

Wrestling with \$WWE

As a whole, this blog is meant to cover anything that's interesting to me in investing. Sometimes that means just general investing theory and thoughts (like the "monthly pondering" I post in each month's links post), but in general that means specific investing ideas and themes. And, over the life of this blog, no investing idea or theme has struck a chord with me as much as growing power of unique content. For a while, I covered that idea in a "search for IP" series, the idea was an overarching force in the (still ongoing!) media stock guide, and the idea has been a huge driver of the investment thesis behind my investment in MSG (disclosure: long).

For a long time (and I think I've said this on the blog before), my biggest regret as an investor was passing on WWE (disclosure: long) before their last domestic T.V. rights renewal (when Fox paid up for the rights to Smackdown, and the huge escalation drove their share price from the mid-teens to ~\$100/share). I've had plenty of stocks go up on me after I passed on them, but WWE in particular irked me. Why? Well, partly because I had started buying a position at ~\$17-18, got a small position, and then stopped buying and sold the stock when it ran up to \$19 (only to see it around \$60/share six or so months later)... but passing on WWE mainly irked me because it was so right in the middle in my wheelhouse. At the same time I was flirting with a WWE position, I was buying up a large position in MSG. My investment thesis with MSG was not only that the company traded below the sum of its parts, but also that the parts were likely to continue to compound / increase in value significantly over time as the demand for "must see" live content continued to drive the value of the Knicks / Rangers. And I thought at the time (and still do think) that very similar dynamics were at play for WWE. Not only was the company fully in my wheelhouse, but I even had

personal experience with the brand. I was a big fan as a kid, and I went to Wrestlemania (the Superbowl for the WWE) a few years ago (you know.... for due diligence. anything for due diligence!). I hadn't watched wrestling in almost twenty years, but despite that it was a freaking blast. Seriously, one of the most fun things I've ever done, and seeing the fan passion around the event was crazy eye opening. I had already done research on the WWE prior to that and thought the stock was interesting, and then I went to their Superbowl and saw the fan passion.... and still I sat around and didn't buy the stock. Frustrating!

Anyway, that's just some background that keeps running in my head as I write this post and think about investing in the WWE. On to the post!

The WWE is the largest wrestling company in the world.... but to think of it just as a wrestling company does the WWE a disservice. It's one of the largest media brands / eyeball draws out there. Look at their YouTube stats; they are one of the largest YouTube channels in the world (that chart is from a Feb. 2019 presentation, so it's a little outdated; you can find more up to date stats [here](#)). Their viewership stats for TV (From their Q1'19 earnings) roughly rival (or surpass!) other sports leagues; for example, compare the average WWE show at ~2.4m viewers to the average NBA broadcast game on ABC at ~3m viewers. I don't think that's a perfectly apples to apples comparison for a few reasons (ABC has wider reach and tends to draw more eyeballs than USA, ABC NBA games are weekend games aired Saturday night / Sunday afternoon versus Raw and Smackdown weekday nights, ABC tends to get their pick of marquee games each week (which should attract more interest / viewers) while Raw / Smackdown is just your typical weekly show since it's averaged out, but the NBA has a lot more games each week so their overall draw / reach is significantly bigger). So it's not a perfect comparison, but I do think it shows the power of the WWE and its draw. The bottom line is

that while it's easy to dismiss wrestling as some foolish hobby for children (or adults who never grew up), this is live entertainment that draws eyeballs and fan passion that rivals professional sports leagues.

There are two key (and somewhat interrelated) pieces to my investment thesis in the WWE that I want to drive home by the end of this article. They are:

1. The type of passion and engagement the WWE drives is hugely valuable, and that value will continue to increase over time.
2. WWE is currently significantly underearning its potential. Any valuation based on its current earnings misses the boat as there are several key near term catalysts that will drive earnings markedly higher.

So I think earnings will be markedly higher 5-7 years from now than they are today. Despite that, I don't think WWE's valuation today is a stretch by any means. At today's share price of ~\$45/share, WWE has an enterprise value of ~\$4B. The midpoint of the company's OIBDA guidance is \$275m; I think that is likely to prove conservative, but if they hit it the company currently trades for ~15x OIBDA. This is a reasonably asset light business; capex should run ~5% of revenue per year (in the next two years, they'll be spending significantly more as they build out a mammoth new global HQ). That would imply WWE's unlevered FCF is ~\$235m/year; taking out stock comp gets you closer to \$190-200m/year. So, at today's prices, WWE is trading for a high teens / low 20s unlevered free cash flow multiple (depending on if you treat stock comp as a real expense or not).

significant appeal). It also has the WWE's backlog (every pay-per-view in history), behind the scenes content, and some other stuff (original series, documentaries, etc.). Until recently, it also had NXT on Weds. nights (the WWE's minor leagues); as I'll discuss later, NXT went to USA late last year so that's no longer a draw for the app.

Currently, the network has 1.4-1.5m subs. That's not bad, but at the time it launched they were targeting 3-4m subs, so it has been a bit disappointing. Between slightly disappointing sub numbers and the huge demand for live events currently, you can imagine why WWE is thinking hard about where the network fits into their plans.

You could imagine a wide range of outcomes from the strategic review, but I think by far the most likely is the company sells the rights to their major events (the former PPVs) to Fox. There are several other potential buyers or bidders, but I think Fox buying the rights makes by far the most sense.

Fox already airs Smackdown on Friday nights, and I think getting the PPVs on Fox would be a game-changer. Think of Wrestlemania like the Superbowl or the NBA finals. Currently, the only way to see Wrestlemania is to subscribe to the WWE network. I don't think that makes much sense; it would be better for everyone (fans, the WWE, and its broadcast partners) if Wrestlemania was on a broadcast network with the largest audience possible. For the WWE, they'd get paid a fortune by Fox for the rights, and having Wrestlemania (and the other PPVs) on Fox every year would drastically expand their reach and likely create new fans for the sport. For Fox, Wrestlemania would likely do huge ratings (leading to huge advertising dollars), and having it on the network would likely increase Raws ratings every week. For fans, it would just be easier to enjoy Wrestlemania, particularly for casual fans, and the shared experience would likely make it more enjoyable.

How much could the WWE get for the PPV rights? I think your obvious comp is ESPN / UFC, which runs for \$150m/year, and I think a figure in that ballpark would make sense (though I think given the WWE's bigger fan base and family friendly nature, they'd likely get more). Obviously this revenue all wouldn't flow to the bottom line; if WWE pulled all the PPVs from the network app and gave them to Fox, tons of people would cancel the network so there would be some offset. However, I think it would be extremely accretive to the WWE's bottom line, and even better for the WWE I suspect having the major events on broadcast TV would drastically expand the brand and attract a bunch of new fans. Again, imagine if the Super Bowl was behind a paywall every year. Would people still watch? Sure! But there would be plenty of casual fans who wouldn't bother turning in, and the Super Bowl would rapidly lose its dominant cultural significance. That creates long term brand erosion: fewer fans, less merchandise sold around the games, less buzz, etc.

How many people would watch Wrestlemania if it aired on broadcast TV? Your average NBA game on ABC does ~3m viewers, and last year's NBA Finals drew ~13m viewers (down substantially from 20m the year before, likely because both LeBron and KD were missing from the series). The average Smackdown on Fox does ~2.5m viewers; I don't think it's a stretch to imagine Wrestlemania could get ~15m viewers if it aired on Fox. Driving so many viewers would likely drive a pretty healthy advertising market for Fox / Wrestlemania; one of the nice things about the WWE in it's current form is it's "brand safe". The Oscars gets ~24m viewers and charged >\$2m for 30 second ad spots this year; it's tough to estimate the ad load for Wrestlemania, but I wouldn't be shocked if Fox could do \$50m in incremental advertising revenue (versus what they get now from whatever they air on random April Sunday nights) from Wrestlemania. That incremental ad revenue alone would go a long way to paying for the PPV rights, to say nothing of all the other PPV advertising revenues, the

increased ratings for Smackdown, or the increased leverage when negotiating retransmission contracts going forward.

Would Fox bid aggressively on the PPV rights? I think absolutely for a few reasons. First, there should be competition; while Fox is the most natural buyer, you could imagine several other bidders. USA would be the most logical alternative bidder; NBC (their parent company) could bid on the PPV rights, promote the PPVs on USA, and then air them on NBC. Remember that NBC is prepping to launch Peacock, their D2C app. You could imagine a world where NBC makes a big bid for the PPV rights (or the WWE network as a whole) thinking that Wrestlemania would draw people to Peacock just like UFC drew people to ESPN+. Speaking of ESPN, they could make some sense as a bidder. Adding the WWE to their UFC rights (plus a bunch of others!) would likely draw a significant amount of subs. Sure, it would be awkward airing the PPVs on ESPN while the bulk of the normal stuff sat on USA and FOX, but at the right price I'm sure ESPN would be interested (Bill Simmons suggested that's where he thought WWE was going around the 33 min mark of this pod; he's obviously not an expert but given he used to work at ESPN and had recently interviewed Disney's CEO I think it's an interesting data point).

Again, it's difficult to put an exact figure on how much shifting the PPV rights from the network to Fox (or another bidder) would have on the WWE's financials, as there are a lot of different moving parts. For example, if the WWE sold the PPV rights to Fox, what do they do with the network? Do they continue to run it as a niche app for their most passionate fan base to watch replays and behind the scenes shows (my preference!)? Do they shut the whole network down completely? How quickly would they get to recut / increase their sponsorship deals? Right now, all the sponsors of WWE PPVs pay for the ~2m eyeballs they get on the network, but if the PPVs were on Fox and drawing >10m eyeballs (as I believe they could), the sponsorship deals would obviously be significantly

undermarket.

However, we can make a somewhat educated guess of how much selling to Fox would improve WWE's financials. To start, let's assume WWE sells the PPV rights to Fox for \$150m (similar to the UFC deal). The WWE network did \$185m in revenue in 2019, so selling the PPVs to Fox would cut ~\$35m in revenue if we assumed the network revenue instantly went to zero. However, the Fox deal should be extremely high margin, while running the network has a large cost base associated with it. There's tech costs, billing costs, costs to acquire customers, etc. The company used to disclose OIBDA and revenue for the network; however, they stopped in FY17, when the network had \$198m in revenue and \$64m in OIBDA (see p. F-36). My guess is that 2017 financials were a bit generous to the network, as there's a huge chunk of unallocated corporate overhead in their OIBDA numbers, a lot of which I would suspect go to helping the network and would be cut if the network no longer needed heavy promotion / investment. However, let's just use the WWE's numbers. Assuming a similar margin now, the network's \$185m in 2019 revenue would do ~\$60m in OIBDA. I'd guess the margins on selling the PPVs to Fox would be incredibly high. Again, take a look at the FY17 financials; television revenue went from \$242m in FY16 to \$270m in FY17, and that increase drove Television OIBDA from \$120m to \$139m. That's ~\$19m in OIBDA increase on \$28m increase in revenue, suggesting significant operating leverage on incremental revenue (~67% incremental margins). Let's use a similar incremental margin from a hypothetical deal selling the PPVs to Fox (though I actually think the incremental margins would be even higher); selling the PPVs to Fox would generate \$150m in revenue and \$100 in OIBDA, for a net decrease of \$35m in revenue and a net increase of \$40m in OIBDA. I realize that was a bunch of text, so I've laid it all out in a table below.

Network			Network PPV To Fox Delta			
	FY16	FY17	Revenue \$	185	150 \$	(35)
Revenue \$	181	\$ 198	OIBDA \$	60	100 \$	40
OIBDA \$	43	\$ 64				

Television		
	FY16	FY17
Revenue \$	242	\$ 270
OIBDA \$	120	\$ 139

All of that was a long winded way of getting to a simple point: selling the PPVs to Fox would likely result in a significant boost to the WWE's near term earnings.... and that's excluding the near term boost from advertising (driven by increased eyeballs / awareness), merchandising (ditto), or the longer term brand boost from the increased exposure. In addition, I've assumed that they shut the network down if they sold the PPVs to Fox, but I actually think the network would still have significant value. While it probably would lose hundreds of thousands of subs if it lost the PPVs, I am sure there are still plenty of superfans willing to fork over \$10/month (or \$5/month if they cut pricing to match the now decreased network) to get access to backstage programs, the catalog, replays, etc. In a now smaller, less ambitious form, the network would likely be highly profitable monetizing those new fans. So I think this \$40m OIBDA boost is likely to prove conservative on a bunch of fronts: I think the network currently is likely a bit less profitable than I've given them credit for, I think a deal with Fox would likely come at a higher dollar figure and higher margins than I've modelled, I think the network would still have some value post losing the PPVs versus the zero value I've given them, and I think there would be a lot of other incremental positives for the WWE.

Outside of selling the PPVs, the other big boost I could see in the near term is from renewing their NXT deal. NXT is basically WWE's minor leagues. NXT airs every Wednesday, and until recently it aired on the WWE network. In late Q3 / early

Q4, the WWE struck a deal to put NXT on USA on Wednesday nights. They gave a few reasons for doing this, but I think the major reason is that AEW (their new competitor) airs on Wednesday nights and putting NXT on cable the same night could help undercut AEW's audience.

So why do I think NXT is a potential earnings boost near term? I suspect that USA is paying WWE very little for NXT. I think the best way to see that is through WWE's guidance. WWE guided to "at least \$200m" in 2019 OIBDA in their Q2'19 guidance, and at the time they still had NXT on the WWE network. They kept guidance flat in their Q3'19 earnings after they struck the NXT / USA deal. Given they were already producing NXT for the network, any incremental fees they got from moving NXT to USA should have flowed pretty much straight through to the bottom line. So my guess is that WWE is getting very little for the NXT deal currently, and I think that's backed up by the WWE's 10-K (if you look at p. 26, they note media revenue increased due to the renewal of Raw and Smackdown.... notably absent is any discussion of fees from putting NXT on USA). So why would the WWE basically give NXT to USA for free? Well, the WWE has mentioned NXT is on a short term deal. My guess is that the WWE struck a short term deal with USA for the NXT with the thought that getting NXT on cable could both harm a competitor and quickly build out proof of the demand for a third program. I think that demand has largely been proven out at this point: NXT is drawing in just under a million viewers every week. While that's not Raw / Smackdown levels, it's still pretty respectable for the WWE's minor league brand that is running head to head with a competitor. When the "short term" deal is up, I would guess USA reups the NXT deal at a nice premium that will be reasonably accretive for the WWE, and all of the premium should flow straight through to the WWE's bottom line. USA pays the WWE \$265m/year for Raw. NXT is only two hours (Raw is three) and does about a third the ratings Raw does, so it obviously isn't worth \$265m/year. A better comp might be AEW, which airs on the same night and does slightly

better ratings than NXT (as I'll discuss later). AEW just reupped with TNT at \$45m/year. I don't see why NXT couldn't get >\$30m/year. Assuming the same 67% incremental margins from the Fox PPV discussion, a new NXT deal could boost earnings by another \$20m.

Putting it together, the combination of just selling the PPV rights and recuttign the NXT deal could add another \$60m in near term OIBDA, which would make the WWE look a lot cheaper. OIBDA would go from \$275m to \$335m, and UFCF from \$235m to \$295m. You can see the new financials and multiples below.

Total EV	\$4,064.10
Current 20E OIBDA	\$ 275.00
Current 20E FCF	\$ 235.00
PPV Sale	\$ 40.00
NXT Recut	\$ 20.00
New OIBDA	\$ 335.00
New FCF	\$ 295.00
New EV / OIBDA	12.1x
New EV / UFCF	13.8x

In addition to selling the PPVs and recutting the NXT deal, there are two others things that I think will drive WWE's earnings higher in the short to medium term. The first is renewing their India rights deal and striking a new MENA deal. They've been talking about renewing and resetting these deals for around a year now (for example, here's a mention in their Q2'19 earnings), so it's tough to say exactly why these deals haven't been struck (the company has given a variety of reasons). However, at some point I would guess the deals do get struck / renewed, and they should provide some incremental earnings.

The other thing for the WWE's earnings in the near term is the brand boost from being on Fox. Remember, the WWE just landed

on Fox in October (at the time, I mentioned how I thought the long term benefit of putting WWE on Fox would accrue to WWE, not Fox. Obviously I stand by that!). Fox has been running commercials for the WWE nonstop; I think the headliner here were all the commercials during NFL Sundays, Thursday night football, and even the Super Bowl, but there were plenty of other places FOX gave the WWE significant exposure (college football, Nascar, masked singer, etc.). None of the marketing has an effect on the WWE's near term income statement, but the effects of all that exposure will have huge dividends for WWE's brand in the medium and long term. Obviously this effect will get turbocharged if Fox buys WWE's PPVs, but even without that the effect of all those Fox commercials should be really beneficial long term. While the majority of WWE's earnings come from their media rights deals, they make a significant amount of money from their Live shows (selling tickets to their weekly shows) and from Merchandising (~20% of OIBDA before corporate expenses). The exposure from the Fox should provide really positive medium to long term tailwinds from those earnings streams.

Anyway, all of this was a long winded way to say one thing: WWE looks somewhat fairly valued based off of their 2020 guidance of \$250-\$300m in OIBDA. But I think that number is likely to prove substantially too low in both the medium term and the longer term. In the medium term, things like selling their PPVs, renewing their international deals, recutting their NXT deal, and getting the brand boost from being on Fox will all drive earnings higher. In the longer term, an investment in the WWE is a bet that demand for the WWE's live sports rights will continue to increase. While I doubt the growth in value continue at the same pace it has over the past ~15 years (when Raw / Smackdown rights grew from ~\$70-80m/year in 2007 to well over \$400m currently), I do think it's a good bet that the rights continue to grow in value over time... and, as they do, the WWE should see continued operating leverage plus growth in their ancillary revenue streams (like

merchandising).

Why is it likely the WWE rights value (or live sports rights in general) continue to grow? There are a variety of reasons, but the core reason is that sports (and I include the WWE here) with a committed fan base is one of the few things guaranteed to draw eyeballs, and every year the ability to draw more eyeballs gets more valuable because every year there are more and better ways to monetize that fan base's interest. Fifty years ago, the only way to monetize live eyeballs was through mass advertising. Thirty years ago, things changed when ESPN started charging cable companies a retransmission fee. Suddenly, you could monetize both through advertising and through retrans fees (or through fans threatening to switch cable providers if they dropped your channel). Going forward, with targeted / personalized advertising producing higher ad rates and the continued competition to draw people into different subscriptions, the ability to monetize sports fan's passion will continue to increase, and that'll drive demand for products like the WWE even higher. Bob Iger was recently on the Bill Simmons podcast, and he talked a ton about sports rights. It was really interesting, but perhaps the most interesting piece was when he tried to think of a time when a major network bought sports rights and had buyer's remorse. Iger could only think of one example: ABC with the 1988 Winter Olympics. The trend suggests most buyers are happy with what they pay for sports rights, and I think that bodes well for WWE's future deals. When the WWE is looking to renew their deals (the current deals run through 2024), every broadcast network will be looking for live rights to stay relevant to consumers as cord cutting continues. In addition, a wave of streamers (Peacock, ESPN+, DAZN, and I'm sure countless new ones to be formed) will be looking for content to keep their current consumer and draw in new ones. Bidding should be fierce, and the WWE will be a huge beneficiary.

Putting it all together, I think ~5 years from now earnings

will be dramatically higher than they currently are, and the WWE's stock price will follow.

There are certainly other pieces of possible upside. The largest would come from WWE selling itself. I think it's pretty unlikely they sell themselves any time soon: I think Vince McMahon (WWE's founder) is crazy competitive and very invested growing the WWE. Still, the possibility is out there, and if it happened it would likely be at a massive premium to today's prices. Most people would point to the UFC's \$4B sale as a comparable (an industry blog suggested this was more like a \$4.5B EV and represented an ~18x EBITDA multiple; I would be very interested in seeing the addbacks to get to that EBITDA number....), but I think that undersells the WWE. WWE produces far more content and has decades of history / proven appeal. I think the WWE would be worth significantly more than the UFC for a variety of reasons. A better way to think of the WWE as a unique / trophy content chest, and those tend to command huge premiums in the market. Think about Comcast buying Dreamworks for a 50% premium in 2016, or (more loosely) Hasbro acquiring eOne earlier this year. If the WWE were put up for sale, I'd expect them to get a mammoth premium. It's also worth noting corporate expenses run pretty high here; ~\$80m/year plus another \$25-30m/year of stock comp. I'd guess the cost synergies for a strategic acquirer would be huge, and there would be plenty of other potential upsides as well (for example, Comcast could buy them and figure out some ways to incorporate WWE into their parks, or do promo bits with WWE characters in some of their shows, etc.). I don't think the WWE is getting sold, but I think both the potential synergies and the historic premium for trophy content suggest if they were they would go for a huge premium.

Are there risks here? Absolutely.

Your biggest risk? Probably Vince McMahon. For better or worse, he controls the company, and he has been known to try to solve every problem by spending money. His recent firing of

his top execs scared Wall Street, and people are perpetually worried he'll do something crazy (like merge the new XFL into the WWE). Things like spending \$200m on a new global headquarters do nothing to alleviate fears of empire building or spending for the sake of spending. I don't have much to add on this risk; if you're absolutely convinced Vince is going to spend the company into oblivion, or that he's out of touch and he's going to destroy the WWE by delivering years of subpar story, or that taking another crack at the XFL is too distracting and going to hurt the WWE, that's certainly a risk. However, I'd suggest that Vince's history suggest that he's willing to make big swings and look silly, but there's ultimately a method to his madness and the man knows how to build a brand (he did build the WWE over the past ~50 years, after all!). On the whole, I think shareholders are well served by Vince, and his moves will ultimately maximize shareholder value.

The other big risk is newer: competition from the AEW. AEW is a startup wrestling league that airs on TNT, and it is currently outdrawing WWE's NXT. I've seen plenty of people point to those ratings as a sign that the WWE has lost it and that the edgier AEW brand is set to take over the wrestling world. I doubt it: I think the WWE has a substantial moat, and that even if the AEW survives it's likely to do so a smaller competitor. Consider a few things:

- The AEW is outdrawing the NXT.... but people only compare the two because they air on the same night. The NXT is like WWE's minor leagues; the AEW's ratings lag far behind the WWE's flagship shows.
- The WWE has a ton of built in advantages: they have better built in distribution, a huge built in fan base, better monetization, etc. In a competition for talent, WWE can always pay more because they make more. And talent has to factor in that going to the WWE offers a proven path to stardom that other leagues (like AEW)

haven't proven (think about WWE launching the careers The Rock or John Cena).

- Think about the WWE like a sports league. How many sports league upstarts have ever been successful at replacing an incumbent? Honestly, I can't think of one. It's incredibly difficult for all of the reason mentioned above (incumbent leagues have better distribution, bigger budgets, etc.). Doesn't mean the AEW can't be successful, but the WWE would have to really stumble for years for AEW to have a shot of even matching the WWE's popularity. More likely, AEW competes for a few years, and then the WWE either buys them out or just starts offering their stars a bunch more money and opportunities and slowly bleeds them dry.

Are there other risks? Sure. Maybe people just stop being interested in wrestling (I think you've got decades suggesting that there's a dedicated fan base here). Maybe I'm wrong about the long term appeal of sports rights, and the next round of negotiations sees the WWE taking big rate cuts. Or maybe the recent India / MENA deal issues is a sign that WWE is losing its international appeal, and the company loses its global appeal (about 30% of WWE's revenue comes internationally). But I think all of those risks are unlikely: the history of IP / sports franchises with passionate fan bases suggests that its value continues to appreciate over time, and that its value travels reasonably well internationally. At today's prices investors are offered the opportunity to buy into that appreciation at a reasonable valuation with several near term catalysts to significantly improve earnings.

Obviously, this is still a work in progress. I've done a lot of research on the WWE over the years, but a big piece of the thesis is drawing from different data points and trying to estimate some stuff out (like trying to figure what Fox would

pay for the PPVs, or what a new NXT deal would look like). I think I've done a good job of it and generally been pretty conservative, but if you've done work on the company and have some thoughts, I'd love to hear them!