DeMatteo Research

IDEA NOTE

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FOXA

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Twenty-First Century Fox Inc

TMT, Event Driven/Special Sit

05/22/2018

PRESENTED

DATE		05/17/2018
PRICE	MARKET CAP	ENT VALUE
$37.77	$70.18B	$82.81B
P/E RATIO	BOOK VALUE	DIV YIELD
17.41x	$10.24	0.84%
SHARES O/S	AVE DAILY VOL	SHORT INT
1,858.00M	8,811,782	N/A

CURRENT

PRICE	$45.17	MARKET CAP	$83.68B

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Chart
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Twenty-First Century Fox, Inc. is a media company, which engages in television broadcasting and film production. It operates through the following segments: Cable Network Programming; Television; Filmed Entertainment; Direct Broadcast Satellite Television, and Other Corporate and Eliminations. The Cable Network Programming segment consists of the production and licensing of programming distributed through cable television systems and direct broadcast satellite operators. The Television segment offers broadcasting of network programming. The Filmed Entertainment offers production and acquisition of live-action and animated motion pictures for distribution and licensing in entertainment media. The Direct Broadcast Satellite Television segment involves in the distribution of basic and premium programming services via satellite and broadband directly to subscribers. The Other, Corporate and Eliminations segment comprises of corporate overhead and eliminations. The company was founded in 1979 and is headquartered in New York, NY.

Publicly traded companies mentioned herein: AT&T Inc (T), Comcast Corp (CMCSA), Netflix Inc (NFLX), Sky PLC (SKY LN), Time Warner Inc (TWX), Twenty-First Century Fox Inc (FOX, FOXA), Walt Disney Co/The (DIS)

Highlights

The presenter is long shares of Fox (FOXA), seeing favorable fundamentals for the FOX SpinCo, consisting of its news and broadcast businesses and sports network assets, that will be created as a result of Disney's planned acquisition of the FOX RemainCo. In addition, he sees the possibility of a competitive bid between Comcast and Disney for the RemainCo, given both companies likely view it as having imperative strategic importance. He thinks SpinCo will trade up to $18 - $19, while the ultimate price of the RemainCo could be $36 - $37; thus, there could be ~50% upside for FOX shares.

- Fox SpinCo will consist of news, broadcasting, and sports assets. At the current bid of $28/share for RemainCo by Disney, Fox SpinCo is being created at $8 - $9, and is expected to earn $1.10 in FCF, implying a 7x FCF multiple. The presenter believes that FCF can improve to $1.80 over the next 2 – 3 years, which means the SpinCo is being created at only 4.5x FCF. He believes SpinCo shares could appreciate to $18 - $19.
    - Sports broadcast is an undermonetized segment right now, when compared to peers. Affiliates are indicating that fees will become more standardized across companies moving forward, which should help FOXA.
        - Most RSNs currently earn $3 - $4 per sub, while ESPN is at $7 per sub and FOXA is at $1.70 per sub. The

        - presenter feels ESPN is probably overpriced, while FOXA should see improvement towards $3. Every dollar of retrans fees is worth ~$1B, or $0.50 per share according to the presenter's model.

    - Fox News has remained robust despite headwinds across the industry, and has not suffered from any disintermediation or fragmentation.

    - The presenter adds that the SpinCo is incentivized to keep valuation at the time of spin low, since there will be tax obligations on the new assets, as well as how management comp packages will be determined. A lower price for the SpinCo means less tax. As a result, the SpinCo is motivated to make investments (such as the Thursday Night Football deal) and absorb costs until after the spin.

- In early May, Comcast announced that it was in talks with banks to finance an offer for Fox RemainCo that could top Disney's offer. This follows previous attempts by Comcast to compete for FOXA, as well as a competitive bid between Comcast and FOXA for Sky. The presenter states that Comcast and Disney both consider the acquisition of FOXA assets as "existentially crucial" in the face of the new media landscape. Both Comcast and Disney are eager to acquire a direct-to-consumer platform that could help them compete with the likes of Netflix, and the various segments of FOXA, such as Hulu and Star, provide a good way to do that. The presenter thinks Comcast and Disney could get "very aggressive" in pursuing FOXA given these dynamics.

    - In their S4, Disney has laid out a large synergy opportunity in a Disney-Fox deal, which the presenter views as "credible." However, the dynamics of a deal means Disney was incentivized to not overstate value, whereas FOXA wants to push it higher. As a result, Comcast could feel it can potentially enable higher synergies than Disney, by as much as 50%.

    - Current bidding with Disney is set to deliver 9% unlevered cash-on-cash yield, assuming the synergies laid out by Disney are realized. Given that the transaction is "highly strategic," there's a decent amount of room for the pricing to go up, in the presenter's view. Comcast, in an all-cash bid scenario, would likely view a 9% - 10% cash-on-cash yield as a "steal," so there is "lots of room for the two to compete."

    - Disney CEO Bob Iger is "heavily incentivized" to complete the deal, without any restrictions on the price of the transaction. Comcast CEO Brian Roberts has also "demonstrated a willingness to get aggressive" for crucial deals. The major question for Comcast, the presenter feels, is the ability to finance the deal, but the "motivation is there."

- The presenter feels there's some level of "antitrust symmetry" between Comcast and Disney that would put the two on similar footing in a bidding war scenario, which should drive up the final price for FOXA.

    - Approximately 50% of FOXA is international, and another 20% is in studios. Past antitrust rulings have indicated that international operations are typically not taken into account, and studios is "indisputably a competitive segment."

    - Current proceedings of the AT&T and Time Warner deal indicate the DOJ tends to focus on national distribution platforms and sports deals as major components of evaluating "market power" in antitrust review. As such, the Fox Sports Network, at 20% - 25% of the business, is the only major segment that's sensitive to antitrust, and this hold true for both Comcast and Disney. As such, neither side is "favored" from an antitrust perspective in the presenter's view.

        - Judge Richard Leon has stated that he will issue a decision on the AT&T/Time Warner deal by June 12th. The presenter speculates Comcast could look to enter a formal bid prior to this decision, or wait until after the decision to assess how regulators currently evaluate the space.

    - Both companies are likely prepared to sell off non-essential assets to assuage any antitrust concerns, and antitrust is unlikely to pose a major hurdle for either one.

- Assuming a winning bid that yields 7% cash-on-cash (from either Comcast or Disney), the RemainCo would be sold at $36 - $37 per share, according to the presenter's model. Combining this with the $18 - $19 of SpinCo yields a $56 "price target," or 50% upside. The presenter expects that a FOXA holder can "collect most of it within a year."

For questions regarding DeMatteo Research Events and Services, please contact:

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