Shifting Dynamics in the Media Industry

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There has been an unprecedented degree of change in the media industry, made clear by a recent research trip to Hollywood.

While the growth of streaming media is a big part of this change, we have also seen mergers, management changes, new entrants, and studios starting to withhold content from the market. In addition, the economics for new programming are changing. This new reality is shifting the investing landscape in the media industry.

After meeting with studios, talent agencies, and cable and broadcast networks, here are some key takeaways—all with implications for investors.

Viewers are migrating away from traditional television.

Broadcast networks haven't had a blockbuster hit show since NBC's *This is Us* reached blockbuster status three years ago. Not long before that, several shows reached blockbuster status every season.

Underlying this dynamic is growing fragmentation of the market as viewers migrate toward streaming content (which is distributed directly to viewers over the internet, bypassing the television platforms that traditionally act as a controller or distributor of such content). It also illustrates the role played by streaming services such as Netflix, Amazon Prime Video, and Hulu.

The decline in linear viewership (i.e., traditional television viewership) is most notable with millennials, but we're

also starting to see it among Generation X. The trend will likely continue as new streaming services emerge.

Going forward, I believe that the only real value provided by linear television will be in live programming, such as sports and news.

Demand from streamers is creating opportunities for independent studios.

Studios, particularly smaller ones, are also gaining traction as barriers to entry have fallen.

Production studios are typically on the hook for a significant portion of the production costs for new movies and shows. A broadcast network typically covers just 45% of production costs, while cable networks cover around 70%. The streaming services, however, are willing to pay around 125% of production costs.

However, there is a trade-off. The streaming services will pay that price in exchange for lengthy distribution rights (including international)—which could last five to 10 years. This limits upside potential for the production company. In contrast, a broadcast network is typically allowed to run a program a few times, after which the production studio gets the syndication and international rights. So while the studio absorbs more of the production cost risk associated with unsuccessful programming, the studio's economics improve dramatically for popular programming that can run for several years in syndication.

The effect will be new opportunities for smaller studios that can't cover up-front production costs on their own.

Studios could be more hesitant to launch new programs on traditional cable networks.

Cable networks are also concerned about their ability to stay relevant. A continued decline in subscribers could mean that the networks won't be able to generate enough advertising dollars to cover the costs of new programming. And studios could be more reluctant to launch new programs on cable networks given a falling number of subscribers.

As a result, there is a growing belief that cable networks will rely more on the syndication market than on new programming to fill hours.

Cable distribution companies will also have to be more creative in keeping subscribers with a la carte packages with networks that viewers actually want to watch. The days of paying upwards of $100 per month for 200 channels are numbered.

Studios will withhold content.

As distribution contacts come up for renewal, some studios will likely pull content off the market to support their own newly launched streaming services. For example, one studio could walk away from $1.5 billion to $2.0 billion of annual license revenue from cable networks in the near term to support future growth of its streaming services. Other studios, are hinting at withholding content to support their own streaming services.

As this happens, the value of remaining content libraries to streaming services should rise. Earlier this year, a streaming service paid an estimated $100 million for rights to stream one more season of *Friends*, a show that hasn't produced a new episode in 15 years, to satisfy subscribers.

Naturally, this will lead streaming services to place more emphasis on original programming.

This could place traditional cable networks in a bind given that their strategy will likely rely increasingly on studio libraries (i.e., syndication). If studio libraries are pulled from the market, cable networks could find themselves disadvantaged in competing for the remaining libraries against streaming services.

The value of sports programming should continue to rise.

The value of live programming, driven by mass viewership and favorable audience demographics, makes sports programming an ideal place for broadcast networks to invest.

This is particularly true for the National Football League (NFL). The next round of NFL contract renewals, which starts in 2020, is expected to result in additional price increases. The size of the increase will be determined by whether new digital platforms, such as Facebook or Alphabet, enter the bidding or if Amazon becomes more aggressive. The NFL is savvy in carving out different programming packages and staggering renewal dates, which should allow it to capture attractive prices for its compelling programming.

Investment implications: Advertising dollars will need a new home.

With all of these shifts beginning to take place, it's hard to make the case that traditional linear television will remain an attractive platform for viewers.

The question is how these trends will affect advertising. We've seen a move toward digital advertising over the past several years, and linear television is the only media industry player that hasn't yet been meaningfully impacted. I think we're very close to a tipping point, where advertising dollars will start shifting away from traditional linear television to other platforms.

Broadcast networks should remain a solid venue for advertisers given live sports, news, and first-run programs; however, non-differentiated cable networks will likely struggle. Those left on cable/linear television in the coming years will likely be older viewers who are typically less technology savvy—not the ideal demographic for advertisers.

As a result, advertising dollars will have to find a new home, with possible beneficiaries being live programming (news and sports), digital, and streaming services.

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