best when income is the worst and vice versa:

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Revenue	$5,631	$3,127	$4,291	$6,154	$4,434	$1,803
Income	$331	$44	-$168	$397	$228	-$49
Cash From Ops	$491	$1,156	$904	-$619	$349	$1,198
Working Cap Chg	-$35	$902	$844	-$1,184	-$79	$1,056

The bigger issue for both income and cash flow is investing in Non-Controlling Interests. These are companies where LVY has some ownership. It reports revenue and income on a fully consolidated basis and then subtracts the income representing the percentage it does not own. This is a significant percentage of the earnings reported above that is not available to LVY shareholders.

In addition, LVY buys additional stakes in these Non-Controlling Interests. Some of these are redeemable via put options for the owners to sell to Live Nation. The put options that are not currently redeemable accrete to higher valuations. This accretion is also subtracted from income available to LVY shareholders. Together these items are costing LVY about $100 million per quarter now or 40 cents per share.

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Net Income	$331	$44	-$168	$397	$228	-$49
Inc. to N/C Interests	-$38	-$47	-$35	-$36	-$41	-$1
Shareholder Income	$293	-$3	-$203	$361	$188	-$50
Accretion of Puts	-$57	-$55	-$49	-$30	-$33	-$36
Income available to Shrs	$236	-$58	-$252	$331	$155	-$86

We will be curious to see if rising interest rates result in lower present values of the future put options and cause the accretion part of the equation to level off or even decline. That could become a small earnings boost for LVY.

On the cash flow side, LVY has capital spending and is making other acquisitions to achieve growth. Then it has cash inflow and outflow with the noncontrolling interest positions and it is also purchasing a larger share of some of these deals. This is crimping the actual free cash flow:

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22
Cash from Ops	$491	$1,156	$904	-$619	$349	$1,198
Capital Spending	$86	$117	$141	$76	$68	$63
Acquisitions	$27	$196	$218	-$1	$26	$14
Free Cash Flow	$378	$843	$545	-$694	$255	$1,121
Investments in N/C/I	-$20	-$7	-$18	-$27	-$20	-$26
In from N/C/I investments	$0	$0	$0	$3	$1	$0
From N/C affiliates	$9	$6	$1	$1	$8	$6
Distribution to N/C aff.	-$83	-$55	-$19	-$16	-$27	-$39
Purchases of N/C aff.	-$67	-$22	-$21	$0	-$27	$0
Adj. Free Cash Flow	$217	$765	$488	-$733	$190	$1,062

The estimate in the 2022 10-K was buying redeemable shares in these ventures will consume $1.14 billion from 2023-2027. That would be in addition to future distributions that LVY makes as a partner in the deals already. On a trailing 12-months, free cash flow is only $737 million and that only had $110 million in purchases of noncontrolling affiliates. Also, capital spending is rising as we will discuss below.

Debt and Cash Flow Could Generate Some Headwinds Going Forward

The debt rating at LVY was recently increased to BB- which is a positive in our view. It has covenants that require the debt/EBITDA ratio to decline to a maximum 5.5x at the end of 2024. Using total long-term debt and the company's trailing Adjusted Operating Income – the ratio is only 4.1x now. Bonds limit senior debt (banks) to 3.5x, that is only 0.75x now.

We see a rollover risk. BB- debt is trading above 7% on yield. LVY has $575 million due in 2024 with a coupon of 4.875% and another $400 million convertible bond due in 2025 with a 2% coupon. Refinancing at 7% would add $32 million to interest expense, or about 11 cents annually. Higher rates on the bank debt are already being seen.

Accounting for convertible debt is already a small headwind for earnings. Fully-diluted shares jump from 228.5 million to 243.7 million with the convertible bonds. The interest rate is low, so even adding back the interest expense net of taxes – does not boost income enough to offset the dilution. EPS in 2Q23 was $1.04 vs. diluted EPS of $1.02. The two cents is not very material, but we wonder if LVY would try to avoid higher interest expense going forward by issuing more convertible debt. That could result in a bigger headwind too.

On cash flow, LVY is reporting that capital spending was abnormally low in prior years. Covid closed arenas and then when markets reopened, there wasn't much downtime to do construction work. Plus, the same supply chain and labor shortages that impacted other markets were in play for arenas too. Capital spending jumped in from 2021's $153 million to $347 million in 2022. LVY is forecasting $450 million for 2023.

This higher capital spending is coming at the same time acquisitions are ramping up and noncontrolling interests are being put to LVY. On the standard definition of free cash flow – Cash from Operations less Capital Spending – LVY had almost $1.5 billion in free cash flow in 2022. Using our numbers where we recognize acquisitions are happening and the noncontrolling interests consume cash too – free cash flow was only $1.0 billion. Now the additional cash outflows are rising. Plus, advertising could rise further and hurt cash from operations.

None of this looks dire by any means. We do not believe a few cents in EPS lost to higher interest expense or dilution derails the growth at LVY, but it is worth watching given that there is not considerable cash available here.

Concert Operating Risks Could Squeeze Profits

We think this is the area worth watching the most. Concerts are the largest segment in terms of revenue but the lowest for profitability. That is understandable as there are more employees, more deals to make, and more steps involved in putting on a concert. It takes 4-8 months of planning and preparation in this unit, while the ticketing operation can operate 24/7 for 365 days a year with much more automation and online focus. But, the concert unit gives the ticketing segment something to sell.

Total aside - we can almost see the article being written in the future, much like American Airlines and Sabre in the 1990s. Sabre was the ticketing operation and there were articles in the press stating "Just think how much more valuable Sabre would be if it didn't have this money-losing airline tied to it – American Airlines should just run its accounting system." We laughed thinking, "what happens to Sabre's business if it doesn't have American Airlines tickets to sell?"

At the moment, the concert business is seeing better profitability:

Concerts	1H23	1H22	2022	2019
Revenue	$6,915	$4,806	$13,494	$9,428
Adj. Op Income	$169	$74	$170	$242
Op. Profit (GAAP)	-$6	-$112	-$158	-$53
Attendance in mm's	56.0	44.7	121.2	97.6

Many more people are attending LVY concerts than in 2019 and the income is improving with higher prices and more people per event. We think it is important to focus on some of the risk factors in this unit and the potential for higher costs going forward.

Real estate alone is a risk in our view. Of the 338 venues that LVY deals with for concerts and events, it only owns 30 sites. It relies on leasing another 188 venues and it operates 53 more. These deals have to be renewed over time. We see several risks that could develop:

- The cost of new construction has risen considerably. Labor, materials, and competition from government subsidies for new factories, semiconductor plants, and broadband for contractors and equipment should all be pointing to higher prices for new construction and routine maintenance and modernization efforts. That seems likely to limit the building of new venues. And even LVY has said capital spending outflow is increasing for its plans.

- The attendance at events is still rising at a strong clip. All the people who own these venues can see that data too. We think LVY still has many lease and operating deals signed pre-covid and early after reopening. As those come up for renewal – the owners may want a larger share of the revenues, or at least higher rents.

- These owners could also be required to boost their own modernization efforts at these arenas. They could ask LVY for more cash toward those goals, or at a minimum ask for higher rents.

- About half the depreciation at LVY is at the concert unit. Higher capital spending will raise depreciation going forward. This is the unit where the AOI (Adjusted Operating

Income) removing depreciation may be skewing the implied profitability more significantly.

The deals signed with promoters and talent also can vary widely. They can require LVY to ramp up more promotional spending, change the percentage of ticket revenue paid to LVY, and ask for more guarantees on minimum ticket sales or minimum levels of guaranteed revenue.

- Advertising as a percentage of concert revenue was 5.1% in 2018 and 4.8% in 2019. LVY only spent 4.4% of concert revenues in 2022. Maybe demand was so high that advertising was less important. That looks like an area that could increase. That would cost LVY about 30 cents in EPS having that move back to 5% of sales

- LVY's goal is to offer very low guarantees on ticket sales and revenues to talent. In late 2021 and 2022, this may not have mattered as people raced out of their homes to do anything. Just like food companies and grocery stores could sell anything in early Covid without promotions, nothing sat on the shelves long enough to spoil, etc and profit margins rose considerably – this may be what happened with LVY too. Going forward, talent may get more picky and the venues will be facing higher costs

- LVY also notes that one way it has growing concert revenues is by charging more for events and adding more VIP packages. That could price more people out of the market, who end up at fewer events. Concerts have very high fixed costs and involve considerable labor for the event. The incremental ticket sale has a huge positive impact on margins. If that incremental attendee doesn't go, it can drive margins down quickly too.

We don't have much insight into the future attendance for concerts. But, we can see reasons for some costs to increase and LVY may not have as much control over venue expenses as it did in the past. That could squeeze margins in an area that has seen some strong improvement y/y in 2023 and 2022.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

Disclosure

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