

Liberty Global PLC LBTYA (NAS) | ★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
50.56 USD	40.00 USD	24.00 USD	62.00 USD	High	Narrow	Stable	Standard	Communication Services

Liberty Global and Telenet Agree to Strategic Purchase of BASE from KPN; No Change to Our Valuations

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The primary analyst covering this company does not own its stock.

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Currency amounts expressed with "\$" are in U.S. dollars (USD) unless otherwise denoted.

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Analyst Note 20 Apr 2015

Liberty Global, and its Belgian subsidiary, Telenet, have agreed to acquire BASE from KPN. BASE is Belgium's third-largest wireless operator, and KPN has been trying to jettison it for a couple of years. We think this is a good strategic move for all involved. However, there are no changes to our fair value estimates or economic moat ratings for Liberty Global, or KPN.

Telenet will pay EUR 1.325 billion (USD 1.43 billion) in cash for BASE, or 7.7 times 2014 EBITDA. The deal will turn Telenet into a full wireless network operator rather than operating as an MVNO in addition to its cable TV business. Telenet expects significant cost savings, primarily from moving its MVNO base of 895,000 customers onto BASE's network. Doing so will remove its wholesale costs and add scale when combined with BASE's 3.3 million subscribers, allowing fixed costs to be spread over more people. Based on expected synergies and additional capital spending of EUR 240 million to improve the network, Telenet estimates the cost at a reasonable 5 times adjusted EBITDA.

We think these synergies are likely, as in-country mergers are usually highly accretive. This will be the first time any of Liberty Global's wireless operations have moved to a full network operator model, and it could be a test to see if it is worth acquiring other wireless operators in other countries. However, we think Belgium was fairly unique, as Telenet had a decent sized MVNO base, and there was a willing seller. We don't see these conditions in Liberty Global's other markets.

Virgin Media has a large MVNO base in the U.K., but the willing sellers have already agreed to sell, and these are much larger businesses than BASE. However, if regulators don't approve the merger of 3 U.K. and Telefonica's O2, then Liberty Global could potentially be a fall-back buyer of O2.

Vital Statistics

Market Cap (USD Mil)	44,860
52-Week High (USD)	55.86
52-Week Low (USD)	38.90
52-Week Total Return %	28.3
YTD Total Return %	0.7
Last Fiscal Year End	31 Dec 2014
5-Yr Forward Revenue CAGR %	4.8
5-Yr Forward EPS CAGR %	—
Price/Fair Value	1.26

Valuation Summary and Forecasts

	Fiscal Year:	2013	2014	2015(E)	2016(E)
Price/Earnings		NM	NM	59.5	25.5
EV/EBITDA		9.1	10.9	9.5	9.1
EV/EBIT		27.1	32.5	22.7	19.2
Free Cash Flow Yield %		8.9	6.3	3.3	4.5
Dividend Yield %		—	—	—	—

Financial Summary and Forecasts (USD Mil)

	Fiscal Year:	2013	2014	2015(E)	2016(E)
Revenue		14,474	18,248	20,307	20,943
Revenue YoY %		45.8	26.1	11.3	3.1
EBIT		2,164	2,765	3,960	4,691
EBIT YoY %		5.1	27.8	43.2	18.5
Net Income, Adjusted		-687	-530	-162	498
Net Income YoY %		22.4	-22.9	-69.5	-407.8
Diluted EPS		-3.05	-3.05	0.85	1.98
Diluted EPS YoY %		—	—	-127.8	133.6
Free Cash Flow		162	6,040	4,631	5,082
Free Cash Flow YoY %		-97.1	NM	-23.3	9.7

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Liberty Global owns cable networks and a couple of small satellite operations in the U.K., the Netherlands, Switzerland, Austria, Belgium, Germany, Ireland, Hungary, Romania, Poland, the Czech Republic, Slovakia, Chile, and Puerto Rico. It also offers high-speed Internet access and fixed-line telephony in most of these markets. In total, it has 24.3 million television customers, 17.3 million Internet access customers, and 14.3 million fixed-line telephony customers.

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For KPN, the deal strengthens its balance sheet at a good price, and removes the risk of the business struggling without a converged product offering.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

	3-Year Hist. CAGR	2012	2013	2014	Forecast		5-Year Proj. CAGR
					2015	2016	
Growth (% YoY)							
Revenue	24.3	4.4	45.8	26.1	11.3	3.1	4.8
EBIT	13.4	8.7	5.1	27.8	43.2	18.5	22.0
EBITDA	23.9	8.5	36.4	28.3	14.3	5.1	6.7
Net Income	—	-30.2	22.4	-22.9	-69.5	-407.8	—
Diluted EPS	—	—	—	—	-127.8	133.6	—
Earnings Before Interest, after Tax	-5.6	3.5	-2.5	-16.5	-12.2	18.9	10.6
Free Cash Flow	42.3	162.1	-97.1	NM	-23.3	9.7	-0.9
Profitability	3-Year Hist. Avg	2012	2013	2014	2015	2016	5-Year Proj. Avg
Operating Margin %	17.0	20.7	15.0	15.2	19.5	22.4	26.7
EBITDA Margin %	45.8	47.5	44.5	45.3	46.5	47.4	48.1
Net Margin %	-4.4	-5.7	-4.7	-2.9	-0.8	2.4	6.5
Free Cash Flow Margin %	29.9	55.3	1.1	33.1	22.8	24.3	24.3
ROIC %	—	—	—	—	—	—	—
Adjusted ROIC %	9.9	14.0	9.0	6.6	11.0	13.6	17.5
Return on Assets %	-0.7	0.9	-1.8	-1.0	-0.2	0.7	2.0
Return on Equity %	-2.0	12.9	-13.6	-5.2	-1.2	4.1	11.4
Leverage	3-Year Hist. Avg	2012	2013	2014	2015	2016	5-Year Proj. Avg
Debt/Capital	0.82	0.93	0.79	0.76	0.78	0.80	0.79
Total Debt/EBITDA	6.12	5.83	6.94	5.58	4.97	4.73	4.54
EBITDA/Interest Expense	2.96	2.82	2.82	3.25	2.51	2.64	2.77

Valuation Summary and Forecasts

	2013	2014	2015(E)	2016(E)
Price/Fair Value	1.31	1.26	—	—
Price/Earnings	NM	NM	59.5	25.5
EV/EBITDA	9.1	10.9	9.5	9.1
EV/EBIT	27.1	32.5	22.7	19.2
Free Cash Flow Yield %	8.9	6.3	3.3	4.5
Dividend Yield %	—	—	—	—

Key Valuation Drivers

Cost of Equity %	9.0
Pre-Tax Cost of Debt %	8.0
Weighted Average Cost of Capital %	7.4
Long-Run Tax Rate %	21.0
Stage II EBI Growth Rate %	3.0
Stage II Investment Rate %	20.0
Perpetuity Year	10

Additional estimates and scenarios available for download at <http://select.morningstar.com>.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	21,211	26.0	23.95
Present Value Stage II	14,350	17.6	16.20
Present Value Stage III	45,903	56.4	51.83
Total Firm Value	81,464	100.0	91.98
Cash and Equivalents	1,159	—	1.31
Debt	-46,159	—	-52.12
Preferred Stock	—	—	—
Other Adjustments	-1,599	—	-1.81
Equity Value	34,864	—	39.37

Projected Diluted Shares 886

Fair Value per Share (USD) —

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

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Morningstar Analyst Forecasts

Income Statement (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	Forecast	
				2015	2016
Revenue	9,931	14,474	18,248	20,307	20,943
Cost of Goods Sold	3,350	5,418	6,810	7,473	7,561
Gross Profit	6,581	9,057	11,438	12,834	13,383
Selling, General & Administrative Expenses	1,860	2,617	3,173	3,391	3,456
Other Operating Expense (Income)	—	—	—	—	—
Other Operating Expense (Income)	—	—	—	—	—
Depreciation & Amortization (if reported separately)	2,662	4,276	5,500	5,483	5,236
Operating Income (ex charges)	2,059	2,164	2,765	3,960	4,691
Restructuring & Other Cash Charges	76	298	537	—	—
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	-146	—	—	—
Operating Income (incl charges)	1,983	2,012	2,228	3,960	4,691
Interest Expense	1,674	2,287	2,545	3,757	3,757
Interest Income	-818	-252	-739	-300	-200
Pre-Tax Income	-509	-527	-1,056	-97	734
Income Tax Expense	75	356	-75	-19	147
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	971	-24	334	—	—
(Minority Interest)	-65	-58	-48	-84	-89
(Preferred Dividends)	—	—	—	—	—
Net Income	323	-964	-695	-162	498
Weighted Average Diluted Shares Outstanding	267	393	915	900	861
Diluted Earnings Per Share	1.21	-2.45	-0.76	-0.18	0.58
Adjusted Net Income	-561	-687	-530	-162	498
Diluted Earnings Per Share (Adjusted)	-2.10	-1.75	-0.58	-0.18	0.58
Dividends Per Common Share	—	—	—	—	—
EBITDA	4,645	6,289	7,728	9,443	9,927
Adjusted EBITDA	4,721	6,440	8,265	9,443	9,927

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Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Fiscal Year Ends in December	Forecast				
	2012	2013	2014	2015	2016
Cash and Equivalents	2,039	2,702	1,159	1,852	1,787
Investments	—	—	—	—	—
Accounts Receivable	1,031	1,589	1,500	1,669	1,721
Inventory	—	—	—	—	—
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	656	1,192	1,263	1,263	1,263
Current Assets	3,726	5,483	3,921	4,784	4,771
Net Property Plant, and Equipment	13,438	23,975	23,841	22,216	20,750
Goodwill	13,878	23,749	29,002	29,002	29,002
Other Intangibles	2,581	5,795	9,190	9,190	9,190
Deferred Tax Assets (Long-Term)	—	—	—	—	—
Other Long-Term Operating Assets	2,219	4,702	5,081	5,081	5,081
Long-Term Non-Operating Assets	2,467	4,011	1,808	1,808	1,808
Total Assets	38,308	67,714	72,842	72,081	70,602
Accounts Payable	774	1,073	1,039	1,140	1,153
Short-Term Debt	364	1,023	1,551	1,350	360
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	3,483	5,587	6,600	6,600	6,600
Current Liabilities	4,620	7,683	9,190	9,091	8,114
Long-Term Debt	27,161	43,681	44,608	45,608	46,608
Deferred Tax Liabilities (Long-Term)	—	—	—	—	—
Other Long-Term Operating Liabilities	4,441	4,789	4,928	4,928	4,928
Long-Term Non-Operating Liabilities	—	20	—	—	—
Total Liabilities	36,223	56,173	58,726	59,626	59,649
Preferred Stock	—	—	—	—	—
Common Stock	3	4	9	9	9
Additional Paid-in Capital	2,956	12,813	17,071	17,071	17,071
Retained Earnings (Deficit)	-2,349	-3,313	-4,008	-4,169	-3,672
(Treasury Stock)	—	-8	-4	-1,504	-3,504
Other Equity	1,601	2,529	1,647	1,647	1,647
Shareholder's Equity	2,210	12,026	14,715	13,053	11,551
Minority Interest	-125	-484	-599	-599	-599
Total Equity	2,085	11,541	14,116	12,454	10,952

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Morningstar Analyst Forecasts

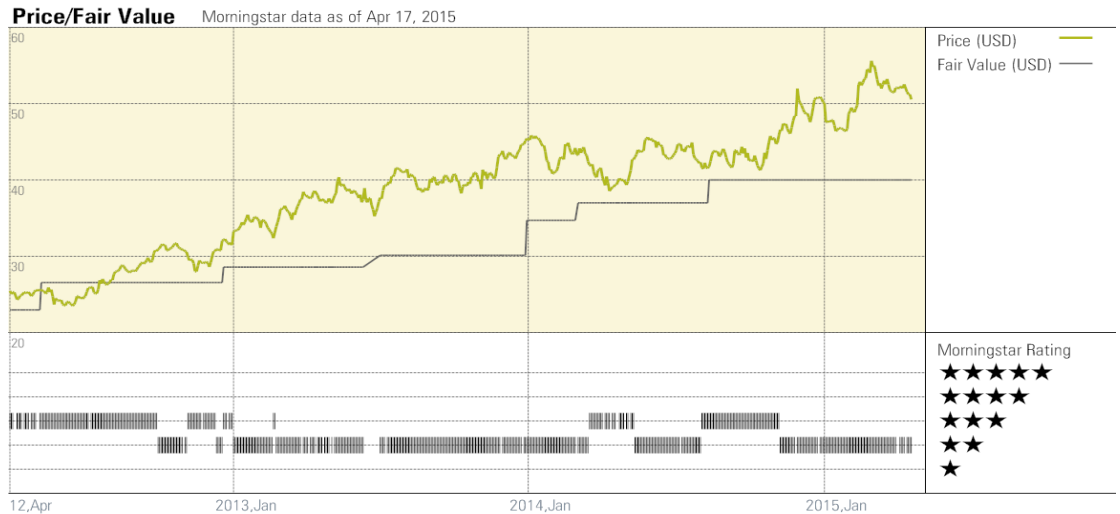
Cash Flow (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	Forecast	
				2015	2016
Net Income	-584	-882	-981	-77	587
Depreciation	2,662	4,276	5,500	5,483	5,236
Amortization	—	—	—	—	—
Stock-Based Compensation	—	—	—	—	—
Impairment of Goodwill	76	298	537	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	36	19	-351	—	—
Other Non-Cash Adjustments	1,007	594	969	—	—
(Increase) Decrease in Accounts Receivable	785	867	861	-170	-52
(Increase) Decrease in Inventory	—	—	—	—	—
Change in Other Short-Term Assets	—	—	—	—	—
Increase (Decrease) in Accounts Payable	-1,172	-1,208	-1,018	101	13
Change in Other Short-Term Liabilities	—	—	—	—	—
Cash From Operations	2,810	3,963	5,517	5,337	5,784
(Capital Expenditures)	-1,868	-2,482	-2,684	-3,858	-3,770
Net (Acquisitions), Asset Sales, and Disposals	869	-5,424	-101	—	—
Net Sales (Purchases) of Investments	—	—	—	—	—
Other Investing Cash Flows	-81	-60	-18	—	—
Cash From Investing	-1,081	-7,965	-2,803	-3,858	-3,770
Common Stock Issuance (or Repurchase)	-970	-1,157	-1,585	-1,500	-2,000
Common Stock (Dividends)	—	—	—	—	—
Short-Term Debt Issuance (or Retirement)	—	—	—	-201	-990
Long-Term Debt Issuance (or Retirement)	1,608	1,352	-1,744	1,000	1,000
Other Financing Cash Flows	-745	-712	-933	-84	-89
Cash From Financing	-108	-518	-4,261	-785	-2,080
Exchange Rates, Discontinued Ops, etc. (net)	19	85	-82	—	—
Net Change in Cash	1,640	-4,435	-1,630	694	-65

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