BTG Advisory

INDUSTRY UPDATE

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Digital disruptors power growth

BTG Advisory looks at global media and entertainment, which is thriving, powered by consumer habits and multiple digital and mobile delivery platforms, but do the challenges of innovation, consolidation, political issues and regulation threaten success?

For the media and entertainment industries, 2016 was a year of innovation and combination and, above all, challenges, especially in the social networking space and the role of government in co-opting or motivating media change.

Social media has continued its expansion and penetration, with concerns over data management and protection looming larger. As Henry Blodget, former lead internet analyst for Merrill Lynch and now editor and CEO of *Business Insider* put it the morning Verizon expressed reservations about acquiring Yahoo for $5bn – an important step in the marriage of delivery and content – after Yahoo disclosed a theft of one billion accounts: “Going forward, this will become one of the most critical components of the media and tech space.” Traditional manufacturing, distribution, marketing and sales paradigms may also open many new doors, but close many traditionally successful avenues as well.

Spending in every category except newspaper and consumer magazine publishing was up in 2016 over 2015, expected to hit $1.8 trillion when the final 2016 results are tallied – nearly $100bn over the previous year. Still, while this represents a 5.5% growth rate in the past year, the global industry compound annual growth rate is not expected to exceed 4.4% a year over the next five years – lagging the broader economy.

The year’s largest announced merger – the $85.4bn AT&T takeover of Time Warner – is still awaiting final regulatory approval. How this process plays out may suggest the nature of future such combinations, as the CEOs of both companies have been heavily grilled by a bipartisan congressional investigating committee concerned with the harm of such a combination to rival content distributors. At the same time, Sumner Redstone and his daughter Shari disclosed that they were scrapping their plans to merge Viacom with CBS Inc. through National Amusements, raising questions about the future of both Redstone-controlled companies. Verizon promptly indicated its interest in buying CBS.

The fear among many dealmakers, however, is that the new United States administration may see broader intervention or tighter regulation of the media space. There’s also been a wave of Chinese investors buying US and UK companies. Skyscanner was bought for £1.4bn by Chinese company Ctrip. Framestore, the Oscar-winning visual effects behind *Gravity* and *Superman Returns*, has been sold to China’s Cultural Investment Holdings Co. for £150m. In the United States, many such combinations could slow if the Committee on Foreign Investment in the United States takes a tougher view.

Then there’s Brexit, the importance of which to the media community, especially the UK media market, is only just beginning to come into focus. “From the investor standpoint, UK companies now are 20% cheaper to invest in,” says Cedric Kutlu Mateosyan, a Madrid-based venture capitalist and founder of the Fools Fund. “For a company raising funds abroad, that company is 20% more attractive to me because of the hit of the pound. And the UK is exporting more. But we haven’t yet felt the real repercussions of the Brexit vote. I am curious to see how that is going to really pan out.” Facebook recently added 500 new workers in the UK. “They’re simply cheaper,” Kutlu points out.

In an online world where every media company across the spectrum of scale wants a closer relationship with its consumers, just making hit shows is no longer sufficient since past performance is no guarantee of future hits – especially without the means to deliver. So, content creators and distributors like Netflix and Amazon Prime are becoming increasingly important members of the media marketplace and themselves potential acquirers or targets to be acquired.

All potential acquirers are looking closely under the hood to make sure there is some potential for growth, which is what stymied Twitter from finding any takers in its most frenetic recent search for a sugar daddy.

Disney, the last remaining big media company without family owners, and with a market value of $150bn, far too big for most companies to swallow, turned its attention to Twitter as a potential acquisition, but in the end, found it wanting.

Market Global and UK

The fastest growing segment of the media and entertainment sector, the internet, will continue to grow at more than twice the pace of the runner-up, video entertainment – 7.8% versus 3.6%, while print/publishing barely hangs on in positive territory at 1.1%. There are even broader divisions in terms of geographical growth, with growth rates of 7% to 9% in some of the largest developing companies in Argentina, Indonesia, Brazil, and Egypt – vastly exceeding growth rates of under 1% in mature economies like the United States, Britain, France, Australia, and Japan. Still, there remain a few surprises, including Russia, despite the hobbling of a continued regime of sanctions, and Africa's largest market, Nigeria, each with media growth rates hovering around the 6% level.

Across all countries there is a clear correlation between the relative size of the under-35-year-old population and the growth in media spending, with many increasingly digitised countries demonstrating a parallel growth in the youth market. In the world's ten youngest markets, media growth is projected at more than three times the level of that of the ten oldest markets over the next five years. As a result, there is increasing appetite for content that is able to speak to this increasingly younger media consumer. So, in December, America's youth-oriented Vice Media signed a content pact with *The Guardian.*

Still, there are some legacy markets like Japan, with an aging population still comfortable with old media tropes, that continue to find profitability in print without a need to move more quickly toward digital delivery. In Japan, the average daily newspaper circulation has declined barely 6% in the past four years, so there is little pressure to move toward the digital delivery that is rapidly assuming existential proportions in the United States and much of Western Europe. In Europe and the Middle East this year, total newspaper revenues approached $43bn, while in the United States it hit barely $32bn – a decline in each case of more than $1bn over a year earlier.

See chart: Global Media Spending Forecasts

Despite these apparent geographical and age differences between markets, the trend continues toward a single global market in some industries and companies. The major film studios are still able and indeed willing to launch tentpole releases in 60 or more countries in a single weekend, bringing in as much as a quarter of a billion dollars in box office revenues. But the power of a single market, China, cannot be ignored, especially by its own domestic content providers. The Hong Kong-produced film *The Mermaid* grossed $120m on its opening weekend in China alone. At the same time, major international distributors like HBO and Showtime continue to be on the lookout for programming in foreign markets, like Israel, that can be repurposed for their broader American and global audiences.

See chart: Motion Pictures (2015)

Global Media Spending Forecasts
(In Billions of Dollars)

Sector	2014	2015	2016	2017	2018	2019	2014/19 CAGR
Digital Advertising	127.3	146.6	168.5	190.8	212.0	231.4	12.7%
Broadband	429.3	463.8	500.5	539.4	581.2	624.6	7.8%
TV Advertising	183.5	189.4	202.5	209.0	223.1	233.9	5.0%
In-home Video Entertainment	324.4	331.9	347.8	359.0	370.2	381.6	3.4%
Audio Entertainment	95.6	97.0	98.8	100.7	102.8	104.6	1.8%
Cinema	37.1	39.4	41.6	43.8	45.8	48.3	5.4%
Out of Home	31.1	33.2	34.8	36.5	38.3	40.3	4.9%
Consumer Magazine Publishing	59.1	57.6	56.5	55.7	55.1	54.6	(1.6%)
Newspaper Publishing	142.4	140.6	140.0	140.0	140.8	142.0	(0.1%)
Consumer Books	72.4	73.0	74.0	74.8	75.4	76.0	1.0%
Educational Publishing	41.0	41.6	42.1	42.6	43.2	43.9	1.4%
Video Games	84.5	94.1	103.5	111.6	118.7	124.5	8.1%
TOTAL	**1,604.0**	**1,681.3**	**1,779.5**	**1,868.6**	**1,966.9**	**2,061.5**	**5.1%**

Source: Wilkofsky Gruen Associates

Motion Pictures (2015)
(In Billions of Dollars)

Total Box Office	2011	2012	2013	2014	2015	% change 15 vs 14	% change 15 vs 11
US/Canada	10.2	10.8	10.9	10.4	11.1	8%	9%
International	22.4	23.9	25.0	26.0	27.2	4%	21%
TOTAL	**32.6**	**34.7**	**35.9**	**36.4**	**38.3**	**5%**	**18%**
International Box Office (Region)	2011	2012	2013	2014	2015	% change 15 vs 14	% change 15 vs 11
Europe, Middle East, Africa	10.8	10.7	10.9	10.6	9.7	(-9%)	(-10%)
Asia Pacific	9.0	10.4	11.1	12.4	14.1	13%	56%
Latin America	2.6	2.8	3.0	3.0	3.4	13%	31%
TOTAL	**22.4**	**23.9**	**25.0**	**26.0**	**27.2**	**4%**	**21%**

Source: MPAA

Top 20 International Box Office Markets
(In Billions of Dollars)

Rank	Country	$	Rank	Country	$
1	China	6.8	11	Italy	0.7
2	UK	1.9	12	Brazil	0.7
3	Japan	1.8	13	Spain	0.6
4	India	1.6	14	Argentina	0.3
5	South Korea	1.5	15	Netherlands	0.3
6	France	1.4	16	Indonesia	0.3
7	Germany	1.3	17	Taiwan	0.3
8	Australia	0.9	18	Hong Kong	0.3
9	Mexico	0.9	19	Turkey	0.2
10	Russia	0.8	20	Switzerland	0.2

Source: MPAA

The UK media and entertainment market is an especially interesting phenomenon. Projections suggest a continuing growth of 3% per year going forward, approaching a total value of £68bn within four years, while passing Germany in 2017 as the largest European market. The growth will be driven by advertising revenues, particularly a 10% growth in digital ad revenues, passing traditional advertising. As in much of the developed world, on-demand, increasingly online, revenues will be driving this growth. By 2020, Britain will see all but about 5% of all households wired for broadband, with at least half of these with high-speed access.

TV vs Digital Ad Spending (US)
(In Billions of Dollars)

Year	TV	Digital
2015	68.88	59.82
2016	71.29	72.09
2017	72.72	82.86
2018	74.53	93.18
2019	76.02	103.39
2020	77.93	113.18

Source: eMarketer

Media consumption is an especially significant metric and here there have been some dramatic shifts, with exponential growth experienced in mobile internet in regions where this is broken out as a separate subcategory. The US figures opposite indicate what is a global change in consumption habits:

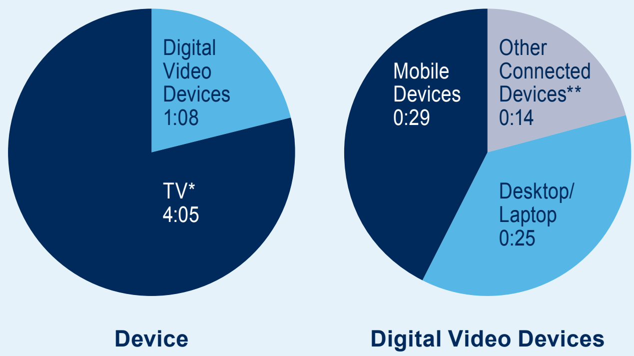
Average Time Spent Per Day with Major Media by US Adults, 2012 – 2018 *(hrs:mins)*

	2012	2013	2014	2015	2016	2017	2018
Digital	**4:10**	**4:48**	**5:09**	**5:28**	**5:43**	**5:53**	**6:01**
Mobile (Non-voice)	**1:28**	**2:15**	**2:37**	**2:53**	**3:06**	**3:15**	**3:23**
Radio	0:26	0:32	0:39	0:44	0:47	0:50	0:52
Social Networks	0:09	0:18	0:23	0:26	0:29	0:32	0:34
Video	0:09	0:17	0:22	0:26	0:29	0:31	0:34
Other	0:44	1:08	1:14	1:16	1:20	1:22	1:24
Desktop/Laptop	**2:24**	**2:16**	**2:14**	**2:12**	**2:11**	**2:10**	**2:08**
Video	0:20	0:22	0:23	0:24	0:25	0:25	0:24
Social Networks	0:22	0:17	0:16	0:15	0:14	0:13	0:13
Radio	0:07	0:06	0:06	0:06	0:06	0:06	0:05
Other	1:35	1:31	1:28	1:27	1:26	1:26	1:26
Other Connected Devices	**0:18**	**0:17**	**0:19**	**0:23**	**0:26**	**0:28**	**0:30**
TV**	**4:38**	**4:31**	**4:22**	**4:11**	**4:05**	**4:00**	**3:55**
Radio**	**1:32**	**1:30**	**1:28**	**1:27**	**1:27**	**1:26**	**1:25**
Print**	**0:40**	**0:35**	**0:32**	**0:30**	**0:28**	**0:27**	**0:26**
Newspapers	0:24	0:20	0:18	0:17	0:16	0:15	0:15
Magazines	0:17	0:15	0:13	0:13	0:12	0:11	0:11
Other**	**0:38**	**0:31**	**0:26**	**0:24**	**0:22**	**0:21**	**0:20**
TOTAL	**11:39**	**11:55**	**11:57**	**12:00**	**12:05**	**12:07**	**12:08**

*NOTE: Ages 18+; time spent with each medium includes all time spent with that medium, regardless of multitasking on desktop/laptop while watching TV is counted as 1 hour for TV and 1 hour for desktop/laptop; *excludes digital; **includes game consoles, connected TVs or OTT devices.*

Source: eMarketer

Average Time Spent Per Day with Video by US Adults, by Device, 2016 *(hrs:mins)*



*NOTE: Ages 18+; time spent with each medium includes all time spent with that medium, regardless of multitasking on desktop/laptop while watching TV is counted as 1 hour for TV and 1 hour for desktop/laptop; *excludes digital; **includes game consoles, connected TVs or OTT devices.*

Source: eMarketer

Curiously, amid all these currents, Outdoor has remained relatively flat – a tribute to new technological advances including the possibility of real-time updating of electronic displays. Polling suggests that some advertisers are using outdoor advertising, particularly in mass transit, as a trigger for mobile purchases, particularly with embedded QR codes that can be accessed with smartphones. The UK model is illustrative of the kinds of trends more broadly prevalent across Western Europe and North America:

United Kingdom Media Revenue, 2010 – 2017
(In Billions of Dollars)

	2010	2011	2012	2013	2014	2015	2016	2017
Newspapers	19.2	18.3	17.4	18.0	18.6	18.5	18.3	18.2
Magazines	4.8	4.5	4.2	3.3	2.4	2.2	2.1	2.0
TV	220.8	221.4	222.0	214.8	207.6	204.4	201.3	198.2
Radio	113.4	114.7	116.0	103.6	91.2	88.5	85.8	83.2
Cinema	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Outdoor	138.6	141.3	144.0	136.2	128.4	126.0	123.6	121.2
Internet	82.0	87.5	93.0	110.1	127.2	142.0	158.4	176.8
Desktop	–	–	79.8	76.8	73.8	72.4	74.5	77.8
Mobile	–	–	13.2	33.3	53.4	69.6	84.0	99.0

Changing Delivery and Consumption

Rapidly changing consumption habits driven by new technology and delivery systems pose the largest global challenges in the media and entertainment space; particularly critical are the efforts to monetise many of this year's key mergers and acquisitions.

New delivery systems – particularly mobile and increasingly wearable – are motivating changes in the nature of the media and entertainment offerings; especially delivery mechanisms, not to mention content, as content-producers continue to seek means of accessing consumers more directly and confidently as a means of rapid monetisation of investments. Mobile wallets are also emerging as new marketing platforms and an answer to the continuing question of how to access consumers at the point of sale.

There is an accelerated move away from traditional bundled media towards a la carte rebundling. The emergence of non-traditional video media companies like Amazon Prime and AT&T, with its DirecTV Now, continue to raise prices paid to film and television producers. At the same time, the internet is emerging strongly as a delivery platform for newcomers like AT&T and Amazon along with HBO Now, Netflix and other similar offerings previously available only through the traditional set-top cable box which suddenly finds itself with a new competitor.

New delivery systems and customisation are also changing the media and entertainment landscape. 3-D printing is revolutionising consumer choice and customisation. For an increasing number of brands, this provides an opportunity to deliver faster and cheaper. At the same time, new delivery technologies are promising to bring online shopping closer to the home.

Amazon is beginning targeted experimentation with drone delivery of foods, while at the same time opening bricks and mortar locations in some high-traffic hubs like New York City.

Virtual reality is becoming real. Technology is finally catching up with media creativity. "While the virtual reality, augmented reality space will affect many industries, the winners will be those that not only have the best technology, but the best creativity – how do you tell a story in a 360-degree environment with sound and image that impacts the viewer," says Kutlu. Increasingly dynamic interactive platforms demand new product offerings with challenges in monetising the substantial investment, with an increasing trend from traditional ad-based to subscription-based models.

So, Amazon Prime, Netflix, the various 'Now' platforms all are subscription-based. DirecTV Now is testing the outer limit of monthly commitments from customers with a $35 per month starting price. With its 60-channel basic offering, it appears to be challenging increasing numbers of customers to cut the cord of traditional cable which costs twice to three times those entry levels. Cable's metrics seem ill-equipped to engage in a price war for customer retention. Clearly the attraction of such companies for traditional properties is persistent as Rupert Murdoch's 21st Century Fox disclosed in early December an agreement to acquire the 61% stake in Sky that it does not already own, valuing Sky at $23bn.

Investment and Consolidation

Some traditional media companies are exploring combinations with counterparts to achieve economies of scale – particularly Gannett's purchase of Journal Media Group Inc. and digital marketing company ReachLocal Inc. Both are small acquisitions compared with its unsuccessful efforts to buy the giant tronc Inc. newspaper group. But the $156 million deal for Reach will help Gannett boost its digital revenues this year past the $1bn mark. Such combinations mark a clear future path for the print publishing industry if it is to remain viable in the digital age.

Traditional newspapers/magazines are continuing to kill their print offerings entirely in favour of online, but increasingly many are finding new and innovative methods of monetising online through native and programmatic advertising, personalisation vendors and interactive models.

Meanwhile, artificial intelligence (AI) is beginning to carve out a broad range of media and entertainment applications – from script and film-making to advertising production. The UK adtech firm Ogury is aiming to become the world's largest mobile data platform, with behavioural profiles of individual users, using ultra-granular proprietary data from more than 300 million global users.

Lionsgate Entertainment Corp agreed to buy billionaire John Malone's Starz in a cash and stock deal valued at $4.4bn, gaining premium cable-TV channels at the very time Malone continues to figure out the best method of propping up his Sirius satellite radio operation whose shares continue to languish in single digits.

And then there is the broader challenge of wireless consolidation. A number of the leading cable operators are seeing their pay-TV subscribers slipping – likely the first leg of a potentially vertiginous downward slope. As a result some of the more innovative are looking at new avenues, particularly wireless. Comcast is planning to introduce a new Wi-Fi based mobile service sometime in 2017 by leasing Verizon's network, and it could even be looking to acquire a wireless company of its own. Like AT&T, both Comcast and Charter, which is bulking up through its purchase of Time Warner, seem to be seeking to become one-stop shops for TV, internet and phone service, or triple-plays as they are being broadly marketed already. As it happens, Charter's largest shareholder is Liberty-Sirius's John Malone, though so far there seems to be no effort to market a satellite radio offering like Sirius into the Time Warner-Charter space.

Chinese investment in Western, especially American, media and entertainment companies is continuing all but unabated. As the Hollywood publication, *The Wrap*, put it recently: "A firehose of Chinese investment has been flowing into Hollywood, as Middle Kingdom firms have scooped up production companies and theatre chains by the billion." The Dalian Wanda Group, and other Chinese firms, are stepping up their investments in Hollywood. Wanda kicked off the year by purchasing AMC Cinemas, followed it with the purchase of Legendary Pictures, and is winding up the year with the unicorn purchase of Dick Clark Productions, home of the Golden Globes, Miss America pageants, and the Billboard Music Awards. Wang Jianlin, founder of Wanda, which began life and remains a real estate conglomerate, also happens to be China's wealthiest billionaire and very close to leaders of the ruling Communist Party.

With China continuing to block domestic access for such American media companies as Twitter and Facebook, not to mention online the internet sites of such major publishers as *The New York Times*, *Wall Street Journal* and Bloomberg, there is growing pressure from the US Congress for the incoming administration to slow or block Chinese investments in or outright takeovers of American firms. However, all this may be subsumed in a larger discussion over Chinese trade practices and a desire for China to halt manipulations of its currency.

All that's certain is that a year from now the media and entertainment landscape and regulatory system promises to be substantially different than it is today.

For Further Information

If you would like to discuss any of the issues raised in this update or would like to know further details about the services we provide to the sector, please contact me.

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