EDISON

Scale research report - Update

# Williams Grand Prix

Industrials

23 April 2019

## Challenging year in prospect

**2018 proved to be an unsatisfactory year for Williams on the track, which will have ramifications for financial performance in 2019. However, with a mixture of new title sponsor, new drivers and an experienced management team there is a clear focus on recovering competitiveness in the F1 championship. In addition, Williams Advanced Engineering (WAE) continues to grow with a healthy operating margin performance.**

### Much improved second half performance

FY18 financial performance remained robust, with Williams delivering a much stronger H2 if we exclude the exceptional land sale profit generated in H217. Group EBITDA for FY18 rose 20% to £12.9m more than reversing the decline seen at the half year. Nearly all of the variation was seen in the F1 operations where a £9.9m year on year uplift in H218 revenues dropped almost entirely into profitability. WAE saw FY18 revenues grow by a healthy 13% to £44.8m, but increased cost of goods sold limited the EBITDA improvement to a modest 2%. Excluding the exceptional profit of £7.3m from the land sale from 2017, group pre-tax profits halved to £3.4m, the decline being more than attributable to adverse non-cash movements in derivative financial instruments mark-to-market values. Net debt fell £5.6m to £11.9m.

### New partner for a difficult season

Williams enters the 2019 season with ground to make up on its competitors on the track, but does so with a new multi-year title sponsorship partner ROKiT announced in February. The driver line up has also been refreshed, and with Sir Patrick Head also returning in a consultancy capacity, the determination to improve race performance is clear. WAE should continue to make progress as it continues to expand its range of external projects. However, FY19 looks likely to be challenging financially as income from commercial rights falls due to the weak performance in the F1 Constructors' Championship in 2018.

### Valuation: Brand remains the key attraction

We believe the volatility of revenues and earnings and the nature of Williams' business represent a challenge to valuation. The share price remains under pressure as track performance waned, but we estimate still trades on a clean underlying historic FY18 P/E of 23.5x, with a challenging year in prospect. If WAE continues to grow with a more level F1 playing field in the medium term, more consistent income and cash flows may develop, potentially benefiting valuation.

**Historic financial data**

| Year end | Revenue (£m) | PBT (£m) | EPS (p) | DPS (p) | P/E (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 12/15 | 125.6 | (11.2) | (116.2) | 0.0 | N/A | N/A |
| 12/16 | 167.4 | 5.9 | 59.5 | 0.0 | 21.1 | N/A |
| 12/17 | 166.2 | 14.1 | 141.8 | 0.0 | 8.8 | N/A |
| 12/18 | 176.5 | 3.4 | 34.0 | 0.0 | 36.7 | N/A |

Source: Company reports

| Price | €14.4 |
|---|---|
| Market cap | €144m |

**Share price graph**


**Share details**

| | |
|---|---|
| Code | WGF1 |
| Listing | Deutsche Börse Scale |
| Shares in issue | 10.0m |
| Net debt (£m) at 31 December 2018 | £11.9 |

**Business description**

The group comprises a Formula One racing team (76% revenues) and Williams Advanced Engineering (WAE, 24% revenues). The Formula One racing team placed 10th in the 2018 FIA Formula One Constructors' Championship. WAE specialises in the commercial application of aerodynamics, materials and battery technologies.

**Bull**

- Liberty Media's ownership of Formula One Group should lead to higher publicity for the sport and therefore higher prize funds.
- WAE continues to grow with a high-end product offering.
- In the medium term the potential for a more equitable distribution of commercial rights in F1 should benefit teams such as Williams.

**Bear**

- Management is focused on track performance over shareholder return.
- Commercial rights income likely to fall due to lower 2018 F1 championship position.
- Weak performances on the track continuing in early races of 2019 season.

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## A robust outcome from a challenging year

Williams delivered a robust performance in 2018, with both the core operations making modest progress. The F1 operation increased revenues by 4% to £130.7m, which we feel is a reflection of a relatively stable share of commercial rights arising from the maintenance of the fifth place finish in the 2017 F1 Constructors' Championship, the same outcome as 2016. There appears to have been some increase in sponsorship receipts mainly delivered in H218, including a one-off payment of £8m from a partner that will not recur in FY19. Group other operating income declined sharply to £8.7m (FY17 £17.7m) in the absence of a one-off payment relating to a driver received in H117.

Revenues grew by 13.0% at WAE to £44.8m continuing the track record of growth seen in recent years. WAE has more than doubled sales over the last three years from £21.3m in FY15. Sales relate to engineering consultancy projects as well as low-volume manufacturing of bespoke products and some royalty income. WAE continues to diversify its revenue streams, achieving a better balance between projects for automotive, motorsports and other external customers. Other revenue remained relatively stable falling to £1.0m from £1.1m in FY17. Overall group revenues grew 6% in FY18 to £176.5m.

**Exhibit 1: Williams Grand Prix Holdings income statement**

| 12 months to December (£m) | H117 | H217 | FY17 | H118 | H218 | FY18 | FY change |
|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | |
| Formula One | 65.5 | 60.1 | 125.6 | 60.7 | 70.0 | 130.7 | 4.1% |
| WAE | 19.9 | 19.7 | 39.5 | 21.5 | 23.3 | 44.8 | 13.2% |
| Other | 0.5 | 0.6 | 1.1 | 0.5 | 0.5 | 1.0 | -11.2% |
| **Group total** | **85.9** | **80.4** | **166.2** | **82.6** | **93.9** | **176.5** | **6.2%** |
| Gross profit | 53.9 | 45.9 | 99.8 | 43.0 | 62.4 | 105.4 | 5.6% |
| *Gross margin* | *62.7%* | *57.1%* | *60.0%* | *52.0%* | *66.5%* | *59.7%* | *-0.5%* |
| Other operating income | 12.9 | 4.8 | 17.7 | 3.9 | 4.8 | 8.7 | -51.0% |
| **EBITDA** | | | | | | | |
| Formula One | 10.1 | 5.9 | 16.0 | 0.2 | 15.8 | 16.0 | -0.3% |
| WAE | 3.4 | 1.6 | 5.0 | 2.3 | 2.9 | 5.1 | 1.7% |
| Other | -3.1 | -7.1 | -10.2 | -5.1 | -3.1 | -8.2 | -20.1% |
| **EBITDA** | **10.4** | **0.4** | **10.8** | **-2.7** | **15.6** | **12.9** | **19.5%** |
| Depreciation | -2.7 | -2.8 | -5.5 | -2.8 | -2.9 | -5.7 | 4.5% |
| Amortisation | -0.3 | -0.3 | -0.6 | -0.5 | -0.6 | -1.1 | 92.3% |
| **EBIT** | **7.4** | **-2.7** | **4.8** | **-6.0** | **12.1** | **6.1** | **27.9%** |
| Share based payments | -0.4 | -0.8 | -1.2 | -0.4 | -0.9 | -1.4 | 14.0% |
| Movement in derivative financial instruments | 2.6 | 1.4 | 4.0 | -1.3 | 0.8 | -0.6 | -114.0% |
| Exceptional item | | 7.3 | 7.3 | | | | |
| Net interest | -0.4 | -0.4 | -0.8 | -0.3 | -0.4 | -0.7 | -11.5% |
| **Profit before tax (as reported)** | **9.3** | **4.8** | **14.1** | **-8.4** | **11.8** | **3.4** | **-75.7%** |
| Net income (as reported) | 9.3 | 4.8 | 14.1 | -8.4 | 11.8 | 3.4 | -75.7% |
| EPS (as reported) (p) | 94.0 | 47.7 | 141.8 | -87.2 | 121.2 | 34.0 | -76.0% |

Source: Company reports

Gross profit increased by just under 6% or £5.6m to £105.4m. The gross margin slipped slightly to 59.7% compared to 60.0% in 2017, which reflected growth at WAE as well additional investment in the F1 operations during the year to try and rectify design issues and the subsequent lack of performance.

Group EBITDA rose 20% to £12.9m (FY17 £10.8m) with the increase largely attributable to a reduced loss in the Other segment, which decreased from £10.2m to £8.2m. Both the F1 operations and WAE generated largely unchanged EBITDA.

Reported PBT for the group fell by 76% to £3.4m. However, adjusting for the FY17 exceptional land sale profit of £7.3m, share based payments and the movement in non-cash mark-to-market reversal of derivative financial instruments (from a credit of £4.0m in 2017 to a £0.6m loss in 2018), underlying PBT rose 36% to £5.4m (FY17 £3.9m). With no tax payable, reported EPS also fell 76% to 34.0p (FY17 141.8p) on a marginally higher average share count.

If we calculate an EPS figure using the adjusted PBT, the adjusted fully diluted EPS figure for 2018 would be 53.3p compared with 39.7p in 2017. We feel this gives a better reflection of the underlying operational performance of the group during the year although 2018 did benefit from the one off £8m partner payment.

As we have stated before, dividends remain a low priority in the capital allocation policy at present and none was declared for FY18. Investment continues to be focused on improving the competitiveness and performance of the racing team, as well as developing WAE's technical capabilities to support the organic growth of the operation.

The balance sheet continued to develop positively with net debt falling a further £5.6m to £11.9m in FY18 following the sharp reduction in the previous year from £36.1m at the end of FY16. This represents the lowest level of borrowings since FY13. The decline was delivered almost entirely by the operational cash flow which increased gross cash balances at the year end to £9.5m from £4.5m at the end of FY17. The net asset value increased by 10% to £51.0m (FY17 £46.6m).

**Exhibit 2: Williams Grand Prix Holdings balance sheet summary**

| Year-end December (£m) | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|
| Fixed assets | 40.3 | 66.1 | 66.6 | 64.1 | 67.1 | 65.3 | 61.7 |
| Current assets | 57.5 | 31.8 | 30.5 | 40.6 | 61.7 | 59.4 | 70.4 |
| **Total assets** | **97.8** | **97.8** | **97.1** | **104.7** | **128.8** | **124.7** | **132.1** |
| Total non-current liabilities | (3.2) | 0.0 | (20.0) | (13.1) | (10.7) | (11.4) | (8.8) |
| Total current liabilities | (57.4) | (25.7) | (41.6) | (66.5) | (86.7) | (66.7) | (72.2) |
| **Total liabilities** | **(60.6)** | **(25.7)** | **(61.6)** | **(79.7)** | **(97.3)** | **(78.1)** | **(81.0)** |
| **Net assets** | **37.2** | **72.1** | **35.6** | **25.0** | **31.5** | **46.6** | **51.0** |

Source: Company reports

## Outlook

Williams Grand Prix Holdings remains unique as the only F1 racing team to be quoted. The performance of the racing team is thus very high profile and visible to investors. With the strategy unchanged to pursue further FIA Constructors' Championship titles in the future, the importance of developing the growing and recurring profitability of WAE remains undiminished. However, in the near term, the share of commercial rights determined by racing performance remains the largest determinant of financial performance.

Unfortunately the track performance in FY18 was disappointing with the F1 team finishing 10th in the Constructors' Championship. As a result, we expect the share of the associated commercial rights from the competition to fall, even if the prize pot generated by Liberty Media has grown. The situation is compounded by the likely absence of the one-off £8m payment from a partner received in FY18. On the positive side the announcement of ROKiT as a multi-year title partner is a replacement for Martini's previous backing although it is uncertain as to whether this is on improved financial terms. Competition continues to intensify which could mean little improvement in the points race this year. However, Williams is clearly continuing to work hard to improve performance on the track and secure new additional financial backing off it.

A rebalancing of the distribution of commercial rights amongst the teams in the medium term would provide a sounder footing for investors. Achievement of this while maintaining the structure of the competition is still far from a given, as the commercial power of the leading teams is significant. We do not expect the outcome of any such changes to make a meaningful contribution to Williams before FY21. A growing prize fund for distribution may be beneficial in the meantime as would an improvement in competitive performance.

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