5 KEY TAKEAWAYS

A First Look At The Newly Combined ViacomCBS

Months after closing the long-anticipated merger, the newly combined ViacomCBS has given a little more color on their direct-to-consumer strategy. Content from Viacom's networks, brands, and existing smaller DTC products (Noggin, BET+), will pair with CBS All-Access to create their general entertainment product, that hopes to compete with Netflix, HBO Max, and others. Showtime will be sold separately as a premium tier, while Pluto TV will remain a dedicated AVOD platform, that can be used to funnel viewers into the subscription based products, as well as maintain customer relationships to offset churn. It's still unclear if these 3 tiers will remain as separate brands, or if they will combine into 1 platform that makes it easier for customers to engage with the services. CEO Bob Bakish has spoken about the strength of Viacom's legacy networks, but for many consumers, these brands are dilapidated, and the company will need to find new ways to target younger audiences who aren't familiar with the likes of VH1 or BET. This is very clear when you start to look at their strategy as a content supplier for 3rd parties, such as Netflix, that they are competing directly against. They are focusing on "renting" their IP to produce content for streaming platforms in order to better introduce/engage with younger consumers. While this will help monetization in the short term, as cost-plus model comes with generous margins in a risk-free way, it's not clear that this is sustainable in an increasingly DTC landscape.

Investors have looked poorly upon this merger since it was announced and management has yet to make it clear how will they compete against other media companies, let along the tech players. At that time the merger was first announced in August, the combined market of the 2 standalone companies was $30B (Viacom at $11.8B and CBS at $18.2). When the merger was completed in early December, the combined market cap had already swiftly dropped 16% (Viacom at $9.9B and CBS at $15.3B). Following their Q4 earnings results, the combined ViacomCBS entity now has a market cap $15.4B (as of 2/28), which means that the entire value of Viacom has been erased in less than 6 months.

Content Windowing Strategies Are Coming Into Focus

As legacy media companies launch their dedicated DTC services, content investments are accelerating as they look to supply these platforms with original programming that can drive subscribers. But these companies also have existing networks within the linear ecosystem that still drive significant cash flow, even as cord cutting continues its assault on affiliate revenue. The main question for these media companies is how they determine the best place for each piece of content, where it can achieve maximum value for the overall company, rather than a specific platform. It's no surprise that high-end premium scripted content will serve as tentpoles for new OTT services, and library content can easily transition after current licensing deals end. Linear programming will slowly gravitate more towards cheaper unscripted content that has potential to garner word-of-mouth buzz through simultaneous viewing.

However, these companies now have new opportunities to use windowing strategies across all their platforms to increase value and customer engagement.

- Disney is increasing production at FX as its primary function becomes to supply Hulu with original premium scripted content. Meanwhile, Disney+ will serve more as a complement to their thriving movie business. Rather than look to shorten the theatrical window, they are utilizing the DTC service to expand the universes of their marquee brands (Marvel, Star Wars) and tell stories that intertwine between platforms and deepen customer engagement. Bob Iger is expected to oversee a lot of this creative development after stepping down as CEO last week.

- NBCU is taking a more conservative approach with the upcoming launch of Peacock, which is understandable since its monetization is predicated more on advertising revenue rather than subscriptions. For the most part, it will focus on next-day viewership of linear programming, from its own networks as well as others. However, their late-night programming will take an inverse approach, with the 2 shows airing on Peacock first, a few hours before the traditional linear broadcasts.
- CBS and AMC Networks have experimented with using the linear ecosystem to draw more awareness of their OTT services. This has mainly been through the form of replaying the first season of a show on Pay-TV, ahead of the exclusive debut of the 2nd season on their DTC platform. And as these OTT services get distributed with the same MVPDs carrying the linear channels, there will be less friction for audiences to sign up for the OTT platform(s).

The WWE Is Reconsidering The Need For Its OTT Service

The WWE had a very busy quarter with the unexpected termination of 2 key senior executives, Michelle Wilson and George Barrios, followed by their announcement of an evaluation of strategic alternatives for their DTC service. The timing of this potential pivot is a little surprising considering they recently completed an overhaul of their OTT platform to include a free tier in addition to the paid tier. The decision to centralize all their digital content and create a customer acquisition funnel for their paid tier seemed to be part of their efforts to stem the decline of subscriber growth over the past year. However, now it seems that Vince McMahon doesn't believe they can achieve the necessary scale, especially in an increasingly competitive OTT landscape, and the best way to monetize their content is through traditional licensing. There have been rumors of selling rights, inclusive of PPVs, to ESPN+ and Amazon, while NBCU's Peacock may be another suitor considering its existing relationship (RAW currently airs on USA Network). These platforms are in need of content that can fuel subscriber sign-ups, and ESPN+ has already seen some early success from combat sports, with Conor McGregor's recent UFC fight bringing in 1 million PPV purchases and 500k new subscribers. If the WWE does go this route, it'll be interesting to see how much content, if any, remains on their OTT network. One of the benefits of a direct-to-consumer product is the customer data that can be leveraged to improve other aspects of the business. In the WWE's case, they can better utilize data to inform touring strategies, marketing for e-commerce/merchandise, and measuring the affinity of superstars. On the other-hand, the value of live sports has never been greater, and they may not want to pass up the near-term revenue, as they try to best position themselves for their domestic linear renewals in 2024.

The Sprint/T-Mobile Merger Received Federal Approval

After a lengthy delay, the T-Mobile/Sprint merger seems to be marching towards the finish line after receiving approval from the federal judge. This will be a relief to Sprint (and majority owner Softbank), which has been idling for the past 2 years with no real strategy outside of their spectrum holding. In fact, the price of the business combination was updated to reflect the declining value of Sprint, where 11 shares of Sprint (up from 9.75) are being exchanged for 1 share of T-Mobile. Meanwhile, the length of regulatory review has not distracted T-Mobile, as it has continued their steady growth of wireless market share, and is now in a real strong position to challenge the leaders of AT&T and Verizon as the industry begins its shift to 5G networks.

The other real winner from this approval is DISH Network, who can complete the acquisition of Boost Mobile (and its 8 million) prepaid subscribers, and start to utilize its spectrum holdings to build a 5G network from scratch on the back of T-Mobile's infrastructure. The wireless business can be a real asset to their declining Pay-TV business, as it is widely known how bundling can help reduce customer churn. Cable companies are starting to see this benefit, but they are somewhat handicapped by their MVNO agreements, whereas DISH will have owner economics and can be more aggressive in pricing. Still, DISH has no experience as a mobile operator, which is a

very different business than Satellite TV, and they may need outside help in order to meet the requirement of covering 20% of the population by 2022.

Video Game Publishers Are Emphasizing Live Services More Than Ever

AAA video game publishers are continuing the transformation of their business models from physical to digital. While other media industries (TV, music), have made this shift by embracing monthly subscriptions for access to "everything", the gaming industry has taken a different path. Console publishers are increasingly making games free-to-play and monetizing the titles through live services, which encompasses everything from cosmetic microtransactions (i.e. skins) to new downloadable content (i.e. expansion packs). While somewhat counter-intuitive, this model has reaped massive rewards for publishers, and the shift is set to accelerate even quicker. These companies have changed (or are changing) their organizational structure to more efficiently release a steady cadence of content for their most popular titles. As more digital games (rather than a physical disc) are played, this creates a rapid feedback loop of player engagement that can be fine-tuned with updates and fixes that can be quickly implemented.

To date, live services have primarily worked as a means to elongate the life a single title, with the longevity of League of Legends being the ideal example. This release strategy should bode well for new franchise releases, such as Apex Legends, where content updates can be planned in conjunction with other initiatives, such as Esports. But the real test will be when existing popular titles shift to sequels, as with the upcoming Overwatch 2, surprisingly just 3 years after launch. Publishers will need to maintain the continuity of gameplay, allowing players to maintain purchased content from the original title, but will also need to introduce enough new features to make the new version an attractive proposition. While the free-to-play nature reduces the friction of trials, these games are expensive and time consuming to develop and may not necessarily be worth the pay-off. As such, publishers will be expected to dedicate more resources towards existing franchises, either through new content, and/or new platforms (i.e. mobile), rather than developing new AAA games.

5 IMPORTANT DATA POINTS

- For the first time, **Google** has provided more insight into the size of YouTube, with the business **generating advertising revenue of $15.1 billion in 2019, up 36% from 2018 ($11.1B) and nearly double from 2017 ($8.1B).**

- In less than 2 months following its release, **Disney+** **amassed 26.5 million subscribers, with roughly 50% signing up directly, 20% of subscribers coming through Verizon's promotional offering for unlimited subscribers**, and the remaining from a variety of other services distributing the app.

- **Spotify** made another strategic podcast acquisition (The Ringer) with **more than 16% of total MAUs now engaging with podcast content, and consumption hours in Q4 have grown nearly 200% Y/Y**.

- The magnitude of mobile gaming is vividly clear, as **Activision's** **MAU more than tripled from 36M in Q3 to 128M in Q4**, following the worldwide release (ex-China) of *Call of Duty Mobile*.

- Cord cutting is accelerating as the **top 6 Pay-TV providers (Altice USA, Charter, Comcast, DirecTV + Uverse, Dish Network** and **Verizon) lost a combined 5.4 million Pay TV subscribers in 2019**, which is up from 3.2 million in 2018.

5 RESONATING QUOTES

"With the rate adjustments that we are implementing in 2020 as well as the ongoing changes in consumer behavior, we expect higher video subscriber losses this year."

Comcast CFO, Michael Cavanagh

"I don't think anything has changed since Q3 in terms of our outlook on the headwinds that we have around ad signals. I think that's very consistent with what we've been talking about over the last several quarters. So I think we'll -- we continue to face those headwinds, and they will be more impactful as we move forward."

Facebook CFO, David Wehner

"In the past, there was a sense that perhaps the platforms were doing us a favor by distributing our content to users. We think the balance of value has changed now. And so you should expect this. Now, I'm not going to predict what's going to happen, but you should expect to see us sitting down with all of the major platforms and discussing our relationship over the coming months and years."

New York Times CEO, Mark Thompson

"We predict that by 2024 roughly half of all U.S. TV households will have cut the cord or never had traditional pay TV."

Roku CEO, Anthony Wood

"When you look around, we're not selling some of our best IP. No one's waking up and going, whoa, you sold your best IP to Netflix. You sold your best IP to Amazon. We don't do that. And when we walk in and talk to our distributors, they're like, what's going on? Why are people doing that? Why are they taking great content off the bundle and getting -- trying to get short-term economics? We're not doing that. Which gives us a real equitable position."

Discovery CEO, David Zaslav