

Reviewing Our Theses on Disney, Charter, Comcast, RBI, F1, and Fox

This article by Francisco Olivera is excerpted from a letter of Arevilo Capital Management, based in San Juan, Puerto Rico.

The Walt Disney Company (“Disney”)

2019 has been (and will continue to be) a busy year for Disney. So far, Disney has:

- Released four of the top five global box office hits, including: “Avengers: Endgame,” which has earned \$2.78 billion at the global box office; “Lion King” (live action); “Frozen 2;” and “Star Wars: The Rise of Skywalker” will be released in the second half of 2019;
- Closed the acquisition of Twenty-First Century Fox’s entertainments assets;
- Detailed its video streaming strategy at an investor day in April, including the financial outlook for its streaming services;
- Announced a deal with Comcast to assume control of Hulu’s operations. Terms were also set for Disney to purchase the remaining 33% of Hulu it does not own today;
- Opened “Star Wars: Galaxy’s Edge,” the largest expansion ever to Disneyland. Galaxy’s Edge will also open in Disney World’s Hollywood Studios later this year; and
- Increased ESPN+’s live and original programming investment, including an expanded partnership with UFC. You must now be an ESPN+ subscriber in order to watch a UFC pay-per-view fight.

Investors have grown more confident in Disney’s long-term outlook because of the Company’s aggressive strategy to succeed in the “streaming wars.”^[1] Disney has restructured its operations, with content production on one side of the business and distribution (via Disney+, Hulu, and ESPN+) on the other. With its brands and intellectual property, Disney has a unique opportunity to create a global direct-to-consumer streaming service. Disney+’s \$6.99 per month price tag is a strong sign of the Company’s ambitions to add many millions of subscribers. Subscribers to Disney+ will have access to all of Disney’s 2019 box office hits.

Disney’s content production is the heart of the business. Popular box office and television content will lead to more Disney+ subscribers, parks guests, consumer products purchasers, and engagement with Disney’s brands. No other content company can monetize its customers as well as Disney.

In the medium-term, Disney’s financial performance will be cloudy. The Company will be spending significantly on integrating Twenty-First Century Fox, and on growing Disney+, Hulu, and ESPN+. When the dust settles, Disney will be in a stronger competitive position and produce much more free cash flow.

2019 year-to-date total stock return: 27.4%

Charter Communications (“Charter”) / Liberty Broadband

Charter’s operating metrics have continued to improve this year, with increasing broadband penetration and accelerating overall customer growth. Investors have become less fearful of Charter’s prospects in the face of declining pay-tv customers. Charter is a broadband-centric business, providing

a service that is essential (and growing in importance) to its customers. The following comment by Charter's CEO on the company's last quarterly conference call is noteworthy:

*Monthly data usage by our residential internet customers is **rising rapidly** and monthly median data usage was over 200 gigabytes per customer. When you look at average monthly usage for customers that don't subscribe to our traditional video product, usage climbs to over 400 gigabytes per month, which compares to an average mobile usage of well under 10 gigabytes per month.*^[2]

Not only is broadband usage growing, but also double in size for non-pay-tv customers and exponentially higher versus wireless users. Given the importance of the broadband product and Charter's advantage versus competitors (such as copper-based internet service providers), we believe Charter's broadband penetration is poised for growth.

Charter's free cash flow margins and growth is positioned to expand as residential and commercial customer additions grow, integration expenses dwindle, and capital intensity in the business declines. Charter is using all of its free cash flow and debt capacity to return capital to shareholders via share repurchases. Growing free cash flow combined with share repurchases produce even faster growth in free cash flow *per share*.

Charter's share repurchase strategy is a significant benefit for long-term investors. Liberty Broadband Chairman, John Malone, recently said the following regarding Charter: "Right now the focus is on building out their broadband infrastructure. Their valuation is strong and their growth is good. They're very cash flow accretive. It's a great business."^[3] We could not have said it better.

Charter 2019 year-to-date total stock return: 38.7%

Liberty Broadband A & C shares 2019 year-to-date total stock return: 43.2% & 44.7%

Comcast Corp. ("Comcast")

Similar to Charter, Comcast's cable business is performing well to start the year. Comcast is on-track to add over 1 million broadband customers for the 14th year in a row and average revenue per broadband customer increased 5% in the first quarter.

The biggest development from the NBC-Universal business is the announcement of a new advertisement-based streaming service, which will launch in 2020. Comcast's approach to competing in the "streaming wars" is to augment Xfinity and Sky's pay-tv services. The new streaming service will be widely distributed to pay-tv customers in the U.S. (led by Xfinity) and in Europe (via Sky). We believe Comcast's approach to compete against the "streamers" is sensible, because (i) it requires less investment, (ii) has the potential to increase pay-tv customer engagement, (iii) will increase opportunities for Comcast's ad customers, and (iv) provides flexibility to monetize its content.

It's too early to tell if Comcast's acquisition of Sky will be a success, but Comcast has moved quickly to consolidate redundant businesses, create partnerships amongst its businesses, and reduce consolidated financial leverage. Sky provides Comcast with significant scale to invest in content and technology that will improve the Company's products and services for many years to come.

2019 year-to-date total stock return: 24.8%

Restaurant Brands International ("RBI")

Jose Cil, RBI's new CEO, led an investor day in May to provide insight into the Company's strategy and

long-term goals. RBI's priority is to grow its three brands (Burger King, Tim Hortons, and Popeyes) globally by expanding from 26,000 restaurants today to 40,000 over the next 8 to 10 years. The target implies store count growing 4.4% to 5.5% annually, an ambitious (but achievable) target. If store count grows 5% annually and same stores sales can maintain low single-digit growth, RBI's free cash flow will grow immensely over the next decade. After the investor day, RBI announced plans to open Tim Hortons restaurants in Thailand and Popeyes restaurants in Spain.

We believe RBI's focus on growing its brands globally combined with its "balanced capital allocation" approach (dividend payments, share repurchases, debt repayment, and M&A) will produce attractive long-term value to shareholders.

2019 year-to-date total stock return: 34.9%

Formula One Group ("F1")

Formula One's marketing and commercial initiatives are starting to gain momentum. In March, Netflix released "Formula 1: Drive to Survive," a documentary series on the 2018 F1 season. The show was well received and we believe it helped expand the league's audience (particularly in the US, where the sport's viewership is growing). F1's management team is also working on improving the race calendar. Two new races have been added to the calendar for next year (Vietnam and Netherlands) and plans for a race in Miami, Rio, and a second race in China are underway. Over time, we believe the race calendar will reflect a balance of legacy race tracks and "destination city" events that will lift F1's global profile.

Management's biggest goal for the rest of the year is to sign a new Concorde Agreement with all F1 teams. The Concorde Agreement is the contract that defines the economic and technical regulations for F1's teams, regulator (FIA), and commercial rights holders (Formula One Group). The current contract expires at the end of 2020, but a new contract needs to be agreed upon by the end of this year.

A more equitable economic structure amongst teams and simplified technical regulations will help create more competition and excitement for fans. More competition and fan engagement will lead to long-term value for shareholders.

2019 year-to-date total stock return: 20.7%

Fox Corp. ("Fox")

Fox was spun-off from Twenty-First Century Fox right before Disney acquired its entertainment assets. Fox owns the Fox network, 28 television stations, a group of cable channels (led by Fox News), and other assets (real estate, Roku investment). After the Disney transaction, Fox has become a purely domestic television business that is highly dependent on the pay-tv bundle. Knowing the secular headwinds being faced by the pay-tv bundle, management created a business focused on the most valuable part of the bundle: live news and sports. Fox owns the most popular news channel, Fox News, and holds the rights to nearly 40% of NFL games, the most watched sports league in the U.S. Fox also owns the rights to the World Series, the World Cup (both men and women's), WWE's "Smackdown", NASCAR's Daytona 500, and a variety of college sports.

In a world where the value of the pay-tv bundle is driven by live content, Fox is extremely well positioned. Half of Fox's revenues are derived from contracted affiliates fees (paid by pay-tv distributors and affiliated TV stations) and half from advertising. 70% of ad revenues are from live programming, which face less risk relative to entertainment programming. Over the next three fiscal years, 73% of affiliate fee revenues will be renewed. Fox has an opportunity to demand higher affiliate

fees because their channel portfolio is relatively small and their live content is arguably the most valuable in the pay-tv bundle.

We continue to hold our investment in Fox given the low free cash flow multiple and pricing opportunity going forward. However, we are vigilant of the secular risks facing the pay-tv industry.

A & B shares 2019 year-to-date total stock return: (8.6%) & (9.6%)^[4]

¹ “Streaming wars” has become a popular way to describe the competition between tech companies (led by Netflix) and traditional media companies (such as Disney, HBO and Comcast) in online video entertainment.

²

Source: <https://seekingalpha.com/article/4258162-charter-communications-inc-chtr-ceo-thomas-rutledge-q1-2019-results-earnings-call-transcript?part=single>

³ Source: <https://variety.com/2019/biz/news/john-malone-faang-sun-valley-charter-1203263342/>

⁴ Total stock return calculated from the spin-off date.