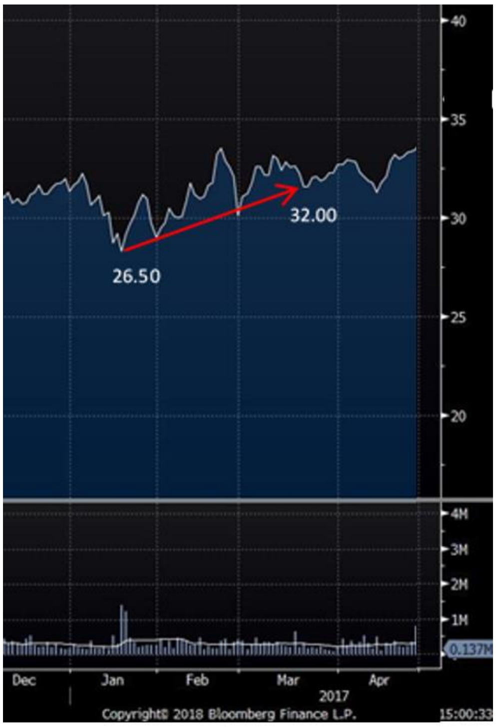
Is Liberty Media liberating Formula One's Growth Potential ?

Company Overview

Formula One (F1) is an international Motorsports Company which hosts one of the premier forms of racing across the globe with the highest class of single-seater race cars. On 23 January 2017 Liberty Media, an American mass media conglomerate, completed the acquisition of Formula One in a deal valued at $4.4 billion. The Liberty Media stock split in 2011, and consequently, this meant that the now newly named Formula One stock would be split into three common stocks. The Series A and C Liberty Media Formula One stock currently trade under the stock symbols of FWONA and FWONK on the Nasdaq Global Select Market, whereas the Series B stock is quoted under the symbol of FWONB on the OTC Markets. FWONA stock carries one vote per share in comparison to FWONK which holds ten votes per share. Additionally, it is worth noting that when Liberty Media bought F1, Formula One Management received in effect of 138 million FWONK shares.

Approaching the start line

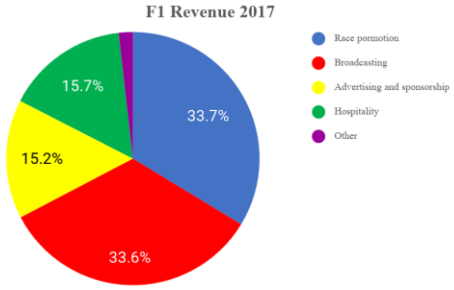
Currently, FWONK is side trading between the $34 and $35 mark, this on the back of the stock market suddenly plunging in the early part of February 2018. Prior to this, however, FWONK reached its highest YTD price of $39.28 following a Morgan Stanley report in early



February 2018 forecasting a 42% growth in broadcasting revenue over the next year, at that point investors were pricing themselves in for an imminent bullish trend. As such it came as no surprise that following the stock market's rapid recovery, the stock entered into another bullish trend only to have the engine stall on this vehicle for upward growth as Morgan Stanley previously reported expected growth of 42% came under severe scrutiny. Ten days later the financial services released another report which instead outlined a grim outlook for the sport's revenue streams over the next three years. The report stipulated that Morgan Stanley's revenue growth model for the sport foresaw F1 accumulating $216 million in net losses by 2020. This has now, however, placed the stock in a unique position. In the build-up to each new season in March, different teams publicly broadcast their car's new colour scheme and shape in February, following which all teams have two weeks to test their new cars in Barcelona. The testing gives the public their first indication of what to expect in the year ahead. This excitement and anticipation spill over into the markets with investors responding in accordance with first impressions of the coming season. Indeed the strong correlation is easy to see. When comparing FWONK's performance from mid-January to mid-March of 2017, the new Formula One season carried a great deal of anticipation over the introduction of the sport's new owners and new car design regulations. Ferrari was the quickest during testing in 2017 which allowed fans and investors to believe that instead of another championship dominated by Mercedes AMG, the World Championship in 2017 would be fiercely contested. As such, the stock grew approximately 20% over that three month period. Taking this into regard along with the fact that FWONK is currently at an 8 month low, a short-term buy option is now available for investors to exercise.

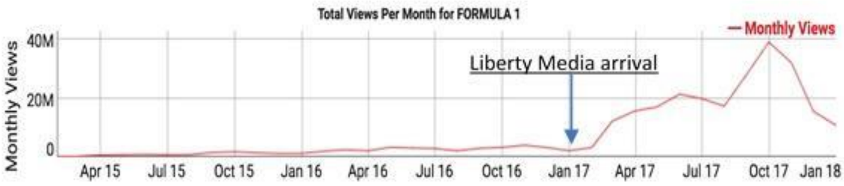
The driving force behind revenue

F1's revenue is built upon race promotion, Broadcasting, advertising & sponsorship and hospitality. The F1 2018 seasons will be the first full season under the new management by Liberty Media. As the new season approaches the start-line, so the finish-line on new media rights deals draws nearer. Revenue generated through broadcasting in 2017 contributed approximately 33% of F1's total revenue. Currently, F1's broadcasting future cash flows stand to experience a 9.6% growth stimulated by the new media rights deals set to be confirmed in Germany, Spain, Italy and Latin America. Most notably is the contract extension recently agreed with Spanish broadcaster Moviestar+. Currently, the Spanish market is F1's most important market in Europe. F1 has further exemplified this fact by continuing to use Moviestar+ as the primary driver in building this ambitious project set to expand the F1 fan base and satisfy it's ever-broadening and wild expectations. This is the latest in broadcasting contracts Formula One has sealed. While in Australia, France, Germany and the U.S, F1 is currently in or set to start contract renewal negotiations.



Social Media Updates and Over the Top Broadcasting

F1, under new management, is listening to their fans and has discovered that the majority of the followers are technically proficient. The online broadcasting market is an unexplored market, one which F1 is set to spearhead with the development of their new F1 TV live subscription service which was officially confirmed on 1 March 2018. F1's commercial chief Sean Bratches said that their objective is to create services directed at the consumer arena that will engage fans and allow for their assets to be leveraged – "whether they are live races, whether they are archival, whether they are data" in an interview with motorsport.com. Liberty Media prioritised gaining social media attention in 2017 across numerous social media platforms, the success of which is in the numbers: The Formula One Youtube channel has experienced exponential gains in video clicks, fans and subscribers since Liberty Media's arrival.



Liberty Media approach pushed the total number of viewers on the F1 Youtube channel from approximately 5 million to the highest point ever of 40 million while the fall in viewership between October 2017 and January 2018 is due to the off-season.

The extensive focus that Liberty Media put on social media platforms is not limited to short-term returns; instead, it puts long-run rewards in mind. Beyond the short highlight clips, Liberty Media is unexpectedly considering moving the whole race online. The recent Deloitte report stating that live-streaming revenues will surpass $7.4 billion globally during 2018, representing a 47% increase compared to 2017, makes the consideration not so surprising after all. According to Frank Arthofer, Director of Digital and New Business of F1, the new F1 TV live subscription service will be the cornerstone of F1's digital transformation. The prosperity of which is found in the price that is set to be considerably more competitive than most cable TV networks, and more importantly, it will offer multiple language commentaries and exclusive on-board camera views which traditional channels are unable to provide. Therefore, the potential subscription figures indicate possible future growth for the sport.

It is worth considering that this may harm the current TV broadcasting deals. Motorsport.com believes that the forthcoming live streaming service was one of the reasons that NBC shied away from renewing its deal with F1. Also, it will still not available in certain countries such as the UK where F1 still has deals with the current broadcasters. Since F1 has licensed digital rights to TV partners in some instances, coverage of live races will be available on a market-by-market basis. The first batch of countries that will have access to F1 TV are Germany, France, USA, Mexico, Belgium, Austria, Hungary and much of Latin America. The balance between TV broadcasting deals and online streaming service is, therefore, something Liberty Media need to manage carefully. Trying to gain viewers online by providing easy access to the race as well as maintain the current profitable TV contracts is definitely what Liberty Media is eager for, but the loss of reliable partners and profits may be a risk.

Room for growth

F1’s global television audience is currently in a precarious position following the sport’s viewers declining from 600 million in 2008 to 390 million in 2016, but with the decline grinding to a long-awaited halt in 2017. Part of the decline was driven by a move to exclusive pay-TV coupled with the predominant Chinese television broadcaster CCTV dropping F1 in 2013. Furthermore, due to the lack of on-track competition, the sport’s fan base began to wane, so unexpectedly F1’s revenue came under strain with a chain reaction of downturns, such as the lowering of the sport’s value in the eyes of broadcasters and sponsors on the horizon.

China is a fruitful market for F1, and the losses in revenue caused by CCTV not renewing their broadcasting contract consequently caused the race broadcasting to be reduced to only regional television networks shown in a few provinces and minor online streaming platforms. LeSports, a Chinese video streaming company, was the sole provider of online streaming in China for three seasons until late 2016 when the parent company LeEco suffered a financial crisis resulting in a suspension of online streaming in China and a loss of an official broadcasting partner. But the Chinese market is far from closed with local media group Sina reporting that F1 is currently negotiating with CCTV in order to bring Formula One back to the national network. Additionally, a new set of online broadcasting deals have already been agreed with broadcasters in Latin America, USA and most importantly, China, the details of which are still pending. This apparent revival of the Chinese market can be accredited to Liberty Media’s finesse in orchestrating the recent renewal of the Chinese Grand Prix contract; China has a great deal of unexplored business potential which Liberty Media has committed to embracing.

Brexit or Brentrance?

Current deals with Channel 4 in the UK will end this year while the next round of UK broadcasting deals can only start after 2024 when the current Sky Sports deal ends, so for the next few years the paid service may be the only service available to F1 fans in the UK. The disadvantage of this current paywall is that it may discourage potential new viewers from and potentially lead to unsatisfied growth in viewing figures from the UK. Additionally by 2024, Lewis Hamilton, the British four-time World Champion, will almost be in his forties and so is likely to either retire or be far less competitive before the renewal of the UK broadcasting contract. A decline in Hamilton’s performance or presence in the sport may lead to a deterioration in viewership across the UK. There may just be light at the end of the tunnel however, according to Sky’s Matt Morlidge, listing at least seven British drivers currently in F1 young driver programmes, all with direct lines of sight toward F1, so who's to say that among them is not a future young star. Although there may be uncertainty ahead, the UK remains one of the most extensive motorsports markets with room for development.

Outlook

Under new management F1 finally seems to be in some clean air, the sport is expanding its horizons and looking to reach new audiences. The successful monetisation of important existing broadcasting deals and the potential for the Chinese market to open up once again will reflect positively on the sport's value and ultimately the stock price as revenues are poised to rise. In the short term investors should be bullish but should be aware that if contract negotiations don't go according to plan or if revenue fails to attain predicted targets the upside of the shares will be limited. Nevertheless, the confidence in F1's new management and investor enthusiasm will continue to drive long-term growth along with Liberty Media's attractive financial position which will serve to limit the potential downside to the shares.