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Streamers vs. broadcasters

Broadcasters fight back

By Derek Terrington

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Executive summary

Streaming is the most disruptive force in video media. Globally, streamed video services continue to grow, led by the US majors, apparently at the expense of non-streamed and advertising-dependent broadcasters.

Streaming growth slowing in North American market, while UK PSBs saw strong ad recovery in 3Q21 and expect strong 4Q21

Recent trading announcements by leading streamers and leading UK broadcasters point in two directions: streaming growth in the North American market is slowing, according to figures from Netflix and Disney, while UK public service broadcasters (PSBs) reported a strong advertising recovery in 3Q21. Both trends were influenced by the pandemic, which slowed the production of new content – this is unwinding and points to a healthy 4Q21. Similarly, leading UK PSBs expect a strong 4Q, with advertising at record levels.

Other trends are at work, however. Content spending is forecast to grow strongly, boosted by the arrival of new streamers, while Netflix and Disney continue to increase their content budgets. Investors are looking at the increased competition, rising content spend and expanding investment in new studio capacity, and worry about longer-term streaming profitability.

Netflix's core objective is subscriber growth in a market where scale is everything

Netflix is a well-established streamer with significant advantages. As it grows, its business model develops. It offers an increasingly diverse range of content in terms of genre and language. Local content is produced in local languages, and this can be dubbed or subtitled for other markets. Soon, other content could be added; for example, gaming, or even music. A huge entertainment offering is emerging. This will support Netflix's core objective: sustained subscriber growth in a market where scale is everything.

Vigorous recovery in UK TV advertising markets

Linear, advertising-funded channels are recovering vigorously from the impact of COVID-19. UK TV advertising markets have seen the return of established brands and the arrival of new ones. New e-commerce businesses, typically tech-based startups, are using broadcasters to build their brands.

UK broadcasters aim to reduce their dependence on advertising, and they are meeting the challenge of streaming by exploiting its possibilities with new business models.

UK broadcasters' diversified revenue streams are growing

The diversification strategies of UK broadcasters are bearing fruit, although they have to be sustained and proven beyond the recent very positive trading news. Revenue and profits from D2C streaming strategies are increasing. Content creation is making a growing contribution, as production studios, expanded by acquisition, benefit from rising demand for content internationally.

Streamers vs. broadcasters – huge difference in ratings

There is a huge difference between the ratings given to streamers compared with broadcasters. Internet-driven streaming is seen as "the future", and broadcasting is seen as a disrupted business. However, streamers face mounting costs and greater competition, while broadcasters are becoming more digital and building content businesses. Can the ratings gap stay this wide?

Streamers power ahead

Netflix leads the pack

Competition for viewers intense and content-backed streamers go from strength to strength

Streaming is the most disruptive force in TV media markets, and continues to grow in strength. Competition for viewers has never been greater, and is set to intensify further. Powerful content-backed streamers continue to grow their subscriber base, gaining viewers from established subscription-based cable and satellite services and from advertising-based broadcasters.

In a short time frame, streaming has gone global, led by the US content and distribution power houses Netflix, Amazon Prime Video, Disney+ HBO Max and others.

Netflix is the second-oldest established streamer and by far the market leader. In 2020, Netflix had a greater share of streamed viewing of digital originals than all other streamers put together (Source: Parrot Analytics).

Leading streamers: subscriber numbers (3Q21)

	Date started	Subscribers (m)
Netflix	01/2007	214
Amazon Prime Video	09/2006	175
Disney+	11/2019	118
HBO Max and HBO	05/2020	73.8*
Peacock (Comcast)	07/2020	54
Paramount+(ViacomCBS)	10/2014	48
Hulu (Disney/NBC)	10/2007	44
Apple TV+	11/2019	20
ESPN+ (Disney/Hearst)	04/2018	17

*Note: Chinese streamers excluded. *4Q21. Source: Corporate announcements, Hardman & Co Research*

Netflix benefiting from widening technology availability, which provides opportunity to drive subscriber growth

Netflix is a global business (operating in more than 190 countries), and it sees streaming as a long-term growth market. As more players enter the market, with differentiated content offerings, consumers find more reasons to take a broadband service or buy a smart TV. This growth in technology-based options opens up opportunities for more players, but especially for a market leader like Netflix, which has the content to drive (and keep driving) subscriber growth.

Netflix's basic strategy of remorseless investment in content continues, but with variations. It aims for content that is global or, if locally inspired, can convey a storyline that will play to global audiences when translated.

It will invest in local language content that appeals in a particular country but, at the same time, has a storyline that crosses any cultural barriers and can be translated into many languages. This means that the service can vary from country to country.

English-speaking audiences seem to have got used to dubbing and subtitles; witness crime dramas in Swedish and Icelandic. This adds breadth and depth to the growing body of content.

The Netflix CEO made a basic strategic point when he described Netflix as a "one-product company" with "supporting elements". Netflix looks to carve out a position in other markets besides video, notably gaming. Gaming is more than just another piece of content. It will enhance the total Netflix offering and help to promote subscriber growth. Other content offerings (for example, music) will do the same, as Netflix moves to develop a movies and entertainment offering.

Netflix has been spending increasing amounts on original content. New content is essential when it comes to competing for new customers. Also, over time, a library is built up, which plays an important part in reducing churn. This library should, in turn, grow in value. Netflix is investing heavily in studio capacity in the UK, in particular, so that it can produce and own more of its own content.

As Greg Peters (Netflix COO and CPO) modestly puts it: "we have created the most compelling collection of entertainment available at the click of a button that has ever existed in the history of mankind" (Source: Netflix 3Q21 analysts' call).

Disney grows strongly

Disney: ambitious subscriber targets and plans to expand in Europe

Disney is pushing ahead strongly. Disney Plus (launched in November 2019) reports to have a target of 250m subscribers by 2024; at the end of 2020, it had 95m. Disney has substantial content assets to draw on, and is aiming to expand in Europe by developing non-English language content. The strategy parallels that of Netflix: spend on original European content that will do well in its country of origin and that has the potential to be a global success.

Amazon Prime Video

Amazon: actively purchasing to boost film content

A subscription service offered on a standalone basis in some territories (US, UK, Germany) or as part of a Prime subscription, Amazon Prime Video was launched worldwide in December 2016. From April 2017, Amazon began to buy up various sports rights, such as the ATP World Tour (UK), the US Open (UK only for five years) and some Premier League football (20 live matches 2019/20 and 2024/25). In May 2021, Amazon bought MGM Studios for $8.5bn (see below). In July 2021, a multi-year deal was agreed with Universal Pictures to add its films to the Prime+ offering.

HBO Max

HBO Max was launched in the US in May 2020, and was rolled out in international markets in 2020 and 2021, entering the streaming market in Europe in October 2021. In the UK, the distribution partner for Warner-Media-owned HBO Max Originals is SkyUK. The advertising-supported service, launched in June 2021 at a discount to ad-free, is reported to have been well received.

Peacock

In 2020, Comcast NBC Universal entered the streaming market by launching Peacock, a free, ad-funded service. Peacock will launch in the UK in 2022 in a deal with Sky (owned by Comcast). Peacock claims to offer "bingeworthy" originals, a huge catalogue of hit TV series and blockbuster films. In the UK, Peacock is currently only available on Sky and NOW TV.

Paramount+

Already available in the US, Paramount+ will be launched in the UK early in 2022. A deal has been reached between its owners (ViacomCBS, which owns C5) and Sky (owned by Comcast) to launch Paramount+ in all Sky markets.

AppleTV+

AppleTV+ is a US subscription service launched in November 2019. It began with a strategy of only using original content, but this led to a very slow start, and subsequently licensing deals were made with film and TV studios in order to build up the back catalogue and challenge Netflix more effectively. Production of original content continues. Apple has also tried a number of reduced-cost bundles to boost subscription uptake, including a bundle with Apple Music.

Sky

Sky operates NOW TV, a streaming service. It plans to move further into the streaming market through the launch of internet-based Sky Glass TV, announced in October 2021, which will be used to aggregate different streaming services.

Comcast is launching a subscription service called SkyShowtime, which will include brands such as Paramount+, Universal and Nickelodeon (from ViacomCBS).

M&A

The strength of content libraries is a key differentiating factor in the digital world. We see this in music, as artist catalogues are bought up, and in book publishing, where English language conglomerates have built up substantial market shares resting on large backlists.

M&A bringing scale and content

The speed of technical change in the visual media market is driving M&A: scale is everything in streaming, and acquisitions are a way of scaling up quickly. Recent deals all bring scale, as well as having a strong content dimension.

- In 2018, Sky was acquired by Comcast for £30.6bn.
- In March 2019, Disney acquired 21st Century Fox from Rupert Murdoch for $71.3bn.
- In May 2021, AT&T announced the merger of Warner Media (formerly Time Warner, acquired in 2016) with Discovery. The $43bn deal is expected to close in 1H22. The Discovery CEO expects the merged company (to be known as WarnerDiscovery) to become the third leading streaming platform after Netflix and Disney. The expanded group includes HBO, CNN and, of course, the Warner studio.
- In May 2021, Amazon acquired Hollywood Studio MGM Holdings for $8.5bn, giving it ownership of decades of classic film content, including the Bond franchise.

Investment in content

The prime strategic objective for all streamers is growth in the number of subscribers. They compete with one another for subscriptions by developing the most attractive content offering, based on the fresh supply of new programmes and the depth of their content libraries. In addition, depending on the country concerned, they can do content and distribution deals with domestic media.

Content spending increasing significantly as competition intensifies…

Competition between streaming services is intensifying as they grow. This is reflected in rising content budgets. Netflix's content spending will increase from $11.8bn in 2020 to $17bn in 2021. Added to this is content spending by a spate of new launches of streaming services (HBO Max, Peacock, Paramount+). The Netflix 2021 production budget for the UK is more than $1bn, to be spent on over 60 productions. According to the BFI, total spending on the production of films and high-end TV will exceed £5bn in 2021.

Content spending

($bn)	2019	2020	2021	2022
Netflix	13.9	11.8	17.0	22.0
Disney+	-	14.0	20.0	23.0
Disney (total)	-	28.6	24.5	33.0
NBC Universal	-	-	17.8	-
HBO Max	-	-	1.8	-

Source: Company forecasts, Hardman & Co Research

…prompting some to expect saturation and consolidation

Unsurprisingly, many industry commentators predict that there will soon be too much content on offer and that, in a saturated market, consolidation and dropout will follow.

More positively, differentiation and focus could enable smaller streamers to prosper. However, this would be a demanding challenge, as scale is still needed to build streamed services.

Alternatively, the answer may lie in bundling together several media offerings. RTL (owned by Bertelsmann) is planning to launch a German-language platform in 2022, which brings together TV, movies, sports services, music, audiobooks, podcasts and digital magazines.

Investment in studios in the UK

The boom in demand for content is led by the streaming majors. As a result, there is a corresponding boom in the demand for sound stages and other facilities.

Much of this expansion is taking place in the UK, which is said to be the second-largest programme and film production hub outside North America. Studio groups such as Pinewood and specialist property developers are building substantial amounts of new studio capacity here.

The leading streamers plan their content schedules well in advance, and this enables them to sign long-term leases on studios. Examples of recent projects include:

- In August 2021, Blackstone Group (private equity) and Hudson Pacific Properties (property developer) signed a $700m deal for their platform (Hollywood-based Sunset Studios) to build a film and TV production facility in Broxbourne, Hertfordshire.

- In September 2021, Netflix signed a new long-term lease at Longcross Studio (owned by Aviva) in Chertsey, Surrey.

- In October 2021, Netflix signed a deal for new TV and film production facilities at Segro Park, Enfield.

- In November 2021, Netflix renewed a deal with Shepperton Studios, owned by the Pinewood Group, to double the size of its production space. Work will be completed by 2023. Shepperton is a permanent production hub for Netflix. Altogether, 14 studios will be devoted to Netflix. Separately, Shepperton will add another 16 stages.

- In December 2021, Buckinghamshire Council approved plans for a £500m expansion of studios based in Iver Heath.

- Disney is reported (Source: *The Times*, 13 December 2021) to have taken a lease on a new studio development at Shinfield Studios in Berkshire. The full cost of the new development (Shinfield Studios Creative Media Hub) will be £600m. Disney production will start in 2022. 18 new sound studios will be built.

- It is reported (Source: *The Times*, 2 December 2021) that London+ Regional Properties is to acquire the Pyramids business park at Bathgate, in West Lothian, Scotland, to be redeveloped as a film and TV production centre.

- Also in Scotland, in November 2021, Hackman Capital Partners (HCP) and Square Mile Capital Management announced the purchase of Wardpark Studios in Cumbernauld. These studios have five stages, and carry out work for Sony Pictures, among others. Wardpark will be expanded further.

- RD Studios is investing £20m in a new studio facility (including five new sound stages), to open in April 2022 in West London.

- Dagenham Studios: LA-based property developer HCP will invest £300m over the next three years to build a film studio complex with up to 12 sound stages in Dagenham.

- In July 2020, Sky Studios Elstree (separate from the long-established Elstree Studios) was approved. It is a joint venture between Comcast, NBC Universal and Legal & General, and is located at Borehamwood. The development is due to open in 2022, at a cost of £400m, and involves 12 new sound stages.

- Twickenham Studios: the Creative District Improvement Company (TCDICo.) has acquired a 50% stake in Twickenham Studios from the owner (Sunny Vohra), who holds the other 50% and remains as Chairman. Backed by private equity and institutional money, TCDICo plans to invest in a network of studios across the UK, as well as expanding Twickenham Studios.

Broadcasters fight back

Strategic challenge

Content spend among streamers a strategic challenge for UK broadcasters

In the UK, the streamers pose a major challenge to the broadcasting industry. They are backed by substantial financial resources, and are spending more on content globally. In the UK, Netflix plans to spend £750m in 2021, compared with a combined spending by all broadcasters of £3bn.

As subscriptions grow, streamers are gathering enormous amounts of data about their viewers and their interests.

According to a YouGov poll, in 3Q21, Netflix was the most popular channel in the UK, followed by BBC One, Channel 4, Film4 and ITV.

According to forecasts from Deloitte, television will account for less than half of all UK video viewing by 2023, with subscription video on demand (SVOD) and advertising-based video on demand (AVOD) accounting for all of the decline. In 2017, broadcasting accounted for 75% of all viewing hours; this figure is forecast to fall to 49% in 2023. Over the same period, viewing hours at non-broadcasters are forecast to rise from 7% to 31%.

However, Deloitte puts matters in context by pointing out that broadcast TV saw viewing hours fall by 21% between 2010 and 2019, but, over the same period, advertising revenue fell by 14%, from £5.8bn to £5bn.

Established advertising-led TV companies are perceived by investors as vulnerable to the challenge from streamers. The success of the streamers is a challenge to every current business model in British broadcasting.

Nevertheless, broadcast TV remains only way to deliver mass audiences to leading brands

However, broadcast TV is still the only way of delivering mass audiences to leading consumer brands. According to the Broadcasters' Audience Research Board (BARB) figures, terrestrial television dominated TV viewing in 2020 with only two of the top 20 programmes accounted for by a non-broadcaster, in this case Netflix.

During the pandemic (so far), broadcasters have seen a steady share of viewing (March 2020, 58.8%; March 2021, 57.4%), due mainly to increased consumption of news and popular sporting events.

Taking a global view, Netflix expects to continue to benefit from a secular move from linear to streamed entertainment, with growth in the use of new devices, and the entry of new streamers into the market underpinning this growth.

However, Netflix itself observes that "existing linear networks that offer compelling internet apps will generate more viewing and become more valuable". (Netflix 3Q21 results presentation).

UK broadcasters fight back with common streaming platform

It has recently been reported in the media, but not confirmed, that UK broadcasters are to create a common streaming platform. This is to be carried out by Digital UK, which was merged with Freesat in July 2021; the combined entity covers terrestrial and satellite programmes.

The basic plan is to create a single streaming app for all leading UK streamed services: BBC iPlayer, ITV Hub, All4 and My5. With the potential for adding services and perhaps selling advertising, this could be a crucial competitive response to the US-based streamers.

UK commercial broadcasters

Both ITV and STV appointed new CEOs at around the same time, in January 2018, and new, digitally focused strategies soon emerged. The two broadcasters face very similar challenges, and have adopted similar strategies to deal with and take advantage of the rise of streaming. Both aim to strengthen their position in the mass advertising market and become digitally led media and entertainment businesses.

UK commercial broadcasters strengthening positions in mass-market advertising and transforming their digitally led businesses

Both ITV and STV have expanded into content production, supported by Nations & Regions spending, but also driven by acquisitions to expand in attractive genres and enabling them to sell to a wide range of customers.

UK content producers, in turn, are expanding their capacity. Their overall aim is to attract UK audiences to support their mass-market advertising (ITV, STV, Channel 4, Channel 5), so original UK content must be distinctive if it is to play well in the home market. Calls from UK politicians for more "Britishness" in programmes are probably unnecessary.

Big spending advertisers seek quick and efficient access to the mass market, which only the leading free-to-air (FTA) commercial broadcasters can provide. However, advertising markets, in turn, are being disrupted by digital, with data and insights created from AI underpinning targeted advertising.

Until recently, mass-market advertising has provided scale. However, because of its very broad targeting, it has also resulted in relative inefficiency and wastage. Nevertheless, increasingly efficient technology and data capture and analysis have enabled advertisers to target their linear audiences with greater accuracy. These changes have seen the emergence of data-driven linear (DDL), which is essentially a combination of scale and the precision made possible by data.

Online-only TV adspend (January to July 2021)

Sector	£m	% +/- vs. 2019
Price comparison websites	79.5	+26%
Food delivery/subscription	65.1	+194%
Online market places	63.1	+103%
Used cars	36.3	+235%
Travel	32.4	-57%
Streaming platforms	32.1	+137%
Gambling	31.6	+25%
Finance	28.0	-9%
Technology	28.0	+72%
Estate agents	26.9	+18.1%
	423.0	
Others	136.9	
Total	**559.9**	**+37%**

Source: Nielsen, Thinkbox

If the pandemic suppressed linear TV advertising generally, it had the opposite effect on so-called online-born businesses. This is not a new trend, but has recently begun to take off in a meaningful way – as quarterly figures for ITV and STV show – and has been driven by the jump in e-commerce activity during the pandemic. Nielsen reports that, for the first half of 2021, the online-only TV adspend was £560m, 37% ahead of 2019.

ITV

A faster pace of change

ITV moving at pace with digitally led strategy

ITV's strategic aim is to be a digitally led media and entertainment company. Since the new CEO arrived in 2018, the pace of change has accelerated in response to rapidly changing markets, with a focus on growing the UK and global studios business, expanding the D2C business and on the digital transformation of broadcasting.

The speed of change in ITV's business has been hidden by the impact of COVID-19 on almost all parts of the group in 2020, with the non-advertising parts of the Broadcast division (now Media and Entertainment) collectively rising 6%.

ITV revenue profile

(£m)	2017	2018	2019	2020
Direct to consumer	65	81	84	87
SDN	70	73	69	73
Other	160	147	142	153
Broadcast revenue (non-advertising)	**295**	**301**	**295**	**313**
Total advertising	1,781	1,795	1,768	1,577
Total broadcast + online	**2,076**	**2,096**	**2,063**	**1,890**
Studios: internal	523	551	573	472
Studios: external	1,056	1,119	1,249	898
Total studios	**1,579**	**1,670**	**1,822**	**1,370**
Total segment revenue	3,655	3,766	3,885	3,260
Less: intersegment revenue	(525)	(555)	(577)	(479)
Revenue from external customers	**3,130**	**3,211**	**3,308**	**2,781**

Source: ITV annual reports, Hardman & Co research

Trading background: 3Q21

Inevitably, the results were flattered by comparison with COVID-19-hit trading periods, and benefited from a strong tailwind, but the advertising increase was more than just a rebound.

Spending revival among mature consumer brands and entry of D2C and e-commerce brands into TV market boosted advertising

The rise in advertising reflected two main trends. First, there was a revival in spending by mature consumer brands such as P&G and Unilever. Anticipating a consumer spending revival, they took advantage of the discounts in the TV market to commit to a renewed round of spending. These brands are traditionally big spenders on TV advertising, but, more fundamentally, there was a re-assessment of the benefits of brand building vs. performance marketing. So, the big brands committed to TV, and look set to continue to do so.

Secondly, and influenced too by the discounts on offer, was the entry into the TV advertising market in a major way for the first time by new, digitally based D2C and e-commerce brands such as Cazoo and Deliveroo. These brands were ready to scale up their businesses – and chose TV to do it. More than 300 brands advertised on ITV for the first time. The new brands understand that brand advertising is necessary to differentiate themselves from rivals and, if this is done successfully, less paid search is needed.

Some industries increased their slice of the advertising cake materially. For example, D2C motor brands accounted for 6% of total automotive advertising in 2019 and, by 3Q21, this figure had risen to 24%. Automotive accounts for 11% of total TV advertising.

The 3Q figures reflect the benefits of the rollout of the "More Than TV" strategy, which was the first phase of ITV's strategy for growing the digital business.

The company is now entering the second phase of the strategy, driving digital change further and faster. According to the CEO, "we are becoming an increasingly scaled digital business".

Digital initiatives

"Digital transformation is key to unlocking success in many areas of our strategy." (Source: 2020 Annual Report).

Digital now permeates all parts of ITV's business. There is accelerated investment in digital processes across the group. There are digital initiatives in all four "pillars of value" (Broadcast, Streaming, Studios and D2C) within the group.

Streaming

ITV's "re-invention" of the TV advertising market means that the broadcaster now offers a reach proposition (linear mass advertising) and a targeted addressable option, achieved through Planet V – an addressable advertising programme, which allows advertisers and agencies control over the planning, purchasing and reporting of their campaigns across ITV Hub (ITV's AVOD product). This year, so far, AVOD has increased by 54%.

Planet V is for all customers, big and small. It supplies ITV's own data to clients and agencies, which is blended with their (private) data in order to target a chosen market as accurately as possible. Currently, over 90% of advertising orders are booked through Planet V.

At the end of 3Q21, ITV Hub recorded 34.8m registered users, up from 33m users at the end of 2020. The Hub has been redesigned, and the number of hours of available content is set to double compared with 2021.

Studios

New digital processes are being introduced into programme production. ITV continues to strengthen the studios business, diversifying by genre, geography and customer. In the context of strong global demand for content, the number of original hours sold to streamers in 1H21 was up by 84%. At the nine-month stage, demand from streamers was said to be growing "very strongly".

D2C

Provoked by the success of Netflix, Britbox USA (the digital subscription service) was launched in the North American market in March 2017. Britbox UK was launched in November 2019, and the service is steadily being rolled out internationally (Australia in November 2020, South Africa in August 2021 and the Nordic area in 2022). Content comes from the UK PSBs, which offer an increasing amount of original programming. Britbox was launched on Xbox in the UK in November 2021. Britbox UK has been an expensive launch for ITV so far, incurring a venture loss of £59m in 2020, after launch losses of £21m in 2019.

Distribution deals

In July 2021, ITV and Sky announced a new long-term partnership. In 2022, the ITV Hub will be launched on the Sky Q box, allowing Sky customers to watch all ITV programmes within the ITV Hub user interface. This increases opportunities to deliver advertising at scale through Planet V.

In November 2021, ITV announced a new long-term commercial partnership with Virgin Media O2. This includes full integration of the ITV Hub platform on Virgin TV set-top boxes. ITV will also offer linear addressable advertising through the Planet V platform.

Media Equity Fund

ITV plans to launch a Media Equity Fund, which will take minority stakes in early-stage digital and D2C businesses in return for advertising inventory; a bit like STV's initiative with Scottish SMEs.

STV

STV is Scotland's commercial PSB. Its status as an affiliate of the Channel 3 network means that ITV supplies national network programmes and sells national advertising around them, but advertising aimed at Scotland is also sold around the national schedule. STV pays a fee for the network schedule.

Local advertising in Scotland is boosted by the STV Growth Fund, which is an investment fund designed to attract SMEs to TV advertising. Investment in this fund was recently increased from £20m to £30m. In 2020, national advertising was £65m, and regional advertising stood at £14m.

STV benefits from an agreement with ITV in terms of which its contribution to ITV for the national programme budget varies according to national advertising revenue. This has helped to protect broadcast margins.

New CEO and three-year strategic plan

A new CEO, Simon Pitts, joined STV in January 2018, and immediately set about implementing a three-year strategy for improving the company's long-term growth rate, to be achieved by:

- maximising the value of the broadcasting business;
- driving digital growth by creating "STV for Everyone"; and
- building a world-class production business.

STV continues to invest in its strong Scottish broadcast franchise, but the strategic emphasis is on the non-broadcast businesses, in order to reduce dependence on the linear TV advertising market and to place digital "front and centre" of the group.

The sources of advertising growth are changing. Between 2017 and 2019 (i.e. pre-COVID-19), total group advertising increased by £8.1m (8.7%), with 86% of this increase coming from regional advertising and digital advertising.

The non-broadcast businesses accounted for 24% of group operating profits in 2018, rising to 34% in 2020, and STV is targeting 50% by the end of 2023.

New three-year plan, same objectives, faster rate of change

STV now has a new three-year plan with the same strategic objectives as before, but aiming at an accelerated rate of change:

- Broadcast: to grow its position as the leading mass-market TV advertising channel in Scotland, boosting this position by growing Scottish-based advertising.
- Digital: to double digital revenues from STV Player to more than £20m by the end of 2023 (2020: £13.7m).
- Studios: to quadruple production revenue to more than £30m by the end of 2023 (2020: £8.7m).

STV will invest £30m in the 2021-23 period, 75% of which will be concentrated on the digital business and studios.

Broadcast

STV has a strong position in the Scottish broadcasting market, being the most watched commercial channel in almost every timeslot. Also, since 2019, it has been widening the lead it has in peak-time viewing.

In terms of viewing audience, STV has a lead over all other broadcast channels.

In Scotland, STV has widened the viewing gap between itself and ITV over the past six years. In 2020, under the impact of COVID-19, STV outperformed all other leading broadcast channels.

The STV Growth Fund has successfully brought SMEs (some of which have never advertised on TV before) into the Scottish TV advertising market, and this has played a key role in pushing ahead advertising revenue.

Digital

In 2017, STV's digital business accounted for just 7% of group revenue. By 1H21, the figure had doubled to 14%.

Growth in digital revenue has been driven mainly by upgrading the STV Player, STV's online video on demand service. Distribution deals with online platforms such as Freeview Play (3Q20), Virgin Media (4Q18) and Sky (4Q19) mean that STV Player is now available on all major platforms across the UK.

The STV Player's content offering has been much strengthened, particularly the offering outside Scotland, with STV exclusive content, as well as with third-party content deals. By 2020, STV Player had 3,000 hours of player-only content, of which 1,200 were acquired in 2020. During 2020, STV Player was made available outside Scotland for the first time, increasing the addressable audience to 51m. The official launch was in July 2021.

Studios

The studios business has been largely built up by acquisition. It is now a stronger and more diversified business, and is winning new work in a growing market.

Benefiting from the Nations and Regions policy of stimulating content production outside London, STV has swiftly built up a portfolio of labels (production franchises) to supply the parent and others (the BBC, Channel 4, Channel 5 and Sky) with content.

The business is now made up of eight creative labels (including three in-house labels), each of which tends to focus on a particular genre.

STV Studios was severely constrained in 2020, when revenue fell by 38%. However, the business was robust enough to incur only small losses of £0.3m. Further, international sales grew strongly, to account for 40% of the total. Investment in new shows continued apace, and the benefit is now being seen.

Recent trading and outlook

In the 3Q21 Trading Update, strong tailwinds were behind a better-than-expected advertising recovery, with total advertising up 28% for the nine months. Guidance for the full year was an increase in total advertising of 22%-24%.

However, it also reflects strategic success in strengthening the broadcasting franchise. In particular, regional advertising has been robust, and is expected to be up 20% after a fall of only 5% in 2020.

On the back of new content deals, STV Player-only content and new distribution partners, digital advertising on STV Player is expected to rise by between 35% and 40%, according to the company.

STV Studios has been transformed within a short period and, this year, revenue will nearly treble to between £20m and £25m.

Conclusion

Streaming remains a long-term challenge to all broadcasters' viewing figures, and therefore to linear advertising revenue. STV's strategy is, firstly, to strengthen the Broadcasting division, controlling costs and building on the use by Scottish SMEs of TV advertising.

At the same time, STV aims to diversify and reduce its dependence on advertising. Streaming is providing STV with other growth opportunities in digital and in programme making. These businesses are at the point where they will make an important contribution to group profit. STV aims to derive 50% of group profit from non-broadcast sources by 2023.

PSBs like STV have delivered a mass audience to leading companies that are eager to protect their brands. What is more, new, fast-growing D2C and e-commerce brands have turned to TV advertising, and not online, to promote their brands.

STV revenue profile

(£m)	2017	2018	2019	2020
Broadcast	92.0	94.5	92.3	81.2
Digital	8.2	9.6	13.0	13.7
Studios	10.2	16.3	13.7	8.7
Other	6.6	5.5	4.8	3.5
Group total	**117.0**	**125.9**	**123.8**	**107.1**
Total advertising	93.5	97.4	101.6	90.9
Total non-advertising	23.5	28.5	22.2	15
Group total	**117.0**	**125.9**	**123.8**	**107.1**

Source: STV annual reports, Hardman & Co Research

Channel 4 for sale? Again?

Channel 4 now faces mounting competition from global streamers

Channel 4 was launched by the Thatcher government in 1982, and, subsequently, various governments (Blair, Major, Cameron) have considered selling it off. When it was set up, it was designed to increase competition in the UK TV market. Now, however, like all UK TV broadcasters, it faces increasing competition from the global streamers.

Integral role in UK TV broadcasting ecology

The current Ofcom enquiry into the future of Channel 4 has served to highlight its role in the broader ecology of UK broadcasting. Channel 4 commissions all its content from independent production houses, and is a vital source of business for this sector, spending £522m on content last year and contributing to the levelling up agenda. According to its CEO (quoting research from Oliver & Ohlbaum), Channel 4 spent £171m on productions outside of London in 2020. This compares with the BBC (£144m) and ITV (£77m).

If Channel4 were to be acquired by a commercial broadcaster, it would be required to do better commercially than it did in 2020, when it made profits of £74m on revenue of £934m – margins of less than 10%.

Rumoured likely suitors for Channel 4 include ITV, Sky and Miroma Ventures (the investment arm of Miroma, a communications group), which is chaired by Lord Grade, who was CEO of Channel 4 between 1988 and 1997. Comcast, owner of Channel 5, could also be interested.

According to the Incorporated Society of British Advertisers, a change in ownership of Channel 4 could reduce competition, as well as potentially weaken the supply of programmes aimed at younger and more diverse audiences. Leading advertising agencies argue that Channel 4 provides a "brilliant" platform for brand building.

Channel 4 is following a Nations and Regions strategy by moving out of London and setting up a new HQ in Leeds, which will be the centre of its digital drive.

Channel 4 has moved decisively to meet digital challenges. Digital revenue (based on All4, the UK's biggest free linear streaming platform) grew by 11%, to £161m, or 17% of group revenue, in 2020.

In 4Q20, Channel 4 announced a new digital strategy (Future4), which is aimed at turning the company into a digital-first PSB. Targets have been set for 2025:

- double viewing on All4, including a £30m Global Format Fund, which will invest in British created and produced content formats with global potential;
- at least 30% of total revenue to come from digital advertising; and
- at least 10% of revenue to come from non-advertising sources.

Privatisation a potential money raiser for government, but could cause collateral damage to independent film and production sector

Everything (including, especially, any takeover price) depends on what happens to Channel 4's remit. Privatisation could raise money for the government (estimates range between £0.5m and £1bn), but there could be collateral damage to the independent film and TV production business. By now, the channel has become an integral part of the UK TV ecology and management. It was set up with a unique business model and, if it can adapt to the world of streaming, this should continue. Also, the more the channel can demonstrate that it will not be a burden on taxpayers, the stronger its case will be.

BBC

Substantial potential global opportunity for BBC after likely switch to paid-for streamed service

The BBC received £3.75bn from the licence fee in 2020/21, but raising revenue in this way is widely regarded as inefficient and is subject to evasion. So, when broadband has been rolled out sufficiently throughout the UK, it is likely that viewers will have to pay the BBC for a streamed service. A switch from a compulsory licence fee to a voluntary payment will make a profound difference to the BBC, which will have to pay much more attention to what licence fee payers want, especially regarding cultural biases and impartiality in news coverage and commentary. Furthermore, the global opportunities for a streamed service from this most powerful of British brands seem immense.

At the moment, the focus is on shorter-term funding. On 16 January, the Culture Secretary suggested that the licence fee will be fixed at £159 for two years, and axed in 2028. The BBC's current funding arrangements end on 31 December 2027, and the Culture Secretary made it clear she was seeking new ways of funding the BBC thereafter. Also, there is a Private Members Bill demanding that the BBC should be funded by subscription.

It is clear that the BBC will be under financial pressure at a time when the streamers are aggressively increasing their content spending. However, it would be better if the BBC could avoid years of trench warfare with the government of the day, and come up with its own proposals for long-term funding and how it will cope with the streaming challenge.

Share ratings diverge

Streaming vs. broadcasting

The surge in the number of subscribers to streamed TV has led to high ratings for the market leaders (e.g. Netflix on 6.9x revenue), while the perceived technological threat to viewing numbers, and hence to advertising, has led to relatively low ratings for UK broadcasters (e.g. ITV on 1.24x revenue).

Technology-based businesses are seen as “the future” by investors who have continued to chase share prices higher. Tesla is the acute example of this, and the same approach has pushed Netflix to its substantial premium.

If the market decides that you are a digital success, your rating will rise – possibly by a large amount. Analysts who can’t explain this trend in terms of operational performance tend to talk about “thematic investment”. Or, perhaps, FOMO is the key.

In the car manufacturing market, the value of Tesla (EVs only) is far ahead of that of Toyota, Volkswagen and Daimler (petrol and diesel, with huge investments going into EVs). The flip side of this is the relatively low rating accorded to established (old tech?) businesses. Daimler Benz, for example, is on 0.57x revenues. Tesla’s market cap/revenue is 15.2x; General Motors is on 0.58x.

In the UK, the commercial PSBs are investing in streamed content distribution, and in their own content production businesses and libraries. This is adding to their non-broadcasting growth, while reducing their relative dependence on mass-market advertising.

Streamers, on the other hand, are investing huge amounts in content and seeing much increased competition from rival streamers, while there are slowing rates of increase in subscribers in mature markets. Recent trading results prompted talk of saturation and maturity in the streaming market.

While streamers seldom compete head-on, they do compete with each other for consumers’ time and attention. It is not clear that there is enough demand for all of them – so consolidation or exit may follow. In this market, scale is everything.

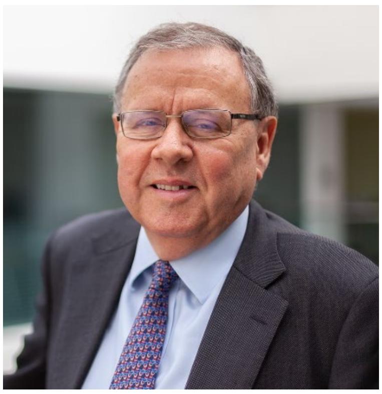
Slower growth from the streamers may lead to a fall in their ratings, while continued growth by increasingly diversified UK broadcasters may lead to a rerating. The real challenge to the broadcasters, though, is maintaining their grip on the mass advertising market.

Comparative market capitalisation to forecast revenue ratios

	Price	Mkt. cap.	Revenue	Mkt. cap./rev.
Netflix	$525.7	$232.85bn	$34.0bn	6.9x
ITV	117.9p	£4.33bn	£3.5bn	1.24x
STV	335p	£156.5m	£149.5m	1.05x
Tesla	**$1,049.6**	**$1,136.7bn**	**$74.9bn**	**15.2x**
Daimler Benz	€74.79	€80.0bn	€138.95bn	0.57x
General Motors	$61.1	$88.7bn	$152.7bn	0.58x

Note: Revenue figures are consensus 2022 estimates. Source: FT Equity forecasts, Market Screener, Hardman & Co Research

About the author



Derek Terrington

Derek Terrington is responsible for covering media stocks at Hardman & Co.

He has more than 30 years' experience in the City, and was rated top analyst in the Institutional Investor Survey for the Publishing sector for four years from 1988 to 1991. He has worked at leading City brokers and financial institutions, and was Head of Media Research at UBS, KBS and Commerzbank, as well as Partner and Head of Research at Teather & Greenwood. On the buy side, he has been a media analyst at AXA Fund Managers.

Derek joined Hardman & Co in 2013. He is a graduate of the University of Cape Town, with an MA in Economics.

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research@hardmanandco.com

1 Frederick's Place
London
EC2R 8AE

+44(0)20 3693 7075

www.hardmanandco.com