5 KEY TAKEAWAYS

The PVOD Window Has Arrived

As soon as movie theaters across the country shut their doors in late March, the speculation and discussion around a PVOD window heightened immediately. As outlined last quarter (LINK), there were some relatively easy decisions to make by the studios, with tentpoles such as *No Time To Die* and *Mulan* being pushed to later in the year, and smaller budget films going to straight to VOD (i.e. *Scoob!*), being licensed to 3rd parties (i.e. *Lovebirds*), or being released on the studio's DTC service (i.e. *Artemis Fowl*).   As the summer arrived, and COVID-19 cases still rising in parts of the country, the decision-making process became much more difficult. At first, studios took an overly optimistic lens, and decided to postpone their July releases by a few weeks with the hope that theaters would be able to re-open in time. That didn't work out, and was probably counter-productive, as they were forced to change releases dates again, just a few weeks later. As the severity of the pandemic set in, and the hope of a summer box office season dissipated, there has been an inflection point in the industry's attitude towards PVOD. While one could argue it's easy to look back in hindsight and see these mistakes in judgement, there were some studios that had the foresight, and nerve to make bold decisions, rather than trying to hold on the traditional model. Universal has been the smartest thus far. They quickly pushed back their big summer tentpoles, *F9* and *Minions: The Rise of Gru* to Summer 2021. Additionally, they released *Trolls World Tour* directly to video-on-demand, even if there hand was slightly forced, and gained some valuable insights. Soon after, they released mid-budget movies *The High Note*, *The King of Staten Island*, and *Irresistible* on VOD as well. These are exactly the type of middle budget movies that are increasingly being squeezed out and finding homes on OTT services, rather than seeing the inside of theaters. All these decisions built up to the surprising announcement of an agreement with AMC Entertainment for a PVOD window after an exclusive 17 day theatrical window.

While many of the financial details of this arrangement are unknown, the framework of this deal is fairly evident, and as a multi-year agreement, it is much more than an experiment. NBCUniversal will have the option to make a film available on PVOD after it has an exclusive theatrical run of at least 17 days, which equates to 3 weekends. This time frame is shorter than the 30 – 45 days many anticipated, but at 17 days, films have usually earned over 75% of box office revenues by then (See Chart of the Week). Additionally, the Universal films that are released on PVOD will remain in theaters, which creates a dual revenue stream for first-run movies. This also means that the downstream windows, from EST to VOD to Pay 1 and beyond will remain unchanged. Lastly, Universal is not allowed to promote a movie as a PVOD release until after the 10th day (or 2nd weekend) of their theatrical release. This will prevent movie-goers from waiting to see it at home, instead of going to the theaters as they would have done otherwise. These terms make it look pretty advantageous for Universal, who are trading $10 movie tickets at a ~50/50 split, for $20 PVOD rentals at an ~80/20 split. In fact, with Fandango, and their recent acquisition of Vudu, not to mention Comcast's set-top box (or Flex), and perhaps Peacock sometime in the future, Universal has an array of platforms that can rent movies on PVOD directly to consumers, where they can keep 100% of the revenue. However, the key component of the deal not mentioned so far is that AMC Entertainment will receive a cut of each PVOD purchase, regardless of the retailer (i.e. iTunes, Roku, etc.), and will receive enhanced economics when customers use their AMC On-Demand service.

AMC Entertainment has faced financial difficulty recently, with debt levels approaching $5 billion, and net debt leverage over 6x. And with all of their theaters closed for the entirety of Q2, their cash position has been slowly dwindling. They have been able to restructure their debt, reduce costs through layoffs/furloughs, and re-negotiate leases to extend their cash runway until mid-2021. But this doesn't seem to be a deal where their hand was forced. By participating in all PVOD revenues, they are taking a calculated risk that they can offset the inevitable cannibalization of movie-going that will occur by opening up this new window. That exact level is hard to quantify without the financial terms. We do know that AMC makes about $9 profit per moviegoer, between ticket price and concessions. There is speculation that AMC would receive 20% of all PVOD purchases, which would be $4 from 3rd party platforms and slightly more through AMC On-Demand. At these levels, they would need about 2x more PVOD purchases than moviegoers in days 18+ to break-even. However, it's unlikely that this 20% take rate is

accurate because it doesn't give room for Universal to enter simultaneous deals with the other major exhibitors and still maintain improved economics. Without such deals, Universal may not be able to release their films as widely as possible, a big inhibitor to the success of tentpole franchises. There is expectation that this will become more common, although it will be interesting to see if an industry standard emerges, or if the various studios and exhibitors enter into different types of agreements. Another factor in AMC Entertainment's decision was that a PVOD window will help studios generate more film profits, which would result in them greenlighting more films, and everyone would benefit from the bigger box office pie. While this is a nice idea, it's unclear that studios will return the favor in such a way. In fact, on Comcast's Q2 earnings call, NBCU CEO Jeff Shell said "this new model in the U.S. and hopefully other places will restore some of those economics for us to allow us to probably not make more movies but to keep our production levels the same as they've been in the past." The biggest benefit for studios will be the ability to carry marketing dollars from the theatrical window into the next, rather than having to re-start promotional spend for VOD 74 days after its release. Those cost savings will add-up, and allows them to use the theatrical release as marketing for the PVOD window. In addition, with many of these studios having DTC platforms now, eyes are already starting to look at shortening the Pay 1 window.

The other big PVOD announcement was Disney deciding to release *Mulan* in a Premier Access Window on Disney+ for $30, but only for Disney+ subscribers. This is the first time a major tentpole with billion-dollar box office potential will be offered on PVOD. After trying desperately to keep a global theatrical release date, Bob Chapek has made a "one-off" decision with *Mulan*, offering it on Disney+ in countries where the service is available, and in theaters in the regions where it is not. Even with a $30 price point, this is somewhat surprising as they would need a considerable amount of purchases and attendance to be close to matching the returns from a traditional release. With the pandemic having varying effects on different parts of the world, it's extremely difficult to forecast international box offices. Many European theaters have only recently re-opened, with limited capacity, and attendance is slowly building up through library titles. The APAC region is much further along in the path to recovery, with some countries like South Korea and Australia doing noticeably better. However, for Disney to release *Mulan*, it must have gotten comfortable with the return of movie-going in China, a critical market not just for box office, but also to limit the impact of piracy. It still faces some challenges in the Middle Kingdom, as it still doesn't have an official release date, there has been minimal marketing, and *Tenet* is also scheduled to be released on September 4th.

As of August 3, Disney+ had a remarkable 60 million subscribers, with many of these passionate, loyal enthusiasts considering the lack of new and original content over the past 9 months. With most of their content production shut down, Chapek made the decision to sell *Mulan* as a $30 add-on for subscribers, rather than including it as part of the streaming service. Disney experienced recent success by releasing *Hamilton* on Disney+, but that was slightly different as it catered to a broader audience, which helped bring in some of the ~3M subscribers they gained during July. There will be considerable demand from existing subscribers, after all they are the hardcore Disney fans, but it's tough to see this film as a piece of content that leads to a substantial amount of new Disney+ subscribers. There may be a large group of audiences that sign up for the month, purchase *Mulan*, and then churn. While Disney would no doubt be happy about that, their recent efforts show they are more interested in building up long-term subscribers through annual plans and bundles. So, what would be considered a success for Disney? Assuming a $1 billion global box office in a "normal" environment, which is roughly the average of their recent Live Action Reimaginings, they'd take home $600 million (60% split) from a theatrical release. From Disney+ alone, that would require about 26.6M purchases (assuming a 25% fee to distributor platforms – Apple/Google at 30%, Roku 20%), with international box office being the icing on the cake. At a margin of $22.50 per PVOD purchase, and 60% of International Box Office, the permutations are outlined below:

International Box Office (millions)	PVOD Purchases (millions) 5	10	15	20	25	30	35	40
$100	$173	$285	$398	$510	$623	$735	$848	$960
$200	$233	$345	$458	$570	$683	$795	$908	$1,020
$300	$293	$405	$518	$630	$743	$855	$968	$1,080
$400	$353	$465	$578	$690	$803	$915	$1,028	$1,140
$500	$413	$525	$638	$750	$863	$975	$1,088	$1,200
$600	$473	$585	$698	$810	$923	$1,035	$1,148	$1,260
$700	$533	$645	$758	$870	$983	$1,095	$1,208	$1,320
$800	$593	$705	$818	$930	$1,043	$1,155	$1,268	$1,380

It's also worth mentioning that Disney has *Black Widow* and *Soul* (Pixar) both scheduled for a November release. If *Mulan* does prove to be successful, it would be hard not to imagine Chapek moving these titles to the Premier Access Window on Disney+ as well.

AAA Publishers Embrace The Free-To-Play Model

Video games have been one of the sectors that have benefitted the most over the past 6 months with people confined to their homes all over the world. That came through in Q2 results, with many of the AAA publishers beating their Q2 revenue estimates, and then subsequently increasing their full year guidance.

	Calendar Year Q2 Revenue (millions)				Current Fiscal Year Revenue (millions)			
	Guidance	*Actual*	*Difference*	*%*	*Previous Guidance*	*New Guidance*	*Increase*	*% Increase*
Activision Blizzard	$1,690	$1,932	$242	14%	$6,800	$7,275	$475	7%
EA	$1,220	$1,459	$239	20%	$5,525	$5,625	$100	2%
Take-Two	$800	$831	$31	4%	$2,680	$2,850	$170	6%
Zynga	$430	$452	$22	5%	$1,650	$1,800	$150	9%

The video game industry has been less heralded than other forms of media/entertainment, despite having a much bigger TAM. In 2019, the global games market generated $145 billion in revenue compared to just $42 billion from the global box office. There has been a lot of growth from the mobile gaming segment (46% of 2019 revenue), and it's important to note this has been additive to the overall market, rather than cannibalizing time spent playing on consoles/PC. The smartphone has opened the market to an abundance of new players, especially those who are unable to purchase expensive hardware. Most mobile games are casual in nature, due to limited tech, and are free to play by monetizing through advertising. This lowers the barriers to entry for users to play a game, as they can simply test it out to see if it is enjoyable, and in some instances can pay to upgrade to an ad-free version. The success of the free-to-play model has transformed how console/PC publishers are thinking about their own games. AAA publishers have been incorporating live services (i.e. microtransactions, expansion packs) into their games for some time, but for the most part this has been on top of the initial $60 purchase. Over the past few months, there has been a steady stream of releases of free-to-play titles that are based on premium IP, with many utilizing the battle royale format popularized by Fortnite.

The premium (released annually) *Call of Duty* title, *Modern Warfare*, debuted last August, and was met with the expected fervent demand from such a long-lasting franchise. To build off the momentum and broaden the audience, Activision released *Call of Duty: Mobile* around the world in October. The mobile version, which is not directly linked to the premium title, but instead uses gameplay and maps from many prior console/PC versions has been a resounding success. By June 2020, the free-to-play title had over 250 million downloads and generated over $300 million in revenue. To add an extra dimension to the *Call of Duty* franchise, Activision released *Call of Duty: Warzone*, a standalone free-to-play battle royale game for PC and consoles in March. The timing was fortuitous, as many people in the U.S. were just starting to shelter in place due to the pandemic, and the game saw

immediate engagement ([See Chart of the Week]), bringing in over 60 million players by May, and 75 million by August. While a separate game, *Warzone* is closely linked with *Modern Warfare*, with shared progression systems and content offerings, which has encouraged many players to upgrade into the premium version. In fact, hours played in the *Modern Warfare* universe increased eight-fold year-over-year, driven by both existing and new players. Activision has created an ecosystem around one of their marquee franchises, which allows for players to engage at different levels, while providing easy ways to players to upgrade their experience, either within the same game, or to a more premium version. All these efforts will be further boosted by the *Call of Duty* Esports league, whose inaugural season concluded this past weekend. While the pandemic forced the matches to be played online, the home/away format for live audiences provides another way to aggregate *Call of Duty* fans and build a community. The launch of *Call of Duty: Blacks Ops Cold War* later this year will need to maintain that same integration with *Warzone* in order to keep players happy and allow them to carry on with their achievements. The reveal trailer for the game will actually be premiered inside the *Warzone* game, highlighting the potential of a free-to-play game as a marketing platform and social network. The success with *Call of Duty* thus far has encouraged Activision Blizzard to rollout a similar strategy for some of their other franchises. This fall, they will release a new premium version of *Crash Bandicoot* on consoles, and it will be closely followed by the release of a casual *Crash Bandicoot* game on mobile, developed by their King studio. If they are able to successfully expand the audience for this franchise, expect this playbook to be applied to the Blizzard titles, such as *Overwatch* and *Diablo*.

Call of Duty wasn't the only premium free-to-play title released in the past few months. Riot Games has had remarkable long-term with success with *League of Legends* as it has become the most popular Esport. It is finally expanding its portfolio of games, with the introduction of team-based shooter *Valorant*, and it's easy to see it being developed into their next Esport title. Riot leaned into their passionate viewing audiences, with a unique strategy of promoting the game in early April. Riot distributed closed beta versions to select popular streamers for them to play on Twitch, and viewers could receive a key to play by watching the streams. This led to near record setting viewership on the first day ([See Chart of the Week]) and they slowly expanded the pool of players that could enable these drops. While it hasn't seen the same type of engagement since it's official launch in June, it has received positive reviews, has a solid streaming audience, and it's expected that Riot can fine-tune this game into another long-lasting franchise. That same vote of confidence cannot be applied to Ubisoft, who launched their free-to-play battle royale *Hyper Scape* last month. The publisher has been facing some difficulties with the delays for several of their premium titles, as well as recent allegations around workplace misconduct that has led to the departure of several key executives. *Hyper Scape* followed the same release strategy as *Valorant*, with the distribution of beta drops for viewers of Twitch streams, but it failed to gain any momentum. This is a real worrying sign considering that Twitch integration was one of the unique features of the game. Viewers can earn rewards by watching, but can also impact the matches in real time by voting on in-game events that affect all players. In theory, this seems like a nice idea considering the popularity of streaming to the gaming community, but has been executed poorly. The influence of elements outside the game reduces the in-game parity and diminishes the skill level of the best players, which in turn reduces interest from players.

At some point, there will be closer integration between streaming and playing, but it most likely won't happen until cloud gaming becomes more widespread. There was anticipation that Amazon could do something unique with their debut title, *Crucible*, but that has been quite a disaster, with the game going back into development, and their 2nd title, *New World*, having its release date postponed from August 25th to Spring 2021. Microsoft may have had similar plans for the next-generation of Xbox, with their assortment of first-party titles, and news that the upcoming *Halo:Infinte's* multi-player mode would be free to play. However, last month's decision to shut down Mixer eliminates their ability to control all parts of an integrated gaming ecosystem. Mixer, which shot the first arrow in the battle for video game streamers with the exclusive signing of Ninja last August, was never able to port audiences over, nor develop new fans. Shroud has already moved back to Twitch, while Ninja seems to be debating his options, with streams on Twitch and YouTube in the last few weeks. Exclusive contracts will continue, but it's fairly evident that they are not as valuable to the platform as once seemed. The domestic streaming space is now back to 3 platforms, with Facebook Gaming, a distant third, slowly gaining momentum. The launch of their new dedicated app should help improve their standing, and the continued focus on mobile, can differentiate themselves, and position themselves well in emerging markets like Asia, where Twitch doesn't have as much of a presence.

Legacy Media Networks Prepare For OTT Expansion Overseas

Legacy media companies have fought hard to hold onto the traditional TV ecosystem over the past 5 years. While Netflix and others have paved the way in streaming, the steady cash flow from selling content on a B2B basis, and receipt of distribution fees regardless of network viewership was a business model too good to pass up. However, over the past year, as vMVPDs safety nets disappeared (LINK), and cord cutting trends have continued to accelerate, networks are finally starting to accept that the world of streaming is a reality. There has been a flurry of organizational changes as linear and OTT leadership teams are consolidated, and not solely as cost-saving measures. Some media companies acted sooner to prepare for this future and have DTC products in place to build upon, while others are further behind in making their pivot. One common trait they all share is the recognition that international scale will be instrumental to success.

- **Disney**: Disney has seen astounding early success with the launch of Disney+ last November, and it has been the focal point of their earnings calls ever since. With their profit generating businesses of theme parks and movies shut down, and the media networks division slowly eroding (with substantial dollars tied to live sports), Disney+ has been the lone bright star. But, the direct-to-consumer services still lost $800 million in Q2 as it continues to ramp up, and with production shut down, there have been bigger efforts to push their bundle (Disney+, ESPN+, Hulu) and annual plans. The PVOD announcement of *Mulan* garnered a lot of attention, but the more important information from their Q2 earnings call was about their international strategy. On June 25, Disney announced the shutdown of their Disney-branded linear channels in the UK after being unable to renew distribution deals with Pay-TV providers. This was an aggressive move to go all in on streaming, as that content will now be exclusively on Disney+, and future content no longer needs to be balanced between the different platforms. Disney shut down additional linear channels in EMEA and APAC (ex-India), and as a result, took a write-down of $5 billion in the quarter. The second piece of their international strategy is the creation of a general entertainment streaming platform under the Star brand. Many expected Hulu to fill that role, but Bob Chapek told investors last quarter there were no current plans to invest in that product internationally. This quarter, the strategic rationale has come into focus. Hulu does not have any brand recognition outside the U.S., while Star (Hotstar) is incredibly well-known, especially in APAC regions. Hulu also contains content from 3rd parties, where Star will only have Disney-owned content from ABC, FX, 20th Century Studio and others. Lastly, and perhaps most importantly, it will share the same BAMTech platform as Disney+ and ESPN+, which might eventually lead to a uniform product, rather than 3 distinct services. At the very least, it will lead to better data-driven insights and learnings that can be shared between services to drive more efficiencies. Comcast also owns 33% of Hulu until at least January 2024, so that might have been another factor in the decision. The plan is to roll out the service in early 2021 and another investor day scheduled for later this year should provide more clarity on their strategy, as well as updates on projections across their DTC businesses.

- **Warner Media**: The hiring of Jason Kilar as CEO of WarnerMedia in April was a significant move that made AT&T's intention clear: the focus is HBO Max. Kilar, as the first CEO of Hulu, has been steeped in the product/tech side of OTT, and it was not that surprising to see him hire his former CTO at Hulu. Kilar is quickly laying out his vision to set the company for long-term success, and the foundation of that strategy is the need to own the customer relationship. This is partly why they still have been unable to gain carriage on Roku or Amazon FireTV, but HBO Max has much bigger problems than that. The launch of HBO Max on May 27 has been very underwhelming and highlights the difficulties of transitioning from a linear network to a DTC business. There was a myriad of confusion what HBO Max is, how it is different than HBO, and ultimately how consumers can access the service. At the end of June, HBO Max had 4.1 million subscribers, which isn't necessarily bad. The most alarming sign was that out of the ~30 million existing HBO subscribers who have access to HBO Max for free, only 1 million actually activated their account. One their biggest advantages, an existing subscriber base, has been neutralized by brand confusion. While that problem doesn't go away overnight, it is easily fixable, and Kilar has implemented major organizational changes to address the future of WarnerMedia. The recent restructuring of the

business has eliminated key executives at the various networks, and consolidated the focus and decision making under a single umbrella. Warner Bros. CEO Ann Sarnoff will oversee all of the entertainment portfolio, with Casey Bloys expanding his programming directive to HBO Max, and cable networks, in addition to HBO. While the executive changes to the content teams attracted the most attention, the less-heralded move of naming Andy Forsell (another former Hulu colleague) as the General Manager of HBO Max better reflects the strategy. Forsell will report directly to Kilar and this newly created business unit will responsible for the product, marketing, consumer engagement and global rollout of HBO Max. Streamlining efforts into 1 content organization supported by 1 product team allows them to be more nimble and scale more efficiently. The international roll-out will begin in Latin America in 2021, where they can utilize strong HBO brand recognition and AT&T's existing local assets. But expanding into other regions, especially EMEA, may be more troublesome due to long-term exclusive licensing deals, such as the one with Sky.

- **ViacomCBS**: Out of all the legacy media networks, ViacomCBS actually has one of the oldest OTT services, with CBS All-Access launching in 2014. It, along with Showtime, has steadily grown over time (11 million combined subscribers as of 12/31/19), but was never a focal point for Les Moonves, or CBS Management. After the merger with Viacom, Bob Bakish has made it clear that All-Access will be the workhorse product for the newly combined company. This summer, they have broadened the library, adding more than 3,500 episodes of content from Viacom networks, with an emphasis on kids programming. This service will be re-branded in 2021 (rumored to be named Paramount+) as it becomes more aggressive domestically, and begins to expand internationally. CBS All-Access had previously launched in English speaking countries, Canada and Australia, but there is a significant opportunity to leverage Viacom's international footprint. Legacy Viacom generated ~$2 billion in revenue in 2019 from their international networks, and while not a substantial portion (~20%) of total revenue, the boots on the ground, relationships, and local content partners will be extremely advantageous as they rollout overseas. Additionally, Bob Bakish ran MTV Networks International from 2007 to 2011, and Viacom International Media Networks for the following 5.5 years before becoming CEO of Viacom. As a result, he has a strong knowledge of all of regions from LatAm to EMEA to APAC, and global expansion seems to be a key component of his strategy, with a focus on distribution partnerships. They've already begun executing a playbook with Pluto after acquiring it early 2019, growing MAU from 15.6 million to 26.5 million in the past year, with another 6.5 million international monthly active users after launching in Latin America and Europe. CBS All-Access will probably follow in its footstep, as it looks to build an ecosystem of freemium content. For now, it seems like they will be kept as separate products, albeit with heavy cross-promotion, but it would not be surprising to see them consolidate into one product soon enough. With this in mind, it was a little surprising to see them license *SpongeBob: Sponge on the Run* to Netflix internationally (keeping the U.S. rights to promote the re-brand of All-Access in early 2021), but ViacomCBS continues to be happy "renting" IP to 3rd parties. This probably signifies that their international plans will take some time to get off the ground as they customize it for each region, starting with Australia, Latin America, and the Nordics next year.

- **NBC Universal**: After a soft launch for Comcast subscribers in April, Peacock rolled out nationwide on July 15th, with a differentiated OTT service, centered on ad-supported content. Without the tentpole of the Summer Olympics to boost promotion and engagement, the initial uptake has been underwhelming. There were 10 million sign-ups by the end of July, which doesn't a reflect a large audience for a mostly free product. Here again, executive leadership is being reorganized to better support Peacock, but this is not an over-reaction to the launch. When Jeff Shell took over as CEO of NBCUniversal in January, organizational changes were expected, and his first major change in May combined broadcast, cable, and streaming under one roof, led by Mark Lazarus. However, there is no head of entertainment programming at NBCU after the sudden departure of NBC Entertainment chairman Paul Telegdy earlier this month. Unlike other legacy media companies, this role won't be as important to Peacock as it will be to the broadcast and cable networks. As the only OTT service with a free tier, NBCU has taken a cautious approach to the "Streaming Wars" and is emphasizing advertising to drive revenues, rather than

subscriptions. Considering the relationship with Comcast Cable, there is an obvious reluctancy to disrupt themselves and encourage cord cutting, but this product seems really built for their ~1 million Flex customers. Comcast also owns a significant footprint in Europe through Sky, but there does not appear to any immediate plans to expand Peacock internationally. They've scrapped plans for an international news network, and for now, it seems like Sky will continue to act autonomously, similar to NBCU.

- **Lionsgate**: Starz has continued to shift from wholesale to retail distribution, and the renewal with Comcast under an a la carte model at the end of 2019 seemed imperious. While they lost about 30% of their linear subscriber base as part of that transition, revenue only decreased 6%, demonstrating the ability to monetize their audiences at higher rates. This will be important as they hone in on their target demographic of women, Latinx, and African-American audiences, rather than try to chase scale as a general entertainment service directly competing with Netflix. With weekly episodic releases, content spend won't be exorbitant as they'll only need 1-2 new shows per month to keep audiences engaged and paying. The challenge with a limited original slate is that there is more pressure to get them right, as under-performance can quickly lead to churn, and the costly proposition of re-acquiring customers. Internationally, they have slightly expanded their content mix to include more general "premium" programming as evident by holding onto *Mad Men*, as well as licensing deals for Hulu Originals *Ramy* and *Normal People*. Starzplay, their international service, has an expansive European and Latin America footprint, with availability in over 50 countries, but has only amassed 1.4 million subscribers since launching in Q1 of 2019. Additional services Pantaya (800k), and StarzPlay Arabia (1.8 million) give them more total subscribers, but having several different products for different markets, doesn't allow them to efficient scale.

- **AMC Networks**: AMC Networks has been reluctant to use strength of their namesake network to break free from the linear ecosystem. The launch of AMC+ on Comcast and DISH demonstrates their reliance on MVPD relationships, and how they don't want to jeopardize affiliate fees. AMC+ expands upon AMC Premiere to include access to some of their niche DTC services, but it is only offered through the MVPD provider. While this gives more exposure to the likes of Shudder, it's more likely that this is the first experiment around building a bundle for their OTT services. Because of their genre-focus, they were never going to scale quickly, with management setting initial targets of 5 to 7 million subscribers with a $500 million run rate by the end of 2024. While these services will not be appealing to everyone, there is an ability to cater to underserved cinephiles around the world. Acorn TV, their most popular service with 1 million subscribers, recently launched in the UK, where their focus on British dramas should perform well, and it's easy to see them having success in other European countries. Shudder, with its focus on horror, should travel well in certain markets, and recently expanded to Australia and New Zealand. These services should continue to rollout across the globe, although it could benefit from more synergies between the different platforms.

- **Discovery**: David Zaslav was keen to talk about the value of their upcoming DTC service as a "SUV" that has something for everyone, but little details on the actual service were provided. This aggregated service has been talked about for a while now, with the hiring of Peter Faricy (and other Amazon execs) in 2018 to lead the efforts. However, Faricy left the company in June, and without a direct replacement, it might take time for his lieutenants to come together and implement a launch strategy. Zaslav has stressed the importance of accessing broadband-only subscribers, and distribution partnerships, and it seems like they are keen on rolling out a MVPD-centric product. Traditional media companies who are entrenched in B2B distribution deals will never get the full value of DTC because they will not own the direct relationship with the consumer. Discovery has the global footprint to expand quickly, and owns their IP, but it is doubtful that their service will make a big splash.

Advertising Dollars Are Coming Back, But Where Will They Go?

Coming into 2020, many were expecting an economic recession, or some sort of a financial downturn to happen, and when the pandemic took hold in March, it seemed all but assured. But the government has continued to provide financial support to the economy through an array of fiscal measures. As a result, the S&P500 is up 5% YTD (through 8/21) despite being down over 30% in late March and unemployment at all-time record highs. While no recession has occurred yet, ad budgets were pulled back dramatically in Q2 with people confined to their homes and many businesses closed. This has been felt across all mediums, but there are some signs that global ad spending is gradually coming back to life. For the most part, it has followed the path of the coronavirus, with APAC furthest along in its recovery, followed by Europe, but worryingly, the U.S., the world's biggest market, is still lagging behind. Digital dollars have been the quickest to rebound, and as outlined last quarter (LINK), direct response advertising has been a key factor in mitigating the decline.

- **Google** search advertising revenues ended Q1 up 9%, but was experiencing a mid-teens decline at the end of March. By June, ad revenue was essentially flat, but Google ended the quarter down 10%, the first time they have experienced a year-over-year decline. There has been further improvement during the first few weeks of July, but a lot of commercial activity (i.e. travel) has dissipated even though overall user engagement is up. Management was very conservative about the prospects of an accelerated recovery for the rest of the year. Brand advertising dollars are non-existent, and Google will continue to develop new direct response advertising formats, especially tied to e-commerce.

- **Facebook** had an initial steep decrease in advertising revenue in March, but still ended Q1 up 17%. Advertising bounced back quickly, with the first few weeks in April being relatively flat compared to last year, and further recovered in May and June. As a result, Facebook ended Q2 with revenues up 10%, with that trend continuing through the first few weeks of July. The global scale of Facebook, and its ability to reach 1.7 billion people every day means it was always going to be one of the first place ad dollars came back to. Despite it's continual criticism for fueling misinformation and recent boycotts by large brand advertisers, the ability to utilize user data to effectively target potential customers still makes it highly valued by marketers, especially SMBs.

- **Twitter** started the year strong, but as a result of the pandemic, was facing ad revenue declines of 27% in the last 3 weeks of March and ended the quarter flat from last year. There was a gradual recovery throughout most of Q2, with the exception of late May to mid-June when many brands slowed or paused spend in reaction to U.S. civil unrest. In the last 3 weeks of the quarter, declines were still around 15%, and although certain markets in APAC were up year-over-year, Twitter ended Q2 down 23%. Twitter has continued to re-build its ad-tech server but the lack of direct response formats is telling in their results. Most of their advertising is tied to large scale events such as sporting events, movies, or product releases, but those have all vanished. DAU growth has surged 20% in the past 6 months, and if they can keep those users engaged on the platform, they should be able to better monetize their user base once their MAP product is completed in the latter half of the year.

- **Snapchat** had strong growth in January and February (58%), but dropped to around 25% in March. In the first few weeks of Q2, that decline persisted, but growth rates were still up from 15% from the prior year, and finished Q2 up 17%. In the first few weeks of July, ad revenues have started to rebound, up 32%, but that is expected drop down to 20% for the full Q3. Direct response advertising at Snapchat has nearly doubled over the past 2 years, and it currently makes up more than half of their revenues, which has helped them weather this storm. With movies coming back to theaters, professional sports resuming, and schools slowly returning to normalcy, ad revenues might surpass the conservative guidance from management.

The other overarching theme from digital companies was the upcoming release of iOS 14 and the impact of IDFA. In brief, IDFA (Identifier For Advertisers) allows mobile advertisers to tie the success of their direct response ads to

specific devices and allows for more advanced targeting without releasing personal identifying information. While IDFA is not going away, users will be now asked if they want an app to track them across apps and websites. By opting out, ad networks will be starved of the user-level data that is so valuable, even if they'll have information on conversion metrics (i.e. 20% of users who saw an ad, clicked on it). Google has had something similar in place, but iOS is the predominant mobile software in the US and this will impact the entire $80 billion mobile ad industry. Facebook, which generates over 90% their revenue from mobile will be in a precarious situation, and they've already identified it as a potential headwind in Q4. Zynga and other mobile game publishers, who rely a lot on customer acquisition marketing to drive user growth, may also feel the effect. This isn't necessarily a light switching off, and advertisers will adjust their practices, but there should be some immediate impact after the new iPhone is released later this year.

TV advertising has faced sharper drop-offs than digital for a myriad of reasons. Most notably, they are solely reliant on brand advertising, whereas digital platforms can turn to smaller companies looking to capitalize on low prices. Additionally the postponement of sports for 5 months came at the worst possible time. The NBA and NHL seasons were just approaching the playoffs when the leagues were forced to shut down, and those games derive the majority of ad revenue. Networks have had to work with advertisers to come up with creative ways to keep the dollars, as well as maintain the value proposition. After re-starting the season in bubbles, several play-off series have been taking place during the afternoon, which is less desirable than the original primetime showings, despite many people still working from home. There have also been noticeably more in-game advertisements. While there have been 15 second split-screen ads before during brief stoppages of play, they seem to be appearing more and more during the actual game, such as in-between pitches of an MLB game. All eyes are on the fall, with both the NFL and college football seasons taking place across the country, and more ad dollars potentially on the line. Many NCAA conferences have already postponed their season, including 2 (Pac-12, Big Ten) of the Power 5. The SEC, ACC and Big 12 are continuing to move forward but there are no assurances that games will be played, as just last week Notre Dame and UNC both shifted to online classes. However, football players have remained on campus and continue to train and prepare for a season, in what is effectively now a bubble. This seems like a temporary solution because only having student-athletes on campus so they can play in football games would bring up a lot of issues about amateurism. The NFL is in a similar scenario as they attempt to start their season next month, playing at home stadiums rather than creating a bubble. This format hasn't worked out too well for the MLB thus far, as there have been game postponements nearly every day after several different teams have returned positive COVID-19 tests. A handful of NFL teams will have limited fan attendance, which seems overly optimistic, and not worth the risk considering the amount of revenue coming in from media rights. The focus for all these sports leagues has been about safely getting through this season to fulfill media rights contracts, and help network partners fulfill their obligations to distributors and advertisers.

On the entertainment side, there is a lot more unknown, with many TV productions still shut down, and no clear timeline on when they can fully resume. The Upfronts in May were cancelled, but advertisers are continuing to work on a rolling basis with networks to find content to advertise against. The problem is that even if/when advertising dollars are fully restored, there won't be any new content to run ads against. While networks are optimistic they'll still have a Fall line-up, it will be significantly lighter than usual. Networks will look to unscripted content, especially isolated reality series such as *Love Island*, which can be more easily produced in the current environment. Some networks will look to their libraries for completed shows that haven't aired yet, or acquire content that has been "lightly viewed." While this will ensure a new line-up, it's unlikely they'll be able to command substantial dollars, even if scatter pricing is up 25%. Networks have started leaning into their AVOD platforms to combine their sales teams and offer more inventory to advertisers that also reaches younger demographics that are outside of the bundle. Tubi, Pluto, and Hulu have both been heavily involved in the ad sales process for Fox, ViacomCBS, and Disney respectively, these past few months. And with the reach of cable networks continuing its decline, AMC Networks is licensing more content, such as *The Walking Dead*, to AVOD services to make up for their expected advertising revenue declines. But the cable news network continue to drive substantial viewership over the past 5 months as there has been a never-ending news cycle. This should continue through the end of the year as the presidential election is rapidly approaching and political advertising starts to accelerate. Many national news networks are expecting record-spending and they are already pacing well ahead of 2018 levels. It's no different at local stations, although there is more variability dependent on the geographic

market. Smaller cities that have had a quicker recovery from COVID outbreaks have benefitted the most, while large markets, like LA, are still struggling.

Is Content Still King?

The last two entrants into the "Streaming Wars" have faced additional complexities as they entered the marketplace with hopes of quickly gaining scale. HBO Max and Peacock have both been unable to secure distribution on Roku and Amazon FireTV, the 2 largest connected TV providers in the U.S. While similarities exist, these battles center around different key points for each OTT service.

Peacock is primarily an ad-supported service, so the bigger disagreement has been with Roku, which usually receives 30% of ad inventory from each AVOD service. Advertising will be a crucial component of the user experience and NBCU does not want to cede too much control to 3rd parties. NBCU has leaned into their traditional marketing expertise to launch Peacock with more advanced advertising and targeting that can generate higher CPMs. But with Peacock offering low ad loads (3 to 5 minutes per hour), conceding inventory would limit their ability to innovate around new formats. Additionally, there is reluctance to connect their proprietary tech stack to Roku, a direct competitor in OTT advertising. On the other hand, Peacock's disagreement with Amazon stems from the ability to directly own the customer relationship. Peacock does not want to be a part of Amazon Channels because it is heavily reliant on that first-party audience data to drive their advertising. There is also a desire to drive viewers to their own app, especially since they offer more than just on-demand content, with live news/sports, as well as a channel feed for library content.

For HBO Max, the bigger argument is with Amazon, who currently has 5 million HBO subscribers through their Channels service. This deal was done some time ago when HBO first offered the service outside of the cable bundle, but (not surprisingly) leaned on B2B distribution. New management at HBO Max realizes the importance of having direct relationships with audiences, especially as they seek to use the OTT service to add value to the wireless business. On Roku, the same problem exists, where legacy HBO is part of The Roku Channel, although with less active users, it might be an easier problem to resolve. After consolidating Xandr under WarnerMedia earlier this year, the plans to launch an AVOD version of HBO Max next year have been confirmed. This could present another wrinkle in the dispute with Roku, as HBO Max will be in a similar position as Peacock, where they would want to limit access to their ad-tech platform.

Carriage disputes are not new to media companies, with negotiations sometimes turning into brief channel blackouts until new rates can be agreed upon. However, in the legacy model, distributors pay the networks for the right to carry their content. In the world of streaming, the business model is inverted, and the OTT apps (networks) are paying the distributors, whether it be through advertising revenue shares or sign-up bounties. As that relationship has changed, it seems as though the leverage in these negotiations have favored these gatekeepers who have not only built a scaled audience, but own the direct relationship with them. This has especially been the case recently as a lot of these late OTT entrants are seeking to utilize these distribution platforms to quickly grow the customer base.

Looking back at the launch of Disney+, it's impressive how they tactfully gained carriage on all these platforms, knowing ubiquity was essential. Then CEO Bob Iger was willing to sacrifice some short-term revenue, and make concessions in order to dictate the terms that were most important to them. For example, the licensing of 20+ shows to Amazon IMDb TV in February seems like a clever resolution to Amazon's insistence on higher ad revenue from Disney's other apps. But, with the upcoming launch of *Mulan* on PVOD, we're starting to see another pain point in these distribution agreements. Traditionally, a PVOD movie would be sold directly by the distribution platform, such as Roku, Amazon, iTunes, etc., with the studio content owner keeping 70% to 80% of the revenues. However, with a day/date release for *Mulan*, Disney is creating a "Premier Access Window" within the Disney+ app where only current subscribers can purchase the film. This is one benefit of direct relationships with the consumer as it allows them to bypass the distribution platforms on which Disney+ sits. However, it's not that simple for

Disney+ to keep 100% of revenues, as they originally noted it would only be available on disneyplus.com and select platforms. Distribution platforms are not willing to let Disney allow in-app purchases without receiving a slice of the transaction. It was no surprise then to see Disney add Apple, Google, and Roku as platforms that offered the ability to purchase the movie directly. Without these agreements, it would have created another level of friction for audiences, forcing them to purchase the movie in one place (internet browser) and then watch it in another place (app). Additionally, as part of the terms of service with the App Store, app owners are prohibited from even marketing/communicating to users that they can make a purchase on a different platform. Some services, such as Spotify and Netflix, no longer utilize the App Store for sign-ups, as all users must go directly through their websites. While this may work for companies that have established customer awareness, it's increasingly difficult for smaller apps to replicate the strategy.

These content vs. distribution battles are not just limited to the media business, and there is a lot more at stake for gaming publishers as they continue to embrace live services. Epic Games CEO Tim Sweeney has always been outspoken in his opposition to Apple's 30% fee, and less than 2 weeks ago, *Fortnite* made a big move to try and enact change. In what was a very calculated and pre-meditated decision, *Fortnite* allowed users the option to purchases V-bucks (in-game currency) through the Epic Games Store for a 20% discount, rather than the standard price through Apple's in-app processing system. This quickly led to Apple removing *Fortnite* from the App Store as a clear violation of the terms of service. Epic Games then filed a lawsuit against Apple, and aired a short video in *Fortnite's* Party Royale mode that mimicked Apple's "1984" commercial and rallied users in support of their mission. The argument Epic makes is that these fees do not exist on open platforms such as browsers or PCs, and these 30% fees are excessive and in turn limit the developers who need to charge higher prices, which in turn hurts the customer. But Apple clearly outlines the terms of app store that are agreed upon by a publisher when their app is listed in the App Store. Apple isn't the sole App Store, as Google Play is available on Android devices, although it does allow users to download apps outside of the store. Epic Games filed a similar lawsuit against Google, but the attention is on Apple because they are the primary revenue driver for mobile games and *Fortnite* in particular. Epic has indicated they are doing this for the greater good of developers and users, but glosses over the fact they have their own app store that charges 12%, which while much lower than 30%, still generates profit to them. They want an open app store because they believe they can build a significant market share in the $120 billion app economy. It's unclear how this will play out, but it definitely will not come to a quick resolution. Apple has changed terms for certain apps, (i.e. Amazon), and probably would do the same for *Fortnite*, but that is not what Tim Sweeney wants. Epic Games, with its Unreal Engine, is a integral part of the next generation of gaming, and they are looking to establish a more powerful position. Despite the regulatory scrutiny on the Big Tech firms, Apple won't change their stance without a full anti-trust investigation, and that could take years. Last week, Apple countered the lawsuit in a notable way by declaring the intent to cut-off developer support to Epic Games, which would impact all other developers who use the Unreal Engine. By maintaining the lawsuit, Epic Games would essentially be pulling these developers into their fight, and hurting the same community they are vowing to help.

As media and entertainment businesses shift to new platforms, there will continually be new battles to be fought, especially during the early stages of these transitions. While it seems like OTT has been around forever, it's still just in infancy, and companies are looking to establish market-leading positions. It's historically been said that content is king, but over the past 6 months, distribution platforms are realizing they might be the king marker, and are flexing more power in these negotiations.

5 IMPORTANT DATA POINTS

- AT&T finished the quarter with 36.3 million U.S. subscribers to HBO Max and HBO, up from 34.6 million at the end of last year. But the breakdown of their subscriber base shows the May 27th launch of HBO Max was not overly successful. **HBO Max has 3 million retail subscribers, and out of the 23.5 million linear HBO subscribers, only 1.1 million (5%) logged into HBO Max despite have free access**. Additionally, there are 6 million HBO subscribers who don't have access to HBO Max.

- Facebook continues to see increased diversification among their advertiser base**. In Q2, the top 100 advertisers represented 16% of ad revenue which is a lower percentage than a year ago**, and down from 20% just 4 years ago.

- WWE transitioned the production of televised programs to their training center and began broadcasting without fans in attendance on March 13. Television ratings for Raw and SmackDown reflect the importance of a live audience to the excitement of their events**. Since March 13, ratings for Raw and SmackDown have been down approximately 19% and 15%, respectively**, as compared to the preceding pre-COVID period this year.

- EA hasn't launched a major title since the pandemic struck, but it's still bringing in new players. **FIFA alone attracted 7 million new players on console in the last quarter, and more people are playing FIFA now at this time than any previous cycle.** Engagement in FIFA and Madden continue to be massively above typical levels, which bodes well for Q3, as people that have played the game recently are more likely to buy the new one.

- T-Mobile is getting right to work migrating Sprint post traffic onto their own network so they can achieve their merger synergies. **Over 10 million Sprint postpaid customers on average are now using the T-Mobile network every single day.** Adding Sprint's spectrum onto the anchor network, they can continue to take-on more traffic without diminishing the quality of the network. And the quicker this transition occurs, the quicker T-Mobile can decommission unused sites.

5 RESONATING QUOTES

"We have focused the majority of our attention on increasing revenue durability, meaning that we have multiple lines of revenue to pull from. But most importantly, we want to make sure that any new line of revenue is complementary to our advertising business. We do think there's a world where subscription is complementary. We think there's a world where commerce is complementary. You can imagine work around helping people manage payrolls as well, that we believe is complementary."

Jack Dorsey, Twitter CEO

"The NBA 2K League is not only an interesting opportunity as a stand-alone, but also forms part of building the brand and building overall engagement. It used to be a 3-month experience, then it became a 6-month experience. Now it's very close toward a year-long experience, and that's very much our goal. And that's really a reflection of NBA 2K morphing from being the highest quality sim in the market to one of the highest quality interactive entertainment experiences of any kind."

Strauss Zelnick, Take-Two CEO

"We've got electrostatic sprayers and HEPA vacuums and upgraded MERV-13 air filtration filters that are quadruple the cost of what we had previously. We can't eat all these costs. Ultimately, we're going to have to pass these costs on the consumer as all businesses pass costs on a consumer. So I don't think you necessarily should assume that enhanced cleaning costs are only going to come out of our bottom line."

Adam Aron, AMC Entertainment CEO

"We are an audio-first platform, and so we expect for the foreseeable future the majority of consumption to be audio. Meaning that consumers that watch video will go in and out of the video experience and then being able to put that experience in their pocket and continue. Then when they hear something interesting, pull it back up and then watch the show again. So this is -- you should not look at this as some of the other platforms like YouTube and Snap, where it's predominantly a lean-in experience. Video is an added capability. It is priced very attractively for advertisers, but the share of video on Spotify is low right now. And it will be growing, but I don't think you should expect it to be another YouTube."

Daniel Ek, Spotify CEO

"Our cash flows has been a little better than I think we had projected because of the loss of regional sports. The loss of customers have been less than we projected because we knew that many of our customers don't watch regional sports. So there are other categories where they're approaching regional sports status where those costs are going up beyond what the value is in terms of customers watching those, and we'll have to negotiate through that."

Charles Ergen, DISH Network Co-Founder & Chairman of the Board