Media Sector Report

A Shelter in the Storm

On average, US adults spend 11h consuming media per day. However, even as entertainment option have multiplied, the figure has grown merely 3% over the last year, indicating that the fight for mind space is intensifying. Throughout the report, we will analyze recent developments within the media sector and discuss the forms of entertainment that will drive the industry moving forward.

Shelly Qian | Sayeed Yousuf Ahmed | Mohammed Souit | Julia Jin | Marc-Antoine Millaire

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Cable & Satellite

The Accelerating Demise of Pay-TV Bundles

As Covid-19 continues to dampen the economy and force live sporting events to shut down, we expect to see an acceleration in cord cutting. Amidst the consumer shift to OTT, regular sports viewers have been a life raft for Pay-TV bundles with an 80% subscription rate. However, extended programming gaps from large sports networks such as ESPN may cause Pay-TV's stickiest subscribers to cancel their bundles.

Case Study: Pay TV Performance Throughout a Recession

In addition to sports driven cancellations, Pay-TV will likely not fare well in the event of a Covid-19 recession. Given the average video cost of ~$100 paired with the proliferation of streaming as a viable substitute, reduced disposable income may further exacerbate a decline in Pay-TV bundles. As seen in figure 1, even when Pay-TV was considered to be a recession proof sector, the 2009 economic downturn eroded industry wide revenue.

The Cable Industry's Blessing in Disguise

The importance of broadband connectivity amidst Covid-19 will enable cable to more than offset any losses from accelerated cord-cutting. In fact, during the week of March 16th, OpenVault reported an 81% surge in downstream consumption.

Stay at home measures may prompt users to upgrade to higher speeds while cord-cutters continue to swap their bundles for higher priced pure broadband plans. In fact, in 2019, the number of new broadband-only subscribers closely tracked that of video-subscriber losses. Moving forward, we believe Covid-19 will accelerate the product mix shift from low-margin video to high-margin broadband with EBITDA margins of 9% and 62% respectively (refer to figure 2). This difference is largely attributable to programming costs associated with video. Although Diversified cable companies are poised to benefit, pure-play satellite operators such as Dish and DirectTV are particularly vulnerable as they are heavily reliant on video.

Figure 1: Video revenue is not recession resistant

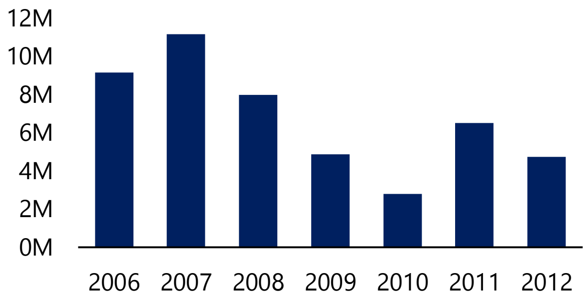
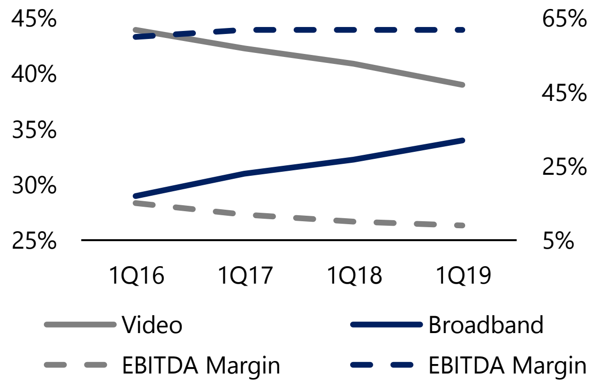


Figure 2: Video weaknesses will not erode profit



Sources: LionTree 2019 Year End Letter, Bloomberg

Cable Networks

Traditional Cable TV Keeps Falling

The number of cable TV subscriptions is expected to decelerate at an annualized rate of 2.6% over the next five years. As a result, cable networks are shifting towards on-demand platforms which will enable cable networks to cater to niche audiences.

Cable Networks are Driving Political Polarization

Cable Networks offer a wide array of television programs through traditional cable providers and more recently, digital platforms. They also operate studios and facilities for content production purposes.

Historically, broadcast TV offered content that appealed to their broader audience and reflected the general sentiments of society in aggregate. However, the last decade's emphasis on personalization and the resulting shift from ad supported content to subscription models has led producers to create targeted content that reflect the existing biases of each individual consumer. Although this seems like a win-win scenario where consumers are receiving content that they are most interested in and cable networks are subsequently maximizing engagement, this type of curation can enforce radical views within our society.

Creating and enforcing regulations surrounding content production is crucial in mending the future of our increasingly polarized society. However, while government intervention is necessary, cable networks also have the ethical obligation to self-regulate. As the shift towards more personalized on-demand services increases, content producers must adopt new standards and practices to avoid enforcing dividing views in our society.

Impact of Covid-19

The impact of the global pandemic varied dramatically among cable networks. With endless content coverage opportunities, news networks experienced a dramatic increase in viewership. CNN grew their YoY audience by 125%, averaging 1.72 millions viewers for the April-May period, the largest increase of its sector. On the other hand, sport networks experienced all times low levels of viewership as sporting events across the globe were cancelled. ESPN, experienced a 41% drop in viewership for the April-May period.

Conclusion

The rapid shift towards streaming and the growing demand for an *a la carte* model has brought turmoil to a traditional sector. As consumers look for content to confirm their existing views, the accessibility of polarized content drastically influences the cultural, political and business spheres of our society. Whether or not cable companies take action in regulating content distribution will dictate the future direction of the industry. The moral dilemma of recentering content rather than catering to the biased views preferred by consumers will be one of the biggest challenges faced by cable networks moving forward.

The decline in revenues resulting from a halt in content production may impact future competition across producers and distributors. While some companies had enough liquidity to survive the recent economic shutdown, the possibility of a second wave halting production once again could have devastating impacts for smaller distributors dependant on live content.

Sources: LionTree 2019 Year End Letter, Bloomberg

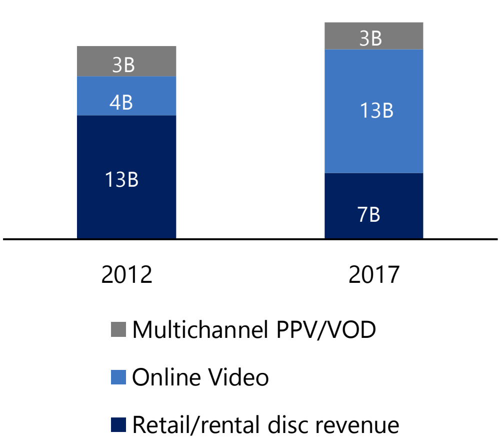
Content Producers

Online Video as the King of Media

Across the years, the favourite content format used to be print, which then switched to voice through the radio and ultimately shifted to video. Image requires less effort; It is accessible by everyone and portrays emotions quicker than any other format. That is why video holds leadership. Video and the Internet have changed everything, and now the media and entertainment industry has found its new growth engine through the shift in distribution, with more and more firms producing their own content delivered direct to consumers, where content producers find themselves in the steering wheel.

Online video consumption has drastically increased in recent years with online video set to grow at a 18.6% CAGR through 2026. Paid-TV viewers spend more than 15 hours per week consuming video content. And while the amount of people that are cutting their paid-TV services is increasing, their spending on video is also going up as they invest more in streaming services. Whereas on television there are 30- or 60-minute blocks with allowance for commercials, streaming services have no blocks.

Figure 3: Consumer spending on home video



The primacy of the video format is also driven by a rise in video consumption through social media (news videos and ads). According to the Reuters, The majority of news videos are being consumed offsite, not on news websites. 33% of consumers do not watch news videos and, of those that do, only 33% access them via Facebook, and another 33% consume them through news websites.

Moreover, consumers are watching an ever-increasing percentage of videos on their smartphones: 76% of smartphone owners view video on their devices, half of them on a daily basis. Thus, short-form content is mostly consumed through social media on cell phones. However, long-form content is also consumed through mobile devices by younger audiences. This is making media companies change their strategies. With the ever-increasing rise of cord cutting, The shift in streaming has led telecom companies' rise in acquiring content producers to regenerate the lost revenue from cord cutting. For example, AT&T allows their customers to watch DIRECTV on their cell phones, adopting a video-first, mobile-first strategy.

Conclusion

Even if traditional TV prime times and viewings are decreasing, the video format has definitely won, with the Internet becoming its primary channel posing a shift in the way content producers develop content for their customers at a rapid pace with the increase in "binge watching" and production of short form content.

Shift in Topics and Media Offering

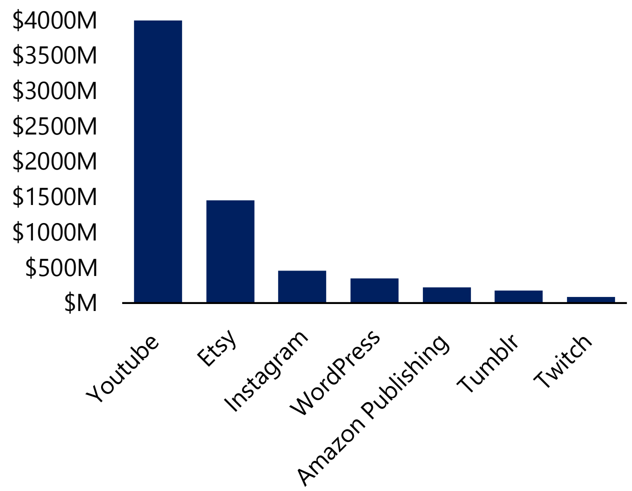
In terms of entertainment, content preferences also vary among cultures and regions, which makes content development more complex. Tolerances for theme and subject vary across cultures. For example, what may be young adult content in North America may be classified as restricted in the Middle East. Thus, large media firms face the tension of producing content for everyone (global) but, at the same time, for specific groups (local). Content needs to be specific enough so that it moves audiences, but loose enough so that it can connect with more than one group. That's why adaptation and localization are key.

Another change in topics in media content comes from the increasing importance given to diversity as it has become a focus in all aspects of the media and entertainment space: subject matter, talent and actors, producers and directors. Although the content is the same, its origin and the possibilities of how the public can buy it vary. Customization is becoming a must, as consumers value above all their capability to personalize content packages. Thus, more than 40% of TV consumers say that the ability to customize their packages—selecting or eliminating channels—would make them subscribe to paid-TV.

On the other hand, in terms of origin, user-generated content is gaining momentum. This has brought multiple advantages, as user-generated content, which proliferates in social media, has gained acceptance among other users/consumers, up to the point that they are more likely to trust content created by a consumer than by a brand. That's because authenticity is the most valued feature of content and sometimes brands cannot reproduce it.

Furthermore 60% of consumers believe that user-generated content is more authentic. Thus, media firms leverage their own customers' input, offering the public user-generated content.

Figure 4: Where online content creators make money



Conclusion

Content has changed in terms of who creates it and the formats the audience consumes. However, in terms of topics, the preferences remain similar, although there are perceived differences in interests among age groups and ethnic groups. What is clear is that media companies need to stay in touch with their customers, as they are competing with multiple actors that sometimes rise in a solo manner. While user-generated content can compete with professionally produced content, media companies must leverage what they learn from them: the importance of authenticity, Let's not forget, influencers, Instagrammers and YouTubers narrate their lives on the Internet. And what better story is there than the live narration of one's own experiences?

Source: PWC Media outlook, Deloitte Media Outlook., Kagan Media Analysis

Social Media

False Information

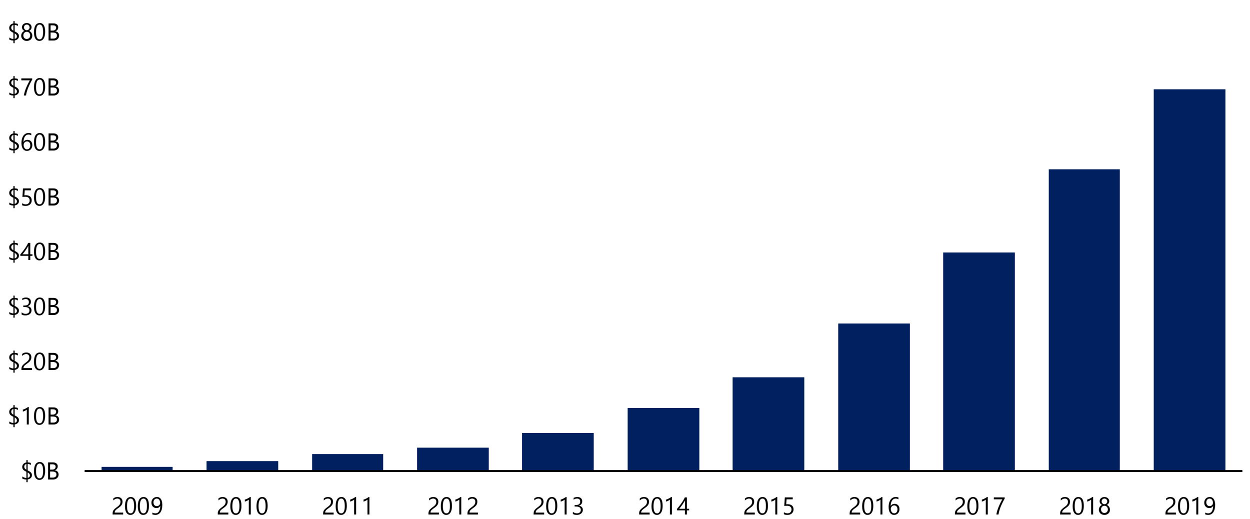
In many ways, social media is replacing traditional media. For many people, social media is more accessible, information spreads further faster, and is more engaging. Social media has the power to unite people and to incite influential change. More and more Americans are abandoning the daily newspaper in favour of online news sources, with a significant number getting their information from social media platforms like Facebook and Twitter. However, this abundant amount of information also comes with more than a few false news. In a troubling time where rising political tensions, a pandemic, and civil unrest are all occurring simultaneously, false information is more dangerous than ever.

In May, Twitter labeled tweets from President Trump as "potentially misleading," in an attempt to address misinformation. On the other hand, Facebook has long been criticized for its hands-off approach to controversial posts, with President Trump's message "When the looting starts, the shooting starts" eliciting a string of reactions, including virtual walk-outs and resignations from employees.

Furthermore, the Anti-Defamation League and NAACP called forth an ad boycott, joined by over 500 companies, including The North Face, Unilever, Starbucks, and Coca-Cola. The majority of Facebook's revenue comes from digital advertising, with the company making around 69.66 billion USD from ads in 2019 (as seen in Figure 5). While it would take many more companies joining the boycott to create a significant impact to Facebook's revenue, the company is also starting to label posts that violate the platform's hate-speech policies.

Even if Mark Zuckerberg is reluctant to change his ways, the growing threat to any business' profits is guaranteed to open a conversation at the executive table. Media companies need to determine when to take an active stance on making changes, in order to avoid these kinds of situations which forces them to be reactive.

Figure 5: Facebook's Advertising Revenue from 2011 to 2019



Source: Statista

Limitations from Regulations

We often see governments enforcing protectionist measures during times of crisis. This happened during the Great Depression, the financial crisis of 2008, and is occurring right now, in 2020.

The OECD/G20 BEPS Project began in 2013 with the goal of stopping multinational enterprises from shifting taxable income to low tax jurisdictions. European countries facing growing deficits are increasingly eyeing U.S. tech giants Alphabet Inc. and Facebook Inc. for their huge profits. The EU is also looking to curb these companies' dominance by creating legal boundaries and increasing regulations. This means Google, Facebook, Apple, Amazon, and more may have to pay more taxes, be held liable for allowing the spread of misinformation, and be discouraged against monopolization.

In addition, China's recently passed national-security law in Hong Kong means that authorities can ask U.S. tech companies to delete users' accounts. American social media platforms have always been popular in Hong Kong because citizens could freely voice opinions over political matters. If U.S. companies comply with such requests, these platforms should expect to see a decrease in popularity.

American companies will continue to be affected by policy changes that are likely to increase following the coronavirus, but it will take much more to curb these tech giants' dominance in the short term. Major internet and social media companies are seeing record numbers of users during lockdowns. Facebook reported that over 3 billion users logged into a Facebook service in the most recent quarter. Google, Twitter, and others have also reported a surge in users. The pandemic has accelerated a number of trends, including online shopping, remote work, and communication services. In May 2020, Mark Zuckerberg announced Facebook Shops, an easy way to communicate with sellers online. In June 2020, Twitter launched a new voice feature on their platform, providing a new way for users to communicate. As long as these major companies continue to leverage these trends, they will continue to grow, and dominate.

Conclusion

With everything that is going on in the world, people are turning to social media platforms to gain easy access to information. At the same time, governments look towards increasing regulations on these entities, and internet companies should see this as an opportunity to improve their credibilities and redefine how consumers view them. Finally, with the number of new regulations that are expected to be placed upon U.S. companies, it is vital for these entities to stay on top of consumer demands.

Sources: Statista, Wall Street Journal, TechCrunch

Industry Drivers

The Future is Sound

2019 has been a breakout year for podcasting with 90 million monthly listeners and a 27% annual increase in podcast creation driven by a surge of top-talent entering the space. Podcast ad revenue has also been scaling quickly at a CAGR of 65%. However, the industry is still significantly under monetized relative to similar media streams. As seen in figure 6, podcast revenue per listener hour is less than 10x that of radio. This is primarily driven by a lack of clarity on key measurements for digital advertisers as the medium was largely downloaded via RSS feeds. Given the shift in consumption to streaming, in January 2020, Spotify announced a proprietary podcast advertising technology called Streaming Ad Insertion (SAI) which will provide advertisers with details on audience, reach, and impact. Although the ad technology is currently exclusive to Spotify's original programming, we believe SAI will help ease advertisers towards the use of podcasts as a medium.

Currently, consumers only spend 1 hour longer on video per day compared to audio. However, we expect trends to favor audio moving forward.

The utility of audio is much greater as it is created to work alongside our busy lives and offers a more intimate experience. Moreover recent innovations and improved functionality surrounding audio hardware will further catalyze industry growth. Despite audio's potential, video represents a trillion-dollar market, 10x more valuable than the audio market of a hundred million dollars.

E-Commerce Integration

E-commerce continues to grow and take share of total retail sales. In fact, according to Business Insider, e-commerce is growing nearly five times faster than in-store sales. This provides opportunities for the media industry, currently facing headwinds from increased ad dollar competition and audience fragmentation, to diversify their revenue mix. Social media networks such as Instagram are rolling out e-commerce tools to leverage their creative influence to bridge the gap between consumers and products. Cable networks such as Discovery's Food Network Kitchen have also incorporated e-commerce elements.

Figure 6: Podcasts are under monetized

	Active Users (Millions)	Hours Per Year Per Active User	Revenue Per Active User Per Hour	Change from 2018
Podcasts	90	364	$0.01	25%
Radio	244.5	682	$0.11	3%
TV	304.1	1806	$0.13	2%
Internet	294	1335	$0.27	12%
Magazine	225.2	124	$0.49	-14%
Newspaper	162	119	$0.77	6%

Sources: LionTree 2019 Year End Letter, Business Insider , TechCrunch, Recode 2018

Industry Drivers

In Home Entertainment

Video Streaming: Affordability, convenience, and personalization are among the many factors causing OTT media services to skyrocket in recent years. The global video streaming market size is projected to grow at a CAGR of 18.3% from 2019 to 2026. However, since Netflix, there have been 300 new direct to consumer platforms created in the US alone leading to content fragmentation and subscription fatigue. In fact, nearly half of US consumers have indicated their frustrations on the growing number of services needed to watch what they want.

Video Games: The video gaming industry is poised for aggressive growth as games become more accessible. The introduction of subscription models and cloud game streaming services will provide publishers with a new distribution channel and expand their total addressable market.

Virtual Events: As in-person events continue to be shut down by the pandemic, many social media platforms and video chat apps, such as HouseParty, have hosted celebrity events. So far, these events have been done out of goodwill, but the rising interest may provide new opportunities to monetize in the future.

Sources: LionTree 2019 Year End Letter, Business Insider , TechCrunch, Recode 2018

Valuation and Performance of the Media Industry

Figure 7: COVID-19 as a catalyst for the Media Industry

Why the Media Industry has proven to be insulated

While several industries have suffered due to the pandemic, the media industry has thrived, as consumers are forced to stay indoors. A surge in big technology stocks has helped the Nasdaq Composite rally 18% in 2020, while the Dow Jones Industrial Average of blue-chip stocks is down 8.6%. The benchmark S&P 500 is hovering in between them, off 1.4%.

Netflix has added 16 million subscribers globally in the first 3 months of the year due to quarantine binging. It more than doubled the quarterly growth it predicted in January, well before the COVID-19 outbreak began to shut down many major economies. It was the biggest three-month gain in the 13-year history of Netflix's streaming service.

Spotify saw a spike in engagement related to the COVID-19 pandemic as people stay at home and governments around the world enforce various forms of lockdowns. The Swedish company's revenue jumped 22% and their subscribers grew to 131 million, towards the higher end of their projection. However, other forms of audio such as podcasts have seen a drop in usage as listeners would stopped commuting and going out.

Video gaming has also seen a spike in engagement as gamers are staying indoors, and people have 'lost sense of time' due to quarantine. Epic Games and its video game competitors are becoming destinations to watch concerts and debut movie trailers. Nearly 28 million fans flocked to an April concert by rapper Travis Scott, which was held virtually in Fortnite. Recently, Fortnite parent; Epic Games, raised $750 million in funding at a $17 billion valuation.

Sources: Bloomberg, Capital IQ, Business Insider

A slowdown in Unicorn IPO's

Public-Private Disconnect

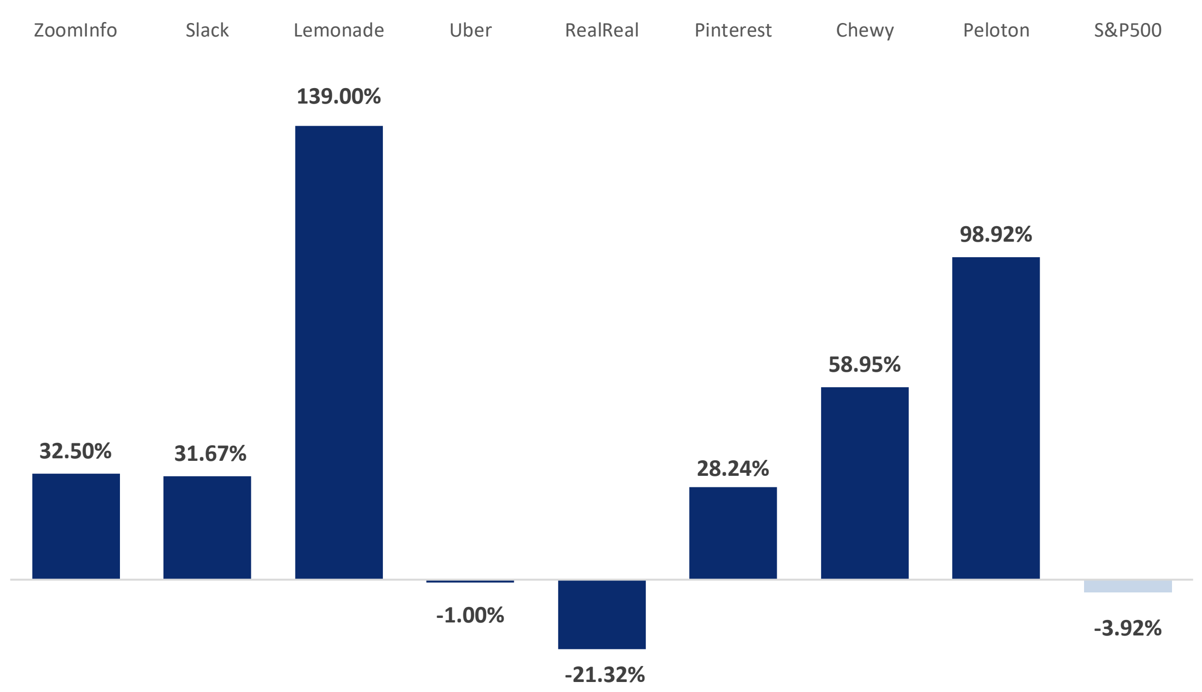
One factor which affects the valuation of private companies is the value, or multiple, at which their public comparable companies are trading. With the economic turmoil caused by COVID-19, the valuations of public companies have dropped, causing a ripple effect on their private counterparts.

A combination of low interest rates and rise of massive venture funds such as SoftBank have resulted in investors having to compete to fund start-ups, instead of the other way around.
However, the pandemic has made investors realize the flaw in the 'growth-at-all-costs' mentality of private companies, in favor of a more grounded approach to valuation, rooted in the fundamental business model and intrinsic value of the company.

To put things into perspective, since 2006, the median Series D+ valuation has grown 6x, while the value of the Russel 2000 equity index has just over doubled. This public-private disconnect will raise the standards for media companies aiming to go public, while making it difficult for unicorn backers such as SoftBank, to offload their risk onto the public.

Given this disconnect, there is a greater probability of companies pursuing private exits as opposed to public market offerings.

Figure 8: LTM performance of technology companies that went public



Sources: Bloomberg, Capital IQ, LionTree 2019 Annual Letter

Media Consolidation

Traditionally, media has been a relatively consolidated industry with many major players owning numerous geographically distributed regional stations. For example, just days after the approval of AT&T/Time Warner $85 billion merger, Disney reached an agreement to buy 21st Century Fox for $71.3 billion. This deal was reached not long after Comcast (which owns NBC, one of Fox's major rivals), bid $65 billion on Fox earlier in June to compete with a prior $52.4 billion offer from Disney. From there, the M&A train began to pick up steam as Comcast reached an agreement to acquire British media company, Sky, and U.S. telecoms, Sprint and T-Mobile announced a merger in an effort to compete with industry juggernauts AT&T and Verizon in the race to implement 5G technology.

However, public markets are starting to realize the flaw in the growth-at-all-costs mindset of private companies, Because of this, and the significantly lower cost of capital for larger players relative to smaller companies, sub-scale companies will be forced to consolidate in the future, in order to maintain competitiveness. Large cap M&A may stabilize in the future and become highly opportunistic. The standard for deals will be higher, but scale players are also bound to act bolder in adjunct areas like video gaming, audio, and core content where there will be a battle for the few best assets and remaining scarce brands.

Furthermore, due to antitrust regulations within the US, large cap M&A activity will bear a lot of friction, as evident by the T-Mobile/Sprint and AT&T/Time Warner mega-mergers. Another potential fork in the road will be the FTC, who are retrospectively investigating anti-competitive practices followed by technology companies in the past, including the likes of Amazon and Facebook.

Sources: Tech Crunch, Vox , Capital IQ

How does the future look?

SVOD: The streaming wars have resulted in 300+ on-demand services, competing for a limited number of viewers. The availability of so many streaming services could be "too much of a good thing," as the overwhelmed consumer, faced with choosing between hundreds of platforms and a vast array of content that requires active selection, spends their precious 11+ hours elsewhere. It also provides justification that players such as Netflix and Disney+ will likely dominate the SVOD market in the coming years, due to their pricing power and ability to produce original content as well access to capital at comparatively lower costs.

Video Gaming: Trends and user-bases may continue to expand as the gaming industry is not in direct competition with the scaled global content and distribution players. the market is fragmented and thus may see future M&A activity. Mobile, instant games, and e-sports might continue to drive player growth and engagement, as gaming is not just an experience for the player, but also for the viewer, with game streaming services seeing rapid growth. Subscription models and streaming gaming from the cloud are particularly high growth prospect as they have the potential to make gaming accessible to a larger audience, which could expand the total addressable market, giving game publishers a new audience and distribution channel.

Audio: Audio should be a greater focus for more of the scaled players, as it seems that the market is "undervaluing" audio content and platforms relative to their video analogs. Companies like Spotify, iHeart, and Sirius/Pandora that play for the long term and innovate while deepening their storytelling capabilities are poised to thrive, and the development of non-music programming speak to the worlds of opportunity being unlocked by the bold and creative. Audio is no longer just music- it is an entire universe of content.