

What If TV Is Actually Not “Dead”?

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There appears to be a relatively common perception that TV is “dead”. The reasons are quite obvious with streaming services as standalone product directly to consumers becoming ever more popular. These over-the-top media services (OTT) draw viewers away from linear, i.e. minutes watched on sets have certainly declined, especially among younger viewers, according to Ofcom¹. This negativity is also to a large extent driven from a US centric perspective, since here we have seen the biggest shift away TV viewing because of very expensive pay-tv bundles that are gradually getting competed away.² As a potential consequence of this and due to rise of digital advertising, traditional customers of TV advertising move their budgets increasingly away to digital advertising.

We agree that OTT is likely to continue to grow and take away minutes from linear viewing. It is hard to say how steep this decline will be but the 1-2% decline in viewership share of stock-exchange listed European broadcasters^{3,7} appears to be a reasonable estimate. Especially the US should experience a steeper decline. However, this does not mean that (linear) TV will completely die out or at least not for the foreseeable future. Firstly, older generations, i.e. 65 years plus in fact watch the same amount of TV or even more and as a general rule the older people get the more they watch TV (especially people, who have children)^{4,5}. It is also likely that TV remains crucial as the center of the living room, with prime time live TV still being considered to be valuable (driven by live events). In this regard, it is also noteworthy that popular streaming services are particularly strong in series/movies, though live events will become more difficult to deliver via OTT, due to technical reach. It is quite difficult to guarantee reliability when suddenly a lot of people want to watch the very same content at the same time. The US has experienced this significant decline is also a different animal than Europe because prices for TV are a lot lower than in the US. Therefore the cord cutting risk should be minimal, as the cost is still very low.

As a result, we would argue that TV is far from dead and should not be dead for a long time. However, due to this negative perception there are several opportunities in the European equities space from our perspective. The two areas that have been most affected are broadcasters and satellite operators.

When it comes to broadcasters, we focus on companies that have strong market positions in their respective markets, as well as, have growth potential when it comes to content and digital businesses.

It is also crucial that their linear TV business remains in a solid situation, i.e. a relatively stable viewership remains key. Supply in general for broadcasting is fixed anyway because of regulation in many countries with regards to how many spots can be broadcast. From a structural point of view, we are not that negative on TV advertising, as we think that effectiveness of TV advertising is still the highest according to several studies, which also shows in pretty good pricing power. On the other hand, the effectiveness of digital advertising is already being increasingly challenged. We do not argue that digital will not continue to grow but there are certainly signs that marketing departments will have to re-

consider their effectiveness, as recent statements by large consumer companies have shown.

Another discussion is streaming service providers' growing overseas budget but TV is still a very local business and for example the English still prefer to watch predominately local content, at least on linear. So it is hard to see why and how streaming companies should allocate their budget to e.g. English, French or German preferences as they intend to serve so many different international markets.

We think valuations are attractive in the subsector at high single digit FCF yields on average, but one needs to be selective. We think that currently the market does not truly differentiate the "good" from the "bad", hence investment opportunities can be found. We also believe that the cyclical nature of TV advertising (and not disruption by OTT service providers) represents a greater risk to earnings for some of the strongest broadcasters. In the times of an economic slowdown, the limited supply of advertising slots protects broadcasters' pricing power but may lead to weakening advertising demand. In such a scenario, valuations within the subsector could become even more attractive than those observed currently.

The more defensive way to invest into the TV theme are through satellite operators that are focused on video (linear TV), while the other parts encompass data applications i.e. for corporations or governments (military mainly). The sub sector began to recover lately after three horrendous years.

The reasons were plentiful for the negative development: For one there was an oversupply in their data businesses. A situation that is improving now, as supply is now growing below demand, which is driven for instance by new applications, such as internet on planes. This may lead to long-term growth in the industry independent from TV, while the individual companies are looking for niches with competitive advantages.

Secondly, there were obviously the increasing uncertainties surrounding the TV business, which to be clear is not affected by oversupply because orbital slots are basically fixed and remain with the individual companies. This means that they are basically monopolies, as satellite dishes on the ground would have to be re-adjusted to a different slot and most end customers/viewers do not feel a need to do so and there is no particular reason for broadcasters to incentivize them to do so either. Still, in 2016/2017 uncertainties were increasing as channel growth was put into question because of declining viewership, as well as, pricing with broadcasters potentially starting to share their growing pain with their suppliers.

So why are a lot of these problems likely not that well-founded in the long-term? First of all, it comes back to the issue that linear TV will not disappear and satellite households are essentially still growing on a worldwide basis but we do acknowledge some channel decline in the developed markets, especially in the US. However, emerging markets should grow and gradual penetration of HD/UHD channels should help to grow the market. Pricing could get under pressure, though the companies deny this. The main counterpoint against a pricing decline would be technical reach⁴, the monopoly positioning, as well as, the relative low costs (~2% of opex for broadcasters⁶). Still, we would not rule it out but we are seeing satellite costs and hence capex as falling as well (capex to sales is very high at around 25-30% but EBITDA margins are usually around 70% making it still a very profitable endeavor⁶). Overall, we believe the market is too bearish on the Video business and can remain a significant cash-cow for the companies.

The recent recovery in the space comes down to somewhat better numbers particularly in

the data area. One other reason has been that an alliance between several satellite operators who have proposed to sell some of its C-band spectrum in the US to mobile operators for 5G. There are an increasing number of indications that the sides will agree on a transaction, as the 5G roll-out is critically important for the US with the regulator (FCC) and mobile operators sounding constructive on the put forward proposal. There could be a significant windfall coming for the individual companies.

Excluding this windfall, we also think the valuations are still attractive with a normalized FCF yield in the high single digits on average, while FCF should be able to grow over time. Leverage is relatively high in the industry. What people often forget is the strong stable nature of the Video business with contract length around 10 years. This also should make the stocks very defensive in nature, in contrast to its recent stock volatility.

The conclusion is that while the structural trend for TV companies clearly creates new hurdles and requires the companies to move faster to improve their business models, the market might have taken a too cautious view on the future prospects of the subsector. Observed sector valuations indicate an expectation of a continuously difficult outlook for TV. Yet, we believe that many negative factors are probably more temporary than structural. This particularly applies to some names within the broadcasters and satellite space that should deliver growth over time. We believe they still have sustainable business models in place to build future value. They should be able to make their businesses less dependent from linear TV over time but still keep them as solid underlying cash-cows. This should support investments into the theme, even as headlines will still suggest that linear viewing continues to decline.

Sources: 1) [link](#) 2) [link](#) 3) Quarterly and annual financial reports and presentations of European broadcasters summarized by Statista ([link](#)) 4) [link](#) 5) [link](#) 6) [link](#) 7) [link](#)

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