

April 28<sup>th</sup>, 2017

## Liberty Interactive Corp: QVCA

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Sector: Consumer Discretionary

Industry: Internet and Direct Marketing Retail

Current Price: \$21.37

Target Price: \$32.32

Liberty Interactive Corporation (also referred as QVC Group) is an American Corporation headquartered in Englewood, Colorado. It was originally a division of Liberty Media, but became independent in 1999. Even though the company owns interests in various subsidiaries, its two main sources of operations and revenues are QVC and Zulily. The company mainly operates in the United States, but also has operations in Europe, Japan, and China.

### BUY

|                 |                |
|-----------------|----------------|
| Current Price:  | \$21.37        |
| Target Price:   | \$32.32        |
| Market Cap:     | \$9.63 billion |
| Average Volume: | 2.73 million   |
| 52-week High:   | \$27.25        |
| 52-week Low:    | \$17.24        |
| Short Interest: | 1.94% of Float |

### Value Creation Ratios

|                 |       |
|-----------------|-------|
| Debt to Equity: | 0.68  |
| Cost of Debt:   | 4.5%  |
| Cost of Equity: | 11.8% |
| WACC:           | 9.1%  |
| EBITDA Margin:  | 13.4% |
| ROIC:           | 9.7%  |
| ROIC/WACC:      | 1.07  |



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## Thesis:

Because of a year of sluggish growth, the market has made QVCA stock fall significantly from its recent high (-25% in the last 12 months). However, global consumer and technology trends, as well as a strong business model based on pricing power, exclusivity, and customer retention, are likely to send the stock back up in the next 2 years. In addition to that, the company can still improve when it comes to creating value and generating profits. Therefore, this stock is a safe investment that, in my opinion, has recently hit a bottom and can only increase in value in the next 24 months.

## Catalysts:

- Short Term(within the year): Ability to overcome current negative market expectations
- Mid Term(1-2 years): successful implementation of initiatives
- Long Term(3+): Ability to sustain the growing mobile trend

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## Products and Segments:

The first and main segment of Liberty Interactive Corporation is QVC (Quality Value Convenience). The company, which has been acquired by Liberty in 2003, generates revenue through its broadcasting network, televised home shopping, and online shopping. Through its online channel network and TV channel, it is able to broadcast live 24 hours a day, 364 days a year in the United States, almost reaching the entirety of American households. Thanks to this presence, QVC is the second highest television network when it comes to revenue generation, and it ranks as #1 when it comes to home shopping networks. On its website, QVC has three different live channels: QVC TV, QVC2TV, and Beauty iQ TV. The products offered range from clothing to accessories, jewelry, personal care, electronics, food, kitchen products, and House & Garden maintenance. Customers can buy easily the advertised products by calling the number displayed on TV. They can also buy online, as on any other online shopping website. Finally, even though it represents only a marginal share of QVC revenue, a few actual outlet stores exist in the United States. As of 2016, QVC US represents \$6.1 billion in revenue, roughly 60% of Liberty Interactive's total revenue. QVC also started operating in Europe in 1993 (in the United Kingdom), and has since expanded to France, Germany, and Italy. The company also went to Asia and has started operating in Japan and China. Overall, international operations account 25% of the Liberty Interactive's revenue (\$2.6 billion revenue in 2016).

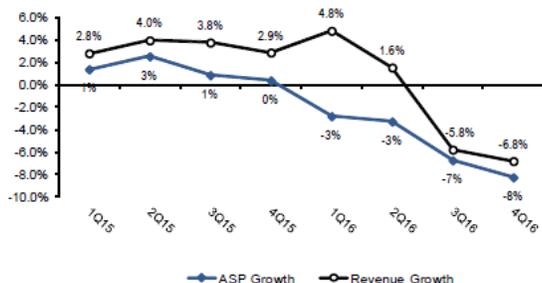
In addition to QVC, Liberty Interactive has acquired Zulily in 2015, for over \$2.5 billion. Zulily is also an online shopping company. However, unlike QVC, it does not have a broadcasting network. Therefore, Zulily is more of a classic Online Retail company. It mainly offers clothing and apparel, but also various goods like toys, kitchen products, bed linens, and any item for home. In 2016, Zulily generated \$1.55 billion in revenue (15% of QVCA total revenue).

## Current Market Pricing:

In the last year, QVCA stock has been struggling. As you may see on the price chart, earnings results in June 2016 led the share price to fall from its \$27-\$28 range (near its all-time high) to the \$20 range. As a matter of fact, after years of strong growth, the market was disappointed in the company's ability to generate revenue.

| In Millions of USD except Per Share | FY 2012         | FY 2013         | FY 2014         | FY 2015        | FY 2016         |
|-------------------------------------|-----------------|-----------------|-----------------|----------------|-----------------|
| 12 Months Ending                    | 12/31/2012      | 12/31/2013      | 12/31/2014      | 12/31/2015     | 12/31/2016      |
| <b>Revenue</b>                      | <b>10,018.0</b> | <b>10,219.0</b> | <b>10,028.0</b> | <b>9,169.0</b> | <b>10,219.0</b> |

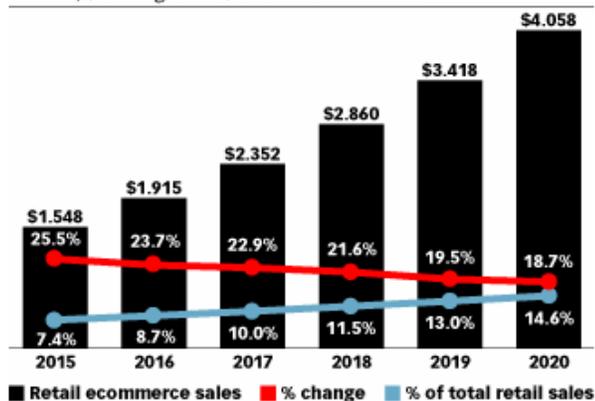
As seen in the above table, from 2014 to 2015, revenue fell by almost 10%, and the increase in revenue in 2016 was only due to the full integration of Zulily in the company's financial statements. The most worrying point for investors, other than bearish German and Japanese markets, have been the growth in the domestic market. As a matter of fact, after being slow but positive for several quarters (never more than 5%), sales growth in the United States eventually became significantly negative (-5.8% and -6.8% in the last two quarters). This led the



market to massively sell QVCA stock. QVCA stock is now underpriced when looking at multiples: 8.20 EV/EBITDA vs 13.23 for the industry, and 21.48 forward P/E ratio vs 29.89 for the industry. This underpricing could make sense considering the current negative growth of the company, but as explained in the next two sections, Liberty Interactive has everything to prove the market wrong in the coming years.

## Strong Business Model and positive trends:

**Retail Ecommerce Sales Worldwide, 2015-2020**  
trillions, % change and % of total retail sales



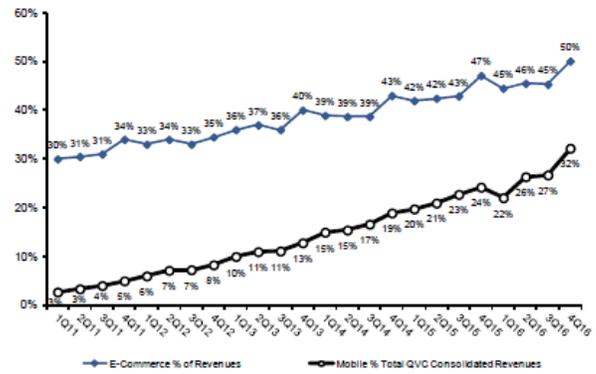
In spite of the current market pricing due to the sluggish revenue growth, two things have to be noted. First, QVCA has a strong business model that will most likely lead to steady revenue and customer base. Then, the current global trends in consumption and e-commerce make me believe the coming years will be way more bullish for Liberty Interactive. To begin with, QVC (85% of the company's revenue) has a competitive advantage: exclusivity. As a matter of fact, as quote by an Aegis Capital Corp report, over 75% of the products displayed on QVC channels and networks can only be purchased through QVC at the time of airing. In addition to this exclusivity, the limited

inventory held for every product makes customers more likely to purchase immediately, without waiting for discounts. Furthermore, as QVC is the only seller of its products, customers cannot compare price and quality, leaving a strong pricing power to the company. Finally, the company's customers mainly have sufficient income to purchase products repetitively and remain customers in the long run. AS pointed out by the same Aegis

research, “Close to 90% of the customer base are women with above average income and household wealth, they make 24 purchases per year, and the customer base has a high 89% retention”.

In addition to this stability in the revenue, pricing power, and customer base, the global trend when it comes to e-commerce, and the increasing portion of QVC it represents, add up to give potential for growth for Liberty Interactive.

As shown in the above graph, the size of the retail e-commerce market is expected to double in the next 4 years, averaging a 20% annual growth rate. Eventually, by 2020, ecommerce sales will represent as much as 14.6% of total retail sales worldwide. Given the current importance of e-commerce for QVC, it is beneficial that this market is expect to grow fast. Indeed, as of Q4 2016, e-commerce represented 50% of the company revenue. This increasing share is partially due to the early launch and success of QVC app that allows customers to make purchases directly from their mobile phones or tablets. Mobile revenues now account for 32% of QVC total revenue. It only represented 1% of consolidated revenue 6 years ago. If this trend keeps on going, it is fair to assume QVC will be able to get back to sustainable revenue growth.



### Current Initiatives:

To boost revenue and send QVC domestic back in the positive growth, Management has decided to take on initiatives, and these have been shared in SEC filings and earnings calls. To begin with, merchandising actions are being undertaken to improve efficiency in the sales generation. First for accessories (13% of global sales), focus will be made on promoting comfort sleepwear and lounge wear, where growth has been the strongest in the past quarters. For jewelry (9% of total sales), growth has been too low in the past quarters. To remediate it, the company will perform inventory clearance and reduce the amount of time awarded to advertising these products. Growth will be brought back with the sale of products that were not available at QVC in the past like Grace Kelly or Fossil watches products. Then, the company needs to bring in more new customers (2.1 million new customers in the USA in 2016, below 2015 numbers of 2.5 million). To do so, the company will use if Beauty IQ network and Facebook live, as well as various advertising campaigns, to promote kitchen, electronics, and beauty products. These product lines together account for almost half the company’s revenue in the United States. Finally, the company will invest heavily in its smaller networks. According to management, Beauty IQ (reaches only 40 million households against 100 million for main networks) has customers that “are 6 years younger, make more money, are more educated, and purchase more frequently”. Therefore, substantial investment will be made in this network. Then, Facebook live content will also be a significant area of improvement.

### Profitability:

When it comes to profitability, the company has been performing slightly better than its industry in the past year. According to Capital IQ Data, latest EBITA margin for QVCA was 13.4%, whereas it was only 9.3%. However, we can see on the EBITA Margin table that the trend is rather

|             | EBITA Margin |       |
|-------------|--------------|-------|
|             | History      | LFY   |
| qvca        | 16.3%        | 13.4% |
| Competitors | 5.9%         | 9.3%  |

positive for competitors, and negative for QVCA (historical EBITA: 16.3% vs 5.9% for competitors). As a matter of fact, as written earlier, Liberty Interactive depends heavily on revenue growth to improve profitability (through economies of scale). However, even though the below table from Bloomberg shows a better than average revenue growth for Liberty Interactive, one should not forget it is not organic growth. The sales growth percentage for 2016 because of the full integration of Zulily for the full year (+1 billion compared to previous year). Without this additional \$1 billion, revenue growth would have been perfectly flat. This flat revenue is the

| Name<br>(BICS Best Fit)              | Sales<br>Growth (%) | EBITDA<br>Growth (%) | EBITDA<br>Margin | Operating<br>Income<br>Margin |
|--------------------------------------|---------------------|----------------------|------------------|-------------------------------|
| <b>Average</b>                       | <b>5.83%</b>        | <b>-6.72%</b>        | <b>12.25%</b>    | <b>8.93%</b>                  |
| <b>100) LIBERTY INTERACTIVE C...</b> | <b>11.45%</b>       | <b>1.86%</b>         | <b>18.21%</b>    | <b>9.89%</b>                  |

main reason why Liberty Interactive is losing its advantage over competitors. However, as the company has made decisions to help QVC grow again, and as the expected revenue trends are all bullish, it is safe to say the EBITDA/EBITA will change direction and increase again in the near future to send QVCA back with the top performers when it comes to Operating Margins. This will lead to an increase in ROIC that will eventually match competitors' (competitors, in spite of lower EBITA, have better ROIC as they have a higher Capital Usage ratio currently).

## Financial Health and Value Creation:

| Description <sup>A</sup>                   | Type             | Principal Due<br>(USD) | Coupon/Base<br>Rate | Floating Rate |
|--------------------------------------------|------------------|------------------------|---------------------|---------------|
| 1% Exchangeable Senior Debentures Due 2043 | Bonds and Notes  | -                      | 1.000%              | NA            |
| 3.125% Senior Secured Notes Due 2019       | Bonds and Notes  | 399.0                  | 3.125%              | NA            |
| 4.375% Senior Secured Notes Due 2023       | Bonds and Notes  | 750.0                  | 4.375%              | NA            |
| 4.45% Senior Secured Notes Due 2025        | Bonds and Notes  | 599.0                  | 4.450%              | NA            |
| 4.85% Senior Secured Notes Due 2024        | Bonds and Notes  | 600.0                  | 4.850%              | NA            |
| 5.125% Senior Secured Notes Due 2022       | Bonds and Notes  | 500.0                  | 5.125%              | NA            |
| 5.45% Senior Secured Notes Due 2034        | Bonds and Notes  | 399.0                  | 5.450%              | NA            |
| 5.95% Senior Secured Notes Due 2043        | Bonds and Notes  | 300.0                  | 5.950%              | NA            |
| 8.25% Senior Debentures Due 2030           | Bonds and Notes  | 504.0                  | 8.250%              | NA            |
| 8.5% Senior Debentures Due 2029            | Bonds and Notes  | 287.0                  | 8.500%              | NA            |
| Bank Credit Facilities                     | Revolving Credit | 1,896.0                | 2.200%              | Benchmark     |

To finance all of its acquisitions and investments in networks and advertising, will need to raise capital. As a matter of fact, as of December 2016, the company only had \$338 million in cash, which represented less than 2.5% of their total assets. Raising equity would probably threaten the stock's value, as it would prove the company cannot afford to take on more debt. Therefore, any further investment will require the

| Kd          | History |      |
|-------------|---------|------|
|             | History | LFY  |
| qvca        | 5.2%    | 4.5% |
| Competitors | 4.1%    | 3.5% |

company to take

on more debt. One could be worried, as the company's current capital structure is already leveraged, with a Debt-to-Equity ratio of 0.68. Because of this, and of the low liquidity of the company, the rating QVC Group is

|                             |     |
|-----------------------------|-----|
| 2) Standard & Poor's        |     |
| 3) Outlook                  | NEG |
| 4) LT Foreign Issuer Credit | BB  |
| 5) LT Local Issuer Credit   | BB  |

not as great as it could be for such a company: Its S&P500 rating is only BB. Because of this risk, the company's long term debt rate is rather high: 8.5% for bonds maturing in 2029. However, most of the company's debt consists of a revolving credit at LIBOR + 2.2%. This eventually leads the current Cost of Debt of QVC Group to be quite low, at 4.5%. However, it is still 1 percentage point above competitors, which shows the relative financial risk that QVC Group and its investors have to assume. Once Cost of Equity has been accounted for, WACC is at 9.1%, below ROIC of 9.7%. Therefore, the company's ROIC/WACC ratio is 1.07, showing the company is creating value. It is still however lower than its competitors that managed to generate higher ROIC, and have a ROIC/WACC ratio of 1.60. As the company has been struggling generating revenue growth and has been investing in Zulily to make it profitable, it has agreed to temporarily lower its profitability (ROIC/WACC had been 1.38 historically) to promote organic growth and bring more profits to its shareholders in the future. In the future, the gap will most likely close, and QVCA will probably match and maybe surpass its competitors when it comes to value creation, leading to significant stock price appreciation.

## **Conclusion:**

Overall, if Liberty Interactive Corporation's common stock is at its current price level today, it is mainly due to fear of the market regarding its ability to overcome the current revenue growth issues. Another concern from investors might be the high level of leverage of the company that brings some financial risk. However, management, which is composed of experienced members (CEO was CMO of Dell, CFO was senior manager for Procter & Gamble) has understand how to remediate revenue issues, and actions undertaken will most likely send the company back on a profitable path. Within the next 2 years, I expect the price to reach at least \$32, which is in line with my pro forma valuation.

**QVC Group (qvca)**

**CENTER FOR GLOBAL FINANCIAL STUDIES**

**BULLISH**

Analysis by Maxime Lattanzio  
4/27/2017

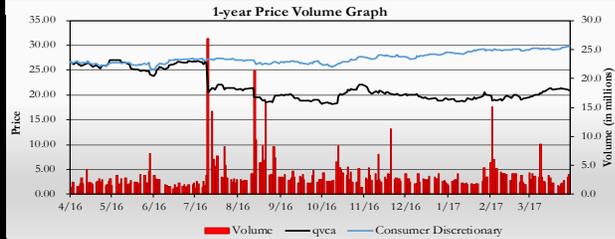
Current Price:  
Dividend Yield:

\$21.37  
0.0%

Intrinsic Value  
Target Price:

\$27.15  
\$32.32

Target 1 year Return: 51.23%  
Probability of Price Increase: 99.2%



|                                                                                                                                                                  |                                      |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|
| <b>Description</b>                                                                                                                                               |                                      |
| QVC Group markets and sells various consumer products primarily through live merchandise-focused televised shopping programs, Internet, and mobile applications. |                                      |
| <b>General Information</b>                                                                                                                                       |                                      |
| Sector                                                                                                                                                           | Consumer Discretionary               |
| Industry                                                                                                                                                         | Internet and Direct Marketing Retail |
| Last Guidance                                                                                                                                                    | November 3, 2015                     |
| Next earnings date                                                                                                                                               | May 8, 2017                          |
| Estimated Country Risk Premium                                                                                                                                   | 7.27%                                |
| Effective Tax rate                                                                                                                                               | 18%                                  |
| Effective Operating Tax rate                                                                                                                                     | 34%                                  |

|                                       |            |
|---------------------------------------|------------|
| <b>Market Data</b>                    |            |
| Market Capitalization                 | \$9,707.40 |
| Daily volume (mil)                    | 1.75       |
| Shares outstanding (mil)              | 454.57     |
| Diluted shares outstanding (mil)      | 481.00     |
| % shares held by institutions         | 85%        |
| % shares held by investments Managers | 72%        |
| % shares held by hedge funds          | 8%         |
| % shares held by insiders             | 8.44%      |
| Short interest                        | 1.73%      |
| Days to cover short interest          | 2.56       |
| 52 week high                          | \$27.25    |
| 52-week low                           | \$17.24    |
| Levered Beta                          | 1.06       |
| Volatility                            | 0.00%      |

|                               |         |         |
|-------------------------------|---------|---------|
| <b>Past Earning Surprises</b> |         |         |
| Quarter ending                | Revenue | EBITDA  |
| 12/31/2015                    | -1.71%  | -16.00% |
| 3/31/2016                     | -0.50%  | -11.14% |
| 6/30/2016                     | -0.70%  | -9.36%  |
| 9/30/2016                     | -2.21%  | -9.00%  |
| 12/31/2016                    | -4.59%  | -8.43%  |
| Mean                          | -1.94%  | -10.78% |
| Standard error                | 0.7%    | 1.4%    |

|                            |  |
|----------------------------|--|
| <b>Peers</b>               |  |
| HSN, Inc.                  |  |
| Wayfair Inc.               |  |
| The Liberty SiriusXM Group |  |
| Duluth Holdings Inc.       |  |
| Overstock.com, Inc.        |  |
| Lands' End, Inc.           |  |

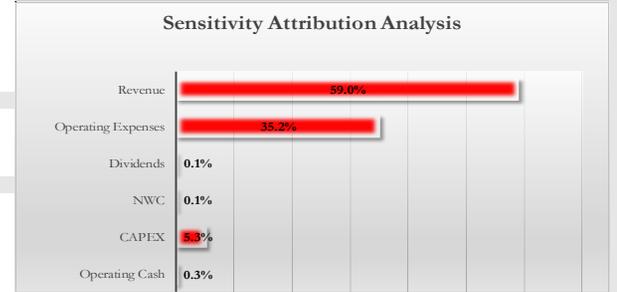


|                     |                              |
|---------------------|------------------------------|
| <b>Management</b>   |                              |
| George, Michael     | Chief Executive Officer and  |
| Maffei, Gregory     | President and Director       |
| Carleton, Mark      | Chief Financial Officer      |
| Sprinkle, Todd      | Chief Information Officer    |
| Baer, Richard       | Senior Vice President and Ge |
| Rosenthaler, Albert | Chief Corporate Development  |

|                                   |     |                                     |     |
|-----------------------------------|-----|-------------------------------------|-----|
| <b>Total compensations growth</b> |     | <b>Total return to shareholders</b> |     |
|                                   | N/M |                                     | N/M |

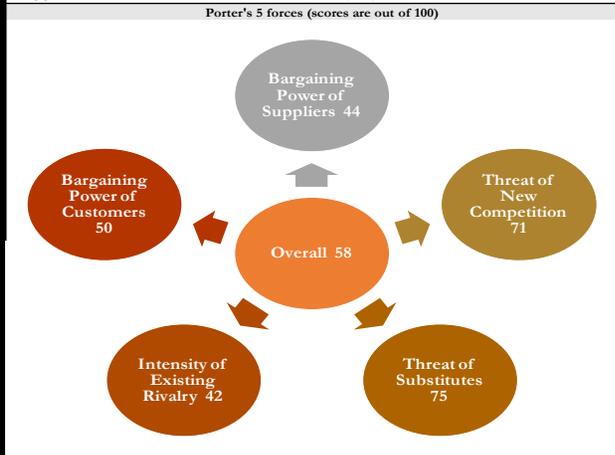
|                             |        |                   |        |                                          |  |                       |  |
|-----------------------------|--------|-------------------|--------|------------------------------------------|--|-----------------------|--|
| <b>Profitability</b>        |        | <b>qvca (LTM)</b> |        | <b>qvca (5 years historical average)</b> |  | <b>Industry (LTM)</b> |  |
| ROIC                        | 18.7%  | 34.43%            | 10.43% |                                          |  |                       |  |
| NOPAT Margin                | 7%     | 14.11%            | 11.5%  |                                          |  |                       |  |
| Revenue/Invested Capital    | 2.51   | 2.44              | 0.91   |                                          |  |                       |  |
| ROE                         | -22.6% | -271.64%          | 10.92% |                                          |  |                       |  |
| Adjusted net margin         | 5%     | 11.54%            | 10.3%  |                                          |  |                       |  |
| Revenue/Adjusted Book Value | -4.39  | -23.53            | 1.06   |                                          |  |                       |  |

|                                        |       |                   |      |                                          |  |                       |  |
|----------------------------------------|-------|-------------------|------|------------------------------------------|--|-----------------------|--|
| <b>Invested Funds</b>                  |       | <b>qvca (LTM)</b> |      | <b>qvca (5 years historical average)</b> |  | <b>Industry (LTM)</b> |  |
| Total Cash/Total Capital               | 2.3%  | 3.5%              | 36%  |                                          |  |                       |  |
| Estimated Operating Cash/Total Capital | 2.2%  | 3.3%              | N/A  |                                          |  |                       |  |
| Non-cash working Capital/Total Capital | 3.8%  | 4.4%              | -28% |                                          |  |                       |  |
| Invested Capital/Total Capital         | 29.4% | 27.5%             | 72%  |                                          |  |                       |  |



|                                 |       |                   |        |                                          |  |                       |  |
|---------------------------------|-------|-------------------|--------|------------------------------------------|--|-----------------------|--|
| <b>Capital Structure</b>        |       | <b>qvca (LTM)</b> |        | <b>qvca (5 years historical average)</b> |  | <b>Industry (LTM)</b> |  |
| Total Debt/Common Equity (LTM)  | 0.68  | 0.22              | 0.07   |                                          |  |                       |  |
| Cost of Existing Debt           | 4.58% | 6.61%             | 4.07%  |                                          |  |                       |  |
| Estimated Cost of new Borrowing | 3.64% | 4.04%             | 4.07%  |                                          |  |                       |  |
| CGFS Risk Rating                | BB    | B                 | CCC    |                                          |  |                       |  |
| Unlevered Beta (LTM)            | 0.76  | 0.94              | 1.33   |                                          |  |                       |  |
| WACC                            | 9.11% | 10.83%            | 13.50% |                                          |  |                       |  |

|                   |       |                     |      |                  |  |
|-------------------|-------|---------------------|------|------------------|--|
| <b>Valuation</b>  |       | <b>NOPAT margin</b> |      | <b>ROIC/WACC</b> |  |
| Base Year         | 11.5% | 7.5%                | 2.06 |                  |  |
| 12/31/2017        | -1.7% | 10.0%               | 2.54 |                  |  |
| 12/31/2018        | 3.5%  | 10.9%               | 2.72 |                  |  |
| 12/31/2019        | 3.8%  | 11.4%               | 2.90 |                  |  |
| 12/31/2020        | 2.9%  | 11.8%               | 3.03 |                  |  |
| 12/31/2021        | 2.9%  | 13.0%               | 3.38 |                  |  |
| 12/31/2022        | 2.9%  | 13.5%               | 3.53 |                  |  |
| 12/31/2023        | 2.9%  | 13.9%               | 3.67 |                  |  |
| 12/31/2024        | 2.9%  | 14.4%               | 3.82 |                  |  |
| 12/31/2025        | 3.0%  | 14.8%               | 3.96 |                  |  |
| 12/31/2026        | 3.0%  | 15.3%               | 4.11 |                  |  |
| Continuing Period | 4.0%  | 10.7%               | 2.92 |                  |  |



|                   |       |                       |             |                   |  |                        |  |
|-------------------|-------|-----------------------|-------------|-------------------|--|------------------------|--|
| <b>Period</b>     |       | <b>Revenue growth</b> |             | <b>Net Claims</b> |  | <b>Price per share</b> |  |
| Base Year         | 11.5% | \$3,107.20            | \$6,234.00  | \$26.25           |  |                        |  |
| 12/31/2017        | -1.7% | \$3,292.35            | \$5,414.05  | \$29.90           |  |                        |  |
| 12/31/2018        | 3.5%  | \$4,006.47            | \$4,247.48  | \$33.89           |  |                        |  |
| 12/31/2019        | 3.8%  | \$3,770.33            | \$2,996.88  | \$38.01           |  |                        |  |
| 12/31/2020        | 2.9%  | \$4,079.33            | \$1,655.80  | \$42.24           |  |                        |  |
| 12/31/2021        | 2.9%  | \$4,368.81            | \$160.55    | \$46.57           |  |                        |  |
| 12/31/2022        | 2.9%  | \$4,607.11            | -\$1,400.59 | \$50.96           |  |                        |  |
| 12/31/2023        | 2.9%  | \$4,699.33            | -\$3,023.27 | \$55.39           |  |                        |  |
| 12/31/2024        | 2.9%  | \$4,805.84            | -\$4,702.65 | \$59.82           |  |                        |  |
| 12/31/2025        | 3.0%  | \$4,894.87            | -\$6,433.72 | \$64.24           |  |                        |  |
| 12/31/2026        | 3.0%  | \$4,991.28            | -\$8,210.76 | \$68.60           |  |                        |  |
| Continuing Period | 4.0%  |                       |             |                   |  |                        |  |