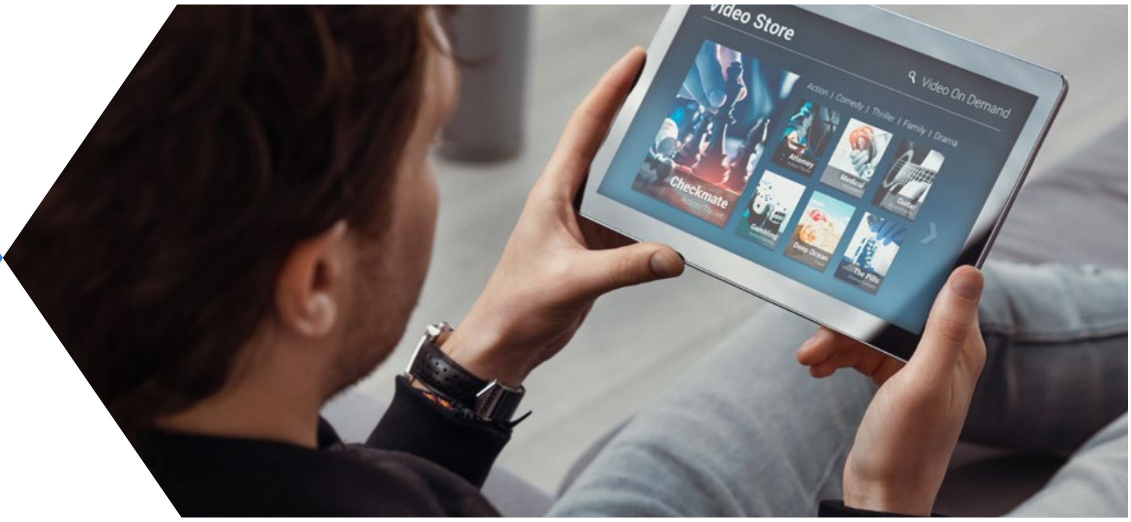
Look Forward to the Post-Covid-19 Shakedown in Consumer Entertainment

Maria Palm, Partner and David Bishop, Partner



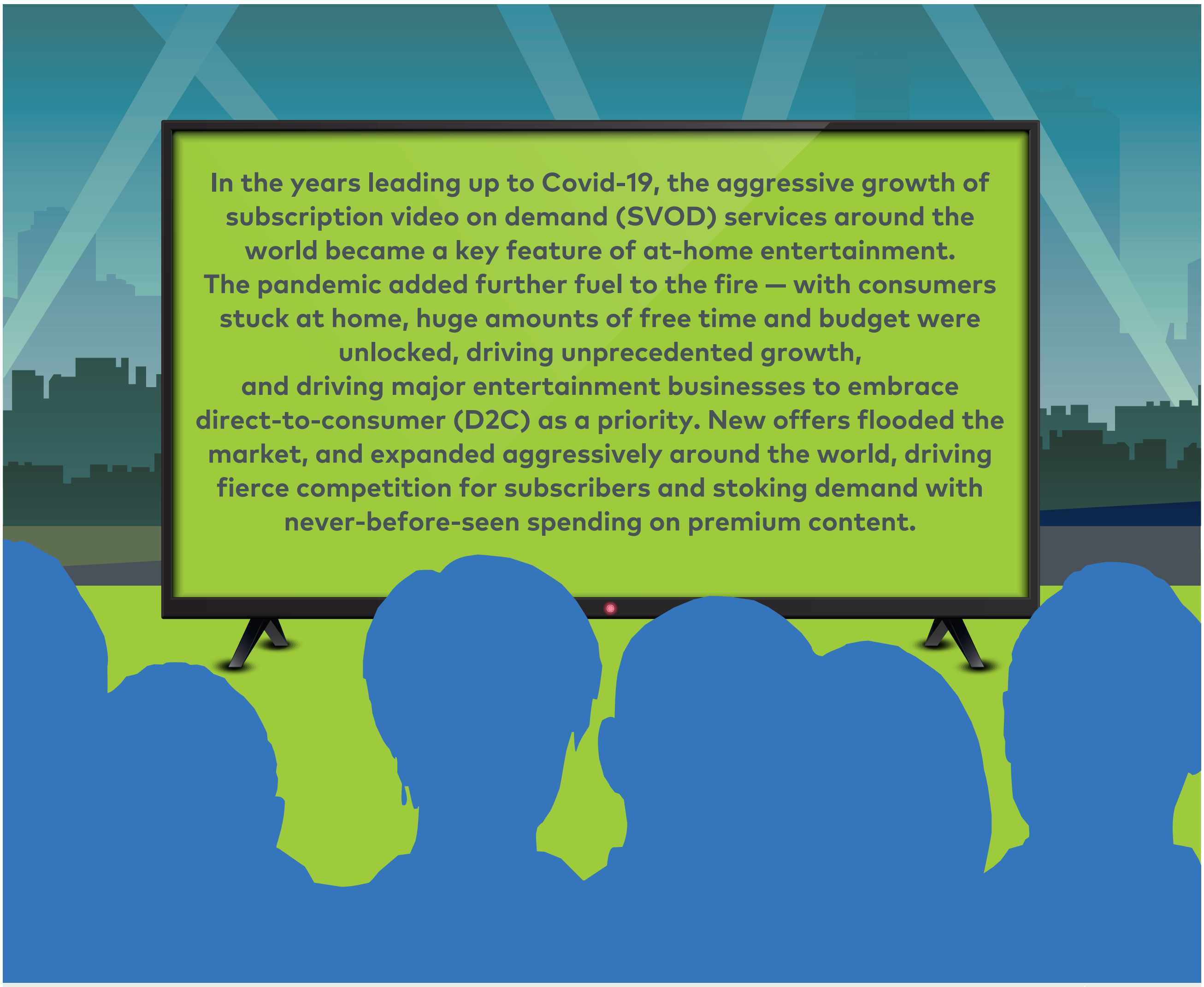
OUTLOOKS

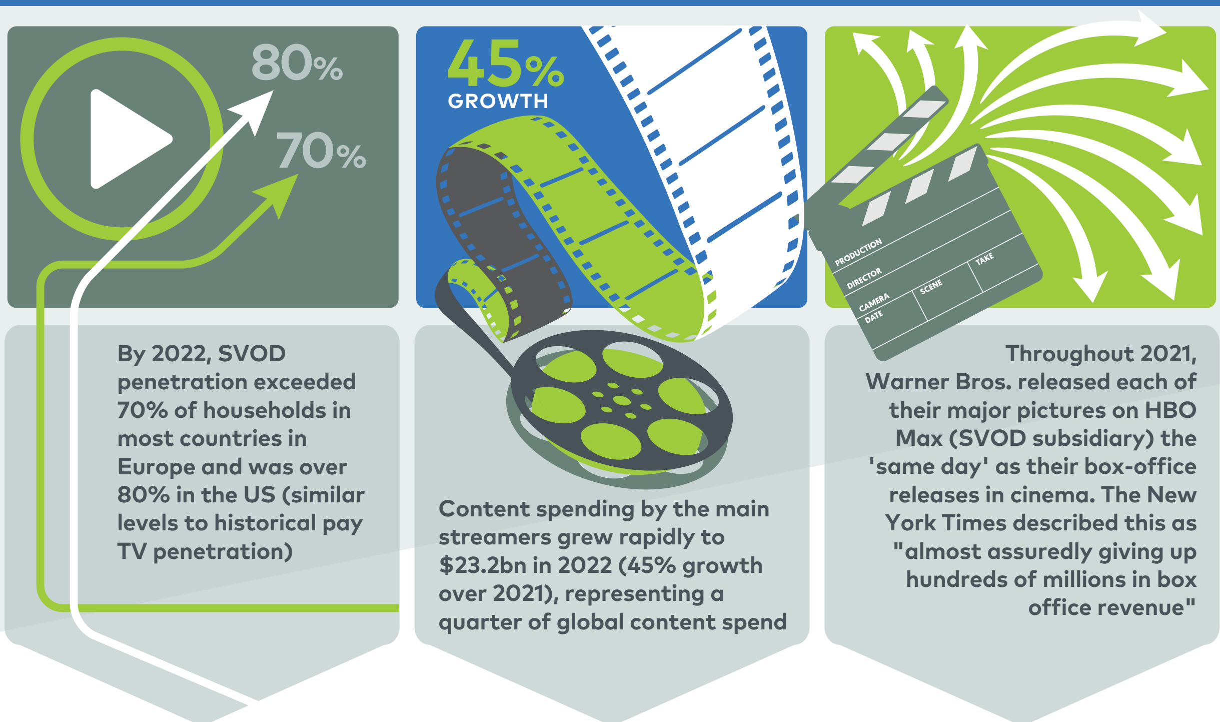
L.E.K. Look Forward Into 2024

Welcome to Look Forward, L.E.K. Consulting's annual analysis of the challenges and opportunities in the year ahead. In this Infographic, Partners **Maria Palm** and **David Bishop** look forward to another fascinating year ahead for the consumer entertainment business as COVID's impacts continue to unwind and focus shifts to profitable growth.

Look Forward to the Post-Covid-19 Shakedown in Consumer Entertainment

The pre-pandemic rise of subscription screening services (SVODs) seemed unstoppable, with locked-down consumers adding to further growth during the pandemic. But with personal spending under pressure entertainment businesses are having to fundamentally rethink their models.





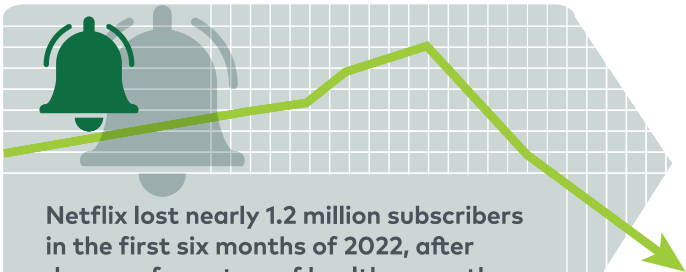
Source: L.E.K. research and analysis, Ampere Analysis

The post-pandemic recovery brought a reckoning.

SVOD subscription growth dried up as consumers were let out of their houses (and pruned the assortment of media services they'd bought during Covid-19). In 2022, it became clear that the economics of the prevailing SVOD offers were unsustainable - with very low average pricing (vs. traditional Pay TV bundles), month to month contracts, and a dependence on expensive premium drama series.

This drove big drops in market capitalisation, and rapid business model adjustments to move closer to unfashionable but long-proven pay-TV offers.

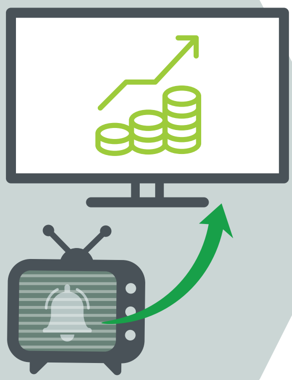
Pricing growth became a priority, and advertising tiers were introduced to co-fund viewership. Password sharing was cracked down on, content releases trended from series stacking to habit-forming weekly episode drops, and the accountants imposed much stricter discipline on content buying.

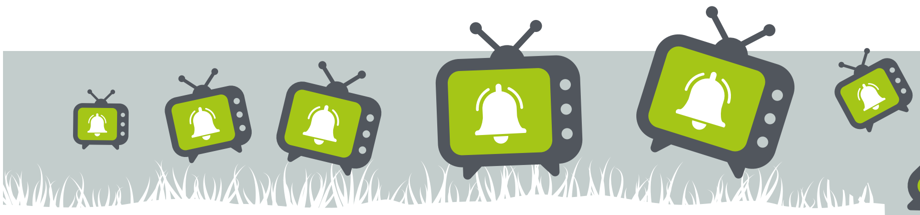


Netflix lost nearly 1.2 million subscribers in the first six months of 2022, after dozens of quarters of healthy growth

By April 2022, Netflix's stock had lost more than $50 billion of market value, making it the worst performer in the S&P500 to that point in the year.

Late in 2022, recently returned CEO of Disney Bob Iger said "Instead of chasing [SVOD] subscribers with aggressive marketing and content spend, we have to start chasing profitability."





The SVOD upheaval has many knock-on effects for adjacent areas of the entertainment economy

Traditional national pay TV businesses will remain under pressure, facing continued decline in subscriber numbers and erosion in average revenue per user (ARPU). However, moves by SVOD services to copycat large parts of their business models have given them a leg-up. And the movement by studios back towards licensing and distribution (away from D2C) has boosted their access to the best content.

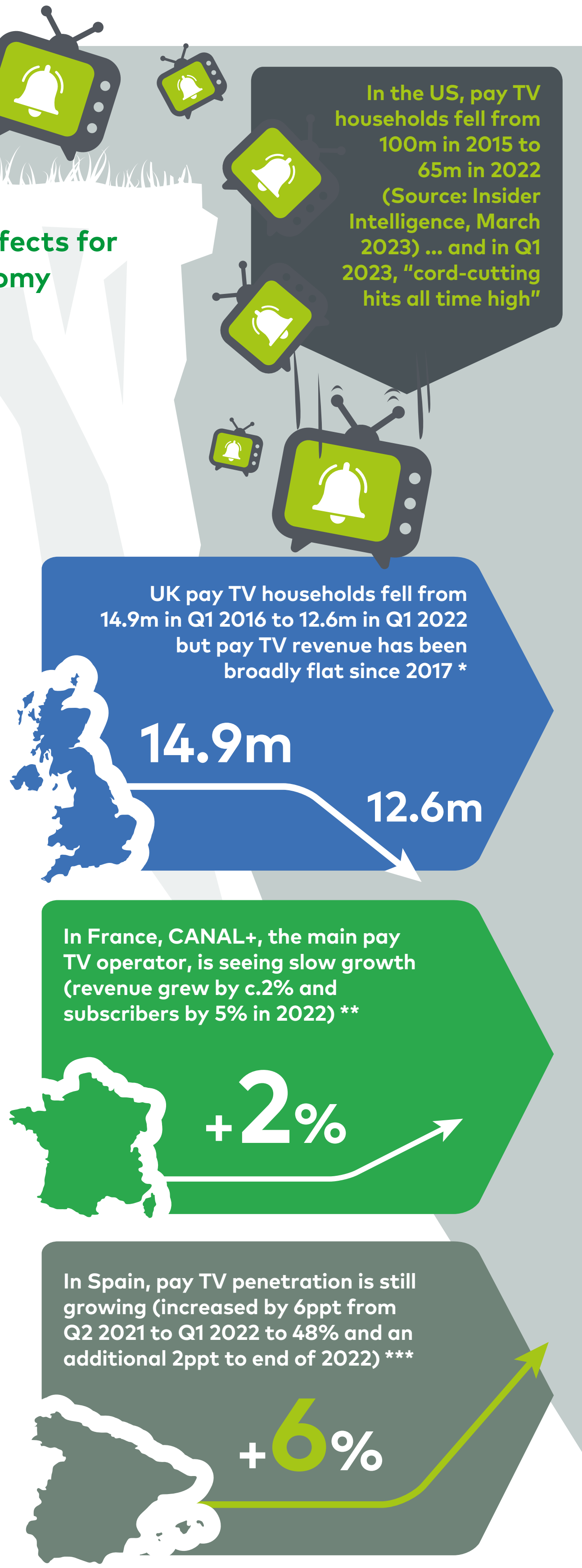
We expect to see winners and losers in this space.

MARKERS OF STRENGTH FOR PAY TV ACTORS:

- Not bundled with telco services
- Limited or single-property-dependent TV offers
- Concentration of key rights value (e.g. national football league)
- Historically high pay TV ARPU
- English language market / lots of US content
- Defensive rather than offensive approach to VOD

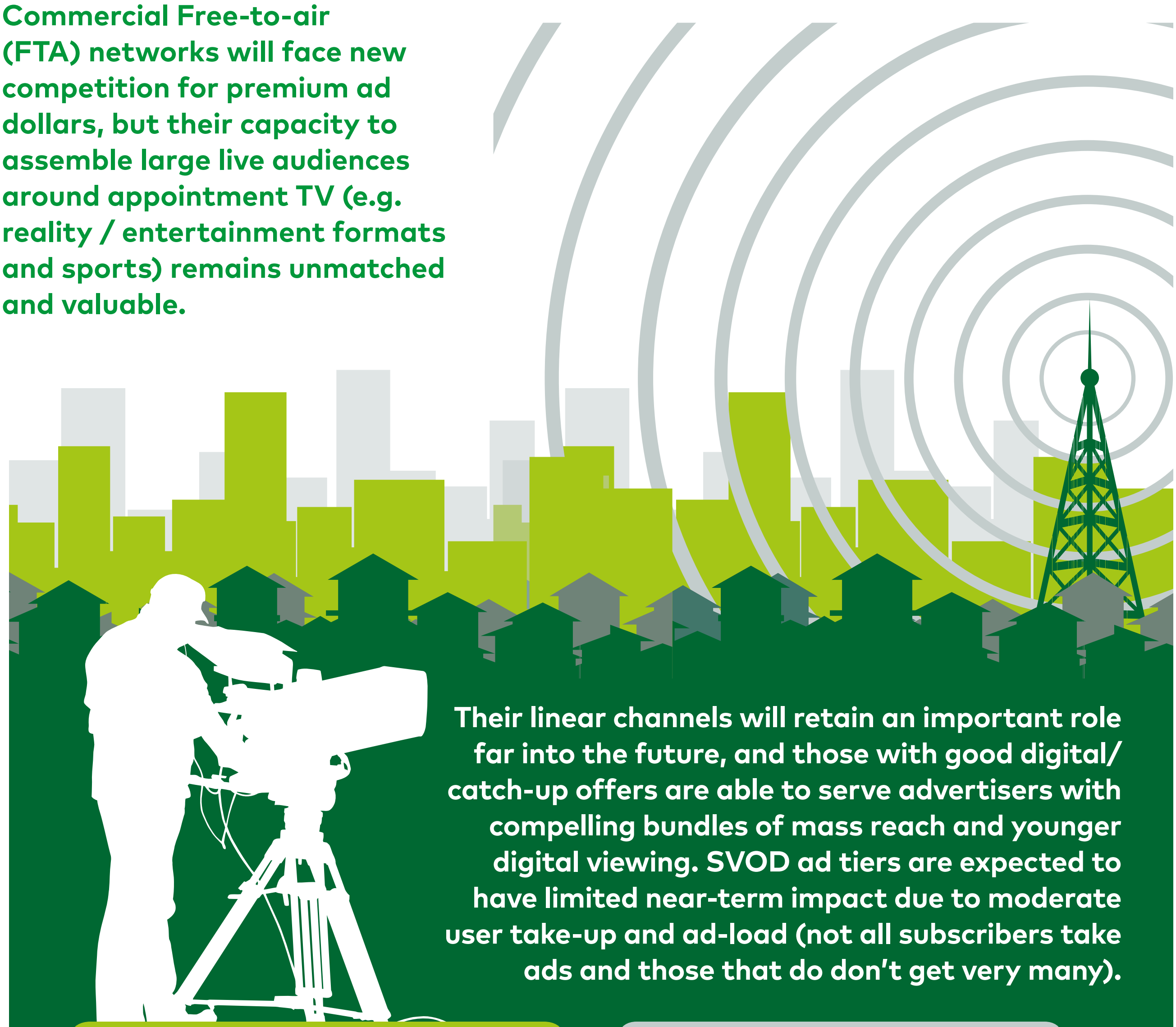
MARKERS OF WEAKNESS:

- Bundled with telco services
- Robust premium content business — combining entertainment and a broad sports offering
- History of holding the key sports rights
- Strong local content position (particularly in non english-speaking markets)
- Strong in-house production
- Offensive approach to VOD
- Successful in multiple geographies



Source: *Ofcom Media Nations; ** SportBusiness; *** Broadband TV News

Commercial Free-to-air (FTA) networks will face new competition for premium ad dollars, but their capacity to assemble large live audiences around appointment TV (e.g. reality / entertainment formats and sports) remains unmatched and valuable.



Their linear channels will retain an important role far into the future, and those with good digital/ catch-up offers are able to serve advertisers with compelling bundles of mass reach and younger digital viewing. SVOD ad tiers are expected to have limited near-term impact due to moderate user take-up and ad-load (not all subscribers take ads and those that do don't get very many).

Public Service Broadcasting (PSB) in the UK still dominates the list of transmissions that draw mass audiences (despite a continued decline since 2016). In 2022, 1,184 broadcast transmissions attracted more than 4m TV viewers compared with only only 48 programmes on video on demand platforms (around 25 to 1).

By February 2023 (four months post launch), only 13% of UK Netflix subscribers were on the new ad tier. By May 2023, global take-up of Netflix's ad tier had reached 5m monthly active users across the 12 markets in which it was offered (around 1 in 50 across the global base of 247m subscribers in Q3 2023).

Source: Media Nations, Ofcom August 2023

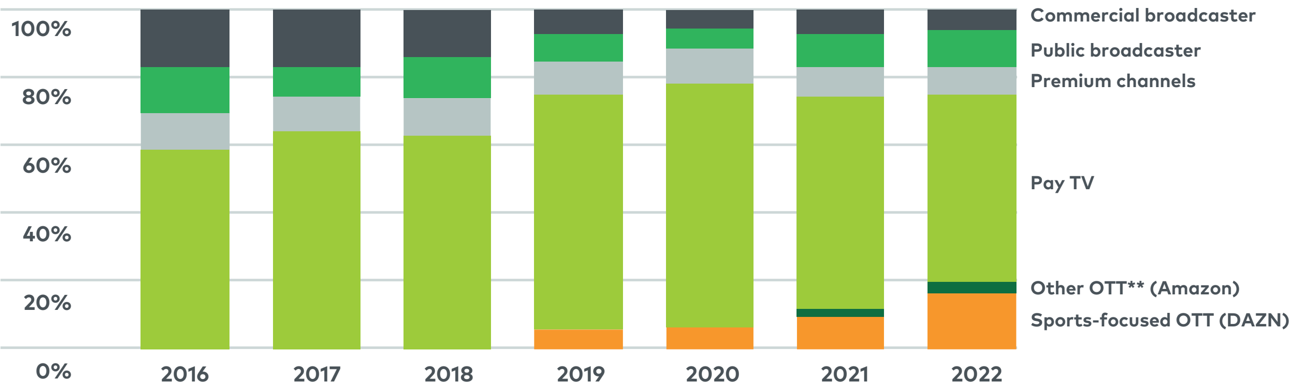
The growth of internet protocol-delivered video-on-demand and the continued search for better and better user experience is driving huge growth in **media technology and advertising technology services.** Broadcasters and content distributors used to run most of these functions themselves with armies of internal personnel. But as standards and systems have converged it has become a huge category for outsourced service provision and third-party tech platforms.

The new fiscal discipline of the streamers, combined with recent industry strikes, has produced a lull in production and a more restrained outlook for premium content spending.

We expect SVOD content spending to spread across a range of use cases, with more selective investment in high-end drama (to drive new business and retention), greater focus on reality / entertainment formats (big audiences) and lower-cost habitual content (e.g. soaps, game shows).

Sports endured a difficult pandemic period, with many interruptions and financial challenges, but their importance to consumers and media networks as drivers of mass live viewing is undimmed. Television rights to top properties remain hotly contested, including by emerging IP-based players.

Spend on sports broadcasting rights in top 5* European markets (2016-22)



*UK, Italy, Germany, France, Spain;

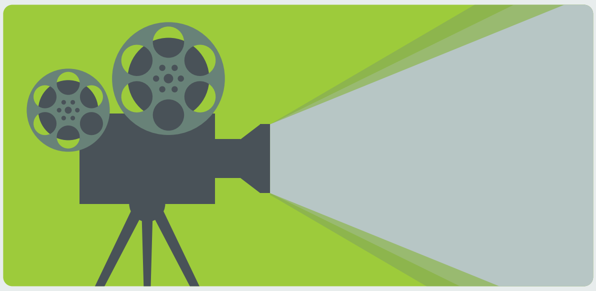
Note: OTT=over the top spend estimated at €2.3 billion across Amazon and DAZN in 2022 (balance of market €11.5 billion)

Source: Ampere Analysis; MediaKind

The days of double-digit value growth at each renewal appear to be over, with little audience growth, and tough subscriber conditions for pay TV buyers and IP challengers alike. While Amazon, Apple and Google are all circling, they have so far been selective and opportunistic (particularly outside the US) and have not contributed to wide-reaching value escalation.

For all the posturing, direct-to-consumer delivery by the sports themselves is not yet a workable economic alternative to broadcast partners, limiting the credibility of this threat.

Many European properties will have to settle for flat-to-down-a-bit annual values in the coming cycle.



While all this is happening, providers of **'in-real-life' entertainment** like concerts and site based entertainment have come roaring back post-Covid-19, as demand for authentic social experiences comes to the fore. In most categories, the demand outlook looks robust (back on pre-2019 trend rather than riding a post-Covid-19 sugar hit).

At the intersection of content and real life, **Cinema** (whose imminent death was regularly predicted during Covid-19) has gained a new lease on life.

Though many individual locations remain challenged, major studios have recommitted to the cinema as a key plank of their distribution (shifting focus back from SVOD) - and the exclusive theatrical window looks set in stone for major releases.

About the authors

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Maria Palm is a Partner based in L.E.K. Consulting's London office. She has over 22 years of experience in the media and entertainment industry and has assisted various clients with commercial due diligence, sales and distribution strategy, and valuation projects. Maria first worked for L.E.K. between 1993 and 1997 before leaving to join British Telecommunications as a strategy manager, where she was responsible for strategy formulation and business development for the Mobility Division. She returned to L.E.K. London in 2000. Maria received a Master of Science in Business Administration from the Stockholm School of Economics and a Bachelor of Arts in French from Stockholm University.

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David Bishop is a Partner based in L.E.K. Consulting's Paris office. He has more than than 19 years of experience providing strategic advice to the media and entertainment industries, in Europe, ANZ and Asia. He is an expert in growth strategy, new market development, and transaction advisory. David holds a Bachelor of Commerce with honours in economics and management accounting from the University of Auckland.

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