Streamed content takes over…

…after the Great Correction of 2022

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Executive summary

Streamed content takes over…

- The Great Correction of 2022 saw the share prices of streamers plunge after market leader Netflix reported a slowdown/fall in subscriber growth.
- Having formerly been seduced by hectic subscriber growth rates, investors quickly refocused, this time on fundamental metrics such as revenue, margins, profits and cashflow.
- Since then, streamers have continued to take a steadily greater share of viewing while linear TV continues to decline. But growth in streaming subscribers in the US and UK is now a fraction of what it was, reflecting pressure on consumer incomes and intensified competition in content.
- The slowdown in growth of subscribers has led to a revision of business models. Netflix is broadening its offer to subscribers by investing in areas such as sport, gaming and gambling, aiming to become an entertainment hub. The business is scalable, with pricing power, so margins are rising.
- Disney has dealt with management issues and with attempts by outside investors to gain a seat on the board. Based on its enormous content assets, it is set to move into profit on its streaming offering this year and, like Netflix, it will be an entertainment hub.
- Streamers see advertising as an attractive source of revenue and are offering advertising-supported tiers at low prices. If their content delivers audiences that advertisers want, streamers will have a slice of high-margin revenue. Plus, streamers view the lower prices as a way of reeling in new subscribers, rather than encouraging trading down.
- In the UK, competition for viewers is intense with the US-based streamers up against the Public Service Broadcasters. ITV and STV have adopted three-legged strategies: linear broadcasting, programme making and streaming, but, currently, they are still too dependent on linear advertising revenue for investors' liking.
- Streaming is now a global business. Netflix identifies 700m connected TVs worldwide and compares this with its subscriber numbers of 260m. Even in the domestic US market, streaming accounts for only 10% of TV time, so plenty of growth to go for.
- In the US, loss-making streamers (Warner Brothers Discovery, Paramount) are considering merging. Outside of Netflix, only Disney looks like making profits from streaming, but Amazon Prime may be on the path to profit too, in view of its strong growth in subscribers.
- Streaming is a disruptive, content-led, subscription-based technology. Challenging all video distribution business models, it opens up global opportunities for a growing variety of content, including gaming and sport. Successful use of content to engage and retain subscribers in a scalable business will lead to strong profit growth. The old saying that "content is king" has never been truer.

...after the Great Correction

Highly rated shares slumped when the growth in streaming subscribers stalled in 2022

Prior to 2022, investors put a high rating on shares such as Netflix, clearly believing that the company was the winner in the race for the future of video distribution. However, net losses of US paid subscribers in 2Q, 3Q and 4Q'22 shattered this dream and shook the entire streaming industry. Share prices plunged. They have recovered since, but only modestly, and not to the extent of Netflix.

Streamer share prices: 2021/22 high/low; end-2023

$	Netflix	Disney	Comcast	WBD	Paramount
High	682.6	192.3	67.0	77.3	99.2
Low	175.5	81.1	29.3	9.2	10.7
End-2023	486.8	90.3	43.8	11.4	15.0

Source: Company websites

Awakening from the dream, investors went back to basics and began to demand commercial success, with growth in revenue and profits and strong, sustainable cashflow. Questions were raised about high debt levels, which resulted from accelerating content spending, where it was not always possible to demonstrate a positive return.

The video distribution industry is facing two imperatives:

- streaming is the technology of the future but needs substantial investment; and
- streaming is loss-making in the short term for some newer entrants to the market. They will need to decide for how long they can tolerate the cash outflow and higher debt.

In the short term at least, there are many challenges. In some cases, weak linear TV advertising is hitting revenues. All are affected by inflation in content costs, following settlement of the actors' and writers' strike. Sport is seen as a major audience builder, but sports costs are rising too.

M&A activity could solve some strategic and operating problems, such as losses, but who would buy and who would sell?

Slower growth in streaming markets plus investor demand for better financial performance is driving changes in business models

Slower growth in streaming and investor demand for better financial performance is driving changes in business models and corporate strategies. Market leaders are evolving into "entertainment solutions", which will attract and retain subscribers based on the breadth of their content offering.

Netflix is acquiring assets in gaming and gambling, for example, which will drive subscription growth and make price increases possible. Disney probably has the widest and deepest content portfolio and Disney+ (the streaming service) is growing strongly. These two, and possibly Amazon Prime, will be market leaders globally and will benefit from economies of scale. All are offering advertising-backed, cheaper content services.

Other competitors will have to offer attractive content at competitive prices and will be more at the mercy of trends in consumer spending than their larger rivals.

US streaming battleground

Netflix versus the rest

Netflix is the longest-established streamer and market leader with a good trading track record

Netflix is the longest-established streamer and is market leader, by some way. It has delivered subscriber growth year after year, making profits and generating cash but spending heavily on content while taking on rising levels of debt.

TV, generally, was a very local industry, based in regions, towns or countries, until technology made streaming possible, and then it became global. Netflix went global in 2016 and, at the same time, began to build up its original content library, having previously bought in or licensed its content.

Heavy spending on content from 2016

There was a leap in spending on original content between 2016 and 2022, from $5bn to $14.5bn. Over the same period, operating margins grew from 4% to 20%, as the gearing effect of subscriber growth in global markets kicked in.

Following the downturn of 2022, Netflix reminded investors not to focus too heavily on subscriber numbers. This may look to be an obvious comment after the modest period of subscriber growth, but the point being made was that there are other ways of driving revenue, profit and cashflow.

In the US, price increases came to the rescue, with the average revenue per customer rising by 7.3% from $14.78 (FY'21 average) to $15.86 (FY'22 average) compared with a 0.3% fall in average subscribers from 74.234m to 74.001m.

In 2023, 3Q and 4Q results beat expectations, and margins and cashflow improved

The 4Q'23 results were ahead of expectations, with revenue growing by 12.5%, reflecting the benefits of increased paid sharing, price increases and a strong slate of movies. Better-than-expected revenue growth fed through to higher operating income and record 4Q margins of 16.9% compared with 7% in 4Q'22. Globally, subscriber numbers reached 260m.

Netflix: recent trading

$m	4Q'22	1Q'23	2Q'23	3Q'23	4Q'23
Revenue	7,852	8,162	8,187	8,542	8,833
% +/-	1.9%	2.7%	3.7%	7.8%	12.5%
Operating income	550	1,714	1,827	1,916	1,496
Operating margin	*7.0%*	*21.0%*	*22.3%*	*22.4%*	*16.9%*
Global paid members (m)	230.75	232.50	238.39	247.15	260.28
% +/-	4.0%	4.9%	8.0%	10.8%	12.8%

Source: Company announcements, Hardman & Co Research

At the same time as financials improved, Netflix expanded its strategic horizons by creating new content categories that add value for customers. Cashflow continues to be directed to film making and acquisition but also to interests in gambling and gaming.

Netflix offers an ad-supported channel at a lower price, but advertising has been slow to build up; advertisers must want the audiences that Netflix delivers. It remains to be seen if advertising is a "growth lever".

While Netflix emphasises that subscriber growth is not the holy grail, it is keen to point out that there is enormous further potential for growth, on a global basis. It also maintains that scale is a priority. Worldwide, there are nearly a billion broadband subscribers.

The creation of a "deep slate" of content continues as Netflix moves into unscripted content in English and in local languages and into other genres, such as animation, sport and video games. The aim is to grow engagement with a wide range of content offerings. And engagement means retention of subscribers. Pricing strategy will reflect this with a wide range of options for a wide range of consumers.

Netflix sees itself as a global entertainment company

Netflix sees itself as a global entertainment company. Success in this strategy plus a very scalable business model lies behind the company's confidence in becoming more profitable still. In its 3Q'23 results commentary, Netflix claimed that it was nowhere near a margin ceiling. In FY'23, margins of 20% are expected, rising to 22%-23% in 2024.

Netflix makes a major move into live sports entertainment by means of a long-term partnership with sports entertainment company WWE

With the 4Q'23 results figures, Netflix announced a major move into live sports entertainment in the form of a long-term partnership with WWE, a global leader in sports entertainment. Netflix is to pay $5bn for 10 years of content.

From January 2025, WWE's weekly flagship programme (*Raw*) will find an exclusive home on Netflix in the US, Canada, the UK, Latin America and other territories with more countries to be added over time. In addition, Netflix will offer subscribers all WWE shows and specials outside the US (including *Raw*).

There is a strong message for the TV industry here as *Raw* will no longer be on linear and has moved to a digital service, enabling it to appeal to a larger audience globally, which should be attractive to advertisers. The deal is also in line with the Netflix objective of becoming an entertainment hub.

Netflix outlines its opportunities in global terms: pay TV, films, games and branded advertising together make up a market of $600bn. At the moment, Netflix has just 5% of this.

Disney gets its act together

Fiscal 2023 ended on a strong note for Disney, although streaming was still loss-making

Following a difficult 2022 and early 2023, Disney reported group revenue of $89bn (+7%) and a 6% rise in group operating profit to $12.9bn, for the year to September 2023. There was a particularly strong 4Q, with group profits up 86%. Profits on linear networks were steady, at $805m, but losses on direct-to-consumer (DTC) were sharply lower at $400m, a turnaround of $1bn.

At the end of the year, Disney+ subscribers totalled 112m, with 7m added in 4Q. Ad-supported Disney+ products grew by 2m in 4Q to 5.2m. The target for cost cutting (annualised) was raised from $5.5bn to $7.5bn.

The CEO confirmed his target of hitting profitability on streaming in 4Q'24.

Disney's corporate strategy for streaming: ESPN, film studios and experiences

Disney revealed four "building opportunities" that constituted the next phase of its corporate strategy.

- Achieving significant and sustained profitability in the streaming business
- Building ESPN into the pre-eminent digital sports platform
- Improving the output and economics of its film studios
- Turbocharging growth in the experiences business

Disney is to acquire the remaining stake in Hulu (the US subscription streaming service) from Comcast and make it part of Disney+. After much speculation, ESPN+ will be absorbed into Disney+. These moves bring together all of Disney's streaming assets, creating a formidable offering to consumers. Reflecting this strength, streaming prices were increased in 1Q'24.

The combined streaming businesses are set to reach profitability by 4Q'24, helping to narrow the gap in group margins between Disney (14.5%) and Netflix (21%).

Amazon Prime flexes its muscles

Prime Video is a main reason to sign up for Amazon Prime

At its simplest, Amazon uses technology to transform customer experiences. Prime Video fits the bill; it is one of the top two reasons for subscribers to sign up with Amazon Prime, Amazon's paid subscription service, which offers goods and services at a discount to regular purchases on Amazon.

Amazon Prime Video gives subscribers access to popular movies and TV shows. In addition, membership of Prime Video gives access to content from streaming services such as Paramount+, Discovery+, Lionsgate+, StudioCanal and MGM. Prime Video offers a premium streaming service, as well as a broad transactional video-on-demand service.

Prime Video could become a large and profitable business

In its 3Q trading statement in October 2023, Amazon gave a hint of its ambitions, in stating that Prime Video could become a large and profitable business as it continues to invest in exclusive content for members. It does not offer live TV. Exclusive content is provided by Amazon Originals. Amazon Exclusives offers exclusive movies but not made by Amazon.

In March 2022, Amazon Prime acquired MGM Studios for $8.4bn, adding exclusive movies to its offering.

In January 2024, advertising started on Prime Video, following in the footsteps of Disney+ and Netflix. Subscribers who wish to avoid the advertising have the option to upgrade to an advertising-free service for an extra £2.99 per month.

Amazon Prime has proved to be a hugely attractive consumer platform. It currently has 220m subscribers, of which 168m are in the US. In 2022, Amazon Prime Video had 190m subscribers.

Amazon is a formidable marketing machine and has the financial firepower to sustain a period of spending on content, but it remains to be seen how attractive its offering is when compared to Netflix and Disney, which are becoming entertainment hubs.

Warner Brothers Discovery to acquire Paramount?

WBD aims to build scale in streaming

To compete with the leading streamers, consolidation among rivals is a likely option. It is widely reported that Warner Brothers Discovery (WBD) and Paramount Global are in merger talks. Both companies are making losses, or marginal profits, on their streaming assets. The need to make a success of streaming by building scale and cutting costs is the key driving force behind the mooted deal.

Paramount Plus, the streaming service, has 63m subscribers. WBD has 95m and HBO Max has 60m. This compares with Netflix, which has 260m.

WBD itself is the result of a merger, in April 2023, between Warner Media and Discovery. This left WBD with high levels of debt, which the company has focused on reducing. At the end of 3Q'23, net debt was $45bn, after paying down $12bn.

Wall Street unimpressed by a defensive merger

Wall Street was unimpressed by the notion of a combined group and both shares fell on the announcement of a potential tie-up. The main concern was the level of debt carried by both companies; strategically, though, there was concern about their involvement in declining linear TV assets as well as continuing losses on streaming.

WBD's 2023 revenue is estimated (market consensus) to reach $44bn. For 2024, revenue is set to grow by just 1.5%, with a loss at the operating level. No profit growth is expected until 2026.

For the first nine months of 2023, Paramount reported revenue of $22bn (flat against 2022) and a loss of $855m at the operating level. Group performance was better in 3Q, with revenue up 3%, due mainly to a 46% rise in Paramount+ subscription revenues to $1.3 bn. Elsewhere in the group, both linear TV and Studios saw a fall in revenue and profit.

Outlook

With Netflix tightening its grip on the streaming market, investor attention has switched to the rest of the streamers, who may have lost a combined $5bn in 2023, industry sources suggest.

Netflix has a strong market position, established over many years, with a library of many titles and many genres. In addition, with a strong front list, Netflix can (and does) price at a premium to its rivals. Rivals must price at a discount to win and retain subscribers, despite offering some attractive content.

Spending on content remains a battleground, and despite a slight lowering of industry content spend, this lies behind the losses in 2023. Longer term, the cost of content will continue to rise, due to competition among streamers. There is no certainty that there will be profits. The exceptions are Netflix (margins 20% and rising) and Disney, which maintains that its streaming operations will be profitable in December 2024.

There are several possible solutions to the problem of losses:

- Consolidation is one route to lower costs and a stronger content offering. Paramount might be up for sale, possibly to Warner, which has been losing streaming subscribers.
- Major cost-cutting exercises are applied – Disney is cutting $7.5bn, or 7,000 jobs.
- Production costs have risen after the settlement of the Hollywood screenwriters' and actors' strike. The stronger companies can cope with this by raising prices, but weaker ones will have to cut costs further.
- As yet, no competitor has packed up his tent and left the field of battle. A merger of lossmakers has been suggested to strengthen the content offering and take advantage of the economics of scale, but this is not from a position of strength and leaves questions unanswered.

Consolidation is a short-term response to over-investment in content, but M&A is not the solution to any longer-term slowdown in the streaming market, which may cause problems for the weaker players. According to Alix Partners, the US streaming market grew at 22% p.a. between 2017 and 2023 but is maturing and is forecast to grow at "mid-single-digit" rates between 2024 and 2026.

Currently, the advertising market is weak, reflecting slower economic growth and rising costs for consumers. However, in the longer term, digital is set to take a larger and larger slice of total advertising spend. In 2018, digital accounted for 51% of global ad spend and is forecast to account for 74% in 2026.

UK streaming battleground

SVOD households in the UK continue to rise…

The penetration of UK households by subscription video on demand (SVOD) continues to rise. Based on figures from BARB's Establishment Survey, 19.3m UK homes (67.3%) had access to SVOD services in 3Q'23. This a rise of 2.7% on the previous quarter but in line with 1Q'23.

Number of households subscribing to SVOD services in the UK

(m)	1Q	2Q	3Q	4Q
2021	17.4	18.8	18.7	19.1
2022	19.6	19.2	19.5	19.4
2023	19.1	18.8	19.3	-

Source: BARB, Hardman & Co Research

The rise has slowed materially over the past three years. Figures for 3Q'23 are 6.9% above the figure for 3Q'21 but are below those for 3Q'22.

…but streaming markets in both the UK and US are seeing slower growth than before

Streaming markets in the US and UK are seeing slower growth than before. There seems to be many reasons, not least the squeeze on consumers' income. But also a factor is content fatigue, which, Deloitte reports, is a leading reason for 21% of UK streamers cancelling their subscriptions in 2023. Other reasons for cancelling include price (27%), keeping household costs down (24%) and, remarkably, "there was nothing I wanted to watch" (16%). Kantar identifies "boomerang" consumers, who sign up to watch a series then cancel. This applies particularly to new entrants, which offer low prices in order to buy their way in and drive for scale.

Account sharing is a major issue for streamers. Altogether, 35% of subscribers are sharing an account with other households; they either share a paying account or are not paying at all. According to Deloitte, if sharing were to be stopped, 21% of subscribers would consider a full price service, 35% would consider a higher price than they were paying and 35% would consider a service with adverts.

The streamers are approaching this issue carefully as they want to increase the yield per subscriber but are wary of higher prices driving sharers away.

Nevertheless, streaming is popular. The average number of subscriptions per home rose to 2.62 in 2023, up from 2.46 the previous year. In some cases, there is "service stacking", i.e. buying multiple subscriptions. This is a way to see what is on offer, but accounts for cancelling and must be vulnerable to price rises.

Netflix is the service with the greatest access (16.7m homes) followed by Amazon Prime Video (13.0m), Disney (7.6m), Apple TV+ (2.2m), and Paramount+ and NOW (1.9m each).

Leading streamers in the UK market in 2023

(m)	1Q'23	2Q'23	3Q'23
Netflix	17.0	16.5	16.7
Amazon Prime	12.9	12.6	13.0
Disney+	7.1	7.2	7.6
Apple TV+	1.9	1.9	2.2
Paramount+	-	1.7	1.9
NOW	2.0	2.0	1.9
Total UK homes with subscriptions	**19.0**	**18.8**	**19.3**

Source: BARB, Hardman & Co Research

ITV

A robust strategy, focused on content and streaming

ITV defines itself as a "leading global and diversified vertically integrated producer broadcaster and streamer" (2022 annual report). Its vision for 2026 is to be a leader in UK streaming and an expanding global force in content.

ITV operates under two divisional headings:

- **Media & Entertainment:** All of ITV's channels and platforms fall into this division, which consists of Broadcasting and Streaming. In December 2022, ITV launched its new, advertising-funded, free, streaming platform ITVX. ITVX also has an advertising-free subscription offering.

- **ITV Studios:** The accelerating pace of change in the TV market is driving sustained growth in the demand for content for linear and streamed TV. Demand is also driven by a growing range of devices on which content can be accessed.

ITV: revenue profile

(£m)	2021	2022
Studios	**1,760**	**2,096**
Total Studios	**1,760**	**2,096**
Media & Entertainment		
Digital advertising	293	343
Linear advertising	1,664	1,588
Total advertising	1,957	1,931
Digital revenue	54	68
Other revenue	293	182
Total Media & Entertainment	**2,282**	**2,249**
Total	**4,042**	**4,345**
Less internal supply	(589)	(617)
Group	**3,453**	**3,728**

Source: ITV, Hardman & Co Research

ITV's stated corporate strategy is to be a leader in UK streaming and an expanding global force in content. The strategy has three strands:

- **Supercharging streaming:** ITVX was launched in December 2022, starting life with 19,000 hours of content (22,000 at the 2023 interim results stage). ITVX offers viewers the chance to watch programmes before they are broadcast and offers content from the programme archive. Additionally, some content will be offered from international studios.

- **Expanding Studios globally:** Internationally, the demand for content is being driven by global streamers. ITV has shared in this growth and, in 2022, it derived 22% of its revenue from streaming platforms (2021: 13%). In line with other broadcasters, ITV expects slower growth in the streaming content market in future but, nevertheless, aims to derive 30% of its revenue from this market in 2026.

- **Optimising the advertising-driven linear channels:** Linear advertising is a strong cash generator and, in this way, sustains investment in the Studios and ITVX. Optimising refers to keeping a balance between linear and ITVX to prevent one taking share from the other.

Strategy falling into place

At the time of the 2023 interim results, at end-June, ITV was able to report good strategic progress and strong results from Studios (revenue up 8%) and ITVX (revenue up 24%). Although ITV maintained its position as a clear leader in linear advertising, total advertising revenue fell by 11% and ITV described the market as "challenging". Overall, total group revenue fell by 1% to £1.639bn.

More spending on content leads to a 29% rise in users on ITVX

The ITVX business model developed positively. Greater spending on content attracted more users, who watched more and stayed for longer (compared with ITV Hub). With a 29% growth in active users to 12.5m, and a 33% rise in total streaming hours to 737m, total digital revenue rose 24% to £218m (13% of the group total), as at end-June 2023.

Based on these results, ITV stuck to its target of at least £750m of digital revenue by 2026. By 2026, ITV expects about two-thirds of total revenue to come from its growth drivers; i.e. Studios and digital.

A broader strategic development reminds investors that digital cannot be seen in isolation. ITV is creating bespoke partnerships across linear and ITVX to leverage the strength of certain programme brands to help advertisers connect with audiences in unique ways.

Good strategic progress reported in the 3Q'23 statement but with a slower streaming market and intensified competition...

ITV reported "good strategic progress" in the 3Q statement, but, like other streamers, it faces slower growth in the streaming market and greater competition from the big US streamers. Netflix, Disney+ and Amazon Prime are setting up a lower tier of service at a cheaper rate and partly funded by advertising. If advertisers are getting the audiences they want, this could eat into ITV's digital advertising. However, the free ITVX service is already a strong competitor and will offer ever more content, some original and some from its vast library.

...and a similar pattern in November with weak linear advertising

ITV's trading update in November 2023 reported strong revenue growth by digital and studios (+9% to £1.15bn), but the decline in linear advertising (-7%) limited group revenue growth to 1%. ITVX produced total digital revenue growth of 23% to £340m from 27% growth in total streaming hours. Digital advertising reached £283m (83% of total digital revenue).

Despite stronger headwinds, ITV remained confident of delivering digital revenue of at least £750m by 2026.

STV Group

STV Group's strategy is to transform the group into a digital streaming and content-led media company while maximising returns from the linear (broadcast) business. The Studios and Digital divisions are the focus of growth.

Current corporate target is a 50/50 split in profits between linear and non-linear operations by the end of 2023

STV's current corporate target is to get 50% of its operating profits from non-linear TV by the end of 2023 (2018:24%).

The company is organised into three interconnected business divisions:

- **Broadcast:** STV has a leading position among viewers in Scotland and aims to maintain this position and grow Scottish-related ad revenues. STV has a huge reach in Scotland (over 3m adults per month) and has a higher daily/weekly/ monthly reach than all SVOD services combined.
- **Digital:** STV Player is being transformed from a catch-up service to a digital destination. It is available on all major platforms, including Freeview, Sky Glass and NOW. In December 2022, an enhanced strategic partnership was agreed

with ITV around content sharing and advertising sales. The available content on STV Player has been broadened and deepened. In addition to network content, Player exclusive content has been added, and third-party content has been acquired, helping to build up the library.

- **STV Studios:** This division is not short of ambition. It aims to be a world-class producer for the biggest TV networks and global streamers as well as the UK's No1 Nations and Regions production company. STV has targeted revenue of £40m by 2023 (2020: £8.7m). There are nine production labels in the division, with stakes of various sizes being held in the six independent labels; these may become wholly owned in due course.

STV Group is small by international standards: 2022 revenue was £138m and operating margins were 18.7%. The content-led strategy is proving successful in driving growth. However, investors still focus heavily on the performance of the broadcast business where advertising is currently weak.

STV: revenue profile

(£m)	2021	2022
Studios	27.0	23.9
Broadcast	108.8	107.6
Digital	17.8	19.0
Other	1.0	0.0
Total	**154.6**	**150.5**
Less intragroup	(10.1)	(12.7)
Group	**144.5**	**137.8**

Source: STV Group, 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.

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(Disclaimer Version 8 – Effective from August 2018)

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