BETTING ON OTT'S FUTURE – KEY FACTORS FOR SUCCESS

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Betting on OTT's Future

Executive Summary

Whether you're transitioning your traditional television business or launching a brand new OTT service, you've been affected by the rapid acceleration of the OTT business over the past three years. Though some media companies are seizing opportunities to off-set shrinking Pay-TV revenues at home by taking advantage of the remaining growth areas for Pay-TV, the strategy seems to be one of diminishing returns as OTT continues to flourish and mature into a profitable and sustainable business. The barriers to entry are becoming more and more surmountable, and those who don't lose sight of what consumers want will stand to win big.
This whitepaper offers some observations and recommendations for charting the best course for your business.

If there ever was an inflection point when OTT's future competency became somewhat of a foregone conclusion, we'd have to point to 2015. Sure, Netflix and Amazon Prime were already soaring by this point, but that was the year when major media networks decided to launch direct-to-consumer streaming services like HBO Now, CBS All Access and others. It was also the year of bold initiatives like putting a newly imagined version of "Star Trek" on CBS All Access rather than the mother broadcast network. It was also in 2015 that Amazon introduced its download capability that allowed offline viewing, and mobile providers unveiled plans for unmetered SVOD streaming. With all these exciting, new digital offerings, it felt like OTT video had really arrived.

> OTT's increasing dominance inspired media companies to step up their games and find ways to compete, and hence the Virtual MVPD (Multichannel Video Programming Distributor) was born.

A kind of New Age Pay-TV service, vMVPDs offered video live streaming of linear channels along with on-demand functionality, thus challenging popular OTT providers like Netflix, as well as traditional pay TV, by offering a cheaper price point. This more consumer-friendly version of the 'TV Everywhere' model, which launched a few years earlier, allowed subscribers to watch channels online via a cable subscriber authentication process. Virtual MVPDs cut to the chase and allow consumers to subscribe to a 'skinny' bundle of channels.

In the U.S., Dish was one of the first, with the introduction of Sling TV in 2015. A year later, DIRECTV Now, and Hulu's live TV service followed; This year they were joined by YouTube TV and Philo. This has garnered a lot of attention in the last two years as it offers a strategy to keep millennial viewers engaged and presents options for cord cutters. For subscribers who maybe watch 12 of the 192 channels they got from their traditional Pay-TV service, the arrival of vMVPDs was a revolutionary change.

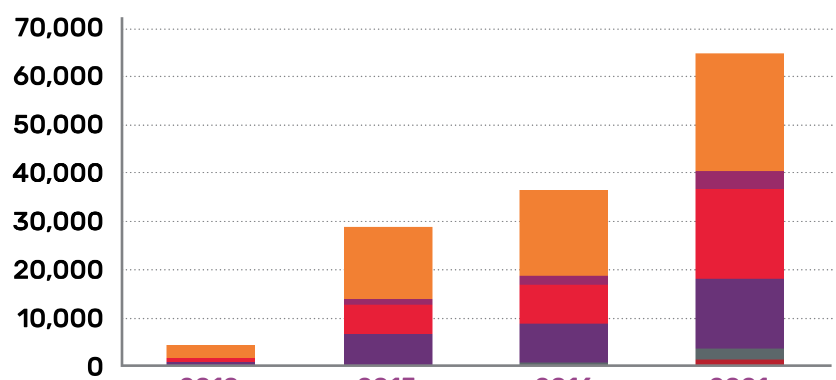
The Growth of OTT

Just recently, there was a study[1] that came out about the growth of OTT. The results of this study were widely reported – in fact, it dominated the news in the television industry trades. The upshot was this: Virtual MVPDs will reach about 14% of the U.S. Pay-TV market by 2030, as compared to the only 4% it reaches now, and the Pay-TV market as a whole will decrease by 7% over that same period. In 12 years, says this study, 30 million U.S. households will have no multi channel Pay-TV service whatsoever, be it virtual or traditional. The traditional linear Pay-TV market will shrink by 26%, reaching only 60% of U.S. households by 2030.

Another study[2] that came out literally days after the aforementioned report, projects that the SVOD market in the U.S. will double by 2022. This one claims online video subscriptions will reach 213.1 million in just four years, as Pay-TV numbers continue to decline. The report also predicts online subscriptions will be split between 130.4 million for OTT platforms like Netflix and 82.7 million subscriptions for virtual MPVDs. U.S. Pay-TV subscribers are projected to decline from a 2013 high of 100.8 million to 95.8 million in 2022.

On a global scale, SNL Kagan[3] reports that there are now over 1,200 OTT services in operation worldwide, up from 978 reported in 2016. And Digital TV Research[4] estimates global OTT revenues will hit the $65 billion mark by 2021.

Global OTT TV & video revenue forecasts by region ($ million)



	2010	2015	2016	2021
North America	2,674	15,389	18,078	24,387
Latin America	32	1,152	1,596	3,586
Asia Pacific	707	5,741	7,894	18,396
Europe West	1,014	6,396	8,199	14,642
Europe East	26	454	633	1,976
MENA	13	255	339	1,328
Sub-Sahara Africa	0	22	37	467

Source: Digital TV Research, 2017

OTT's Impressive Growth

All these reports and studies point to the same thing: OTT's formidable growth path. And while we can safely say these changes aren't happening overnight, the projections are telling a story of radical change within the next few years. But change is really nothing new in the content distribution business, and with each new technological advance, there seems to be a shift in consumer behavior that tips the scales further and intensifies the kind of economic uncertainty that comes with any big shift in the media ecosystem.

In the music business, we moved from vinyl albums to cassette tapes to CDs to downloads to streaming. Each new technology was met with consumer skepticism, followed by intrigue and eventually widespread adoption and economic disruption to the whole music industry. Similarly, the change in the TV industry we're experiencing now was brought on primarily by the introduction of new technology hardware in the form of smart phones, tablets and Smart TVs.

Because consumers could get video anywhere and on any device, Netflix went from a DVD service to a streaming service, YouTube exploded, and the very notion of "TV" was turned on its head. So, the cinematic prophesy of "if you build it, they will come" has really come to the fore now.

> Traditional media companies are stepping out of their comfort zones to figure out how to adapt to customers' new consumption patterns and increasingly fierce competition.

Over the past 20+ years, the television business has weathered many changes, but it has also enjoyed an extended honeymoon with the boon of the international channel business in the 90's. After some initial missteps – and perhaps even a little over-confidence – we saw the roll out of international channels build speed and blossom into a reliable profit center for media companies.

Where is Pay-TV Growing?

For many regions around the world, the Pay-TV business still thrives. In fact, at VO's TV Leaders Summit in Paris June 2017, Digital TV Research analyst Simon Murray pointed out that Pay-TV is still growing in some markets, including Asia and Africa. Indeed, over the past three years in particular we've seen M&A activity heat up considerably, as U.S. networks seek to offset shrinking Pay-TV revenues at home and take advantage of the remaining growth areas.

The strategy has been working. In 2014, Viacom bought the UK's Channel 5 for US$725 million and since then the channel has delivered two straight years of profitability – a first for the channel. This success story was a major factor in Viacom's decision to snap up Telefe in Argentina a year later. Other examples include Discovery's purchase of Eurosport for US$534 million last year and CBS Corp's recent acquisition of Network Ten in Australia.

For some networks, international deals like these not only provide an opportunity to spread programming and other costs across a more global portfolio and achieve economies of scale, but also to use some international markets to test new OTT offerings. We haven't seen the end of this activity, as the rumored mega deals of 21st Century Fox and Disney, Sky and Comcast, and Liberty Global and ITV would indicate.

Despite the big M&A money floating around for Pay-TV services, OTT continues to build steam. Simon Murray also noted that while SVOD channels and OTT platforms were seen as the enemy to international cable and satellite providers just a year ago, there has been a new-found friendship between them now.

Many Pay-TV operators realize they need to offer something new to their subscribers to keep them and attract new subscribers as Netflix, Amazon, and local OTT platforms are entering even the emerging markets. So, perhaps we aren't really experiencing the eminent demise of the Pay-TV business as some industry experts predict, but a transmutation in the distribution of content that is not only more global, but also more consumer friendly and affordable, and potentially more profitable for content creators, media companies and distribution platforms alike.

OTT Players

OTT itself is also subdividing and taking on different forms as it grows. We can expect many more permutations certainly in the next year, but as of now, we can divide the types of OTT players into five broad categories, each with its own set of market advantages:

1. Dominant premium OTT video platforms
   Netflix, Amazon Prime, HuluPlus, YouTubeRed. These companies, and especially Netflix, are spending billions on content and have won fans in many major markets around the world, but the world will not be dominated by Netflix in the years to come! There are already local OTT platforms that are giving Netflix a run for its money: iflix in Asia, Africa and the Middle East, and Lightbox in New Zealand are just two of many examples.

2. Virtual MVPDs
   Sling, DIRECTV Now, Sky's Now TV. You didn't really think the established MVPDs were just going to let their subscribers slip away to be seduced by the likes of Netflix, did you?! The strategy of offering "skinny bundles" and live streaming is compelling for viewers who want to be able to watch live TV, but also catch up on favorite series on demand, and all at a better price point than the traditional mammoth cable bundle.

3. Major studio and broadcaster stand-alone platforms
   HBO Now, CBS All Access, Showtime. Having significant content libraries and high-profile brands consumers value, these media giants can go direct to subscribers. And it seems to be working. HBO Now has over 2 million subscribers, and CBS All Access and Showtime have 4 million in total. This past summer, Disney shook things up by announcing it would end its distribution agreement with Netflix and launch its own ESPN and Disney branded streaming services proving again that Netflix's dominance will be challenged again and again in the coming years.

4. Platform players
   Sony Playstation Vue, Apple TV, Roku. These offer direct video subscription services and are now starting to jump into the original programming arena as well. It's still early days to see if they have the ability to take a slice of the Emmy Award-winning production pie that now is dominated by Netflix and HBO, but there's no doubt that these companies will continue to throw more exciting options at consumers.

OTT Players - Continued

5. Niche SVOD services

   Those who have boldly stepped into the new OTT world have done so with mixed results, but one thing is clear – this game certainly isn't one where you'll find any overnight successes. We often hear about Crunchyroll, the anime focused SVOD service with over 1 million subscribers, and WWE, the wrestling streaming channel with nearly 2 million subscribers. Their success has inspired many to jump on the SVOD bandwagon in hopes that they too would find that golden niche and lure millions of paying subscribers into their fold.

But the path to SVOD glory has been lain with many stories of dreams unfulfilled. Recent examples include Otter Media's FullScreen and NBCU's Seeso – both of which folded. These, as well as a string of others, created a fury of pedantic theories that the costs and time investment needed to turn niche services into profitable businesses were just not manageable nor realistic. Fair enough. Crunchyroll was launched in 2006 and WWE in 2011 so building a successful, profitable business has been a considerable time commitment.

But the same could have been said of the niche cable channel business 20 years ago, which saw countless channels launch and succeed in reaching enthusiast groups and underserved audiences through much trial and error, so don't count niche SVOD out just yet.

OTT Matures

OTT has manifested itself in these various forms and now has reached a level of maturity. While economics, the introduction of truly amazing consumer products, and consumers' general dissatisfaction with their cable providers have played a role, there are a few other key factors that have also contributed to OTT's rise and will continue to fuel its growth.

First, there's timing. We are at a time when the perfect confluence of elements is making it easier than ever before to launch a streaming service. Faster broadband, a growing CDN footprint, affordable hardware, and secure payment mechanisms are all largely in place today. And perhaps most significantly, cloud services, which weren't even available a few years ago, have emerged as a leading technology and infrastructure enabler.

Second, of course, is the abundance of content and success of original programming, which has led to the huge investments we're seeing today.

> Original content is now seen as both a strong value proposition and a means to fill in the gaps in content licensing agreements.

One of the biggest drivers of Pay-TV has been live sports programming, but recently digital platforms like Facebook, Amazon Prime, Twitter, YouTube and SnapChat, along with a handful of other sports-focused digital outlets, have been challenging traditional television broadcasters for sports rights. Amazon paid £10M for UK rights to the ATP World Tour from Sky. Before that, Amazon paid $50M to stream 10 NFL Thursday night games. Meantime, the PGA struck deals with Twitter and GiveMeSport, the English Football League launched its own streaming service, and Formula One signed a deal with SnapChat. These are all indications that we're on the verge of a significant disruption in the traditional sports model, which will add significant fuel to the growth of OTT.

OTT Matures - Continued

Fierce competition Pay-TV providers, studios, and technology providers have felt from premium OTT players has prompted them to offer their own online services. Partly inspired by a fear of being left behind, this has nevertheless driven OTT forward even more.

Another factor is consumer awareness and acceptance of the streaming video experience. The fact that more and more people are willing to pay for online content has changed the game for OTT players. And along those lines, the evolution of OTT as a consumer service has also helped to grow its base. Most platforms now offer features like personalized recommendations; searches by topic, title and more; availability across devices and increasingly more intuitive discovery.

Finally, consolidation brought on by huge media mergers will serve to fuel further global expansion in OTT.

Too Many Platforms, Too Much Churn

Of course, there are still challenges. While the online video ecosystem is more conducive than ever for OTT, those looking to get into the game are faced with a dizzying array of options. For instance, there is no such thing as a typical OTT publisher. While the broadcast and cable industries adopted common standards for delivering content, OTT publishers utilize a variety of approaches to managing video delivery and ensuring subscribers received a high-quality viewing experience.

The struggle lies in how many platforms you need work with in order to be truly ubiquitous. Your list might include Apple TV, Roku, Amazon Fire TV, smart TVs like those from Samsung and Sony, and mobile platforms like Apple's iOS and Android.

> While the process of hitting all of those has gotten easier, video publishers are still faced with a fragmented platform market that makes it a challenge to bring a high-performance experience to all of them.

For smart TV platforms, for instance, everything is based on HTML.5, but for Roku, Apple TV and Amazon Fire, different codes are required. There have been attempts to standardize the process, but the consensus is that everyone is still just going in their own direction.

Other hurdles to OTT's continued growth and success lie with the consumer. If you've been in sales for any length of time, you know how consumer friction can kill the sale. This certainly is the case with OTT. If an OTT platform or SVOD channel is too hard to access, requires a lengthy sign up process, or is perceived to be too expensive, you've lost a potential subscriber in a hurry. And, as is the case with cable subscriptions, churn is a big factor with OTT, however it is even easier to get out of OTT subscription than a cable contract!

In fact, the churn rate for OTT services in the U.S. is 19%. Customers tend to drop services if they just signed up for a certain show or series and don't have any interest spending a monthly fee for more. Churn can also be attributed to dissatisfaction with the quality of the viewing experience or frustration in searching or discovering content.

By and large, however, the challenges facing the expanding OTT business seem to pale in comparison to the rapid progress that has been made facilitating its growth. We can expect many more innovations and standardizations in delivery and issue resolutions in the next year. There are also any number of ancillary businesses, apps and marketing partnerships cropping up that are supportive to the OTT business model by providing consumers with recommendations and seamlessly linking them to content they are interested in, thus reducing "friction" and frustration in a "too many choices" world.

SVOD Across the Globe

> There are already 200 million SVOD subscribers worldwide, two-thirds of which are outside the U.S., and that number is growing daily.

If you haven't already, how will you shift your strategy to embrace the sea change that has already taken hold? Should you abandon the traditional Pay-TV ship and set your sites on OTT? And if so, what should the timeline be for that move? The answers to all these are "yes," "maybe" and "there's no time like the present"!

The barriers to entry into the OTT world are all but vanishing, but we can also safely say that the vestiges of the traditional Pay-TV business are still hanging on and will continue in some emerging markets around the world as well as in first-world markets like the U.S., UK, EMEA, Latin America and Australia as consolidation among the big media companies continues. But linear Pay-TV will be a smaller and smaller portion of the content distribution businesses in the years to come and it seems wise to embrace a hybrid strategy.

While not abandoning the core Pay-TV business, more and more companies have launched or are readying an OTT offering that responds to their subscribers' shifting consumption patterns and will keep them competitive. Existing MVPDs/MSOs, large media networks and major platform players are now working together in many cases to make the vMVPD game play out and compete with the formidable OTT platforms – namely Netflix – in the biggest markets around the world.

Key Factors for Success

Whether your business is content production or distribution, broadcasting or Pay-TV, if you are entertaining the idea of making the leap to OTT, take note of some of the key factors we've identified over the past few years that have yielded some early successes:

- Having a large device base (like Sony, Microsoft, Google)
- Existing customer relationships (like the vMVPDs)
- Content licensing deals in place and a budget for original content (like the premium OTT players)
- A solid brand and infrastructure (like studio and broadcaster owned platforms)

With one or more of these boxes checked, you're greatly improving the odds of winning in the OTT game.

But even with these essentials in place, when getting an OTT service up and running it's important to remember that consumer patience runs thin when it comes to a poor entertainment experience. Therefore, take note of some of the things consumers want while you are developing your service.

Consumers want:

- A high-quality video experience on any device
- Seamless integration between devices as they move between screens
- Features that allow them to personalize their experience and drive content offerings
- Engaging interactive features
- Try and buy offers
- Social media integration
- Flexibility in content packages offered

Perhaps now more than ever in the history of our industry, consumers are in the driver's seat. Should anyone forget this basic premise they will be left on the side of the OTT super highway.

> Successful OTT businesses are generally based around quality premium content that allows consumers to choose how and when they want to watch.

SVOD and TVOD (transactional VOD) offer content and rights owners the benefit of monthly recurring revenue and ad-free content. Letting viewers and subscribers create their own OTT experience with your live and on-demand content library will lead to deeper relationships with consumers and drive more revenue in the long run.

The times may be changing, and it may not be all smooth sailing into the future of TV, but if businesses meet their customers' OTT demands, they will secure recurring revenue and expand their opportunities to reach and gain new customers. In addition, businesses that have direct insight into viewers' usage patterns and tailor offerings based on how programming is resonating with customers, as well as how it is presented and priced, will have the competitive advantage and ultimately win in the OTT game.

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