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MEDIA COVER

Inside John Malone's World

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John Malone and Greg Maffei / Illustration by Michael Hoeweler

John Malone has long been a different kind of mogul.

He hasn't been interested in creating a single conglomerate of enormous scale, or building a powerful media dynasty. Often, the billionaire deal maker is just as keen to sell as he is to buy. As a pioneer of cable television, he has helped shape the media landscape and yet lately has had little use for traditional media content.

Now 77, Malone remains the instrumental force behind 10 companies under the Liberty umbrella that have a combined market value of $80 billion. In interviews, Malone and his longtime chief lieutenant, Greg Maffei, 58, told *Barron's* how they see the world of media and telecommunications and how they value businesses.

"As I get older, I've gotten more diversified personally," Malone says. "It's good to be diversified, given the technological changes that are driving changes in consumer behavior."

The sheer number of Liberty entities—combined with often complex structures—can be daunting to investors. Those who have taken the time to understand them have been rewarded, however. Liberty Media, Malone's main investment vehicle, took shape in 2006 and is up about tenfold since then, adjusting for a dizzying series of transactions, including the well-timed sale of DirecTV to AT&T in 2015.

This is an opportune moment to assess the Liberty empire, because many of the stocks have lagged behind the market in the past year and look appealing. And to see the world as Liberty does is to gain a valuable perspective on how media and telecommunications businesses are being transformed by fast-moving changes in technology and markets.

Investors stand to benefit from such a view. The Liberty stocks offer plays on a range of businesses like the Atlanta Braves baseball team, Formula 1 car racing, and home-shopping leader QVC, and on stocks like Charter Communications (ticker: CHTR), Expedia Group (EXPE), TripAdvisor (TRIP), and Sirius XM Holdings (SIRI).

Liberty Media itself is organized as three tracking stocks: Liberty Braves (BATRK), Liberty Formula One (FWONK), and Liberty SiriusXM (LSXMK). Malone is also chairman of Liberty Global (LBTYA), the biggest international cable company.

There are a group of Liberty entities that track other stocks: Liberty SiriusXM, Liberty Broadband (LBRDK), GCI Liberty (GLIBA), Liberty Expedia Holdings (LEXEA), and Liberty TripAdvisor Holdings (LTRPA). These all trade at discounts to the value of their stakes, making them cheap alternatives. Liberty SiriusXM, for instance, languishes at a 29% discount to its asset value, which is dominated by a 71% interest in Sirius. The widening discount on these Liberty stocks this year provides an opportunity for investors.

"Malone has long been focused on economic return," says Vijay Jayant, an analyst with Evercore ISI. "He's not an empire builder for the sake of owning assets. His strategy has worked out well for the people sitting on the same side of the table as him—the shareholders in his companies."

Warren Buffett is often a point of comparison. Among the major differences is that Malone favors creating pure-play companies, while Buffett keeps everything under one roof at Berkshire Hathaway. Malone is comfortable with financial leverage, while Buffett shuns it. "Our businesses are rationally levered with cheap money," Malone says. "It creates a higher return on equity for our investors. There's no reason to think the leopard will change its spots."

Berkshire is a believer in Malone, holding about $2 billion of Liberty SiriusXM and $700 million of Liberty Global.

Liberty's investments are concentrated in industries that appeal to Malone and Maffei, the CEO of Liberty Media: live entertainment, cable TV, and travel. Liberty will showcase them in its annual investor day on Wednesday, when Malone will make a rare public appearance. Maffei will also speak.

Malone loves cable TV. He was one of the original cable entrepreneurs in the 1970s as he built Tele-Communications Inc. into a giant, then sold it to AT&T in 1999 for $31.8 billion. He got back into cable when one of the Liberty companies bought a stake in Charter Communications in 2013.

Since then, Charter has bought Time Warner Cable and become the No. 2 cable company in the country behind Comcast (CMCSA). And Charter's stock has tripled since Malone got involved, easily topping Comcast's gain.

Charter trades at a higher valuation than Comcast in part because of Malone. Investors like Malone, viewing him as buyback friendly and willing to sell Charter to Verizon Communications or another buyer for the right price. Comcast CEO Brian Roberts, in contrast, is viewed as more of an empire builder who wants to keep the company in his family's control. Many on Wall Street weren't pleased with Roberts' latest big deal, the $40 billion purchase of Sky, the British satellite TV company.

When it comes to content, Malone likes sports programming because of its consistent appeal to viewers in a fragmented media world, and he is particularly happy with the outlook for Formula 1, a premier auto racing business.

"Seldom have I seen an opportunity to control a global sport," he says. Formula 1, which is popular in Europe and Latin America, wants to build a U.S. fan base. Liberty recruited as CEO the well-regarded Chase Carey, the former president of 21st Century Fox. (Fox is a sister company of *Barron's* parent.) Profits are rising under Carey as Formula 1 boosts the number of sponsors.

Traditional media content like TV shows and movies "competes with everything that has ever been created, while live sports only competes against itself," Malone says. Formula 1 controls its TV rights, as does the National Football League.

Maffei says, "I think traditional content companies, like cable networks, will be challenged by declining subscriber fees due to cord shaving, and reduced audiences, which will impact ad revenue and massively increase investment by newer entrants with better business models like Netflix (NFLX) or different business models like Amazon.com (AMZN), which will raise costs of making content, threatening pricing, and further fragment their audience."

Cable TV providers like Charter face challenges stemming from cord-cutting and shaving (or skinnier programming bundles), but remain dominant in their best business, broadband—high-speed internet access—and retain pricing power.

Compared with media and technology giants like Amazon, Alphabet (GOOGL), Apple (AAPL), and Walt Disney (DIS), Liberty has limited cash and financial firepower for acquisitions, but Malone and Maffei have still been able to act. Liberty Media engineered a complex $8 billion deal to buy Formula 1 in early 2017, its largest transaction in recent years. Also, Sirius XM Holdings, which is controlled by Liberty Media, agreed in September to buy Pandora Media (P) the music-streaming company, for $3.5 billion in stock.

"In the past, Liberty has had more excess liquidity to do deals," says Chris Marangi, co-chief investment officer at Mario Gabelli's Gamco Investors, which owns $850 million of Liberty and related companies. "It has to be more creative in financing transactions. I'd love Liberty to do more transactions like Formula 1. The question is, where do they get the money to do it?"

Illustration by Michael Hoeweler

Here's Malone's take: "We're not out there competing to buy Red Hat for $35 billion, but we have always been an opportunistic company. We try to position ourselves so that we can take advantage of opportunities through timely investments, good management, and synergies with our existing businesses."

Malone is known for complex financial engineering and a passionate dislike of taxes, but he has a Buffett-like talent for identifying good managers and for patience.

“My No. 1 role is making sure that we have great management—aggressive CEOs who think about long-term wealth creation for our shareholders and themselves,” he says. “I can’t micromanage them. They wouldn’t take the job if I did, and I don’t have the knowledge or skills to micromanage them.”

Still, Malone and Maffei may be more engaged than they let on, says John Tinker, an analyst with Gabelli & Co. “They don’t micromanage, but they want to know the growth story and how it’s going to be achieved,” Tinker says. “They will hold management’s feet to the fire if necessary.”

Malone’s effective control of the Liberty companies allows him to take a longer-term view and insulates the businesses and their managers from outside pressures, including activists. (In a separate role, Malone is also an influential holder of Discovery (DISCA), the cable programming company, through supervoting stock.)

His method of control through supervoting stock is ingenious. He leverages relatively small economic stakes in Liberty companies—all fall below 10%—with a total value of about $5 billion into an influential voice or effective control of virtually all of them through ownership of supervoting stock.

The beauty of Malone’s approach is illustrated by Liberty Broadband, which holds a 20.6% stake in Charter. Malone’s stake in Liberty Broadband of less than 4%, worth about $500 million, gives him a strong voice at Charter—a company with a market value of $75 billion—and effective veto power over important strategic decisions.

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—John Malone

The Liberty companies generally have two or three sets of shares outstanding. There are one-vote shares (Class A); nonvoting shares (Class C), which trade with a K at the end of their ticker symbols; and illiquid or nontraded supervoting stock with 10 votes each (Class B), which are largely owned by Malone. Here’s a look at the 10 Liberty companies:

Liberty SiriusXM

At about $41, the shares trade at a big 29% discount to their asset value, which consists almost entirely of Sirius stock, now at $6.25 a share. The discount has widened from a range of 15% to 20% in 2017, reflecting selling by arbitrageurs and among some hedge funds after a rocky performance this year. "The discount is nutty," Maffei says. "One way or another, the discount will go away." That could happen from a merger of Liberty SiriusXM and Sirius, but a combination could be years away because of tax issues.

Sirius is down over 10% since its deal to buy Pandora, which has dragged down Liberty SiriusXM. The deal muddies what had been a simple Sirius story involving strong cash flow and heavy stock buybacks. The Pandora deal will probably delay any combination of Liberty SiriusXM and Sirius.

Liberty Formula One

It reflects Liberty's ownership of Formula 1 and a 34% stake $3.9 billion in Live Nation Entertainment (LYV), the concert promoter and owner of Ticketmaster. Formula 1 is building a direct-to-consumer broadcast streaming business, and sponsorship revenue is growing. The 21 races annually feature 10 teams with two drivers each. Evercore's Jayant says results are likely to show improvement in revenues and earnings in 2019 after ample investment spending since Liberty took control in January 2017. He carries a Buy rating and a price target of $43.

Liberty Braves

It holds the Atlanta Braves baseball team and a real estate development project called Battery Atlanta around the team's new stadium, SunTrust Park. The shares, at about $26, are up from $15 when the tracker was created in 2016. "The Braves are one of the few public plays on sports teams," Gabelli analyst Tinker notes, citing English soccer club Manchester United (MANU) and Madison Square Garden (MSG), owner of the New York Knicks and Rangers. That creates scarcity value. The Braves have been doing well on the field—winning the National League East this season—and financial results have improved since the new park opened last year.

Tinker thinks the Braves will be spun out of Liberty and ultimately sold at a premium to a billionaire. A spinoff could be years away because of tax issues. The shares aren't cheap, trading for more than 30 times projected 2019 earnings before interest, taxes, depreciation, and amortization, or Ebitda, but teams trade on trophy value. The Braves are now valued at less than $1.5 billion inside the tracker. Tinker thinks the team is worth over $2 billion. He has a private-market value of $42 a share. "There's no rush to do a spinoff of the Braves. I can't say it won't happen at some point," Maffei says. "There has been a lot of valuation creation there and more to be done."

Illustration: Michael Hoeweler

Liberty Broadband and GCI Liberty

The two companies offer plays on Charter. Liberty Broadband is the purer of the two with a stake of 54 million shares in Charter. GCI Liberty, formed earlier this year, is more complex. It owns 24% of Liberty Broadband; 27% in LendingTree (TREE), a mortgage provider; and an Alaskan cable TV business worth about $2 billion.

Jayant is bullish on both, arguing that Charter's profits should improve in 2019 after getting past integration issues with Time Warner Cable. Liberty Broadband, at $83, is valued at a 10% discount to the value of its Charter stake, and GCI Liberty, at $49, is effectively valued at a 19% discount to Charter. "Each step allows the purchase of Charter at a progressively larger discount, but at the cost of greater complexity and lower liquidity," Jayant wrote earlier this year of the two companies.

Jayant sees a potential combination of Liberty Broadband and GCI Liberty as early as 2019 in which Liberty Broadband would pay a premium over GCI Liberty's stock price but below its net asset value. A merger of Liberty Broadband and Charter that would collapse the current 10% discount could take longer, he says.

"Charter is doing great," Malone says. "It's still a growth vehicle." He notes that Liberty Broadband has some debt—about $500 million—which makes it a slightly leveraged play on a leveraged Charter. "If you like Charter, you should like Liberty Broadband even more," he says.

Qurate Retail.

Qurate (QRTEA) owns QVC, the leading home-shopping channel, and No. 2 HSN, as well as online retailer zulily. The shares, around $24, have moved little in recent years as investors have reacted to lackluster revenue growth, disappointing results from HSN, and the possibility of greater involvement by Amazon in home shopping.

"The last two years have been challenging," says UBS analyst Eric Sheridan. "But there has been stability at core QVC, and Liberty is a supportive owner that is returning cash to shareholders through buybacks with most of its free cash flow." The buyback "yield," or annualized repurchases divided by market value, is running at a 7% rate. The stock is valued at about 12 times estimated 2019 free cash flow. Sheridan says its core female customers are younger at 35 to 50 years old and more affluent than is commonly perceived. Amazon is a threat, but it began a live shopping show in 2016 and ended it a year later. He has a Buy rating and $31 price target.

Liberty TripAdvisor and Liberty Expedia

The pair offers plays on TripAdvisor and Expedia, trading recently at 6% and 9% discounts to the underlying shares, respectively. Liberty TripAdvisor holds a 23% stake in TripAdvisor and a controlling 58% voting interest in the travel-review site.

TripAdvisor has gained 110% this year, making it one of the top stocks in the S&P 500. Its strategy of getting revenue from direct bookings of hotels and travel experiences like tours and museums is paying off.

Liberty TripAdvisor traded for as much as a 20% premium to TripAdvisor in 2017, reflecting the view that it would get a premium for its supervoting stock if TripAdvisor were sold to Booking.com or another buyer. A sale still could happen, but the premium has been washed out. The company is the only Liberty entity controlled by Maffei, who obtained the 2.8 million supervoting shares in a stock swap with Malone in 2014.

Liberty Expedia, at $43, is similar to Liberty TripAdvisor, holding a 16% stake and 53% voting interest in Expedia—again reflecting supervoting stock.

Liberty Global

Malone's global cable ambitions have been thwarted in Europe, with its greater competition, tougher regulation, and lower pricing relative to the U.S. Liberty Global shares, at about $25, are little changed since 2012.

Liberty Global agreed earlier this year to sell its operations in Germany and neighboring countries to Vodafone. The sale will net the company about $12 billion in cash and leave it largely concentrated in Britain with its Virgin Media cable operations. The cash represents a good chunk of the company's current $19 billion market value.

"The market is skeptical that the deal will close and cautious about what the company will do with the cash if it closes," Malone says. "Would I buy the stock here? Probably not. If the deal closes, Liberty Global is very cheap. If not, it's appropriately priced." Malone thinks the market is too cautious on regulatory approval. He puts an 80% chance of approval.

Liberty Latin America

The company, spun off from Liberty Global in late 2017, offers a play on the Puerto Rican economic recovery and growth in telecom services throughout the Caribbean. The shares, at about $20, are little changed this year.

Liberty Latin America operates the largest cable system in Puerto Rico, which had enviable 50% cash-flow margins—against about 40% for major U.S. cable operators—before Hurricane Maria devastated the island in September 2017. Cable cash flow collapsed after the storm and is now 70% recovered to pre-hurricane levels.

James Ratcliffe of Evercore wrote last week after the company’s third-quarter earnings that “the business is gaining momentum with the Puerto Rico segment continuing its recovery.” He has an Outperform rating and a $25 price target.

How will Liberty fare in a post-Malone era? “My longtime CEOs” would have the “first right to acquire my control stock when I’m pushing up the posies,” he has said. That prospect sits well with investors, given the job done by Maffei, Discovery CEO David Zaslav, and Liberty Global CEO Mike Fries.

Malone divides his time between the Denver area, where Liberty is based; Florida, where he’s a resident; and Maine, where he owns some 7% of the state, mostly forest, making him one of the largest private landowners in the U.S. He also spends time in Ireland, where he owns a castle.

Does his Florida residency reflect the state’s lack of an income and inheritance tax? “You should see what I pay in property taxes,” Malone jokes.

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