MEDIA

TWO CIRCLES DATA DRIVEN SPORTS

SPORTS MEDIA'S HYBRID FUTURE

GROWING OUT OF THE UNCERTAINTY: PART THREE

GROWING OUT OF THE UNCERTAINTY

The Covid-19 pandemic has had an unprecedented impact on every business sector, and almost all for the worse. Sport is right at the heart of those affected. Protecting the health of employees, and ensuring sport can continue to operate safely for both athletes and fans, is a priority at this time.

However, Two Circles projections show that the pandemic will cause several paradigm shifts in the sports landscape - specifically in how the world engages with sport, the types of products and experiences sports fans demand, and the organisations who invest in sports rights. Long-term planning is therefore critical now.

This is the third in our multi-part content series, *Growing Out of the Uncertainty*, where we demonstrate the long-term impact the Covid-19 pandemic is likely to have on sport, and provide a roadmap for sports properties to minimise the challenges to their businesses and maximise the opportunities they present.

About Two Circles

We use data to grow direct relationships between sports and fans, and drive business growth for over 300 of the world's leading sports properties. Our technology-driven, service-led offering helps our clients improve customer experience, increase revenue, and enhance their partner proposition.

Each year, Two Circles processes and analyses tens of billions of data points on sports fans globally, more than any other sports organisation. As a result, from the beginning of the century to present day, we have a unique insight into how fans are engaging with sport, and how successful that engagement is being commercialised. This enables us to accurately project future growth in our clients' three main revenue areas: event day, sponsorship and media.

SPORTS MEDIA'S HYBRID FUTURE

MATTHEW ENTWISTLE
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Covid-19 has seen 95% of people spend more time consuming media[1] – and for many, watching sport has been a source of light in an otherwise gloomy landscape.

This has played out through record viewing figures. German football's Bundesliga, the first major European sports league to restart, was the first to experience a Covid-19 viewing bump – attracting over 6m TV viewers in its home market for its first post-Covid-19 gameday on Sky, more than double the usual audience it would expect. A search of the sports media will show a similar story for football, rugby, golf and other sports that have returned to action.

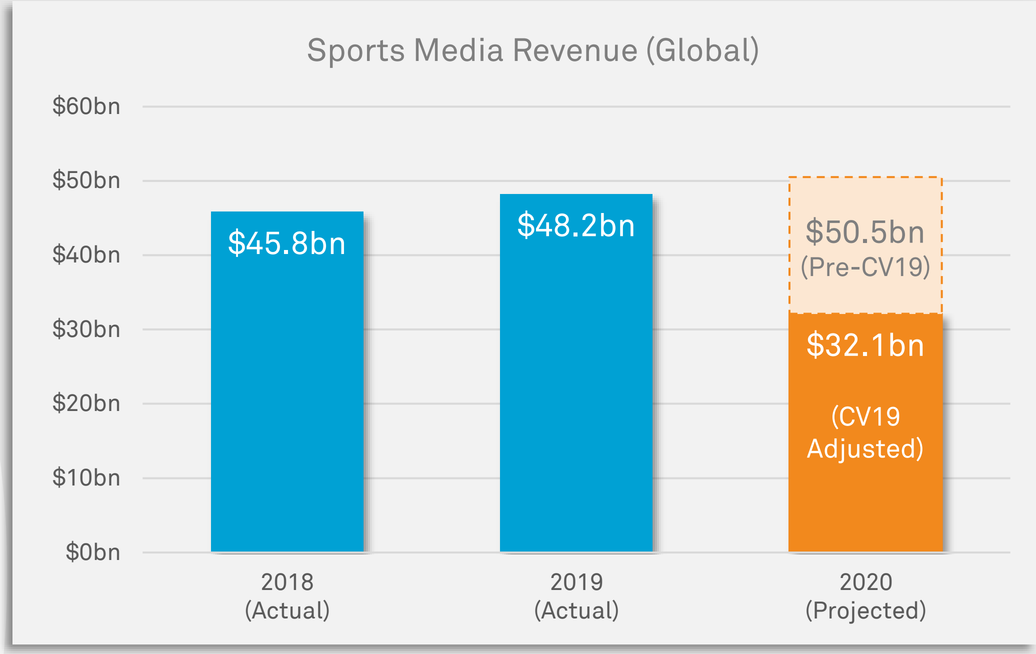
The records haven't just been delivered through live sport; bringing light relief, familiarity and entertainment during the relative blackout period, documentaries, archive footage and eSports broadcasts brought records tumbling.

Michael Jordan documentary *The Last Dance*, for instance, drew an average 5.6m TV viewers across 10 episodes and became ESPN's most-viewed documentary, while outside the US it was watched by 23.8m households in its first four weeks of release on Netflix.

That sport has shown, once again, whatever the market conditions it will win the battle for attention should be no surprise: sports media as a genre has thrived since the dawn of mass market internet, the average person consuming 38% more media content in 2019 than in 2009[2].

And though we project the revenue generated by sports media rights[3] in 2020 to fall from $48.2bn in 2019 to $32.1bn by year-end – a 33.5% decrease on 2019 and $18.4bn short of our pre-Covid-19 projection of $50.5bn – this is primarily due to rebates for cancelled events, not a lack of appetite for content.

That said, one thing we're less confident about is the current commercialisation model for sports media – specifically sport's relationship with pay-TV broadcasters.



Source: Two Circles; projections current as of July 30 2020
Note: Figures cover net revenue received by rights-owners for audio-visual content via rights-fees or direct subscription sales during 12-month period

We believe that, in all business sectors, Covid-19 will accelerate paradigm shifts in how people engage with products (B2C) and which commercial entities invest in them (B2B). This will see businesses forced to accelerate innovation, or run the risk of long-term revenue decline.

In sports media, we believe Covid-19 will accelerate shifts in consumer behaviour that will have a significantly negative impact on the pay-TV industry, on which the sports industry is commercially reliant at present.

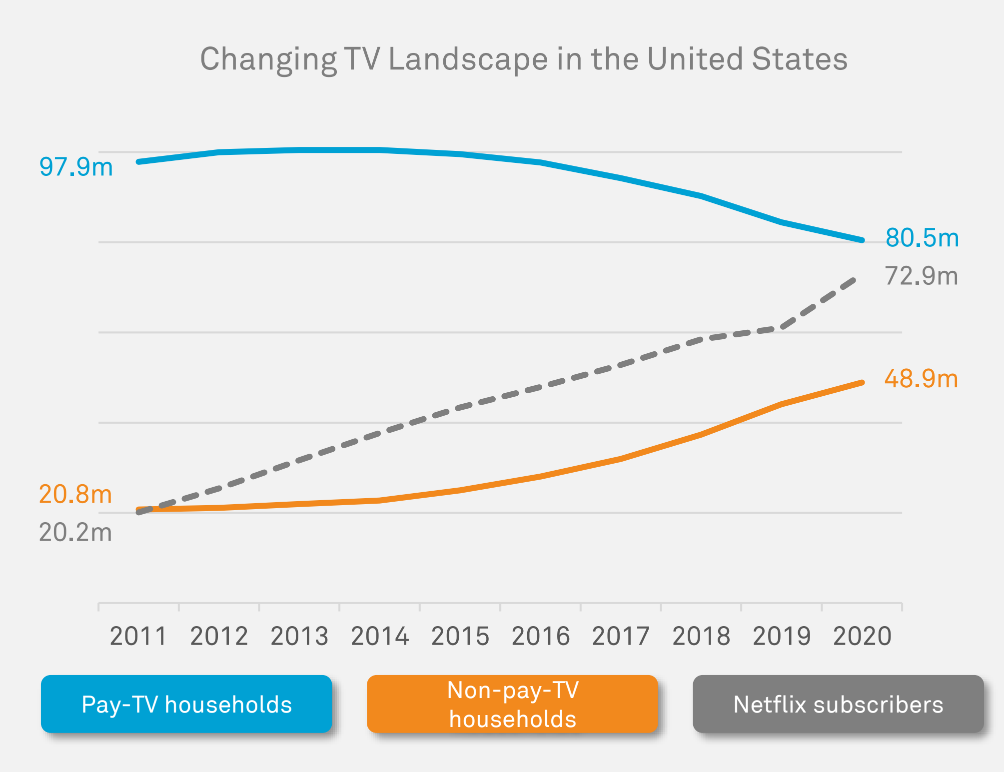
As a result, selling all or significant amounts of rights to pay-TV to achieve media growth will no longer be viable. Rights-owners therefore have to change how they package and distribute content to hedge risk and more actively become masters of their own destinies.

PAY-TV SQUEEZE

Most track the birth of pay-TV to 1975 when HBO became the first US network to deliver its programming by satellite. Four years later Bill Rasmussen founded linear pay-TV broadcaster ESPN, building a subscription business around sport's popularity and appointment-to-view programming.

Though the number of pay-TV subscribers passed 1bn globally for the first time in 2018[4], pay-TV revenue has been in slow decline; despite generating $192bn[5] globally in 2019, pay-TV industry revenue peaked in 2016 and is projected to fall to $150bn in 2025[6].

This is primarily due to the American and Western European trend of cord-shaving – decreasing spend on linear pay-TV packages – and cord-cutting, unsubscribing from pay-TV



Source: eMarketer, Netflix
Note: Netflix 2020 figure is for Q2

completely. In 2019, the largest pay-TV providers in the US[7] lost 4.9m net subscribers[8], while in the UK pay-TV subscriptions have been in decline since 2017 – the number of pay-TV households predicted, pre-Covid-19, to fall to 15.4m by 2023, a 7.5% decline over four years.[9]

We believe declining pay-TV subscriptions will be accelerated due to Covid-19. Pay-TV is one of the largest recurring discretionary household expenses - 94% of US households own a TV, more than two-thirds pay for a TV subscription,[10] and the average US customer was paying $109.60 per month for pay-TV in November 2019[11].

As the world navigates a Covid-19 recession – and global unemployment rises faster than at any time in history since at least the 1930s – consumers will tighten purse-strings. These high-cost, monthly linear pay-TV subscriptions will be put under the microscope, in particular when compared to lower-cost OTT streaming services such as Netflix, which was available in the US for between $8.99 and $15.99 a month in November 2019.

The data shows this is already happening. UBS estimates US pay-TV subscribers declined at a 6% annual rate during Q1 2020, while Sky, Europe's largest pay-TV operator, said Q1 2020 revenues fell 3.7% year-on-year. Sky predicts Q2 2020 will be "negatively impacted to a greater extent".

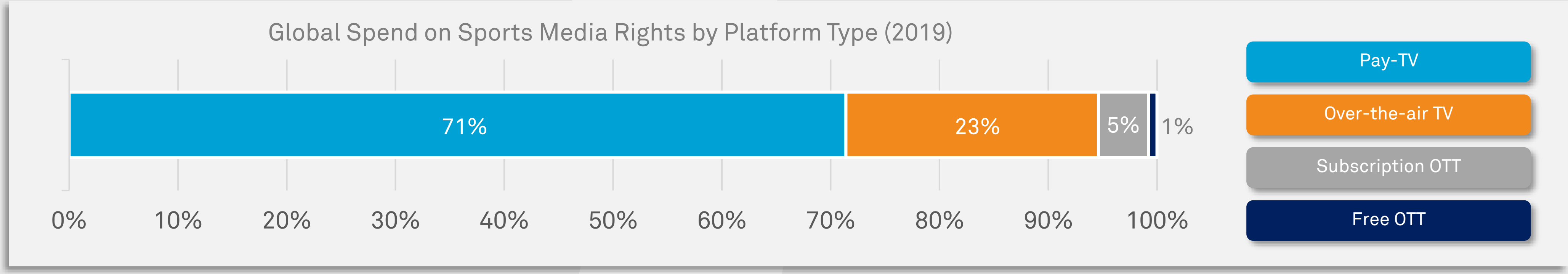
Netflix, by comparison, increased its worldwide paid subscriber base by 23% year-on-year to 182m in Q1 2020. Though we believe Covid-19 will have a positive impact on pay-TV broadcaster's OTT streaming platforms with 'Netflix-style' pricepoints – such as ESPN+ in the US and Now TV (Sky) in the UK – these platforms are a long-term bet, currently running alongside their elder pay-TV siblings to offset churn.

RIGHTS-FEE REDUCTIONS

The consequences of accelerated linear pay-TV subscription decline will be significant for the sports industry, as we believe it will see the amount spent on sports media rights, by pay-TV broadcasters, decrease after consistent growth for the last half a century.

Though one day ESPN+, Now TV and others may well prove commercially successful, their long-term profitability won't be known for years to come; premium sports rights cost billions, and take significant subscriber numbers to commercialise at a 'Netflix' pricepoint, a model DAZN is trying to crack. Sport will still continue to thrive as a media property, but until a proven, long-term viable pivot is established, pay-TV broadcasters simply cannot continue their current levels of spend if there's increasingly less revenue coming in.

In 2018, over a quarter (26%) of broadcaster content spend was on sports rights acquisition[12] and according to



Source: Two Circles

our data analysis, pay-TV broadcasters[13] accounted for 71.4% of a total $48.2bn spend on media rights ($34.4bn) in 2019. We believe this will be the apex of the pay-TV spending curve globally; 2019 the year that, collectively, pay-TV broadcasters as we know them reached the peak of their sports rights spending.

Premium properties such as the NFL and Premier League will be protected from these market dynamics in the short-term – pay-TV refusing to lose their 'crown jewel' content to stem the flow of subscriber churn – but outside the top-tier, we're already seeing this play out.

In the last six weeks alone, US pay-TV broadcaster Fox Sports ended its $93m-per-year deal with the US Golf Association seven years early with NBC Sports filling the void, but for $56m less per year.

Rugby Australia, meanwhile, saw a similar deflation in its new deal with pay-TV broadcaster Foxtel for the 2020 Super Rugby Australia – worth a maximum of AU$10m, a 70% reduction in what Foxtel was due to pay pre-Covid.

MEDIA'S HYBRID FUTURE

Those sports rights-owners with a heavy reliance on pay-TV income need to adapt the way they commercialise their media businesses fast or experience a decline in a key revenue stream for decades to come. This adaption comes through what we call the hybrid media model.

Until recently, sports media's commercial model was simple: typically, a rights-owner created packages of live rights to drive the maximum demand from the pay-TV market, and sold packages exclusively to one or two pay-TV broadcasters. If the rights-owner had a commitment to visibility, a package would additionally be sold to an over-the-air broadcaster for a lower rights-fee. Any cash that could be earned for non-live rights was a bonus.

But Covid-19 will bring into greater focus the reliance on one type of media platform – primarily pay-TV broadcasters – to deliver growth. And it will require rights-owners to develop a new model, a hybrid model, where they cut and sell rights for pay-TV broadcasters, free-to-air broadcasters, subscription OTT platforms such as Amazon or DAZN, 'owned' D2C streaming services and free digital publishers – all in the same rights cycle. The future is growing your portfolio of media partners, not limiting it.

This spreads the risk and brings every media platform to the negotiation table – critical in driving competition, a primary contributor to the growth in value of media rights this century as triple or quad-play providers looked to tie subscribers into long-term broadband or phone deals, drawn in by live sport on their pay-TV platform.

"THE FUTURE IS GROWING YOUR PORTFOLIO OF MEDIA PARTNERS, NOT LIMITING IT"

There will still be markets where this competition will continue from triple or quad-play operators – in particular developing nations – but competition is inherently built into the hybrid model as every relevant media platform with video capabilities active in a territory will have an option to commercialise sports rights.

Some media partners will be attractive from a rights-owner perspective because of the rights-fees they're prepared to offer, others by their large audiences. Certain media, including new players or those who have never considered sport before, will also be able to expose a rights-owner's product to a new audience through their creative approach and content production expertise. Sport has relevancy for every media platform's audience, and therefore all have the potential to be at the table.

And though we don't see live action being anything other than the most valuable commercial media rights for the foreseeable future, the onus is on rights-owners to develop new packages of content – any mix of live, near-live and non-live rights – that can be commercialised through a greater number of media partnerships.

It won't be a simple case of 'live' or 'other' anymore; the Covid-19 period has illustrated that sports fans don't just want live action, they want the soap opera around it – and therefore every major media player needs a fit-for-purpose proposition based on their own unique model and audience.

In the hybrid model, value will be found by selling, activating and evaluating media rights by knocking down the walls that have existed since 1975.

The billion-dollar question – literally – for sports rights-owners is what right content packages to create, and what distribution channels will drive the biggest long-term commercial growth. Sports rights-holders hold the chips, but where should they be placed?

Data holds the key to the answer. By understanding the audiences a rights-owner is reaching or wants to reach, and how and where they want to consume their content, rights-owners will have the foundations for their hybrid packaging and distribution strategy.

References:

[1] GlobalWebIndex Multi-Market Research, April 16 2020

[2] Two Circles, June 2019

[3] Net revenue received by rights-owners for audio-visual content via rights-fees or direct subscription sales

[4] Digital TV Research, May 2020

[5] Digital TV Research, June 2019

[6] Digital TV Research, May 2020

[7] Representing about 95% of the market

[8] https://advanced-television.com/2020/03/04/research-2019-us-pay-tv-subs-loss-nears-5m/

[9] https://www.rapidtvnews.com/2019101757552/uk-pay-tv-set-for-decline.html

[10] United States Pay TV Subscriber Churn Analysis, Forecast to 2024, February 2020

[11] Leichtman Research Group, November 2019

[12] Ampere Analysis, October 2019

[13] Broadcasters who primarily charge subscription fees for channels, and whose channels are available primarily through satellite, cable and telecoms services

THREE STEPS FOR HYBRID SUCCESS

The rights-owners we forecast having the strongest media growth in the next decade will achieve it through three primary areas:

1) Hedging with a D2C proposition

'Owned' D2C media platforms – run by rights-owners and delivered to fans directly OTT – will be one of the defining features of this era of sports broadcasting, and their development will experience accelerated growth due to Covid-19.

For some rights-owners, they will be used to commercialise exclusive premium rights, at scale, in a home market – which we've seen done in the United States, for example, by the UFC through UFC Fight Pass. This, where a premium commercial relationship is established between fan and rights-owner directly, is the holy grail in sports media.

However, for most, owned D2C streaming platforms will be used to build direct relationships with fans in a market using free or low-cost subscription offerings, the data they provide enabling rights-owners to better understand fan behaviours and propensity to consume both media and non-media products.

Much like sport's central role in the telco quad-play, video is becoming the gateway to building a direct relationship with fans, cross-selling products and creating more valuable opportunities for commercial partners such as advertisers.

As they achieve scale in a market, owned D2C streaming platforms will also become a means of stimulating competition when there are a low number of viable third-party media platforms to commercialise their content.

2) Syndicating content to grow international audience

In lockdown, record numbers consumed sport, and with internet penetration and access to digital media rising globally, the amount of time spent watching sports media will continue growing post-Covid-19.

That means there is a growing pool of people sports properties can engage with – primarily outside their home market – through video content on third-party media platforms to grow their long-term audience. And the more they can grow their audience, the bigger the commercial opportunity becomes.

Traditionally, sports properties have exploited media rights outside their home market by selling them to the highest bidder – often a pay-TV broadcaster – or sought to grow international fanbases by giving linear broadcasters free rights in exchange for guaranteed levels of coverage.

In the current media landscape, where digital now accounts for the majority of consumption, the number of potential media partners is vast – from pay-TV and over-the-air broadcasters to subscription OTT platforms and free digital publishers.

In the hybrid model, rights-owners need to package rights to establish a wider mix of media partners, and a mix that enables them to recruit and deepen the affinity of followers, fans, players and consumers in accordance with their long-term objectives for audience growth in a specific market.

3) Appreciating the untapped value in non-live

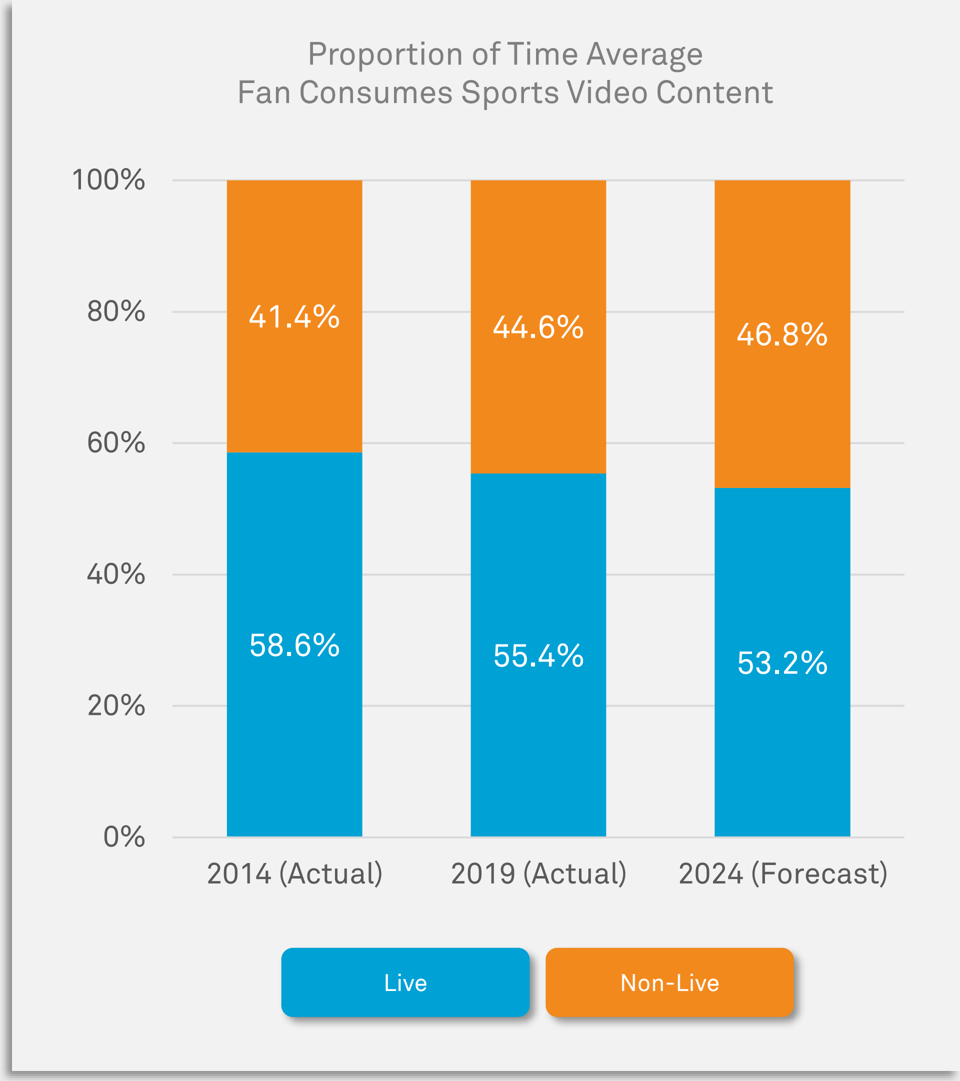
In 2019, live rights accounted for 86% of sports media rights value globally – however, our data shows of total sports video content consumption, the average sports fan watched 55.4% live. Though this is the clear majority, it is a lower proportion than five years before.

Due to sport's growing cultural relevance, athletes generating their own content and a larger number of media platforms covering sport, fans have access to greater amounts of clips, highlights, outside the ropes and behind the scenes programming than ever – and they are consuming them in greater levels than ever.

To date, however, rights-owners have prioritised the commercialisation of live rights, throwing in non-live media assets - primarily digital – into live rights packages without fully realising the commercial attention they garner.

The Covid-19 pandemic has illustrated our long-held view that the rights formats with the greatest opportunity for commercial growth are non-live rights, with innovative use of archive (such as The Open For the Ages), existing products reimagined (the 'virtual' NFL Draft) and new shoulder content (*The Last Dance*) all drawing in record viewers.

In creating the new hybrid model, rights-owners need to develop new packages by mixing and matching live, near-live and non-live rights. This will enable them to create a fit-for-purpose proposition for every media partner and finally appreciate the untapped commercial value outside live rights in the process.



Source: Two Circles
Note: Sports fans in the world's 80 highest-income territories, per The World Bank