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Holland Views – Formula 1 (FWON) – Price: $34; MCap: $7.8bn

A simpler Formula

The Covid crisis has resulted in much change to some company capital structures. Formula 1 (FWON[1]) is notable as a company that has greatly reduced its debt and simplified its capital structure considerably – without issuing new shares: This is our third in-depth look at FWON since 2017[2]. As we first said then, we think F1 is a 'rare bird' investment. Today its shares offer value to longer term investors seeking great franchises and importantly now come with far less debt.

What attracted us to Formula 1?

> *"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**

- FWON shareholders own a share in an entire Sports League, an extremely rare asset
- F1 is a unique, globally recognised brand with 390m million unique global viewers
- With pricing power (i.e. contractual rate increases in promotion and sponsorship deals)
- F1 was under-managed/under-monetised under Eccelstone and now has top-class management with a long-term outlook. We see lots of opportunity to accelerate growth.
- This is an extremely asset light business and thus very high return on capital

  …in short, F1 is a dream business

And what has changed in the last three months?

Fig.1: Never waste a crisis: FWON is now a simpler and more resilient entry

	Jan-20	Jun-20
FWON market cap	$10.9bn	$7.8bn
non F1 equity stakes	c$6bn	c$0.6bn
FWON Net Debt	$5bn	$1.6bn
annual Interest costs	$195m	$89m
F1 2023 P/FCF est	12x	13x

Source: Holland Advisors

- A much **simplified capital structure** as per Fig.1
  - Equity stakes monetised (reduced from c.50% of MCap to c.10%)
  - Consequently, Net debt reduced from $5bn to $1.6bn
- **FWON shares -25% YTD**. ***Before*** any re-leveraging in coming years (ie sizeable buybacks of stock), this is a business that offers investors a **13% IRR's** (our best guess) from today's starting price.
- A **purer equity play** on F1 (no LiveNation exposure any more)

[1] We remind you that Formula 1 is publicly traded via a 'tracking stock' and is legally a part of John Malone's Liberty Media conglomerate. In this note, 'FWON' is the tracking stock/holding company, 'F1' is the operating compa1ny.

[2] Holland Views – FWON, Lollapalooza at speed, Nov 2017, $38 Holland Views – FWON, Economies of scale, Dec 2018, $31

- Team '**cost caps'** now agreed with the teams. Covid could prove the catalyst to "*create a financial structure for the sport that allows smaller teams to compete* " A renewal of the Concorde agreement has been deferred until 2021 but a sensible outcome that promotes growth is now very likely?

In this note we discuss:

1. Debt reduction and a simplified capital structure
2. A recap on the F1 machine - A cash cow and a growth engine
3. A word on the near-term uncertainty
4. And an updated look at Valuation

Debt reduction is welcome

Much as we love John Malone and his track record, we were never totally relaxed by his willingness to embrace debt (and, frankly, financial engineering) to juice equity returns. Even if his businesses are always cash generative and the tax benefits good (F1 enjoys a 7.5% cash tax rate in the UK!). Our work on Marriott and Ashtead's clever use of affordable through the cycle leverage has helped our understanding on this issue, but Malone and team do like to push it a little!

But we always liked the idea of being long term shareholders in Formula 1. So, it is with some relief that we see Greg Maffei (Malone's right-hand man and head of Liberty Media) de-lever FWON in April. His hand we suspect forced by lenders and the huge uncertainty about 2020 F1 race calendar. The group needed to reduce its significant interest costs and thus divested its 30% stake in Live Nation leaving a far less leveraged owner (FWON) of the Formula 1 racing business.

To remind you, the FWON tracking stock included a significant equity holding in Live Nation (worth c.$5bn as recently as February). That stake had halved in value by the time the asset was transferred to Liberty Media sister company Sirius XM along with $1.3bn of other FWON holding company debt liabilities in exchange for a $1.4bn cash injection. FWON shareholders also obtained 'call-spread option' allowing it to participate in any upside to Live Nation shares over the next 12 months (to $47).

Long story short, this action greatly simplifies FWON's capital structure and also means that debt leverage will likely fall further and quickly in the coming years. Assuming that 2021 reverts to a 'normality of sorts' in terms of F1 season schedule, the cash generation potential of this business could mean that Net Debt/EBITDA could fall below 1.5x as soon as 2023 (see Fig.2). We elaborate on this cash generation later and our model is available on request.

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