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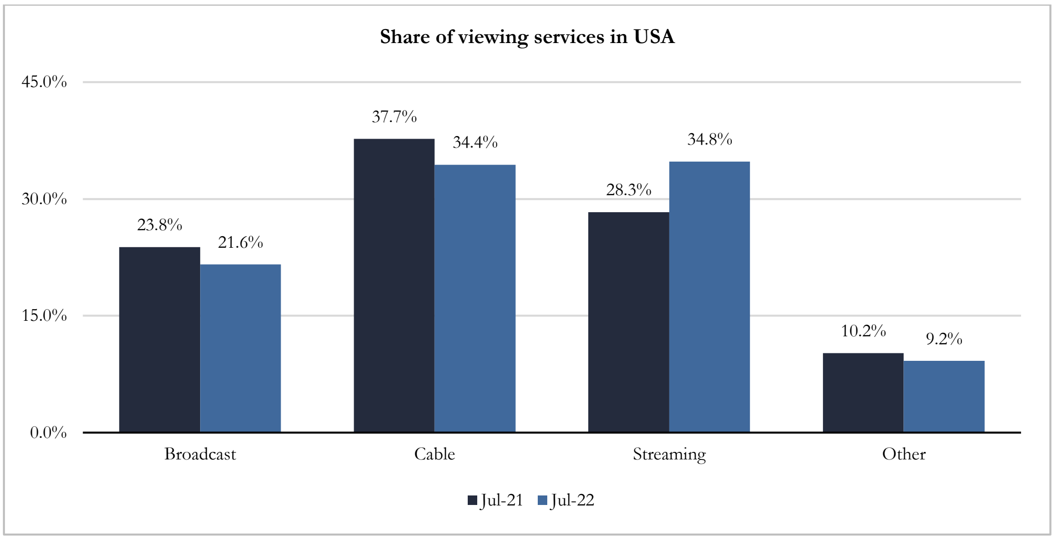
The Value of Long-Term Investing

Investment Insight

STREAMING WARS: DISNEY'S MARCH GATHERS PACE

The shift to streaming video has dramatically changed how the media industry works and how content is consumed. Some of us remember when we had to sit down in front of the TV at the right time, set the record button or scour through our DVD library to watch our favourite show. Today, we can watch what we want when and where we like. According to Nielsen, streaming video on demand (SVOD) is now the most popular form of viewership. Media companies have been forced to pivot to avoid falling by the wayside: Peacock, Paramount+, Disney+, Apple TV+, and HBO Max have all launched in the past three years to catch up with the demand.

Streaming climbed to a new level during the pandemic as strict restrictions forced people to stay at home. Not only was this a catalyst for demand, but film and television production was put on hold too, and with little, if any new content like reality TV shows being released, viewers switched to streaming.



Source: Nielsen and BofA

Share prices of streaming companies soared during the pandemic but this year investor sentiment has changed significantly. With the reopening of economies, consumer have other options to spend their time and money so comparisons are difficult. The cost of living crisis is forcing people to adjust to higher inflation and increasing mortgage costs and increased churn is a concern. The pioneer, Netflix, admitting to losing subscribers at the start of 2022. Streaming platforms bore the brunt of the negative sentiment as expectations were recalibrated and multiples declined.

Light at the end of the tunnel

However, we believe that as we move towards the end of the year that there is light at the end of the tunnel and that investor sentiment towards streaming platforms can improve.

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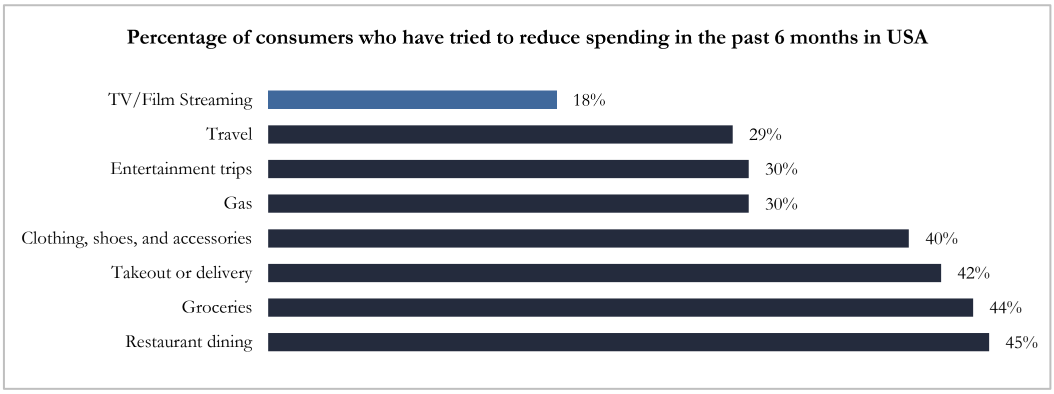
First, there is evidence over the past six months that people have been cutting back on buying food at restaurants or takeout and shopping for clothes rather than closing their TV or film streaming accounts.

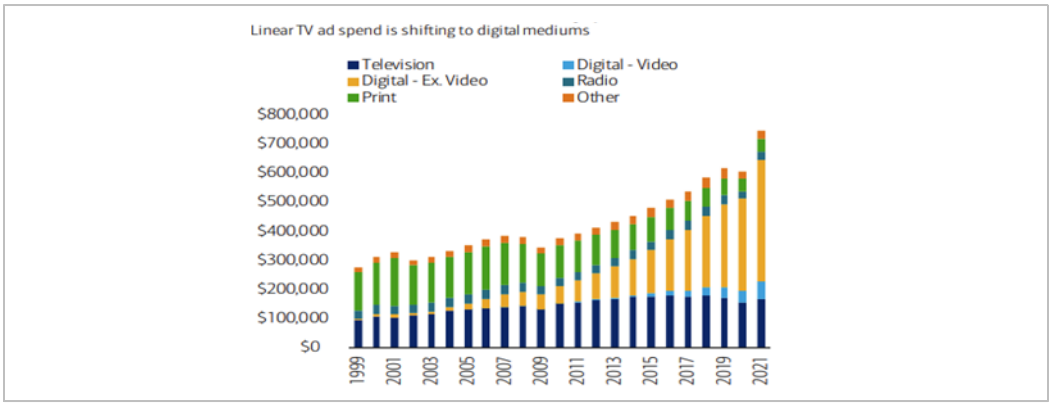


Source: National Research Group

Streaming has become an essential part of daily life and represents good value for money compared to other things. Given that the average time spent watching Netflix is almost an hour and a half a day, and costs around $15 a month, it is very cheap entertainment per minute consumed.

Second, both Netflix and Disney+ are about to launch advertising-based, video-on-demand (AVOD) packages that can help reduce churn and bring in a new revenue stream. These tiers will be priced cheaper and so users can trade down to them if they are budget conscious.

The global advertising market has grown significantly over the past two decades, spurred by the growth of digital advertising and overall GDP growth. However, linear TV advertising has given up market share spend to digital formats, and we think that there is a large opportunity for digital video advertising to take share from linear TV given its high levels of engagement.



Source: S&P Capital IQ, BofA Global Research

Note: *Digital Video includes In-stream video formats (YouTube, Hulu, etc) and other full-video formats (In -banner, In-app etc,) but does not include video in social networks*

Streaming platforms will be able to tailor the advertisements down to the household level and hence can broaden the advertiser base given that the cost of targeted advertising campaigns would be much lower than for a full-scale national TV advertising campaign. However, for the legacy TV companies, it will not be as simple as replacing the TV advertisement revenues for AVOD since the advertisement load will be only three to five minutes per hour.

Cost per thousand impressions (CPM) is likely to be lower for streaming than the much higher levels of linear broadcast TV and there are likely to be initial execution issues and experimentation for each brand over the most effective ad placement and the best type of programming.

For the industry and the transition it is an open question whether AVOD revenues will be an addition to linear TV revenues, or if it is a substitution. It could even be a subtraction if the ad load is lower and CPMs are not able to offset. For the platforms offering a lower price for consumers it is an open question too if they can ensure that advertising revenues offset that price difference or if they will lose revenues.

Netflix and Disney have taken different strategies for AVOD. Netflix has priced their basic subscription with ads at $6.99 compared with the standard package of $15.49 in the US. Disney has priced its ad-supported package at the same price as the existing plan and introduced a price increase of $3 per month to upgrade to the ad-free package. It means that Netflix is seeking to offset customer churn downwards by offering an ad-supported lower cost package, whereas Disney is attempting the opposite by asking existing users to go for a higher price plan.

Netflix previously increased the price by a regular moderate $1 per month intervals. They now will have an additional advertising revenue stream. However, there are complications: Netflix has already encountered issues with the media rights and is not able to provide subscribers to the ad-supported tier full access to all its programming.

One advantage that Walt Disney has over other platforms is that it has three streaming platforms, Disney+, ESPN+ and Hulu which it can offer as a bundle, currently on offer at $19.99 in the US. Approximately 40% of domestic subscribers use the bundle and so this helps to offset churn and makes customers feel that they have better value for money despite not necessarily wanting to subscribe individually to each channel. The AVOD package also allows Walt Disney to raise individual channel price more aggressively and sets a floor for the price.

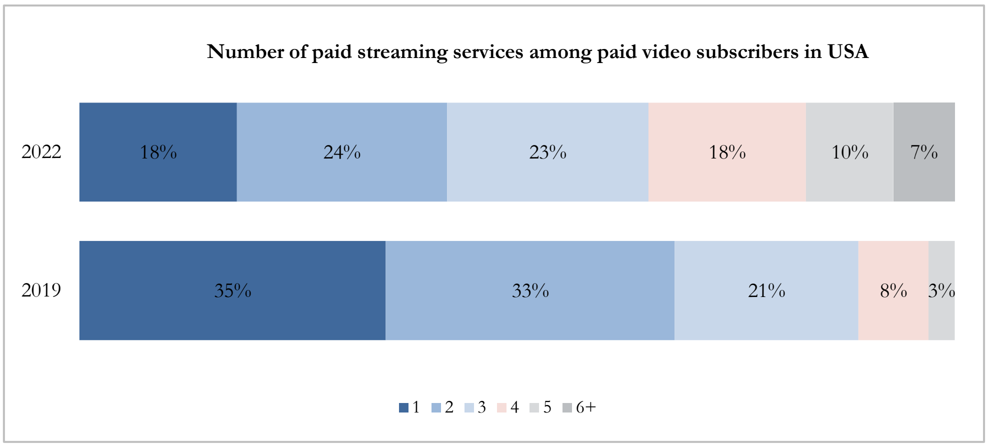
Maintaining subscriptions

There has been a continual decline in cable TV subscribers in the US. Sports are one of the key reasons why people keep a cable TV subscription. The NFL in particular is the content of many of the most viewed TV programmes. Significantly, Amazon Prime has won the rights to show Thursday Night NFL, the first of the Tier 1 sports packages to be shown on a streaming platform.

Source: Amazon

The sports leagues are typically cautious about offering rights to streaming platforms since the breadth of viewership is lower and it takes additional effort to find the event. If Thursday Night NFL is successful for Amazon Prime (indications are positive) we may see more sports move to streaming, especially given the ability of some of the big tech companies to pay up for the ever-increasing prices for the sports rights. Apple has also won the rights to show MLS (Major League Soccer) on a global basis in a deal that was prices far above what traditional TV companies were willing to pay. Netflix has also recently mooted the idea that they are interested in live sports rights.

SVOD and AVOD have broadened the market for new entrants. Apple and Amazon are two newcomers with significant resources that do not have a media background. Both have invested billions of dollars on studios, new original content and sports rights to create a compelling package of content to compete against the more established media platforms. Sports rights have increased in value over the last decade and with the two new deep-pocketed entrants, prices could rise even higher.

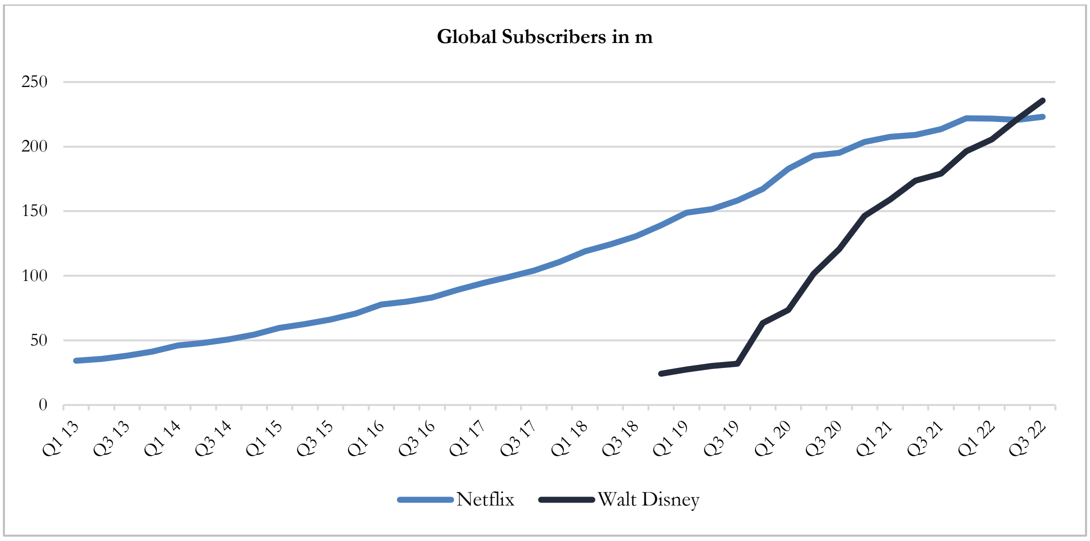


Source: Nielsen streaming media consumer surveys

Amazon has also bought existing media rights, acquiring MGM and the James Bond film franchise for $8.5 billion, outbidding both Comcast and Apple. With these acquisitions, Amazon has brought greater competition to the market and increased consumer choice, with the average person now subscribing to two or three services.

As with our investments, quality and value are going to be the key criteria for subscribers and will determine the success of these streaming services. They will need to offer high-quality programming at an attractive price.

Walt Disney has had great success in attracting new subscribers and to keep the audience engaged with its timeless content and deep library. From a standing start, it has overtaken Netflix in terms of total subscribers. That is why we believe that Disney will prevail as one of the two or three core subscription services.



Source: Netflix, Walt Disney Company reports, J.Stern & Co. research

Streaming has disrupted the industry, changed the delivery mechanism and allowed greater choice and flexibility for the consumer. But many things have stayed the same. The strategy of offering advertising tiers and the bundling of the platforms is highly reminiscent of the standard cable TV playbook. Media companies are still using the same tactics of investing in the best content, selling advertising to engaged audiences and packaging up the programming to broaden the audience.

That is why we believe that streaming is not a panacea but an evolution resulting from technological advancements. It has enabled new entrants but has not substituted quality of content as the most important factor. Walt Disney has demonstrated that it can attract subscribers given its compelling content. It also knows how to offer advertising alongside its content, which should ease the transition to AVOD and help to generate industry-leading CPMs. The company has already attracted more than a hundred advertisers pre-launch, which should help to achieve a smooth transition. Of course, this kind of innovation does not come for free. Walt Disney has incurred significant costs to launch its streaming platforms that have impacted its share price. However, we believe that they will help to make streaming increasingly profitable, similar to linear media.

Streaming is about a change in the delivery mechanism but the quality is still key. That is why we believe that by offering compelling content at an attractive price, Walt Disney can retain and grow its position as a global media giant.

Giles Tulloch
November 2022