Accelerating Changes in the Media Landscape

May 24, 2021

Amidst the COVID-19 pandemic, changes in the media landscape have accelerated at an even faster rate than we envisioned a couple of years ago. The rise of subscription video-on-demand (SVOD), advertising video-on-demand (AVOD), and pay video-on-demand (PVOD) services, along with continued linear television cord-cutting and extended movie theater shutdowns, have forced Hollywood to reevaluate its value proposition to consumers.

Importantly, advertisers have started to reevaluate their strategies on both the traditional linear and digital sides.

After recently spending time with a variety of executives in the media industry, we are updating our previous thoughts on the changing dynamics in the media landscape.

Viewers Migrating Away From Traditional Television

Linear television viewers continue to cut the cord at a steady pace, as evidenced by the 7% reduction in households with traditional cable services in 2020. Looking over a longer time horizon, just over 60% of households have traditional cable today, compared to over 80% in 2015. Part of this migration is the result of a demographic shift, as younger viewers tend to shift to digital services more easily while older viewers are more likely to continue to utilize traditional cable services.

The rise of new subscription streaming services such as Paramount Plus and Disney Plus, along with more traditional streaming services such as Netflix, Hulu, and Amazon Prime Video, are offering viewers a variety of high-quality programs that are generally superior to traditional linear television programs—all while significantly reducing or eliminating advertisement interruptions.

It is expected that some new streaming companies that own existing cable networks will eventually release new original content over the paywall of a streaming service in order to drive subscriber growth, while at the same time negatively impacting the value of traditional television. Ironically, as more viewers exit traditional television, the cost of an existing cable package to the remaining subscribers will likely rise as there will be fewer subscribers to cover the cost of a cable network, accelerating the decline of linear television.

The Nuances of Live Programming

Live programming, such as news and sports, should continue to be a value driver for linear television in the near term. News, however, remains under pressure with significant rating declines, particularly after the election, as viewers are finding alternative ways to receive the news, in part due to the perceived politicization of some networks to viewers.

Sports programming is at an interesting point with linear networks, given the historical focus on reaching the broadest audience for sporting events. League executives and team owners are well aware of the evolving media landscape and it is clear that these shifting dynamics are impacting the structure of sports programming. For example, recent National Football League (NFL) contract renewals gave the winning companies the continued ability to show NFL games on their networks, but also provided them with the ability to simulcast the events on their streaming service. Notably, Thursday Night Football games will only be available to view through a streaming service. The NFL also reserved the right to cancel the contracts after seven years and renegotiate terms, given how fast trends are changing with regards to traditional cable television.

In addition, the National Hockey League (NHL) recently signed a new national contract that places a greater focus on streaming hockey games rather than broadcasting them through traditional television services.

As sports leagues continue to explore digital streaming avenues, the value of traditional cable bundles will likely decline further as sports programming is an important advantage of subscribing to cable services.

Studios Focus on New Content

Studios continue to benefit from the insatiable demand for new content. The business model for a streaming service is fairly simple at the moment—aim to grow subscribers.

In order to achieve that goal, there is a need for new original content that will attract and retain subscribers. New high-value content typically gets aggressive bids from multiple streaming services, and a vast majority of studios are focused on ramping up the volume of new content over the next few years.

In addition, there continues to be a need for a long-tail library (older programming) to satisfy the need for "comfort food" within a subscription streaming or AVOD service. This allows subscribers to watch shows that have been released and viewed in the past, but are still relevant today. As a result, the value of high-quality library content remains elevated.

Studios remain in a healthy position with multiple avenues for content distribution—streaming, theatrical, and linear television—with streaming taking the dominant share.

The Future of Movie Theaters

Movie theaters took the brunt of the hit from COVID-19, which forced the shutdown of theaters for an extended period of time. This allowed studios to experiment with new business models such as PVOD, where a movie intended to be released in a theater is released directly to a streaming service for home viewing.

The current consensus is that theaters will likely survive. However, movies that run in a theater will likely be blockbuster types with the potential to generate several hundreds of millions of dollars of revenues. Lower-budget and lower-potential revenue movies will most likely be released directly to a streaming service.

In addition, the period of time a movie plays in a theater will likely be significantly shorter, around 30 to 45 days, as roughly 90% of a movie's box office receipts occur within the first 30 days. After this period, the movie would be released to a streaming service. As mentioned above, streaming services need new content to help retain and attract subscribers, so gaining quick access to blockbusters will be an important factor.

Investment Implications: Advertising Dollars are Shifting

As advertisers continue to sort through the changing landscape, it is becoming clear that as more viewing hours shift to online and streaming services, advertising dollars will continue to follow. The rise of AVOD services plays nicely to this trend, with dollars shifting from traditional television to AVOD.

Traditional television dollars will continue to support sports programming given the broad reach sports still provides. However, as we previously mentioned, sports leagues are now rethinking their digital strategy and the role traditional television will play in the changing environment.

It is clear that companies that benefit from the shift of content to online and streaming services, particularly AVOD, should do well over the coming years to the detriment of companies tied to traditional forms of advertising.

As we continue to monitor the shifting media landscape, we remain focused on identifying what we call structurally advantaged companies—growing companies in growing industries whose long-term growth potential is underappreciated by the market. The acceleration of this secular shift increases our confidence that this trend will drive disparate performance among industry participants and create compelling opportunities for the structurally advantaged companies in which we invest.

Jim Golan, CFA, partner, is a portfolio manager on William Blair's U.S. Growth & Core Equity team.

Disclosure:

This content is for informational and educational purposes only and not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines, and restrictions.

Information and opinions expressed are those of the authors and may not reflect the opinions of other investment teams within William Blair Investment Management, LLC, or affiliates. Factual information has been taken from sources we believe to be reliable, but its accuracy, completeness or interpretation cannot be guaranteed. Information is current as of the date appearing in this material only and subject to change without notice. Statements concerning financial market trends are based on current market conditions, which will fluctuate. This material may include estimates, outlooks, projections, and other forward-looking statements. Due to a variety of factors, actual events may differ significantly from those presented.

Investing involves risks, including the possible loss of principal. Equity securities may decline in value due to both real and perceived general market, economic, and industry conditions. The securities of smaller companies may be more volatile and less liquid than securities of larger companies. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks. These risks may be enhanced in emerging markets. Different investment styles may shift in and out of favor depending on market conditions. Individual securities may not perform as expected or a strategy used by the Adviser may fail to produce its intended result.

Investing in the bond market is subject to certain risks including market, interest rate, issuer, credit, and inflation risk. Rising interest rates generally cause bond prices to fall. High-yield, lower-rated, securities involve greater risk than higher-rated securities. Sovereign debt securities are subject to the risk that an entity may delay or refuse to pay interest or principal on its sovereign debt because of cash flow problems, insufficient foreign reserves, or political or other considerations. Derivatives may involve certain risks such as counterparty, liquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Currency transactions are affected by fluctuations in exchange rates; currency exchange rates may fluctuate significantly over short periods of time. Diversification does not ensure against loss.

There can be no assurance that investment objectives will be met. Any investment or strategy mentioned herein may not be appropriate for every investor. References to specific companies are for illustrative purposes only and should not be construed as investment advice or a recommendation to buy or sell any security. Past performance is not indicative of future returns.