HollAnd Advisors

Holland Views – Formula One (FWONK): Price: $31; MCap: $7,375m

A winning Formula

In November[1], we wrote about a truly unique, capital-light business, with, what seems an unsurpassable moat and excellent growth prospects that had been acquired by the Liberty Media group and which could now, for the first time, be invested-in via a tracking stock – FWON. At the time, we wrote:

> *"With John Malone's backing and Chase Carey at the helm, F1 will arguably be managed by the best Media/Sport rights value extracting team on the planet"*

Much has happened since; in short we remain very impressed. The deal closed in January and Carey then hired two industry heavyweights (ex-F1 team manager Ross Brawn and ex-ESPN executive Sean Bratches) to work alongside him and drive the strategy of monetising F1's global opportunity. Carey's recent investor presentation in which he discusses some strategic options (excerpts later and attached) is a must-read in this regard. The current primary and secondary equity offerings provide a good opportunity for us to recap on recent developments and reflect on our original assumptions. It also offers another opportunity to buy into what we assess 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 Eccelstone, 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.

First, a word on the tracking stock FWON (and what you are buying)

Formula One, the business, now inside the Liberty Media Corporation and – in typical John Malone fashion – sits alongside a portfolio of media assets (notably, SiriusXM, LiveNation, The Atlanta Braves and some other listed holdings). Malone has helpfully created tracking stocks and the Formula One-specific tracking stock is FWON. Fig.1 shows the capital structure of FWON. Notably, of the c$7.4bn current market capitalisation, $3.3bn of value is contained within the listed stakes owned by the group. Normally we are allergic to high debt levels, but the recent refinancing (which lowered the effective interest rate from c.5% to 3.75%) and the equity issuance (c.$380m which will be used to pay down debt) combined with Liberty ownership encourage us to be sanguine regarding the debt level the business currently has. The debt should also be seen in the context of c.$500m FCF run-rate (pre-interest) that we think the business could generate

[1] *Holland Views, Sky High, Pub Debts, Fast Cars and Airlines, Nov 2016*

this year. Indeed the excellent and resilient cash characteristics are a central element to our positive stance on FWON.

Fig.1: FWON capital structure

FWON share price	$ 31	
Q1 17 # shares	238	
FWON equity capitalisation	$ 7,375	
Capital Structure	31/03/2017	24/05/2017
Total FWON Debt	**$ 6,697**	**$ 6,346**
FWON Cash	$ 626	626
FWON Net Debt	**$ 6,071**	**$ 5,720**
FWON Listed Stakes		
Live Nation stake	$ 2,366	
Time Warner	$ 421	
Liberty Braves	$ 218	
Other listed holdings	110	
Private investments	159	
FWON non F1 equity value	**$ 3,275**	

Source: Liberty Media Corporation Prospectus, Holland Advisors

Reassessing the Growth prospects

As a reminder of why we think F1 has a significant growth opportunity, please indulge us with another recap of what we highlighted in November.

> *"Why do we like the business? It's pretty rare, it's almost impossible to buy a global sports franchise of the scale of Formula One. You can't buy the Olympics, you can't buy FIFA. This is about as broad and wide as you can get, with a huge competitive moat in our judgement. Unique scale, massive reach, five continents, 21 countries, 21 events in 2016, over 400 million fans, and a very attractive demographic for sponsors and advertising, and a very attractive financial profile. Revenue from multiple sources, including broadcasts, sponsorship, and venues, opportunities ahead that I'm going to talk about, multi-year contracted, we have an enormous percentage of revenue we can look forward and say we know it's coming, it's under contract, makes it very secure, allows us to support higher degrees of financial leverage, allows us to know and have certainty on the asset-light model that we have, and a very tax efficient structure."* – Greg Maffei, Liberty Media CEO

That all said, the rump valuation (i.e. excluding the equity value of the listed stakes), still puts the F1 business on circa 25x its historical cash earnings. Now we can debate whether last year was representative given the business was in flux etc. but the reality remains that we need to be comfortable with F1's growth prospects in order to buy the shares today. In short, we are. We think that, at today's price, that multiple could fall from 25x to c.7x in 2020. This assumes revenues grow at 7% cagr 2017-2020 and also that margins rise.

Pricing power: Q1 2017 update gives a hint on growth resilience

Conveniently for us, F1's first quarter as a quoted business saw '*Primary Formula 1 revenues*' grow by +7% YoY. This reflected just one race (Sydney) and more importantly reflects the legacy business and strategy, i.e. such growth was realised without any of the monetisation efforts that Brawn and Bratches are likely to develop. Notably, the company commented that the growth was

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