BLACK DRAGON CAPITAL

DISRUPTION OF THE MEDIA INDUSTRY

PART 1

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In the Anywhere, Anytime, Anyplace environment of today, technological advances in bandwidth, encoding, and delivery, OTT is disrupting the media industry, transforming the consumer experience, and quickly approaching a watershed moment.

Disruption of the Media Industry

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Introduction

The media landscape is changing. We live in an era of anytime, anywhere, anyplace content consumption. Streaming is breaking the paradigm of legacy business models like pay-TV. Within two years, the media industry worldwide will reach a watershed moment where revenue from OTT will overtake that of cable and pay-TV providers. In the US, the most mature OTT market, the switch will occur in 2023, with the rest of the world following in 2024.

Over the past decade, and accelerated by the COVID-19 pandemic, advances in technology and innovation have given consumers everything they traditionally received from their cable provider with the added benefits of OTT-only features. We are participating in a shift from the flat experience of legacy broadcast and cable to an enhanced experience, allowing the consumer to choose to be a passive viewer or create their own experience. A closer relationship between the content creator and the consumer is forged by pairing machine learning with big data - a personalized experience that cable alone cannot match. Cost is not the only consideration for cutting the cord with cable providers; the decision is also driven by a desire for choice, flexibility, convenience, and personalization.

> ***"When disruption occurs, new lanes are created, and in those lanes are opportunities.***
> ***– Chris Lencheski, Winning Streak"***

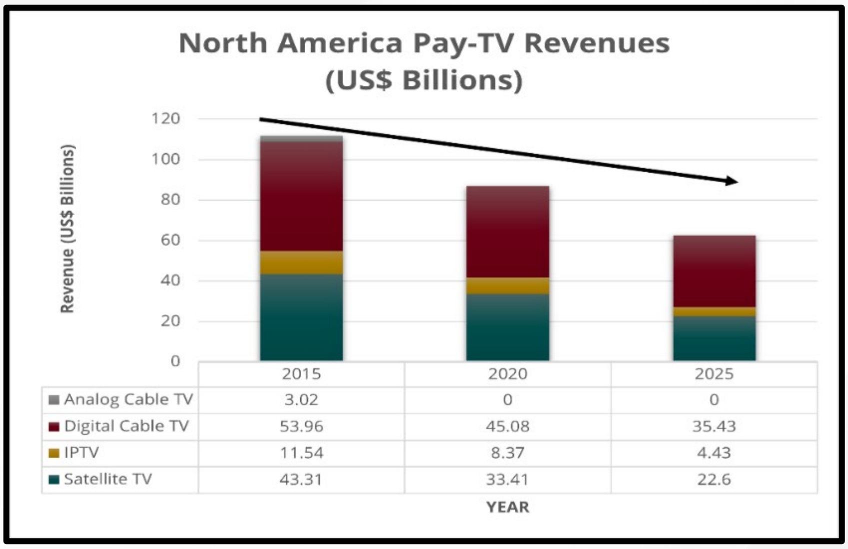
Watershed Moment

Industry research shows a global decline in pay-TV viewership and respective revenues.

North America

In North America, revenues from traditional pay-TV (satellite TV, IPTV, Digital Cable TV, and Analog cable TV) have dropped substantially in the past five years. By 2025 they are projected to be half of what they were in 2015 - falling from $105 billion to an estimated $56 billion during 2025.

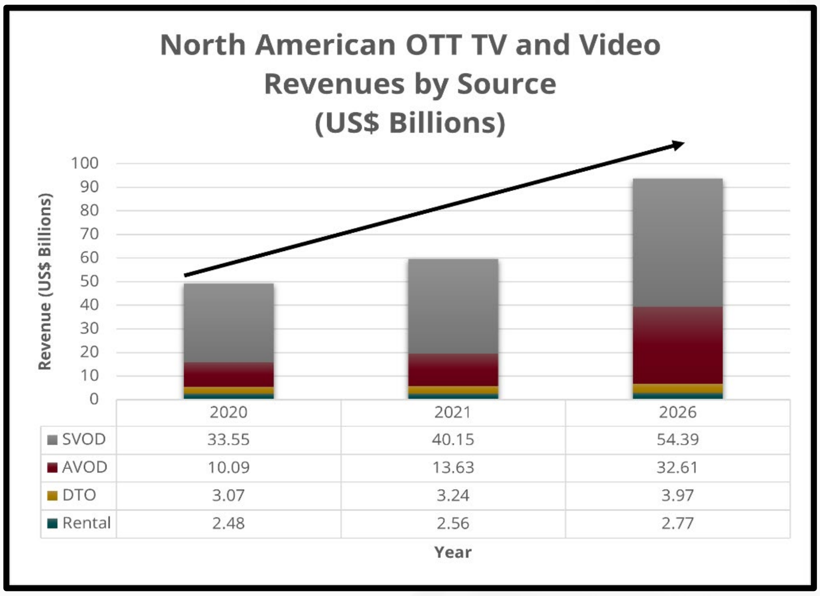
Simon Murray, a principal analyst at Digital TV Research, says, *"Subscribers are turning against high traditional pay-TV fees by seeking cheaper alternatives. OTT allows viewers to see what they want when they want – they are not tied to the channels' schedules. The value of the linear schedule for recorded programming is rapidly diminishing."*



Source: Digital TV Research

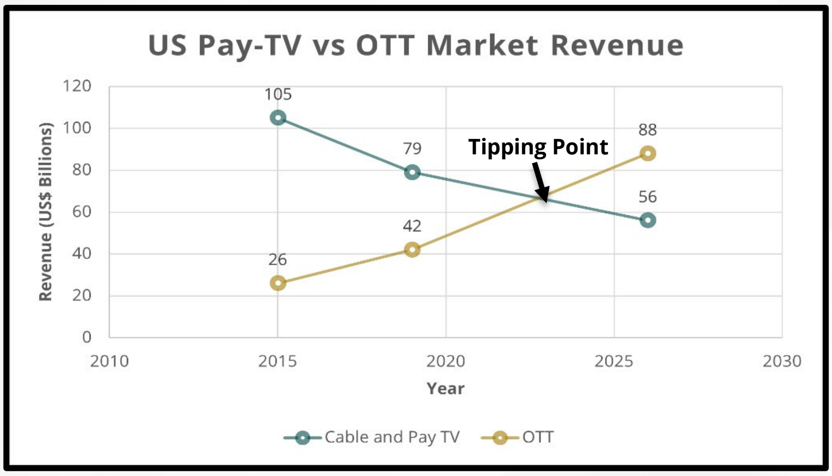
In contrast, US OTT video streaming consumption and revenues have skyrocketed.

The US is by far the most mature OTT market, with revenues reaching $42 billion in 2020. Murray estimates revenues to reach $88 billion by 2026, registering a CAGR of approximately 11%. Although SVOD (subscription video on demand) revenue contributes the lion share of overall OTT revenue, AVOD (ad-based video on demand) revenue is increasing at a greater rate of 18% CAGR vs. the 7% CAGR of SVOD.



Source: Digital TV Research

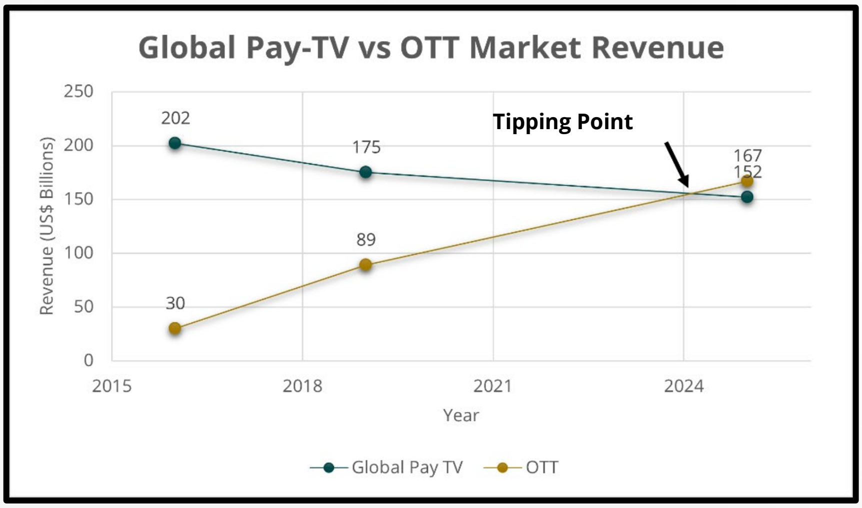
Comparing US pay-TV revenues vs. OTT illustrates the watershed moment occurring during 2023. Assuming steady CAGR, both will reach $64 billion, with OTT subsequently overtaking US pay-TV in revenue.



Created using Digital TV Research Data

Global Trends – OTT vs. Pay-TV Revenue
OTT and pay-TV revenue trends are consistent throughout the world.

Globally the intersection of OTT and pay-TV revenues occurs in late 2024, a year after the US, assuming trends remain consistent. However, unlike the trends in the US, SVOD and AVOD are growing at approximately the same rate of 11% and 12%, respectively.



Created using Digital TV Research Data

This trend has extensive repercussions on advertising, data analytics, content creation, and technology. For example, when pay-TV viewership declines, where do advertisers go? Do they move to the free ad-supported tiers such as Hulu, or do they use the less disruptive strategy of product placement?

As live sports everywhere were put on hold, during COVID-19, advertisers scrambled to move their inventories to streaming platforms. As live sports have come back, viewership has remained low, prompting advertisers to stay on digital to maximize their investment.

"The biggest difference in advertising post-pandemic will largely pivot around additional ad dollars going to new formats and companies evolving their advertising planning aligned to broader industry ecosystem changes.
– Media Expert and PwC Principal CJ Bangah"

What is Driving the Shift?

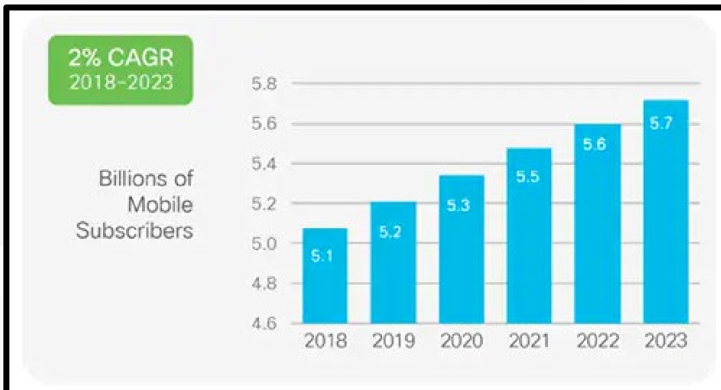
Technology Convergence and Consumer Needs
The surge in cutting the cord from traditional pay-TV to OTT platforms is driven by the intersection of technologies and changes in consumer behavior and wants. Consumers want the ease of use, convenience and added benefits that OTT platforms provide.

Viewers create their own experience
This era in media has put the consumer in the driver's seat, giving them flexibility, convenience, and choice. The consumer becomes the director. They can choose a lean-back experience or become an active participant. OTT becomes a strategic advantage for content creators in this consumer-forward age, providing them an avenue to offer greater choice and personalization. For example, the advances in multi-access edge computing (MEC) and improved bandwidth enable the content creator to provide multiple camera angles and live stream choices to the consumer, customizing their experience.

The proliferation of mobile phones
The proliferation of more powerful mobile devices and better high-speed wireless service has untethered the consumer to view content whenever and wherever they want.

> *A March 2020 report by Cisco estimated 82% of all internet traffic globally is attributed to video[1]. That is an increase of over 12% since 2015 when video attributed to 70% of internet traffic.*

Global mobile subscriptions are projected to grow to a penetration of 71% of the worldwide population by 2023.



Source: Cisco Annual Internet Report, 2018–2023

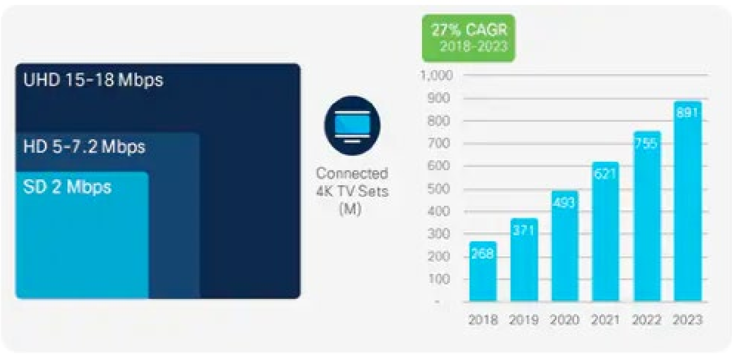
[1] Numbers include YouTube, Vimeo, Reddit, etc. as well as SVOD services.

As technology has evolved, bandwidths and processing speed increased, latency from camera to glass decreased, video stability has improved, and buffering times have diminished.

5G and MEC for increased engagement and multiple camera angles
The introduction of 5G combined with higher MEC will be the final disruptor of traditional live sports broadcasts, legacy TV providers' last firewall against OTT. The combination of 5G and MEC allows content providers to create in-stadium experiences for live fans. Content providers will become more innovative to drive engagement with in-stadium fans. Allowing fans to see close-ups, different camera angles, and replay enables fans to view plays from perspectives they don't have at their seats. Stats on their devices will sync in real-time with the on-field play.

This technology opens up more significant innovation in gamification and betting to engage the fan differently for the in-stadium and at-home viewer. No longer will fans at home need to turn off notifications or ignore incoming texts due to the delay of OTT over broadcast.

Larger Screens and Higher Resolutions
By 2023, 66% of connected flat-panel TV sets globally will be 4k (Source: Cisco Annual Internet Report, 2018 – 2023)



Source: Cisco Annual Internet Report, 2018–2023

The median size of LCD TV screens in the United States is getting bigger, with the average LCD TV screen size expected to eclipse 50 inches by this year creating a better home theater experience.

5G also allows for the transmission and viewing of 4K video quality at home on connected television (CTV) devices for live sports and the home movie theater experience. Conviva reports[2], 75% of all viewing time in Q4 2020 was on CTV devices:

- Smart TVs – Samsung, LG, Sony, etc.
- Gaming Consoles – PS5, Xbox, etc.,
- Devices that connect via HDMI to your TV – Apple TV, Roku, Amazon Fire TV, etc.

A report by Deltatre 'A New Digital Decade,' sites that 40% of sports fans in the US prefer Smart TVs as their preferred device for viewing live events.

[2] Conviva – Conviva's State of Streaming Q4 2020

The proliferation of devices, larger screens, and better network connections combine to make OTT ready for live sports.

Personalization

Personalization is key. Consumers are not all alike, and they don't have time or patience to look for things to watch. Technologies such as AI and Machine learning have improved personalization for consumers.

> ***"Our personalization enables us to create more than 250 million tailored experiences.***
> ***– Todd Yellin, Netflix Vice President of Product Innovation, in an interview with MobileSyrup"***

Localization

OTT video allows multiple audio and subtitling tracks within a single video stream for a seamless localization experience at a massive scale. Now consumers can watch their favorite shows localized for them, no matter where they are in the world.

Signing up/Cancelling

In addition to watching content on larger screens with the same quality as seen on traditional pay-TV, consumers enjoy the convenience of subscriber OTT services that allow them to take their content with them wherever they go. They are also freed from the cumbersome experiences to install, maintain, and eventually return the hardware needed for the legacy pay-TV experience. This places smaller services at a higher risk for increased churn, driving these niche content providers to join larger content providers like Peacock and Discovery+.

Content

Content is the most valuable commodity in this digital era to drive viewership. Without high-quality content choices, the bells and whistles won't be enough to keep consumers coming back. OTT's disruption of the media and entertainment sector reaches far beyond subscriber numbers. Its place in the culture at large is also growing. In 2020 Netflix, for example, received 160 nominations at the Emmys, more than all four major broadcast networks combined, in addition to two Oscars. It's not surprising that content budgets of the major OTT players already rival those of legacy television networks. Disney is reported to have spent $27.8 billion in 2019 on OTT content while Netflix spent $15 billion.[3]

The proliferation of content and release strategies have rattled film veterans as has the definition of a movie. Movies had been traditionally released to cinemas, then put into secondary distribution on pay-TV, DVD, etc. Now movies may be released directly to streaming platforms without a cinematic release.

Movie industry veterans, like Steven Spielberg, have lobbied to disqualify films that release simultaneously on streaming platforms and traditional movie theaters from the Academy

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[3] Variety, Entertainment Companies Spend $121 Billion on Original Content in 2019, January 6, 2020

Awards.[4] However, many disagree. *"As much as I respect Steven and revere him as a filmmaker, he's not reading the tea leaves,"* said Stu Zakim, an Academy member and veteran publicist who worked on previous Spielberg releases. *"That ship has sailed."* 5

Streaming platforms are building their content libraries by purchasing and merging with large studios to create original content to compete with the leader in the space, Netflix, and Disney+. AT&T announced a new direction in their strategy, unwinding their acquisition of Turner Media, from only a few years ago, to spin off its media subsidiary WarnerMedia (media IP that includes Warner Bros, HBO, CNN, DC Comics, TBS, TNT, and Cartoon Network) to merge it with Discovery to create a new company to be named Warner Bros. Discovery. A few weeks later, Amazon announced that they had come to terms with MGM to acquire them for $8.4 billion. They are increasing Amazon Prime Videos' position as a competitor by adding around 4,000 film titles and over 17,000 hours of TV programming to their content library and strengthening its original content creation power. All of this while rumors spread of NBCUniversal exploring ways to pull back right to their Universal Studios content IP from competitive content platforms like Netflix and HBO Max to keep those rights exclusive to their year-old streaming platform Peacock. Media entities understand that deep archive libraries and IP are as valuable as new content to retain viewers. Mega platforms are gobbling up studios to strengthen their positions, deepen content libraries, increase content production, provide new sources of revenue, and keep content IP exclusive to their respective platforms.

This strategy has many benefits to the consumer, one of which is to subscribe to fewer services at once. However, the downside is that not far in the future, smaller streaming platforms will be swallowed up or put out of business by the larger platforms, creating a decrease in niche programming.

Pricing

Finally, choice doesn't end with what, how, or where the consumer watches, but how much they pay. A consumer can choose, in many cases, to pay nothing or a lower price if they choose to view ads and, depending on where they live, can choose in what currency they pay or between alternative payment methods. A report by Deloitte noted that 28% of OTT subscribers canceling their subscription would stay if they could switch to a lower-cost ad-supported tier if the choice was available.

Conclusion

OTT has transformed the consumer viewing experience and disrupted the media industry. With the advances of technology and innovation, OTT is evolving at a breakneck pace and giving the consumer the flexibility, convenience, and personalized user experience that is quickly overtaking traditional pay-TV in revenue and as the destination for all content viewing. This trend extends to live programming as well. In a future paper I will explore the industry's adaptions and ever evolving audience expectations. The OTT providers that stay ahead of the curve give consumers choices in how, where and when they watch content, react quickly to technology shifts, and continue to provide high-quality content will dominate.

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[4] Variety, Steven Spielberg vs Netflix: How Oscars Voters Are Reacting. March 5, 2019

[5] Variety, Steven Spielberg vs Netflix: How Oscars Voters Are Reacting. March 5, 2019