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# The Future of Video

Q2 2016

**REDEF**

# **Agenda:**

**1. Where the Video Industry was (and why)**

**2. The Underlying Fragility of Pay TV Today**

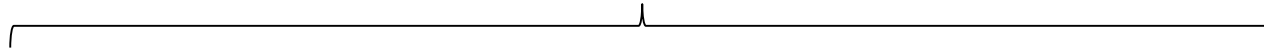
**3. What's Driving this Change (and what that means)**

**4. The Digital Future of Video Services**

# The Traditional Video Ecosystem was Defined by its Constraints

*Severe bottlenecks to content production and distribution reduced industry competition and consumer choice*

## Bottlenecks



### Creatives



**Huge amount of creative talent**  
(writers, directors, actors etc.)  
eager to create

### Production Companies



...But the **high cost of production** meant only a few production companies/ studios were willing and able to finance, preventing most from getting their chance...

### Networks



...and the **limited number of programmers** (i.e. channels) and **24/hour linear schedules** further capped content

### Distributors



And programmers had only a **few delivery models** (i.e. broadcast v. cable), with **distribution tightly controlled** by a handful of MVPDs

### Devices



And the **reliance on a single, stationary and shared device**, the living room TV, limited how much content could be consumed

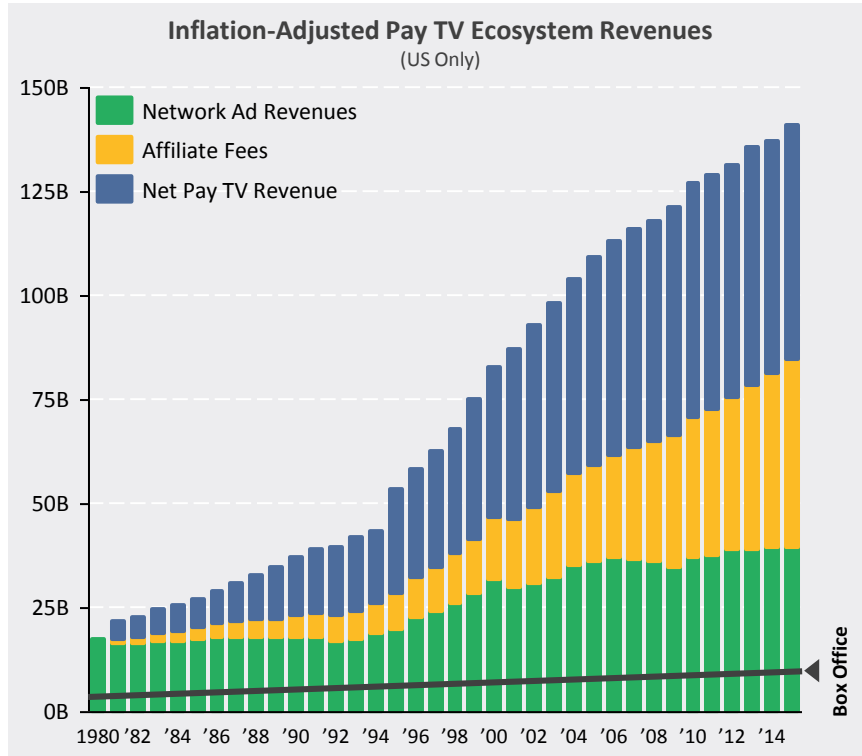
### Audiences



Despite their diversity, **audience attention was limited** to the content that made it through the system

# ...And These Constraints Were Terrific for Anyone in the Business

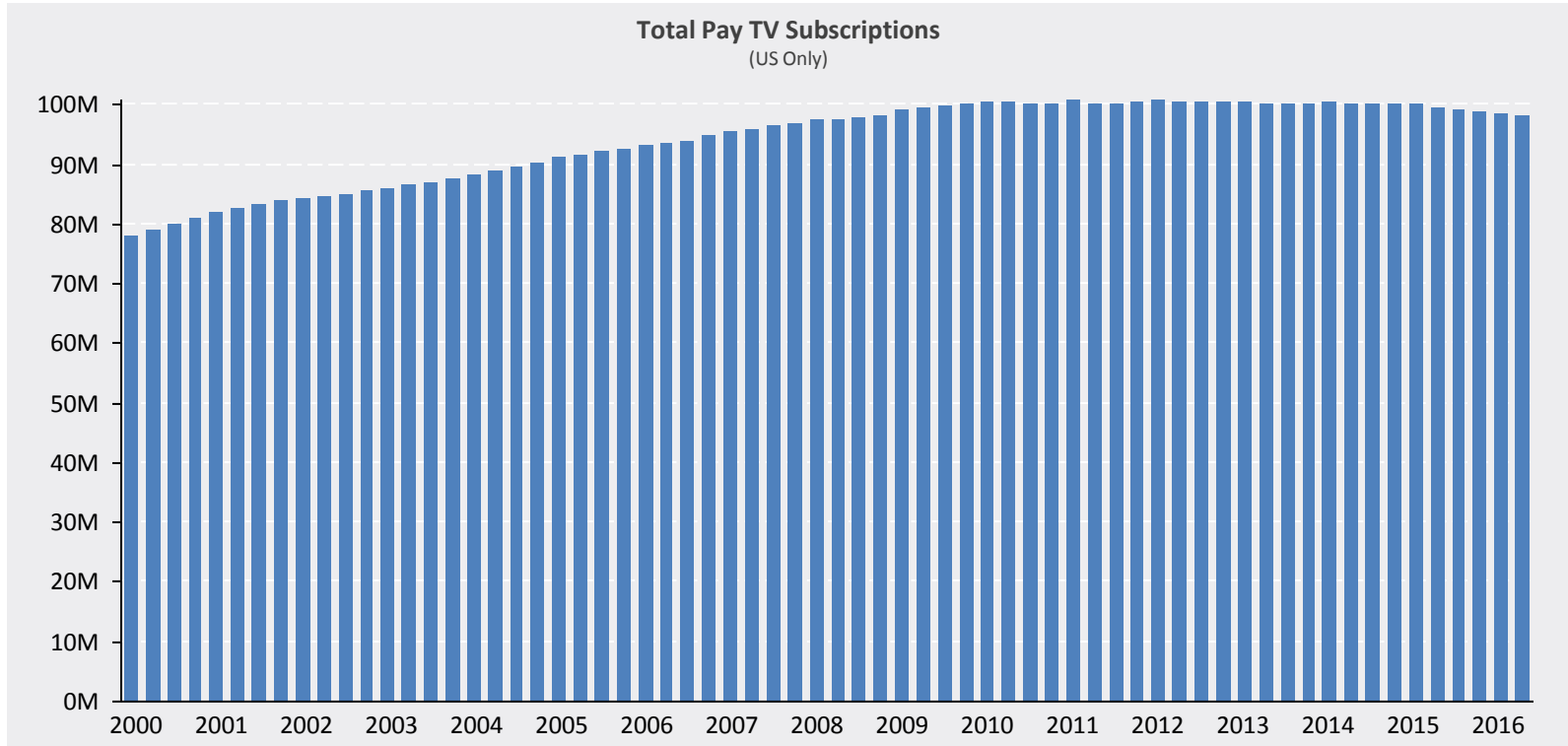
*For almost all content creators, there was only one path to audiences – and audiences had only one path to video. This enabled phenomenal growth and (virtually unstoppable) profitability in television*



- Thanks to its reach, immersive experience and record levels of consumption, television quickly became the most valuable medium on earth
- It was also highly concentrated, with a clear business model (eyeballs) and immense barriers to entry
- Furthermore, there was no “failing out” of carriage, no struggle to find revenue and ease discoverability
- For all its critics, growth remains robust by 2016

# Even Today, Pay TV Subscriptions Have not Materially Declined

*Despite rampant coverage of 'cord cutting', the number of US Pay TV subscriptions has remained around 99M for close to a decade – an astounding 85% penetration rate*

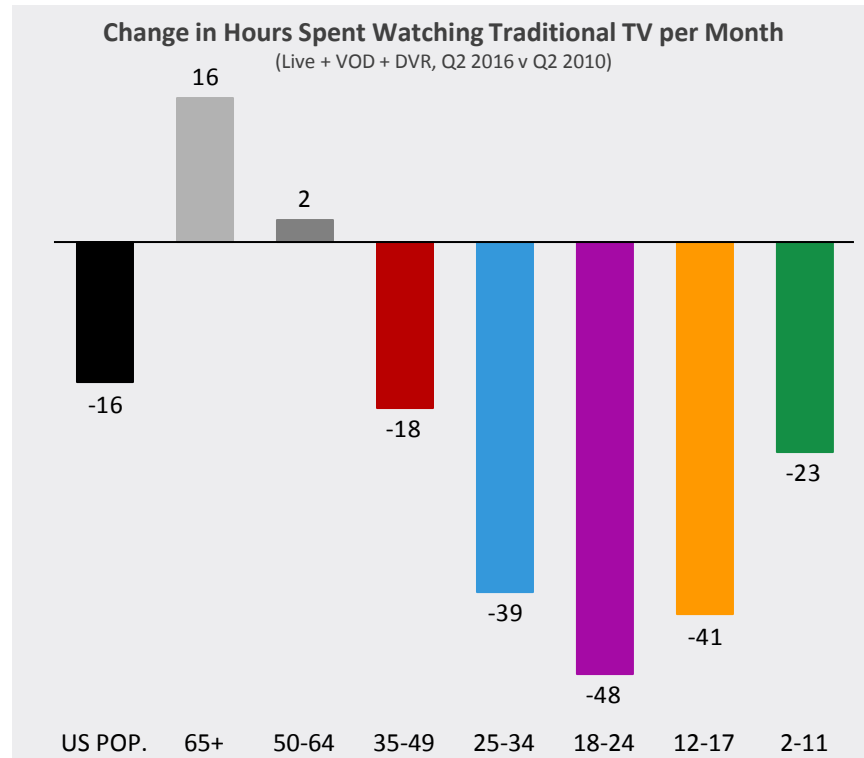
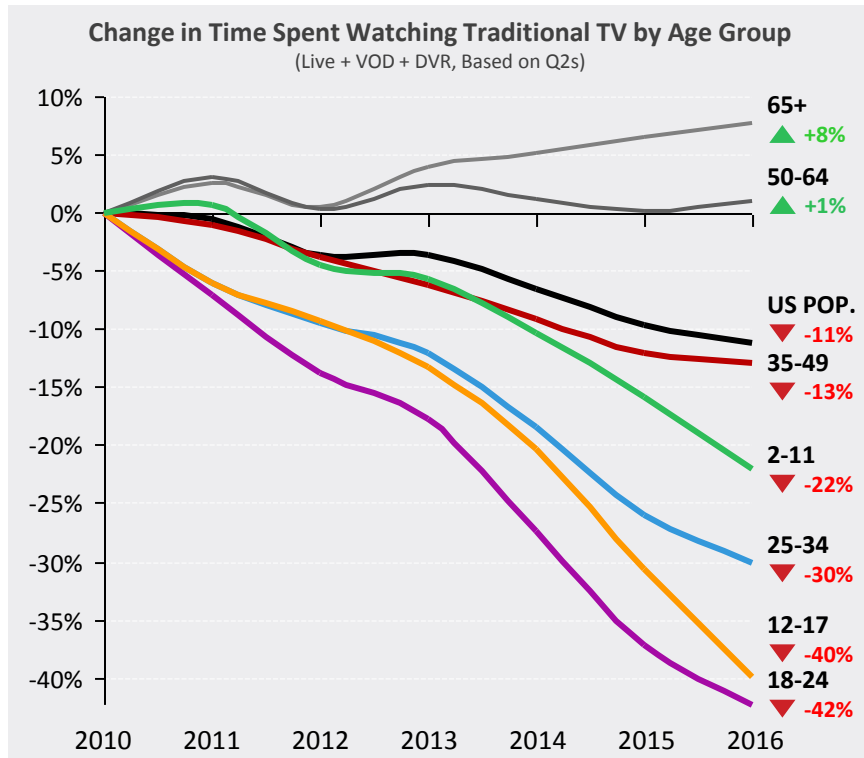


Sources: MoffettNathanson

**But TV's dominance is coming to an end...**

# (1) Audiences are Moving on from Traditional TV

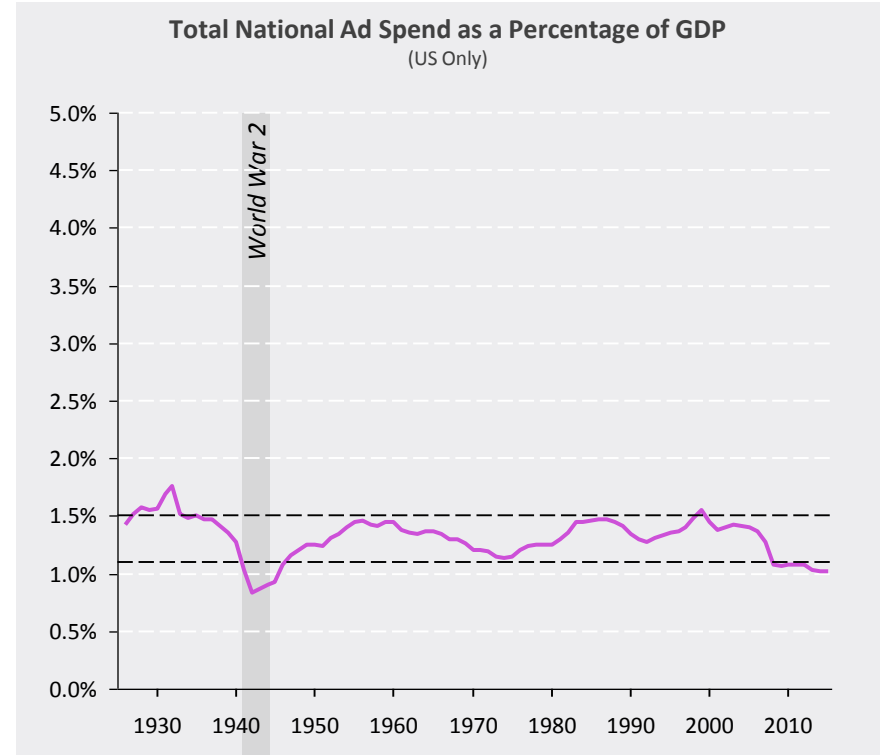
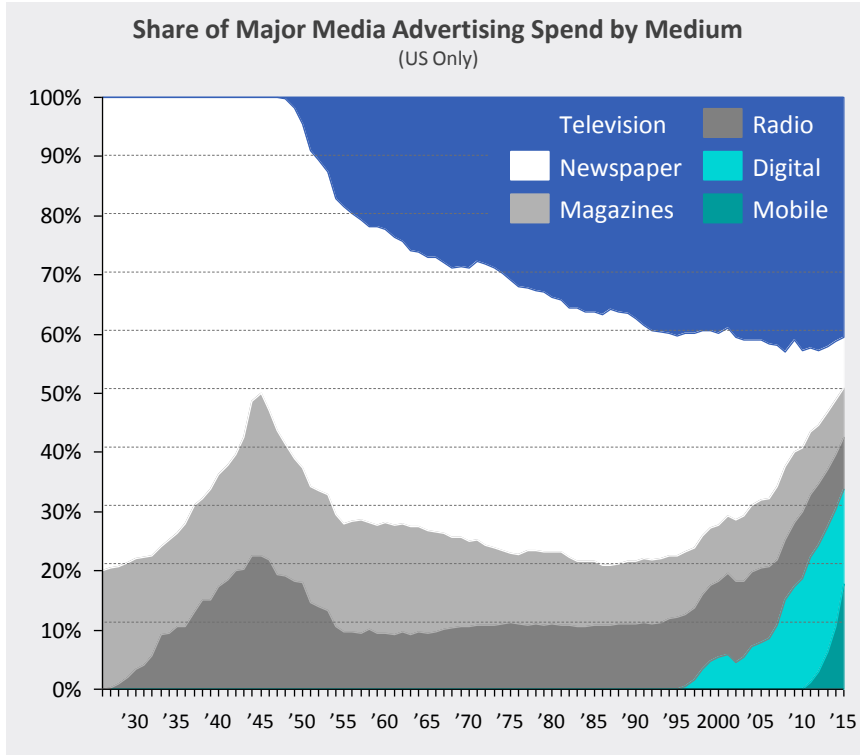
*No matter how strong CPMs remain or long-term carriage agreements are, no industry can sustain the type of “volume” losses currently experienced by the TV business; engagement is the leading indicator to cord cutting*



Sources: Nielsen

## (2) TV Ad Spend Will Soon be Hit by Digital

*If digital ad spend continues to grow, it will need to eat into TV's share of advertising; contrary to popular belief, new mediums do not "grow" the total amount of ad dollars available; ad spend is zero-sum*

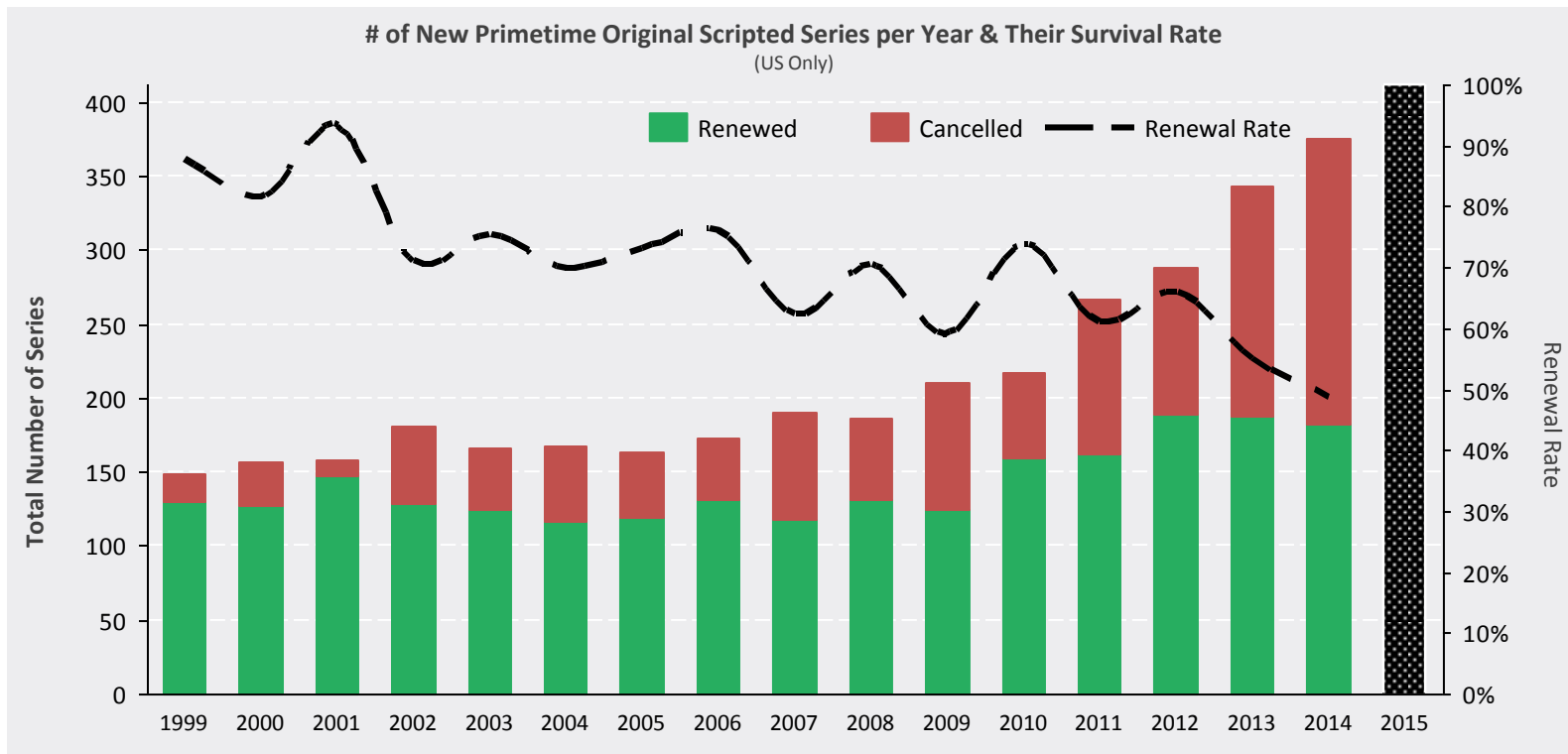


Sources: Bloomberg, eMarketer



### (3) The Network Business Model is Bursting at the Seams

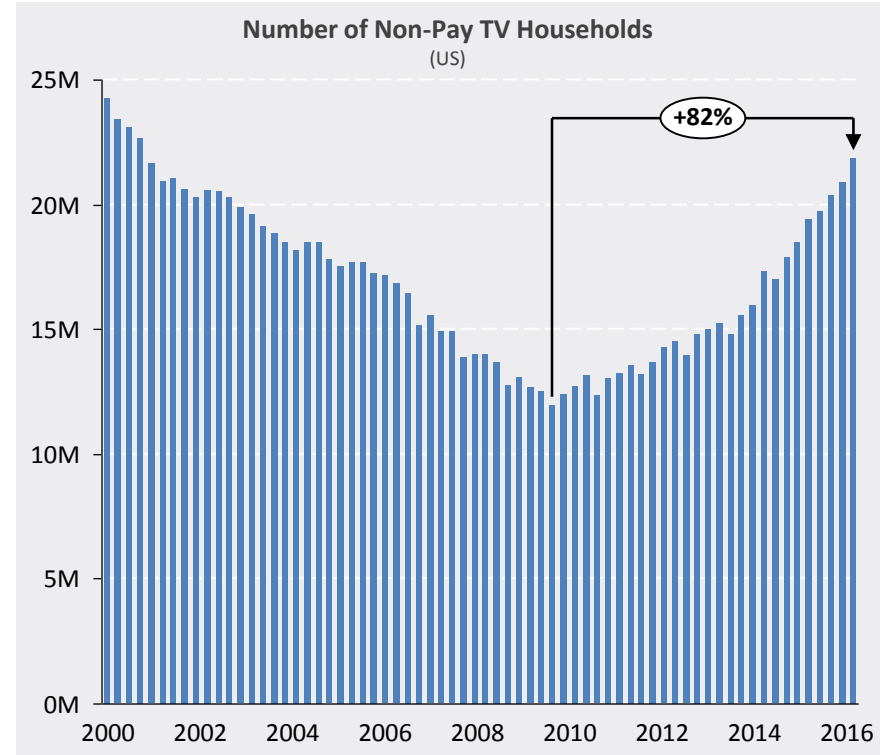
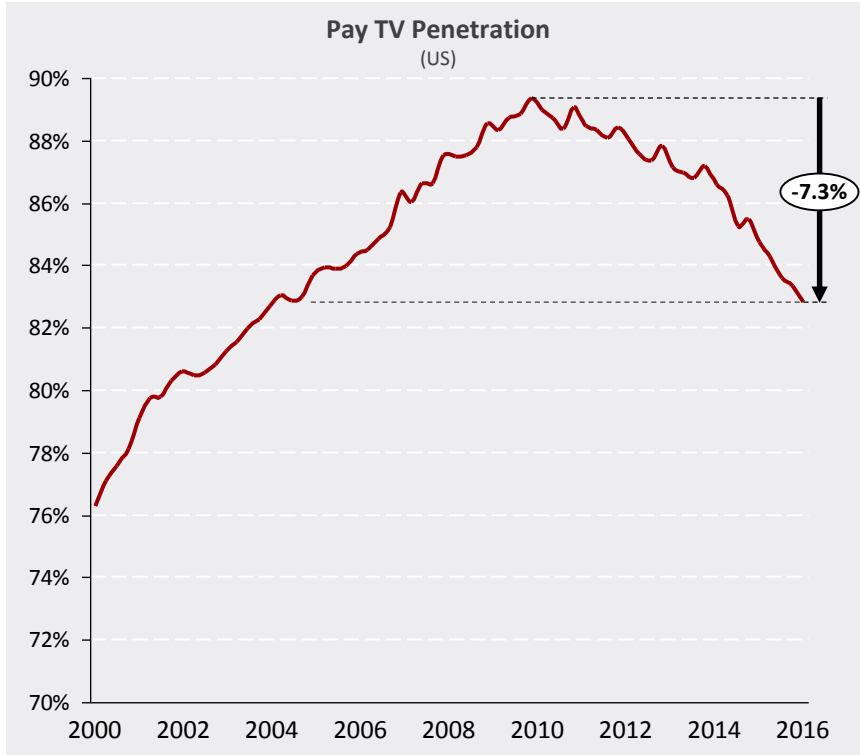
*Despite massive increases in video consumption, the cancellation rates for Primetime Original Scripted Series have surged from 10% per year to nearly 60%. More shows were cancelled in 2014 than aired 15 years earlier*



Sources: FX Research, NY Mag, REDEF Analysis

## (4) Pay TV is in Secular Decline

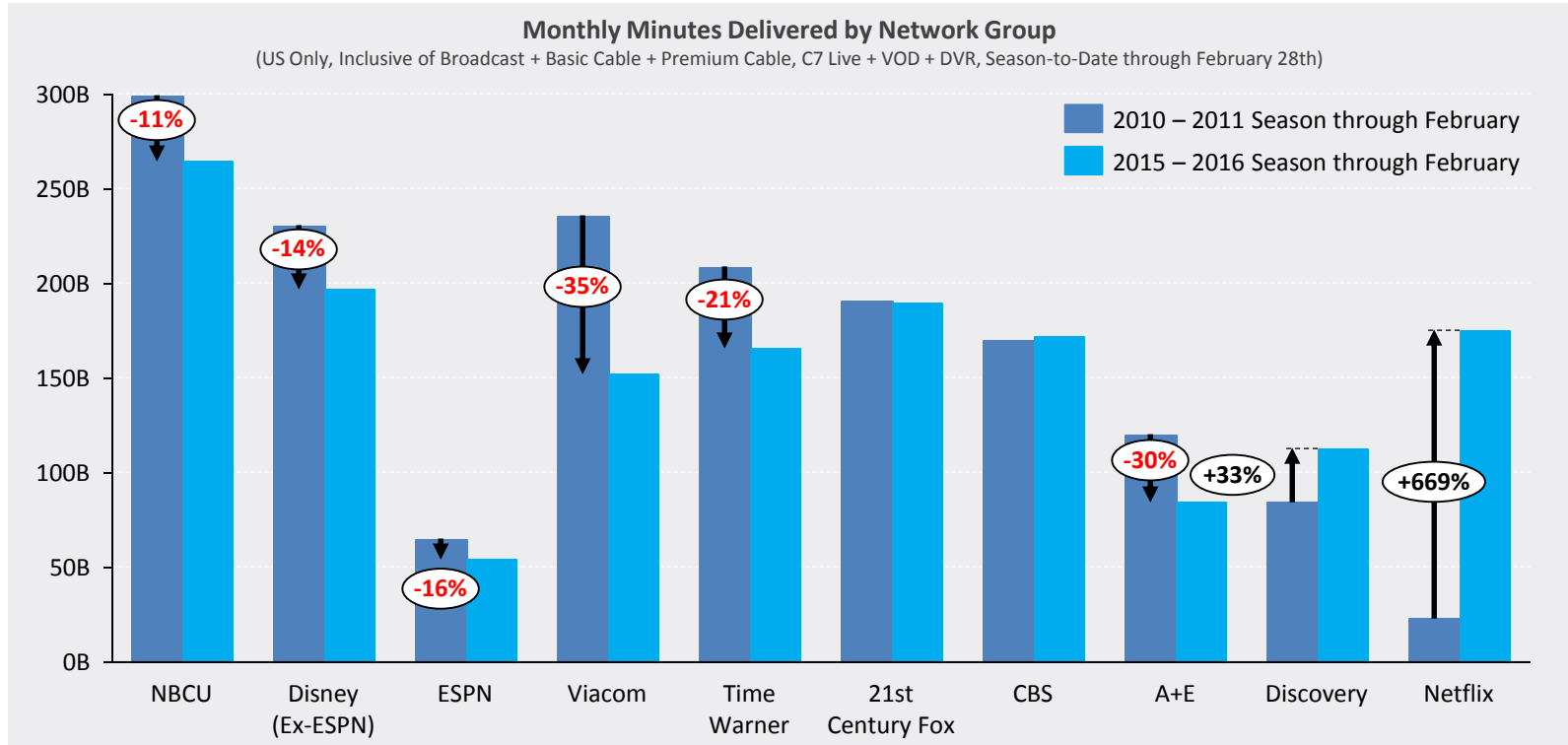
*Though the number of Pay TV homes has been flat for years, penetration is plummeting for the first time in history – leading to a never-before-seen increase in the number of video-watching homes without Pay TV*



Sources: MoffettNathanson

# How has this Affected Incumbents?

*Big Media has yet to fully adapt to this new environment and new challengers are moving quickly to capitalize on this inertia*



Sources: SNL Kagan

**Why Has This Happened?**

# The Entertainment Ecosystem has been Unbound

*The traditional bottlenecks to content production and distribution have been opened up by technology, reducing the power and value of gatekeepers and creating a new bottleneck: consumer attention*

Creators can now skip through the traditional content flows/parties

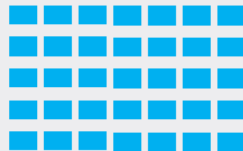
Creatives



Production Companies



Networks



Distributors



Devices



Audiences



All creatives, professional, amateur and aspiring, can create video content at will

Powerful video capture, editing and sharing tools mean everyone can create content (and more inexpensively than ever before)

And there's a historic high in the number of programmers – not just traditional or even digital networks

... And distribution is no-longer controlled by infrastructure owners

While each consumer has a handful of rich, portable, connected and personal devices

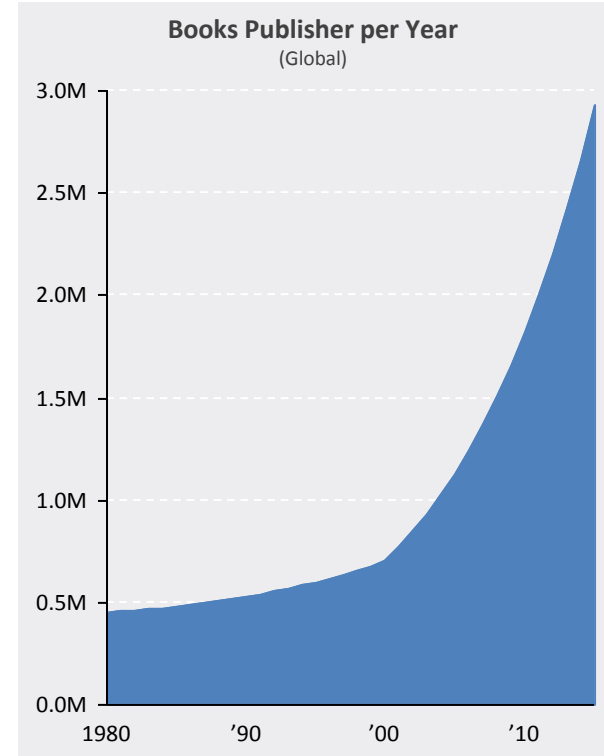
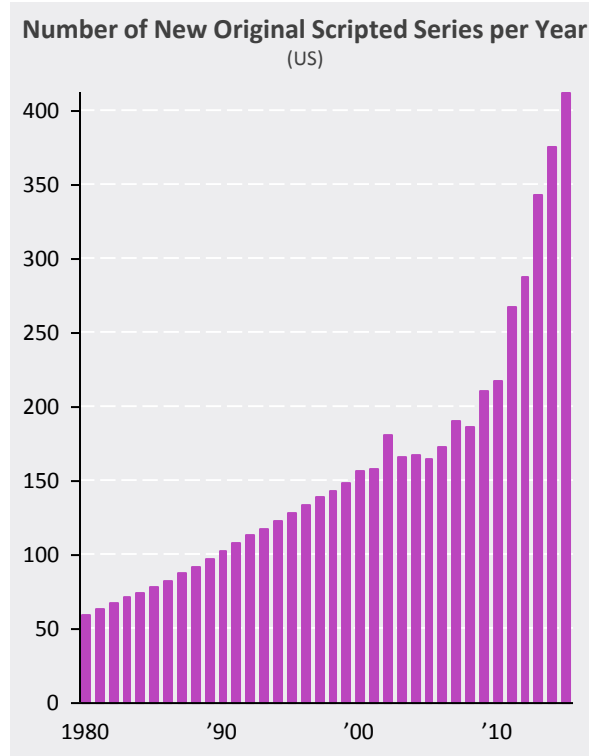
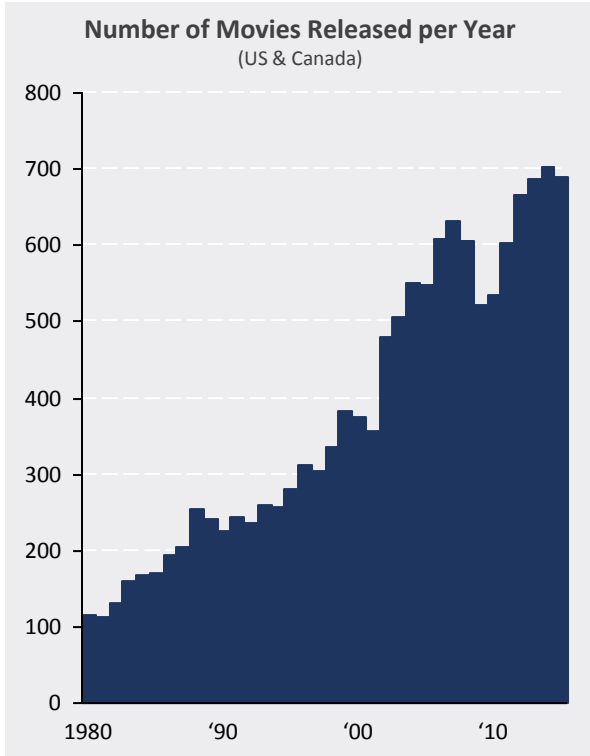
As a result, audiences are both more plentiful and harder to each than ever before

# This Has Led to Seven Critical Trends

- 1 Massive Increases in Content Production**
- 2 Commoditization of (Units of) Content**
- 3 Brand New Capabilities**
- 4 The Emergence of New Content Formats**
- 5 The Rise of the Product Experience**
- 6 The Power of Distribution**
- 7 The Concentration of Digital Ad Revenues**

# #1: Massive Increases in Content Production (1)

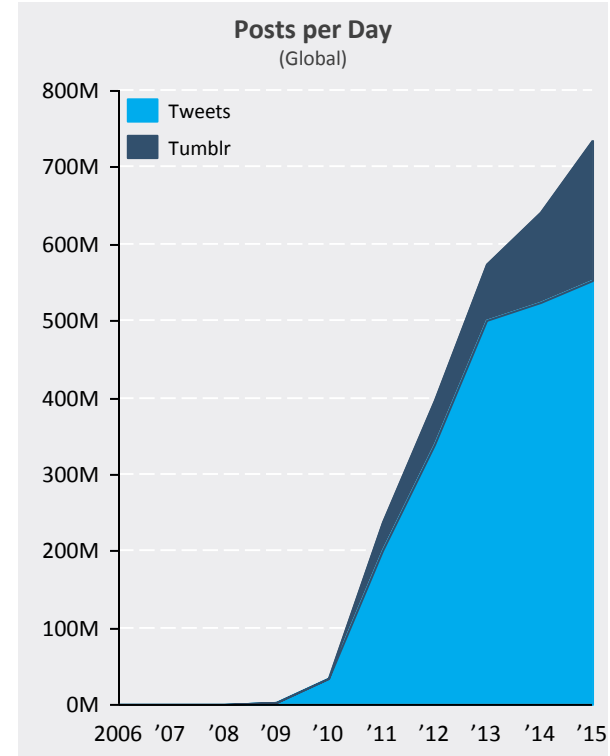
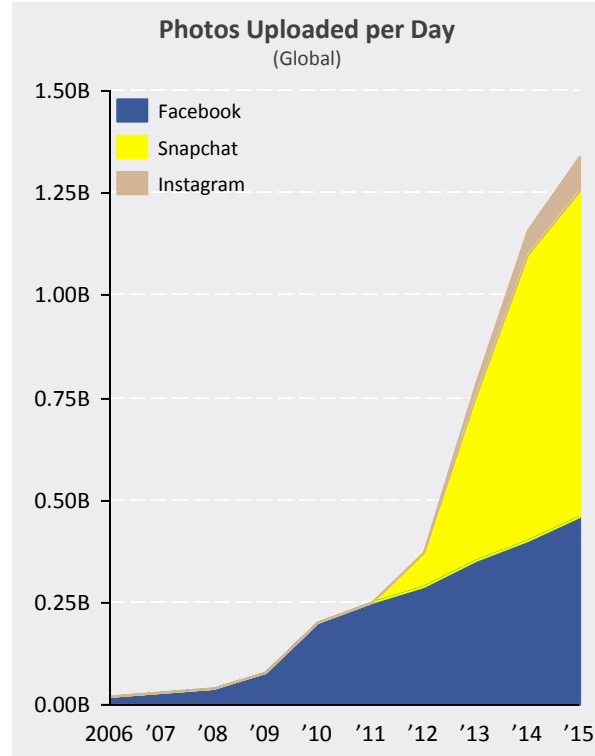
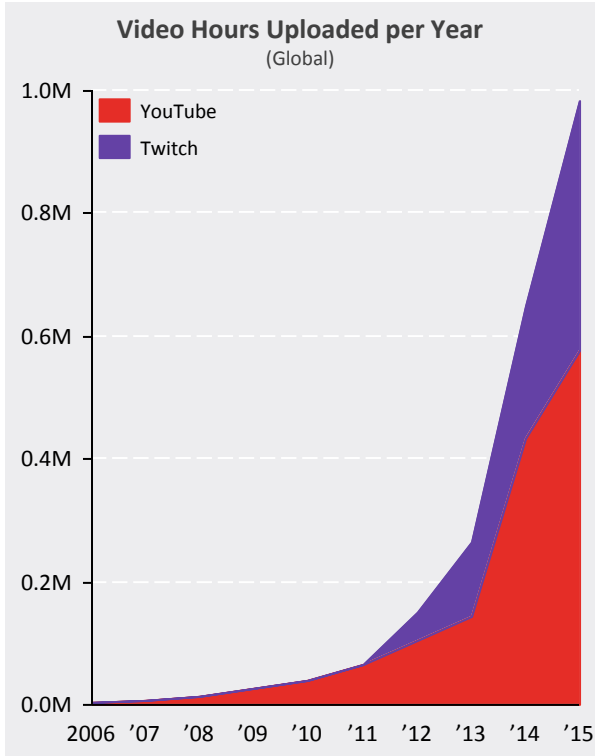
*As technology improved, production costs fell, and distributional controls were relaxed, the industry experienced a massive influx in “professional” content*



Sources: Box Office Mojo, FX Research, NY Mag, UNESCO, Forbes, REDEF Analysis

# #1: Massive Increases in Content Production (2)

*At the same time, UGC content absolutely exploded thanks to free distribution platforms, the proliferation of inexpensive media hardware, and the rise of web/mobile*

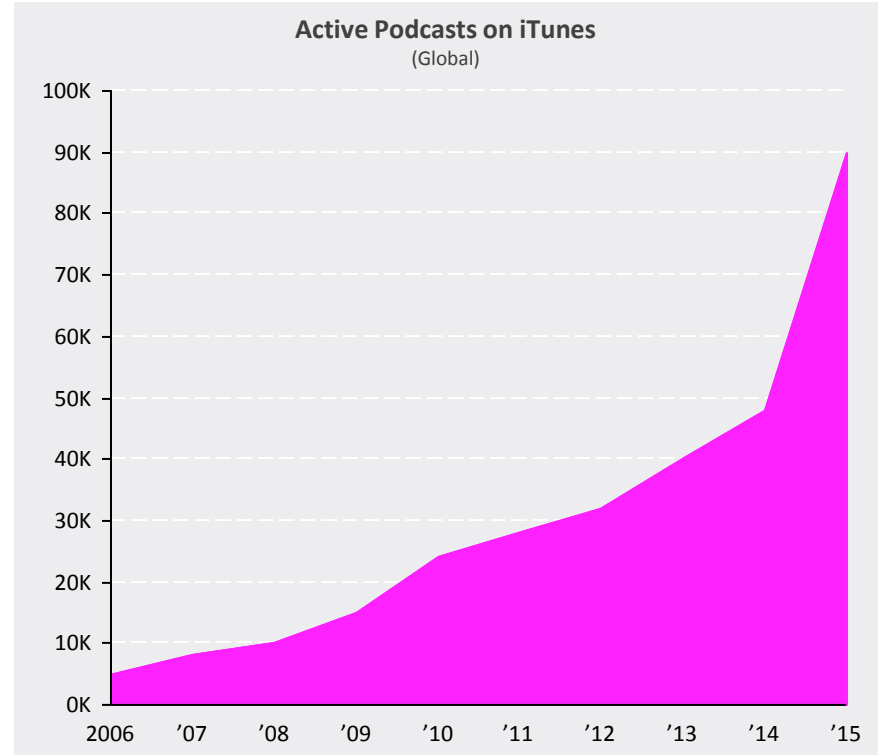
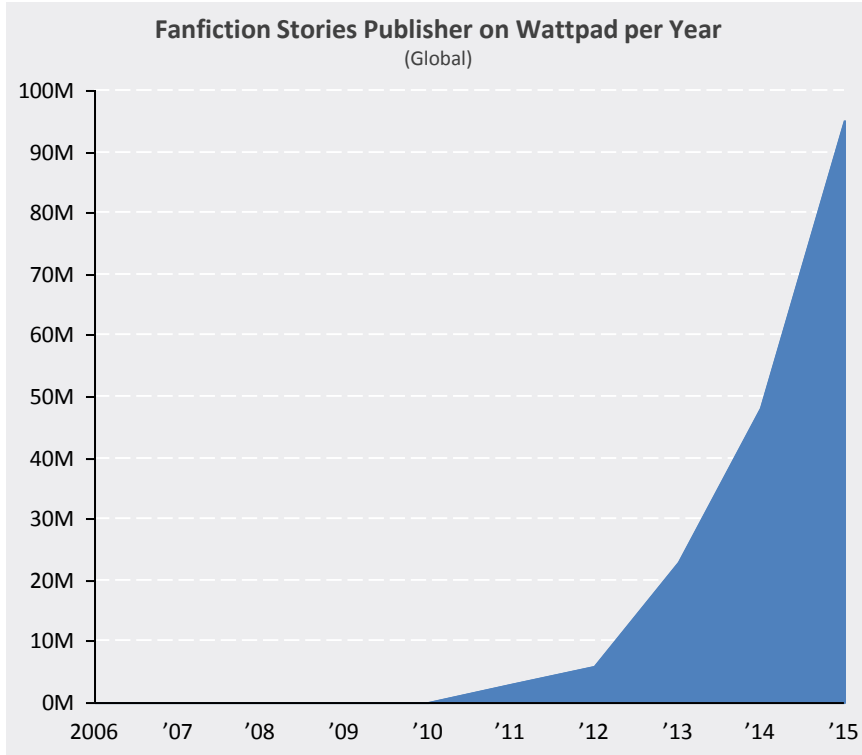


Sources: KPCB, Twitch, YouTube, Twitter, Tumblr, REDEF Analysis



# #1: Massive Increases in Content Production (3)

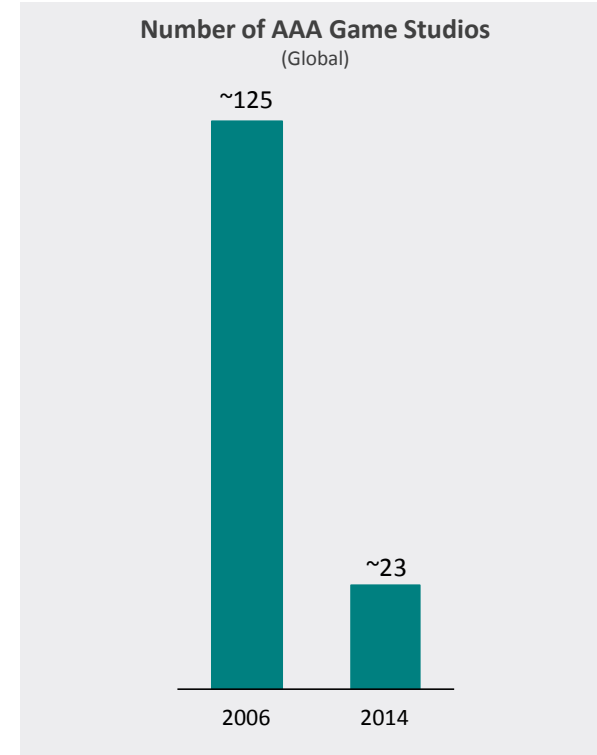
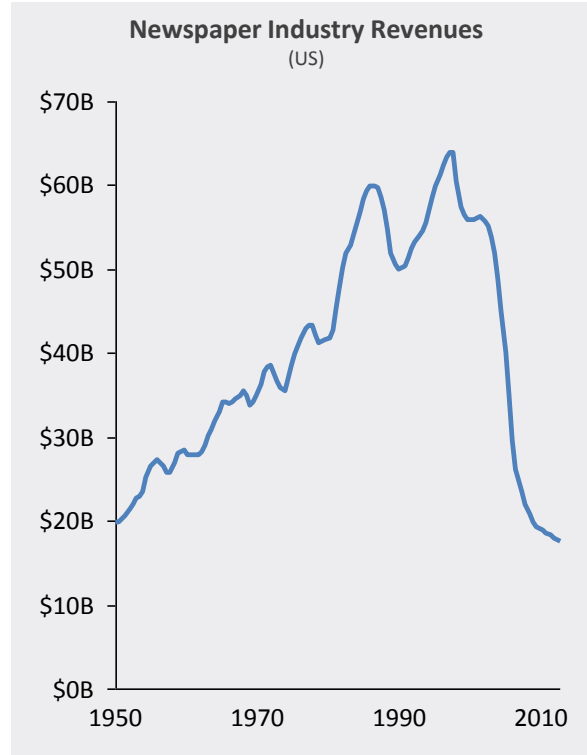
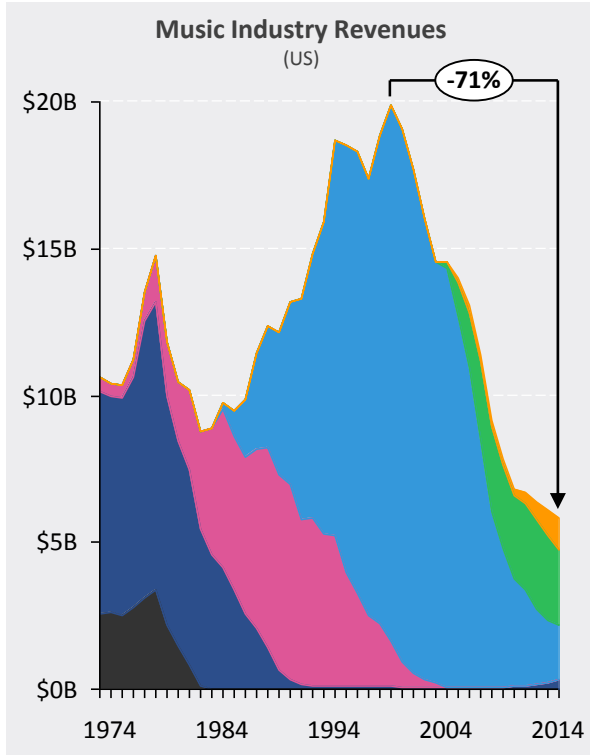
*Entertainment no longer requires established media brands or established distributors; and new brands can scale and build empires faster than has ever been possible*



Sources: Wattpad, Josh Morgan, REDEF Analysis

# #2: Commoditization of (Units of) Content

*It's no longer good enough to make "good" or even "great content" – the reality is that many now can and do. And those that own both distribution and customer relationships are thriving*



Sources: RIAA, Carpe Diem, DICE

# #3: Brand New Capabilities

*New capabilities have created new business models leading to new competitive fronts, opening up the ecosystem to new players, and rewarding different strategies*

## D2C Offerings

- No need for intermediary distributor
- In many cases, intermediaries are impediments and hurt the consumer

## Low Cost Support

- Netflix spends less on non-content costs per sub than HBO despite handling all billing, service, Apple Tax + marketing

## Consumer Relationships

- Can now form meaningful – and two-way – consumer relationships

## Customer Data

- Know not just what's watched, but how, when, why and from where

## Niche Offerings

- Scale no longer a prerequisite for profit
- Targeted, niche offerings are suddenly capable of being profitable

## New Monetization Models

- Native ads, referral revenue, crowdfunding
- Replacing windowing with price discrimination

## Personalization

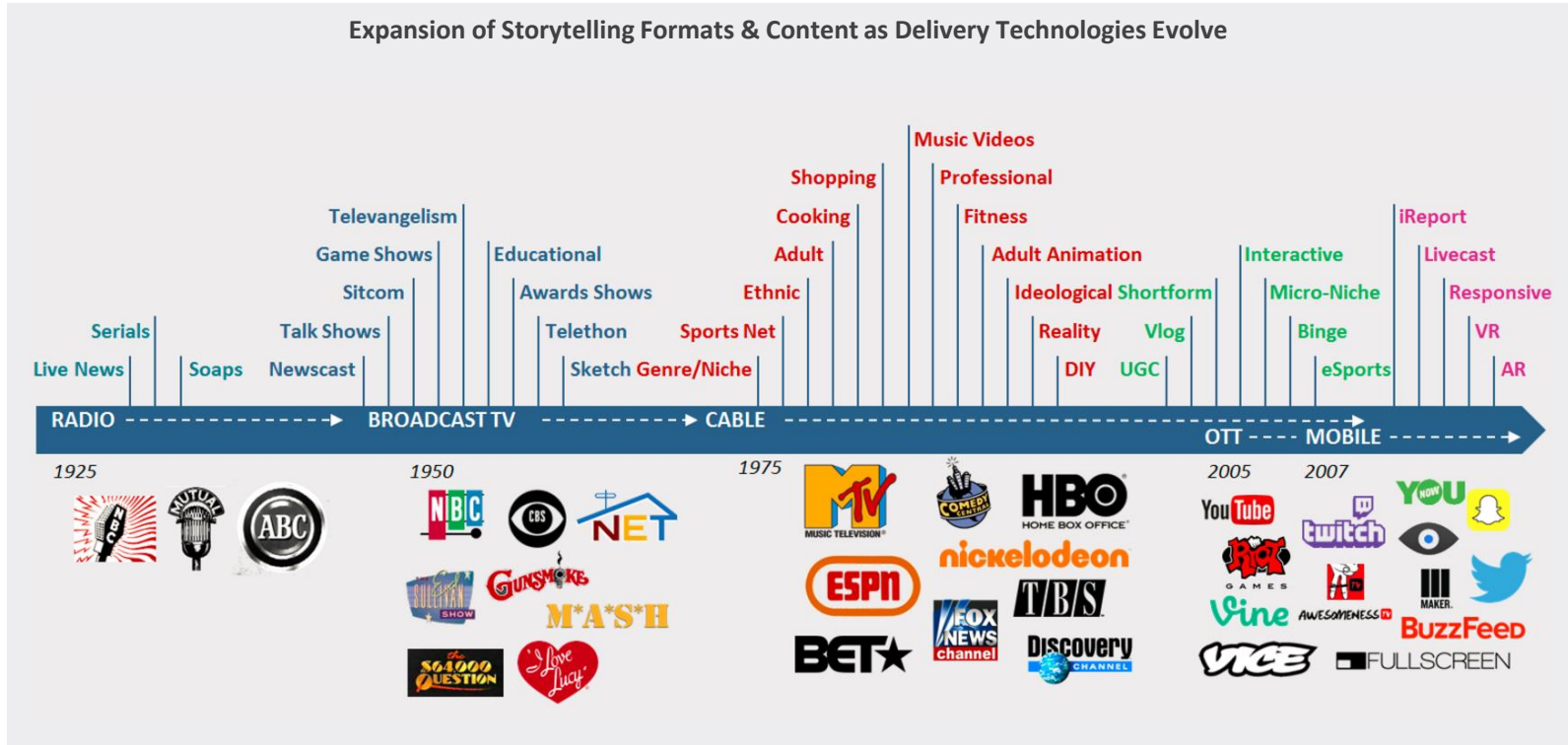
- The same service can act as many different things to many different people

## New Types of Content

- New categories have emerged, from live interactive broadcast to eSports

# #4: The Emergence of New Content Formats

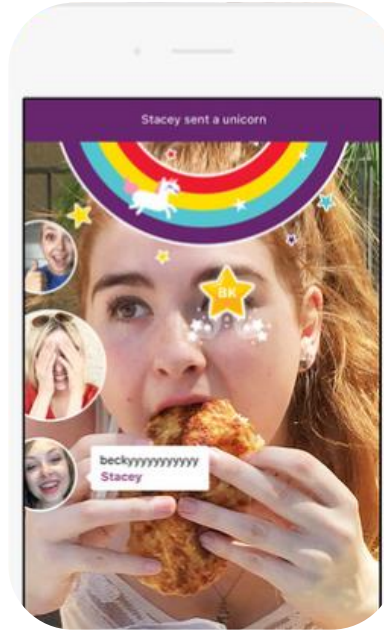
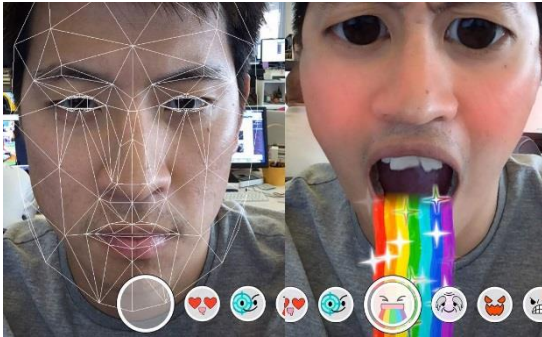
*No matter how resilient traditional TV remains, digital – like every medium before it – offers the opportunity to entertain (and create value) in ways never before possible. And new empires will be built doing so*



Sources: REDEF Analysis

# #5: The Rise of the Product Experience

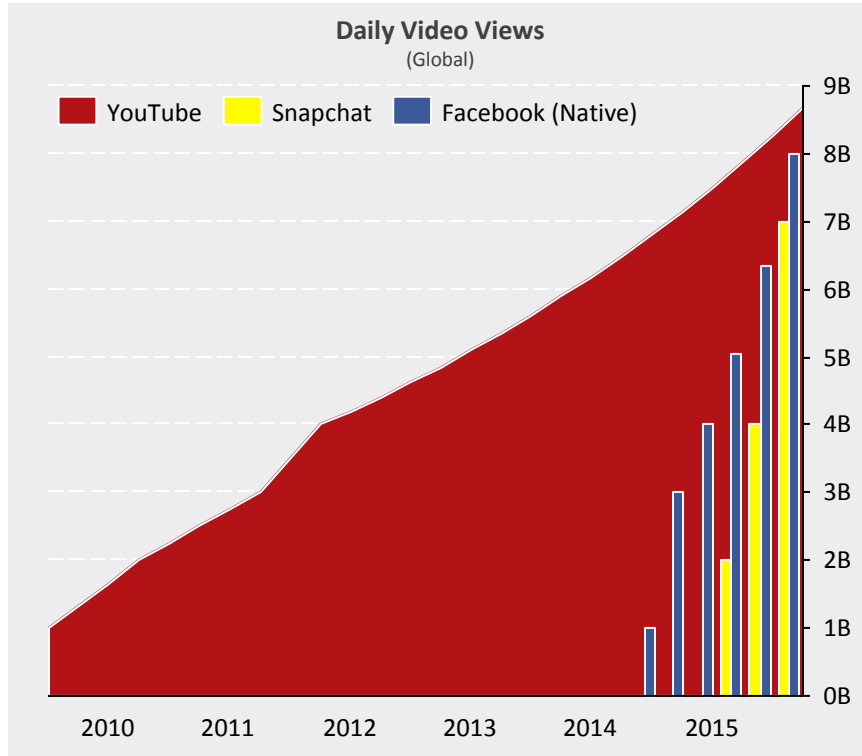
*Experiences are created by content and product – not enough to just deliver good content. Audiences demand exceptional product experiences on top of great content, with the two increasingly intermingled*



- In the cable era, distributors handled only the delivery of content, with media companies handling the rest
- In OTT, content + distribution + experience converge
- Furthermore, emerging video platforms are aggressively investing in capabilities that fundamentally challenge what content consumption looks and feels like
- While first wave of OTT services succeeded through core deliver excellence, the impetus for product differentiation and content integration will only grow
- It is no longer enough to put video on a different rectangle – doing so, in fact, is unnecessarily confining

# #6: The Power of Distribution

*Digital era distributors have unprecedented power because digital allows for audience aggregation and more importantly audience management at unprecedented scale*



The major social networks have shown an unprecedented ability to use their endemic audiences to build video businesses

- Crucially, however, they offer video not because they need to, but because they can
- Yet this offering is uniquely powerful as it mixes content with the watercooler itself

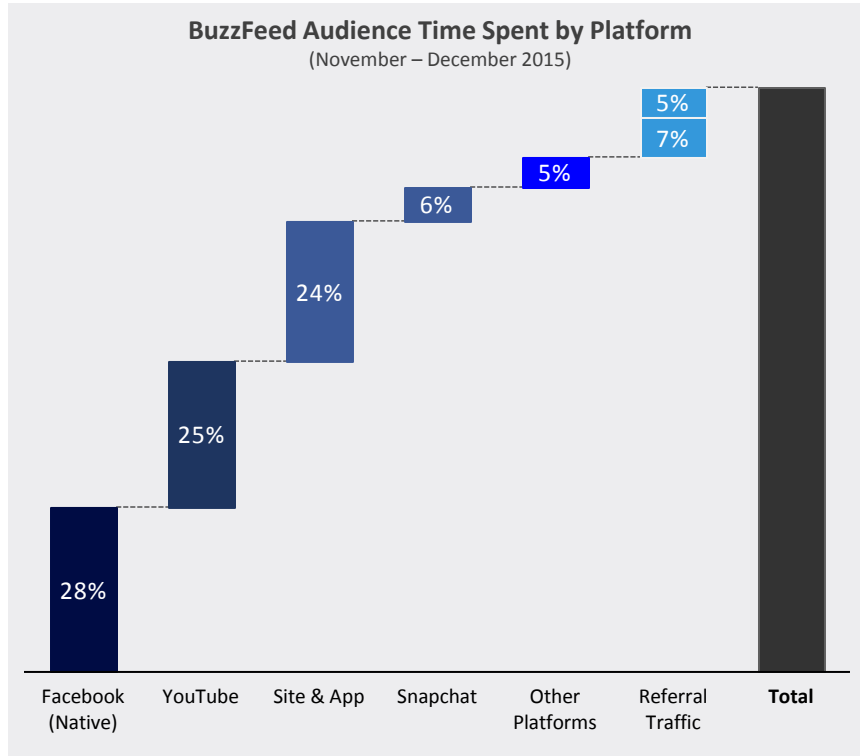
More broadly, control of the algorithm gives platforms the ability to make a winner, crush a supplier and hide an expiring title

- Despite claims that Netflix's library has eroded significantly, Netflix has grown subs 150% and consumption up 130% since Q4 2011

There's no placement more potent than Netflix's header or the top of Facebook's newsfeed. And it can't be bought.

# #6: The Power of Distribution – Social Navigators

*Feed navigators are fundamentally architected for social distribution. They are lean, data savvy, and fixated on the navigation of multiple feeds – living life distributed among the giants*



Social distribution requires new capabilities and new organizational strengths

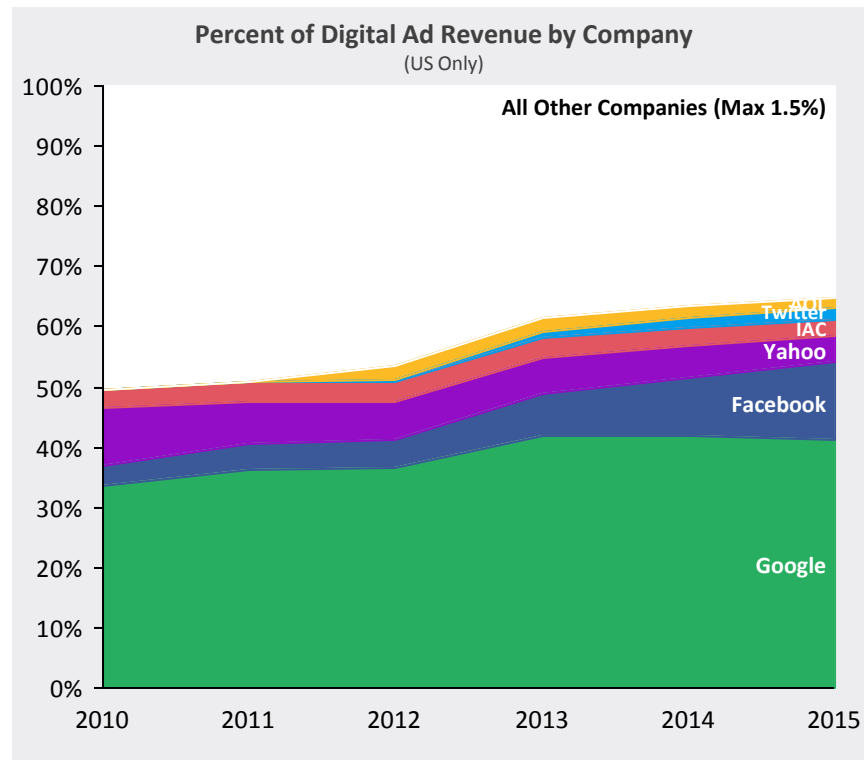
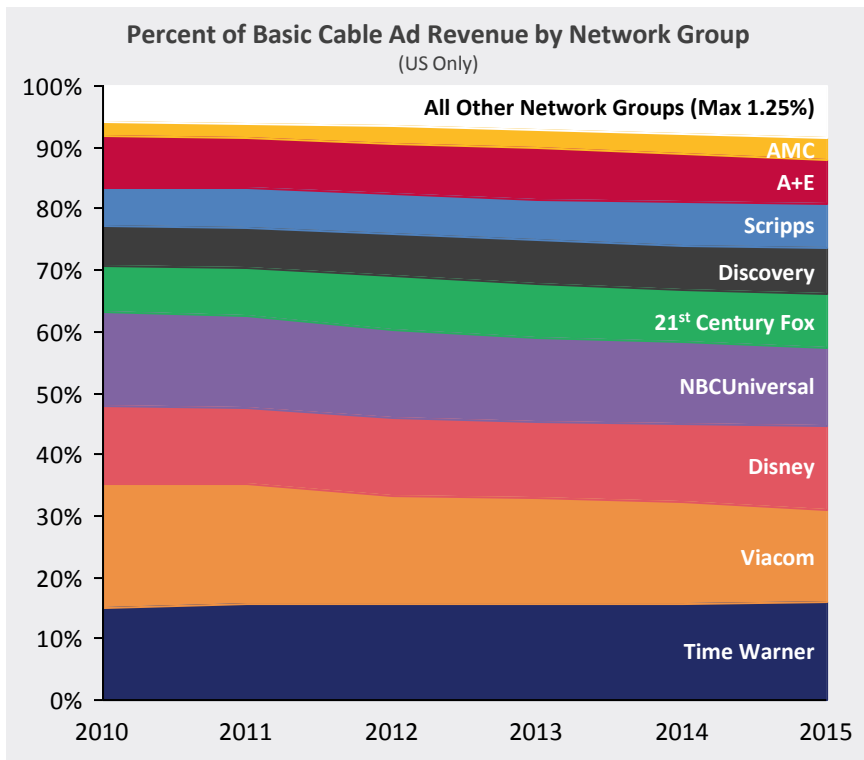
1. High speed of content creation and a relentless focus on content optimization for each platform
2. Networks of new digital talent, i.e. relationships for the 21<sup>st</sup> century
3. Flexible technology with the ability to extend across every major platform seamlessly

Along with these new capabilities come new monetization engines

- 360° monetization becomes a necessity not a luxury
- Value accretion to those who can sell their knowledge and expertise in reaching audiences across platforms, i.e. branded content and social media marketing that works

# #7: The Concentration of Digital Ad Revenues

*Advertising revenues used to scale proportionately; today, they're overwhelmingly concentrated among those with the largest audience, greatest reach and best data*



Sources: SNL Kagan, MoffettNathanson



# How the Video Business Has Changed

*For more than a century, the entertainment business remained largely the same. It was defined by the same limitations, the same problems, the same processes; digital has upended everything*

Editors/Programmers/Insiders decide what's created and watched



Algorithms, influencers and the social web drive consumption; independent content creation abounds

Audiences are captive; TV's dominance is uncontested



Attention scarcity is media's most pressing concern

Competition confined to those with carriage



No controls or limitations on competition

Common and transparent competitive metrics



No set metrics

Singular business models



Ultra-variability in monetization and goals

Distributors own customers



D2C + crowdfunding + two-way content creation

Control promotion, consumption of content



Limited control over promotion or consumption

Talent has few options to reach audiences



Abundance of options, including direct-to-consumer

User experience is standard, inessential

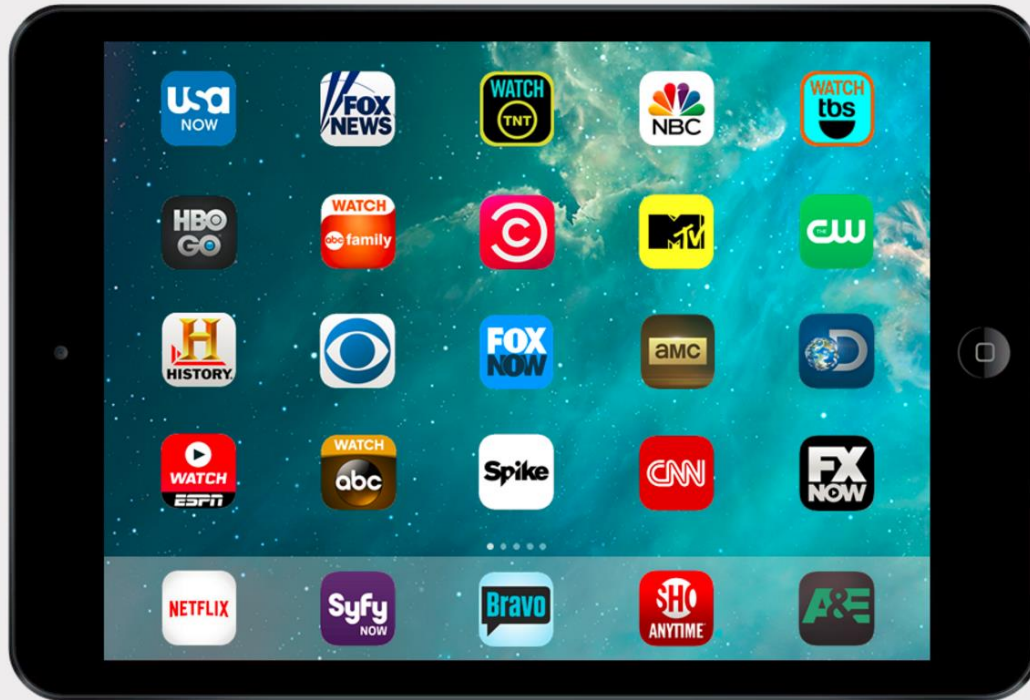


Critical component of engagement, subscriber acquisition

**So What Does the Future of Video Look Like?**

# We Thought the Future Looked Like This

*“An app for every network or show”*



*But it was just a digital adaption of the old model. And it isn't resonating with users.*

# The New Models of Video Distribution

*The traditional network business was straightforward: get carriage, grow eyeballs, and sell ads. Online will work very differently. It'll be more complex, more diverse and more precarious*

**In the digital era, media companies have several positional levers:**

- Vertical / Genres
- Volume of Content
- Variety of Content

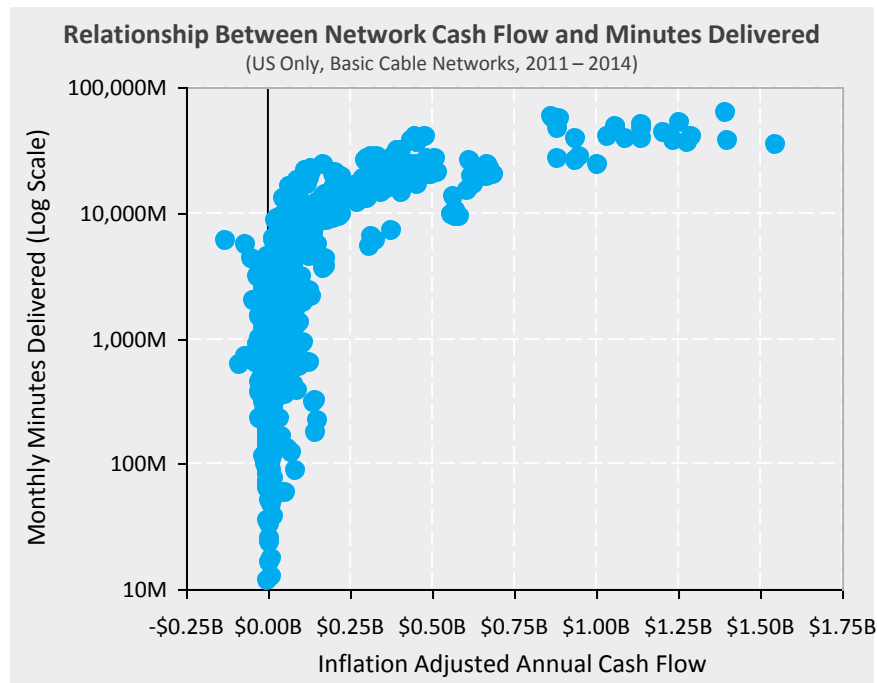
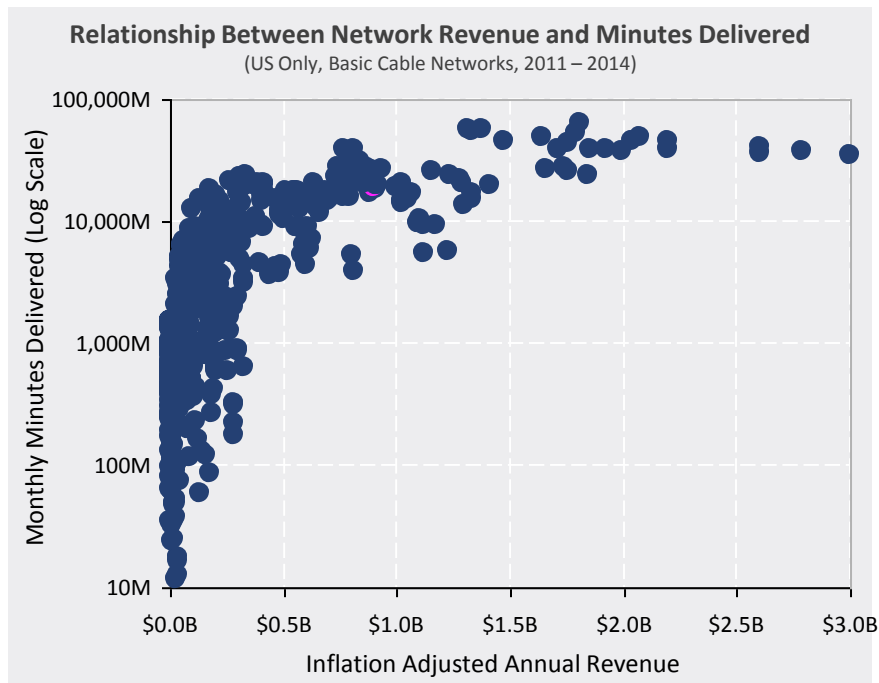
... Each of which will affect their consumer adoption/scale, profitability and product/content needs

We believe there will five dominant models, including three content feeds, one feed-less offering and one-multi feed model



# Feeds will be the Most Potent Iteration

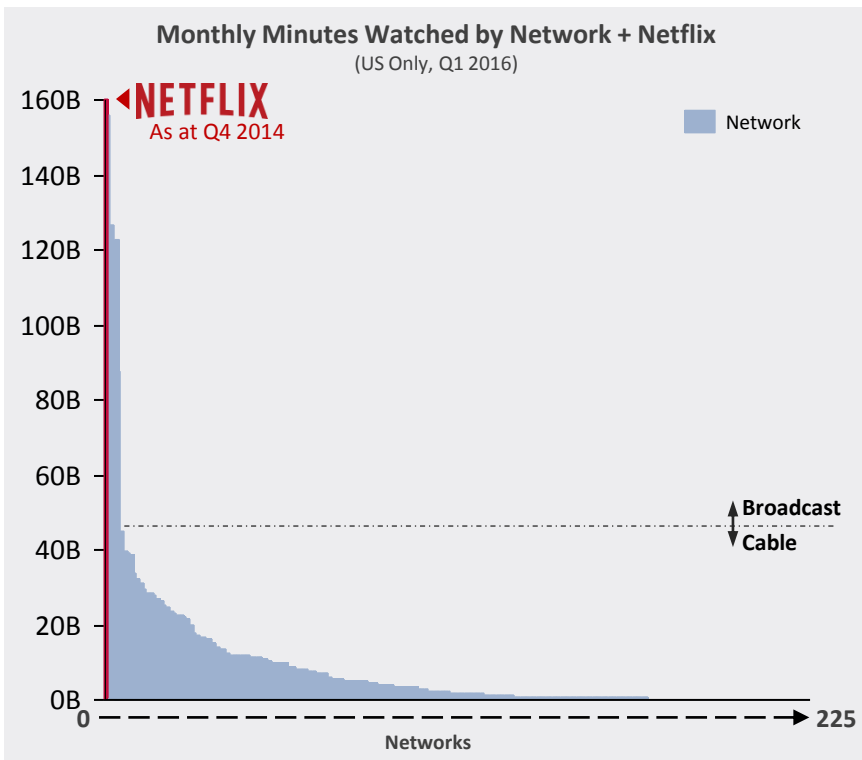
*Value in media has always accrued to those able to build a “feed”. The more popular a network, the easier it is to launch a show, build an audience, attract advertisers, extract high fees, force bundling*



*But the feeds of the digital era will be fundamentally dissimilar to those of the linear, lean-back era*

# Scale Feeds

**Netflix now delivers more entertainment than any broadcast network or consolidated cable group; it isn't HBO. It's HBO + The Disney Channel + AMC + NBC + The Food Network**



## What it Is

- Massive library containing all types/genres of video content
- Primary video destination for 100+ million globally
- Personalization enables the service to be all things to all people

## How it Works

- Soft performance metrics – engagement, churn, adds, binge rates
- Prioritize passionate fandom over total views
- No set amount of budget, original series, hours – invest up to ROI
- Algorithm-led programming, design, content recommendations

## How to Build One

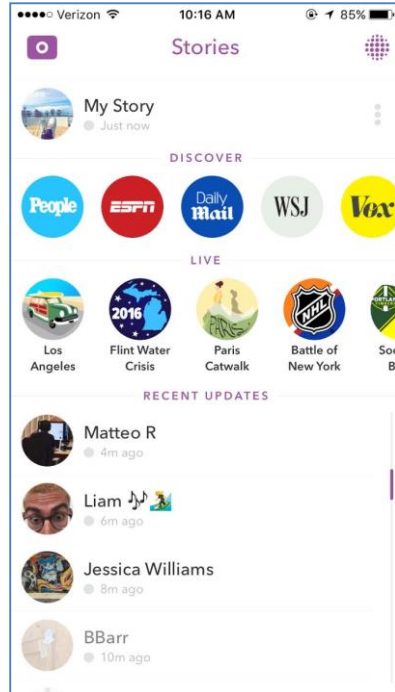
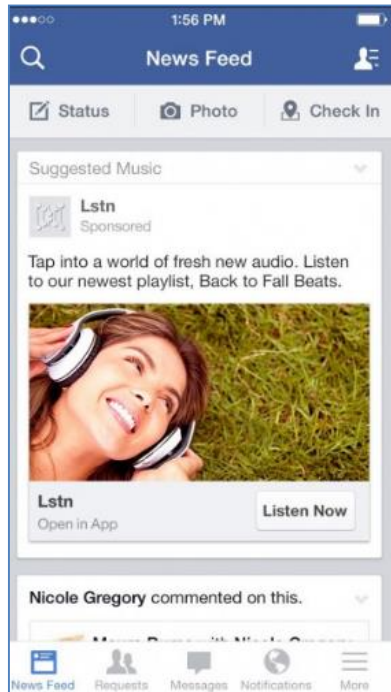
- Converge all network apps and programming strategies
- Accept ST cannibalization to build a LT platform
- Expand globally
- Secure all rights (all windows, all seasons)

## Risks

- Winner takes all markets (consumers don't need 5 Netflixes)
- Hard to grow from sub-scale
- Commoditized life as content supplier
- Licensing likely better than operating own sub-scale scale feed

# Social Feeds

*Social feeds are the spiritual digital successors to Pay TV distribution, providing hours of leanback entertainment, with more content, more formats, and more stickiness than any previous feed*



## What it Is

- The bundle or “feed” in its most potent iteration to date
- Blends together all types of content: photos, premium, UGC, video, communications, networking, video
- Accessed dozens of times per day

## How it Works

- Obsessive focus on engagement optimization
- Content delivered via algorithm or social shares – fully outside the purview of content owners or creators

## How to Build One

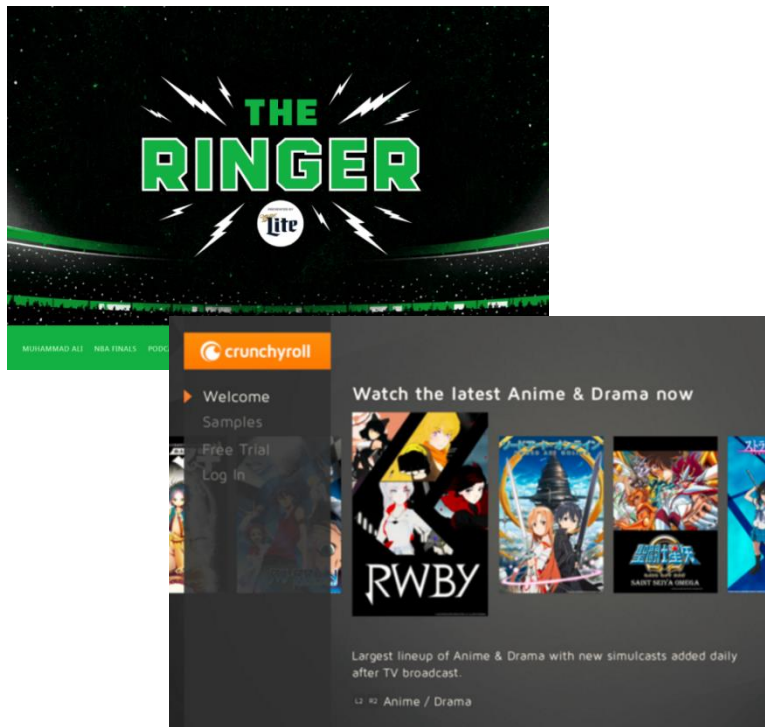
- Can't (anymore)
- Can work with them (will come back to this)

## Risks

- Suppliers are modularized without feed (poor economics, data)
- Platforms don't need/care for any particular supplier
- Unless dedicated to social distributions, they're likely tools not businesses

# Identity Feeds

*Identity Feeds will not be “smaller scale feeds”, they will be fundamentally different in structure, content, and monetization*



## What it Is

- Bundles together all related multi-media: video, podcasts, commentary, merchandise, news, live events
- Creates a community around a focal idea/genre/theme/identity
- T-Shirt Test: If fans won't wear the shirt, it's not an identity feed
- Won't just be “media companies”; will include content marketing

## How it Works

- Single P&L across all content offerings
- Highly skewed customer value, requiring a rigid user funnel
- Whale customer economics (not “hit show”)

## How to Build One

- Build an authentic relationship with most passionate seed users
- Developed over time, not declared or push-marketed
- Focus on a specific identity/sub-culture

## Risks

- Layered management, brand guidelines are anathema
- Low ceiling to growth (can't broaden service too much)
- Old media not staffed up for Identity Feed businesses



# What If You Don't Have a Feed?

*Life without a feed will be possible, but it will be much more difficult and challenging than it was inside the relative protection of the pay TV bundle*

1

## Non-Feed SVOD Services

- There will be scores of profitable video services with small-to-moderate audiences
- But they won't be particularly valuable unless they own a "feed"
- Without it, growth will be difficult, audiences fluid, and economics modest, thanks to unfavorable market dynamics and price/value
- Profit will, by and large, be limited to content license arbitrage

2


## Feed Navigator

- Architected for social distribution: lean, data savvy, and fixated on all multiple feeds; a life among giants
- For most, social navigation will be a tool to launch content and build relationships with audiences; not a business in and of itself
- Costs need to be very low to achieve meaningful margin
- Challenge for traditional media companies to innovate their way down vs. challengers growing up

3

## Content Supplier

- Hyper-competition as the amount of available and catalog content increases
- The concept of "premium" versus "non-premium" continues to erode
- 'Winner Takes All' distribution reduces the number of prospective buyers
- Huge negotiating imbalance with platforms due to data / value



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# The Future of Video

Q2 2016

**REDEF**