



Holland Views – Formula One (FWONK) – Price: \$31, MCap: \$7,233m

## Economies of Scale

“Content, you know, content is where the money is...and content will always be where the money is...but content distribution magnifies the value of content” – Warren Buffett<sup>1</sup>

Regular readers will know our affinity for so-called Dream businesses; those businesses that offer high returns, good growth prospects and a low capital-cost of growth. Many content businesses are Dream businesses. Take three such businesses; WWE, Disney and F1 – all are playing the same game to some degree – monetising a growing audience via a scalable global platform of sorts.

We are drawn to these businesses because they:

- Enjoy unique wholly-owned, sought-after video content and IP portfolios
- Are late starters in taking advantage of the ‘new economics’ of global distribution
- Those ‘new economics’ are leading to increased operational leverage

Fig.1: As content business increase their scalable businesses, margins expand

Mix (% of sales)	Man U				WWE				Formula 1	
	2006	2017	cagr		2009	2017	2021e	cagr	2015	2021e
non-scalable	"Match Day"				Live events				Track Fees	
	43%	19%	4%		27%	19%			35%	
					Other				Paddock	
									18%	
"Scalable"	Broadcasting				TV rights+PPV				Broadcasting	
	28%	33%	14%		43%	34%	58%	18%	32%	
	Commercial				Network				Ads	
	28%	48%	17%		0	23%	20%		14%	
	total scalable mix				total scalable				total scalable	
	57%	81%			43%	67%	78%		46%	?
	group margins				margins				margins	
	24%	34%			19%	14%	31%		27%	33%
	margin expansion realised/estimated									
	+10% points				+12% points				+6% points	

Source: Holland Advisors

We’ve written at some length about Formula One, the business taken over by Liberty Media in 2016. Our work has highlighted the under investment, the untapped market opportunity and the track record of the new management team which we referred to as “*the best media/Sports rights value extracting team on the planet*”. We are positive on both the outlook for substantial improvement’s in F1 the sport and FWONK, the stock which trades on **16x 2018 FCF** earnings. But, that’s a valuation struck before any operational gearing kicks in!

In this note, we will not regurgitate our previous work on the F1 business’ fundamentals – work that we think has aged well. We think F1’s prospects are undimmed. Rather, we take a different tack and focus on the evolving business of content monetisation in the 21<sup>st</sup> century. In particular, we look at the new scope for operational gearing in content businesses under new direct to consumer distribution opportunities.

There is a well-trodden path. Sport content business globally have all evolved from selling predominantly match stadium tickets – i.e. events with a finite, local audience to selling video content of those events to a more global audience. Manchester United (an early beneficiary) and WWE (more recent) are great examples of these trends.

<sup>1</sup> <https://www.cnbc.com/id/100716784>

Fig.1 shows that as content becomes more scalable (via broadcasting or indeed as it's now called: "Narrowcasting<sup>2</sup>"), operational gearing follows. As a truly global sport F1's scaleable revenues look low at 46% of total sales vs Man Utd at 81% and WWE soon to be at 78%.

In time we expect this to change. It is our contention that F1's proportion of *scalable* revenues (i.e. revenue such as broadcasting and advertising) could increase materially from today's c.46%. Additionally, as the owner of the league rather than the producer of the content per se, the marginal profitability of this increase we would expect to be substantial. Our previous and current attempts at modelling F1's earnings power did/do not explicitly take this into account. In other words, based on peer studies, even though we have assumed some margin expansion our earnings power now may look conservative. This note expands on this possibility.

Were F1 to realise c.4m new subscribers (at an average \$80/year subscription) to its OTT service by 2021 (below the 5m management have said is realistic), this alone would meaningfully improve the mix of scalable revenues from 46% to over 60%. The marginal profitability of which we suggest would be substantial. Note that 4m subs is less than 1% of the F1 viewership!

We address three issues in this note:

1. A recap on **why F1 is a premium** asset
2. A look at the **Economics of Content**
3. Thoughts on why **the stock market narrative** on FWONK has become increasingly negative

## 1. F1 is a premium global media asset (with potential for op leverage)

We have written at length<sup>3</sup> on why we think that F1 is another classic 'rare bird' investment opportunity. It has all the ingredients: rarity, barriers to entry, a global brand, low capital needs, multiple growth opportunities and is very likely to be under-earning.

Fig.2: A recap on F1's traits as a 'Rare Bird'

Formula One has a long list of formidable traits, not least:

- It effectively owns a pre-eminent global sports league (it's rare to own a league), the associated brands and – uniquely – the associated media rights and back catalogue.
- Having been setup and run by the one-man-band that is Bernie Ecclestone, Liberty Media is likely to push the pedal in terms of monetising what is unarguably a unique brand.
- It is likely under-earning and it has significant new avenues for sustained growth. Our experience on WWE and ESPN helped us greatly in understanding this.
- It has new, proven, management and after just six races already is showing a newly revived enthusiasm among the F1 fraternity.
- It is extremely capital-light. It has 360 staff yet generates almost \$2bn in revenues. The business has negligible capital needs.

Source: Holland Advisors, 2017

To view the remainder of this in-depth report, please contact Andrew Hollingworth, [Andrew@hollandadvisors.co.uk](mailto:Andrew@hollandadvisors.co.uk) for a complete PDF copy.

### Contact:

**HollAnd**  
Advisors

Holland Advisors London Limited  
2<sup>nd</sup> Floor Berkeley Square House  
London  
W1J 6BD

Tel: (0)871 222 5521  
Mob: (0)7775 826863  
[www.hollandadvisors.co.uk](http://www.hollandadvisors.co.uk)

<sup>2</sup> Narrowcasting describes the ability to stream personalised content. Instead of blasting 57 channels at the world, users take their personalised (narrow) pick of preferred sports, entertainment channels.

<sup>3</sup> *Holland Views – a winning formula*, March 17, *Holland Views – Lollapalooza at speed* – Nov 2017

**Disclaimer**

This document does not consist of investment research as it has not been prepared in accordance with UK legal requirements designed to promote the independence of investment research. Therefore even if it contains a research recommendation it should be treated as a marketing communication and as such will be fair, clear and not misleading in line with Financial Conduct Authority rules. Holland Advisors is authorised and regulated by the Financial Conduct Authority. This presentation is intended for institutional investors and high net worth experienced investors who understand the risks involved with the investment being promoted within this document. This communication should not be distributed to anyone other than the intended recipients and should not be relied upon by retail clients (as defined by Financial Conduct Authority). This communication is being supplied to you solely for your information and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose. This communication is provided for information purposes only and should not be regarded as an offer or solicitation to buy or sell any security or other financial instrument. Any opinions cited in this communication are subject to change without notice. This communication is not a personal recommendation to you. Holland Advisors takes all reasonable care to ensure that the information is accurate and complete; however no warranty, representation, or undertaking is given that it is free from inaccuracies or omissions. This communication is based on and contains current public information, data, opinions, estimates and projections obtained from sources we believe to be reliable. Past performance is not necessarily a guide to future performance. The content of this communication may have been disclosed to the issuer(s) prior to dissemination in order to verify its factual accuracy. Investments in general involve some degree of risk therefore Prospective Investors should be aware that the value of any investment may rise and fall and you may get back less than you invested. Value and income may be adversely affected by exchange rates, interest rates and other factors. The investment discussed in this communication may not be eligible for sale in some states or countries and may not be suitable for all investors. If you are unsure about the suitability of this investment given your financial objectives, resources and risk appetite, please contact your financial advisor before taking any further action. This document is for informational purposes only and should not be regarded as an offer or solicitation to buy the securities or other instruments mentioned in it. Holland Advisors and/or its officers, directors and employees may have or take positions in securities or derivatives mentioned in this document (or in any related investment) and may from time to time dispose of any such securities (or instrument). Holland Advisors manage conflicts of interest in regard to this communication internally via their compliance procedures.