VARIETY PREMIER

THOUGHT LEADER

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MEDIA TRENDS THAT WILL DEFINE 2018

By Andrew Wallenstein, Co-Editor-in-Chief, Variety

It's fitting that a group of stocks known on Wall Street as FANG has taken quite a bite out of the entertainment industry. Two of the letters in that acronym stand for Facebook and Alphabet-owned Google, which have sunk their teeth deeper than ever into the advertising revenue that keeps the entire media ecosystem afloat, from TV to newspapers. The other two letters belong to Netflix and Amazon, owners of the reigning subscription VOD services. 2017 saw an acceleration in their already exorbitant spending on original TV and film content, saddling the traditional U.S. pay-TV business and box office with major competition. It's not an understatement to label them an existential threat.

1 THE WATCHWORD OF THE YEAR IN MEDIA IS: SCALE

While none of the FANG foursome even identifies themselves as media companies they are co-opting Hollywood's core competency — video content — as a key weapon in their own war with each other to keep billions of users worldwide on their respective platforms for as long as possible.

Sure, the media biz wasn't as tumultuous as politics was in 2017. But both worlds reeled from the impact of a fearsome outside force breaking in, resolved to change the rules of an anachronistic game. Much like Donald Trump rocked Capitol Hill, tech giants have upset Hollywood's own apple cart.

To take on these interlopers, the watchword in media this year is scale. M&A has been the order of the day to appease an increasingly skeptical Wall Street, from the stunning $52.4 billion absorption of half of 21st Century Fox by Disney to the long anticipated union of Discovery and Scripps.

There is no question that there are more such deals coming. Viacom and CBS could eventually come back together. Sony and MGM will never escape those rumors that deals will eventually dwindle the number of companies left in the content business. And then there's Liberty Media's John Malone, who is always good for an unexpected move.

While the business-friendly Trump administration was always expected to usher in an era of aggressive dealmaking, another pact risks being derailed by the Justice Department: The contested union of AT&T and Time Warner will be headed for the courts in March.

But in other ways, Washington D.C. is sending far less ambiguous signals that media businesses are welcome to reconfigure itself as they please. The new Republican-led FCC has been driving deregulation at breakneck speed. That's going to clear the path for growing giant Sinclair to close its own deal to snap up Tribune Media in a station business bound for some serious consolidation. And the owners of the distribution pipe are also getting a gift in the erasure of Obama-era policies protecting network neutrality.

Streaming is the name of the game given the sea change in audience behavior right now as more video consumption moves to mobile platforms, particularly from coveted young consumers. Because the tech giants control the app world, media companies are finding mobile is the farthest thing from playing on a level playing field.

A conglomerate like Disney knows it can't afford to be complacent. That's why CEO Bob Iger made one of the sector's boldest move of 2017 by announcing plans to take his biggest brands into the OTT space. It's a remarkable pivot, an acknowledgement of how tightly the FANG quartet has clamped down on the core business of Hollywood: linear cable channels.

Ratings are dropping, which will bring advertising revenue down with it. And the other of Hollywood's twin revenue pillars, affiliate fees, is seeing its growth trajectory lose momentum as cord-cutting begins to reach significant numbers. The advance of virtual MVPDs like DirecTV Now and direct-to-consumer plays like CBS All Access are softening the blow, but so far by only so much.

Also struggling to grow again is the theatrical business, which has just begun to feel the creeping advance of Netflix and Amazon. And they may not even be the only ones ready to make movies. The other half of the acronym, Facebook and Google, may be better known as a threat to advertising, but they too have stepped up their own content investments via Watch and YouTube Red, respectively. Still more companies are competing for premium programming: Verizon, Snapchat and Twitter want more video ad dollars.

And for those who understand the tech sector as FAANG, the extra A will soon make its presence known with Apple pledging to bring at least $1 billion to its own budding original content efforts in the coming years. It doesn't matter how many letters are in the word; they spell big challenges ahead for the media sector just the same.

2 IT'S THE END OF NETWORK NEUTRALITY AS WE KNOW IT

As expected, network neutrality got gutted before year-end by a Republican-led FCC seeking to overturn tighter regulations put in place during the final years of the Obama presidency. There are fears that by giving ISPs the ability to disadvantage new video and communications services seeking to operate on their networks, companies that might have otherwise been poised to become the next Netflix or Skype will be hobbled with payments they can't afford that are required to gain preferential treatment to protect bandwidth. Netflix, YouTube and Amazon are big enough to handle any additional fees that might be imposed, but the next generation of services may not be so lucky, particularly as the migration to 4K video makes streaming more bandwidth-intensive.

Title II could also impact consumers if ISPs are allowed to discriminate against existing streaming services that present a competitive threat to their own owned-and-operated services. AT&T, for instance, doesn't allow usage of its DirecTV Now content count against subscribers' monthly data caps.

In addition, streaming services could face additional fees, or paid prioritization, to protect themselves. While that would seem to impact a company like Netflix, the company has seen its position on network neutrality change over the years; the clear anti-discrimination stance CEO Reed Hastings took while Netflix was still new to the streaming game has given way to a more modulated stance, where Netflix seems to be happy to be a zero-rated service provided no broadband provider gouges them on interconnection fees. Charter, for instance, can't increase fees on Netflix until 2019 as a condition of its acquisition of Time Warner Cable.

Consumers could be put in the position to face additional fees to access desired content, though the prospect of usage-based billing would seem to be a non-starter from ISPs sure to hear intensive negative reaction from consumers to such a move.

3

Regulatory Outlook: FCC Giveth and Taketh Away

FCC chairman Ajit Pai has moved swiftly to roll back decades of restrictions keeping media companies from getting too much power by scaling up through acquisitions. While intended to thwart the kind of concentration in media ownership that could diminish the diversity of voices in the TV marketplace, others have argued the restrictions give these companies a competitive advantage at a time when a new breed of bigger rivals have emerged in the form of tech companies that have already begun luring away video ad dollars even at the local level.

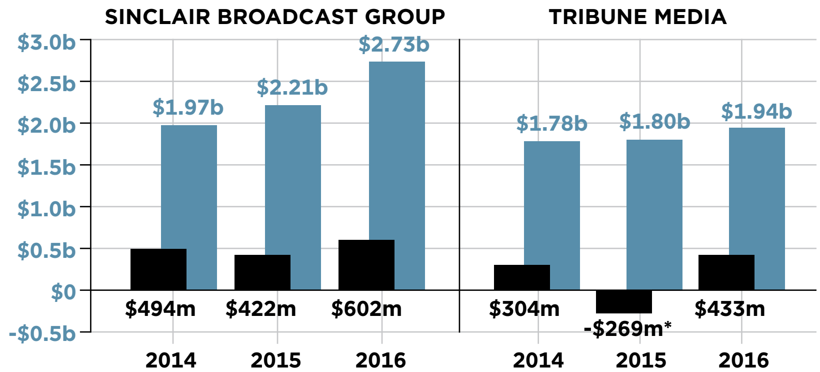
Sinclair Communications is the perfect test case for the strategic soundness of Pai's deregulation drive. The company has clearly benefited from the rollback of restrictions as it moves toward a $3.9 billion deal to acquire Tribune Media, which will make it the largest station owner in the country. But Sinclair has come under considerable scrutiny for propagating politically conservative viewpoints through its stations at the same time that it has taken the industry's lead to push through ATSC 3.0, a new, more innovative broadcast standard with the potential to put the station business on a more even playing field with tech giants.

The TV station business has been under a cloud on Wall Street for many of the same reasons that have impacted the entire media business. But its death has been greatly exaggerated. For one thing, stations aren't as impacted by cord-cutting because they are available via over-the-air TV, and most skinny bundles include them, which protects ad revenues from diminishment of audience reach.

JOINING FORCES

Sinclair Broadcast Group will command even more clout in the industry if its $3.9 billion buyout of Tribune Media is approved by the FCC.

■ Total operating income ■ Total revenue



SOURCES: SINCLAIR BROADCAST GROUP, TRIBUNE MEDIA 2016 ANNUAL REPORTS
*TRIBUNE TOOK A $385 MILLION IMPAIRMENT CHARGE IN FEBRUARY 2016, LARGELY TO REFLECT THE LOSS IN VALUE AT ITS WGN AMERICA CABLER.

4 THE BIG 3 SVOD PLATFORMS ARE SPENDING MASSIVELY

Leading subscriber VOD platforms Netflix, Amazon Prime and Hulu have had a dramatic impact on the TV landscape, powered by the sheer volume of dollars being pumped into original and licensed content. The SVOD category is projected to spend $15 billion in 2017, up from just $4 billion in 2012, according to Morgan Stanley; Cowen estimates that could reach $20 billion in 2018.

The estimates are staggering on an individual company level: Netflix alone projects an $8 billion spend for 2018, up $1 billion this year. Originals will account for half of that spend by 2021, according to Ampere Analysis. Amazon spent $4.5 billion on video content in 2017, double its 2016 investment and a triple on the original side. Hulu is pegged at $2.5-$3 billion, which may seem to pale in comparison but is entirely focused on the U.S market; Netflix is estimated to spend $2 billion in Europe itself.

As incredible as these numbers might seem, it may be just a harbinger of what's to come. Consider the investment Amazon has pledged to make on a serialized take on "The Lord of the Rings," the global rights to which will cost $250 million; when production costs are calculated for what could be a five-season commitment, "LOTR" alone could end up the TV industry's first $1 billion show.

But the spending may be justifiable when you considering the size of the audiences they are reaching. While Amazon and Hulu haven't given any recent estimations of their subscriber levels. eMarketer estimates Netflix reaches a global audience of 128 million, compared to 85 million for Amazon Prime and 32 million for Hulu. Parks Associates believes that 60% of U.S. consumers subscribe to one of the big three video streaming services.

As unstoppable a force as Netflix and Amazon have seemed in 2017, their progress didn't come without some significant adjustments in programming strategy. After years of virtually rubber-stamping season renewals for its original series, Netflix began cutting off a handful of its efforts after just one season, including "Gypsy," "Girl Boss" and "The Get Down." CEO Reed Hastings explained the cancellations as a reflection of new thinking that encouraged more risk-taking, being willing to part earlier with middling material in order to take more swings that could result in bigger successes. 2018 will also be notable for Netflix as it embarks upon a significant expansion in its original films slate, which could see as many as 80 titles released.

Amazon Studios also went through something of a mid-year course correction at the behest of Jeff Bezos, who mandates a stronger emphasis be put on finding high-end drama series at the scale of "Game of Thrones" that can play well across all territories. The mandate was interpreted as a repudiation of a current strategy that had yielded more niche-centric successes like "Transparent." Amazon Studios also has big shoes to fill in top posts vacated by Roy Price and Joe Lewis, leaving open what may be some of the most sought-after jobs in the content biz given the money their successors will be able to spend in pursuit of Bezos' grand ambitions.

AS UNSTOPPABLE A FORCE AS NETFLIX AND AMAZON HAVE SEEMED IN 2017, THEIR PROGRESS DIDN'T COME WITHOUT SOME SIGNIFICANT ADJUSTMENTS IN PROGRAMMING STRATEGY AFTER YEARS OF AUTOMATIC SERIES RENEWALS.

After years of failing to launch an original series that gained the kind of buzz Netflix and Amazon have managed to draw with their own slates, Hulu finally hit pay dirt in 2017 with drama "Handmaid's Tale." But just how aggressive the streaming service will get going forward is unclear as Hulu just went through a transition at the CEO level and very well could find its ownership situation changing once again as the consolidation fever gripping the sector could force a change. Hulu has also leaned far more aggressively into licensed content in recent years at the same time its rivals have been pulling back in favor of originals.

As if the current SVOD onslaught wasn't difficult enough, a second wave of new market entrants into the original programming space is coming. The biggest is Apple, which is pledging to spend as much as $1 billion on original series in the coming year. While that's barely table stakes considering how much the incumbent SVOD players are spending, it's hard to underestimate how much the richest company on earth could eventually spend on content if it so chooses. They are showing early signs that they are going to deliver big, having already announced projects including an "Amazing Stories" reboot from Steven Spielberg and a comedy starring Reese Witherspoon and Jennifer Aniston.

2018 CONTENT BUDGETS

Analyst Gene Munster's estimate of how much the leading SVOD firms will spend

Company	Subscribers	Original	Licensing	Total
Netflix	110 million	$3.0 billion	$4.5 billion	**$7.5 billion**
Amazon	90 million	$1.5 billion	$3.0 billion	**$4.5 billion**
Hulu	12 million	—	—	**$2.5 billion**
Apple Music	30 million	$1.5 billion	$0	**$1.5 billion**

SOURCE: LOUP VENTURES

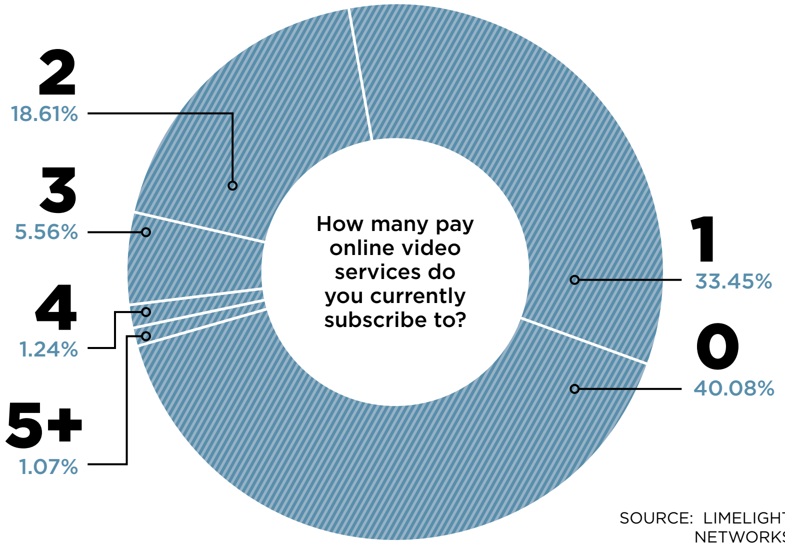
5

Niche SVOD Players Face Uncertain Future

The Big Three SVOD services may dominate the marketplace but they are hardly alone vying for consumers. The U.S. market has over 100 subscription streaming services currently in circulation, and some of them have sizable audiences of their own totaling over 1 million, from anime-focused Crunchyroll to wrestling hub WWE Network. That said, this is a brutal market to be in; several studies have found that less than 10% of SVOD-subscribing households are paying for more than two services. With so many hands outstretched in hopes of luring additional dollars, it's highly likely the SVOD market is headed for a shakeout. To some degree, that's already happened as we saw this year in some fairly prominent closures at Fullscreen and NBCUniversal's Seeso. While these ventures are trying to appeal to cord-cutting consumers tired of expensive pay-TV bills, niche SVOD could trigger a different kind of sticker shock for consumers who try to stitch together their own customized bundle only to find that they've nickel-and-dimed their way to something comparable to what they previously paid in one lump sum (especially with the price of broadband factored in).

Ironically, the salvation for these services could end up being the very same bundling mechanism that is the antithesis of what these a la carte offerings aspired to be: Amazon and Hulu are two aggregators who have had some success enabling consumers to sign up for these niche SVOD services through their own platforms, a dynamic not unlike the one between pay-TV providers and the linear channels they license.

GLOBAL UPTAKE STILL VERY LIMITED



SOURCE: LIMELIGHT NETWORKS

6 CONTENT OWNERSHIP BECOMES A BIGGER PRIORITY FOR SVOD

A key area to keep an eye on is the degree to which the SVOD giants produce their own shows, as opposed to licensing from other studios, enabling them to participate more fully in the economics of a successful show. While the majority of Amazon's original content is produced by its own studio since it first began making such programming available, Netflix is only just starting to close the gap; Canaccord Genuity estimates 14% of Netflix's current slate is in-house. Hulu has yet to create its own studio, though that remains possible.

Netflix upped the ante on its content capabilities this year with the company's first-ever acquisition: Millarworld, a comic-book publishing hub that gives the company the ability to capitalize on intellectual property much the way Marvel has been exploited by Disney. While the company has yet to publicly identify which characters from Millarworld will be turned into programming (the company already has some pieces in play with Fox including its "Kingsmen" film franchise), the upside is tremendous if properly executed.

With studio capabilities in place, Netflix and Amazon also kept busy in 2017 luring over some of the biggest producers in the TV business to switch sides. Netflix wooed ABC mega-producer Shonda Rhimes over from Disney while Amazon coaxed Robert Kirkman ("The Walking Dead") from AMC. Rhimes and Kirkman still have plenty of content that will continue to drive value to traditional networks for years.

There are also experienced showrunners like Chuck Lorre who aren't committing to overall deals with streaming services but have begun producing for them, i.e. Netflix comedy "Disjointed" comes from Warner Bros. TV. While Hollywood studios are getting a nice upfront fee for these kind of productions, the temptation a Lorre might feel to switch sides after this kind of one-off collaboration presents risk. Veteran hitmakers are more vulnerable to poaching than ever because they are attracted to the opportunity to not have to play by the usual rules.

7 PEAK TV WON'T BE PROPELLED BY TV NETS MUCH LONGER

Tech's content infusion could propel the peak TV phenomenon in the U.S. to greater heights in the coming years. Any further growth isn't likely to come from the broadcast or cable networks, which have already reached peak output; any further growth in the overall pie of scripted TV programming is going to come from the SVOD side. While it's natural to ask whether demand is exceeding supply, the ceiling for original content is an unknown in a world that is moving away from a scheduled grid programmed for mass crowds to deep troves of on-demand content playing to niche audience segments across a fragmented marketplace. While that's bad news for the linear channel business, the studios that create that content may be well-positioned as they service the growing demand. On a global basis, the number of new scripted shows is also rising.

Another giant that may have just gotten started in original programming is Facebook, which is putting some ad-supported series out, from long to short form, with a $1 billion budget that could get a lot bigger if the company makes an anticipated move into securing sports rights. Snapchat and Spotify also have some ambitious short-form plans worth watching, ones that could easily expand to long form in time.

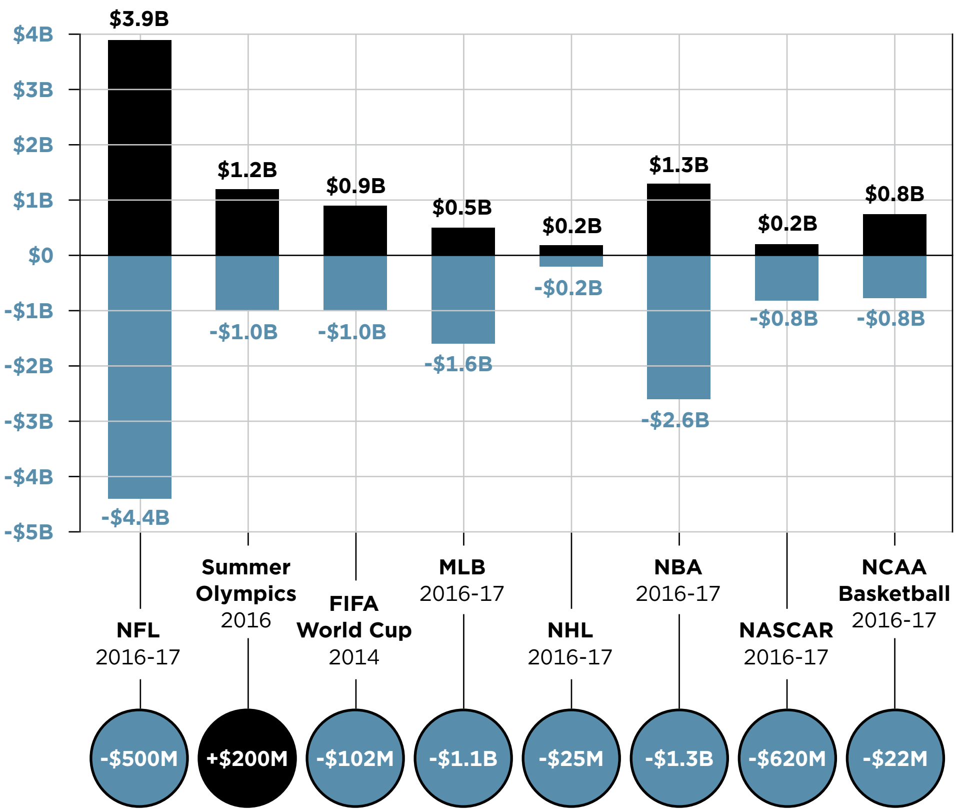
8 THE NEXT BATTLEGROUND WILL BE FOR PRO SPORTS TV RIGHTS

The onus of content costs may be even more deeply felt in sports than scripted content. Look no further than ESPN: A loss of 13 million subscribers from what had hit 100 million six years ago has stripped billions of dollars from its bottom line, making the expense of TV rights to professional and collegiate games an albatross around Disney's neck. The conglomerate has nearly $50 billion in sports rights on its books, including an eight-year $15.2 billion deal for "Monday Night Football" signed in 2011 that may be its most extravagant purchase. The problem is that as some key sports leagues like the NFL experience ratings erosion, the revenues derived from advertising begin to lag the incredible costs attached to carrying games. That sets up what might be the biggest battle of all between the media conglomerates and Silicon Valley: Two of the three biggest sports rights deals will come up for renewal in the coming five years, which will likely set off an epic bidding war for these expensive packages. Tech companies clearly have an appetite for sports, as evidenced by the transition of a Thursday NFL package from Twitter to Amazon; even Facebook kicked the tires on a $600 million package for Indian cricket. Which isn't to say it's a clear either-or proposition between the networks and the tech platforms; the leagues themselves may opt to control their own destinies and seek to extract more value holding on these rights than selling them elsewhere. Another company to keep an eye on in this space is Verizon, which closed a mammoth $2 billion deal to extend its mobile NFL rights. That could be just the beginning of a bigger effort by the telco.

TWO OF THE THREE BIGGEST PROFESSIONAL SPORTS TV RIGHTS DEALS WILL COME UP FOR RENEWAL IN THE COMING FIVE YEARS, WHICH WILL LIKELY SET OFF AN EPIC BIDDING WAR FOR THESE EXPENSIVE PACKAGES.

A SPORTING CHANCE

The cost of rights fees often exceeds the ad revenue (in black) sold against them



SOURCE: MAGNA GLOBAL

9 VIRTUAL MVPDS AREN'T BIG YET, BUT IT'S STILL EARLY

Newly introduced smaller tiers of linear channels known as skinny bundles were supposed to be the saving grace for the media business, helping offset the cord-cutting trend; the high hopes around these products may have helped the media sector with its improbable rebound on Wall Street in the first quarter of 2017. Guggenheim estimated as of the third quarter that 1.36 million subscribers had exited the pay-TV world over the past 12 months, but without skinny bundle additions that number balloons to nearly 3 million. Still, the early signs are that skinny bundles are not the panacea some hoped they'd be.

While programmers have secured deals that ensure that the subs that come from skinny bundles are even more lucrative on a per-sub basis than what they get in traditional pay TV, the current likelihood is that many of these subscribers are not cord-nevers who weren't ever going to embrace full channel packages but existing subscribers to those packages trading them in for cheaper alternatives (the average skinny bundle runs approximately $40 per month, compared to the average pay-TV package, which amounts to $103). While trends could change given it's still quite early in the rollout of skinny bundles, cord-cutting seems to be occurring at a faster rate.

What's most unclear is just how impactful the latest additions to the skinny bundle category, YouTube and Hulu, are because those companies have yet to report any subscriber numbers. But with both companies beginning to step up their marketing efforts in the second half of the year, it's entirely possible 2018 is poised to see the ranks of their subscribers hit higher levels that will prompt many to take notice. Meanwhile, incumbents DirecTV Now, Sony Vue and Dish's Sling remain in the marketplace, growing but not quite blowing the doors off either. Morgan Stanley estimated there would be 4 million subscribers for skinny bundles in 2017, up from 1.5 million the previous year.

10

Cord-Cutting Is Here, and It's Going to Get Worse

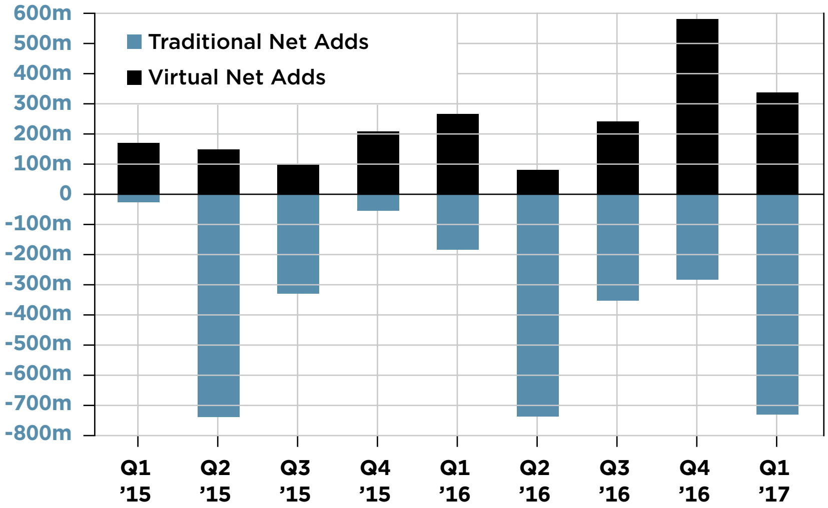
There may be no single factor that dictates the rise and fall of the media stocks more than the cord-cutting numbers coming out of the pay-TV distributors every quarter. 2017 saw a clear acceleration of this drop after a few years of very minor declines, leaving little doubt it's an irreversible trend.

As of the third quarter of 2017, distributors lost 1.36 million subscribers over the past 12 months, according to Guggenheim analysts (with skinny bundles factored in). MoffettNathanson has a drop of 872,000 subscribers in the third quarter alone, compared to 559,000 in the same quarter a year ago. The second quarter was even worse, going from 809,000 in 2016 to 941,000 this year. The year-over-declines are the worst the pay-TV market has ever seen. And that's just the tip of the spear in the context of what this loss could mean when considered over a longer period; Barclays projects 31 million homes could cut or shave the cord over the next decade.

Cord-cutting is such a sensitive subject because it is seen as the clearest barometer of the health of media's biggest revenue stream: the $98 billion in affiliate fees expected in 2018. Digital TV Research estimates that the subscriber level will drop 5% by 2022 to 90.711 million, from 94.957 million in 2017. However, BMO Capital Markets says that U.S. multichannel company won't actually see revenues subside at all over the next five years, projecting $1 growth to $116.8 billion in 2020. The global pay-TV market is estimated to reach $263.5 billion over the same period, representing a 13% increase.

THE NEW MULTICHANNEL MATH

Virtual MVPD gains aren't always enough to offset cord-cutting



SOURCES: COMPANY REPORTS, UBS ESTIMATES

11 DIRECT-TO-CONSUMER OTT: A MUST FOR EVERY TV NET

Given the attrition playing out in the pay-TV universe, it should come as no surprise that 2017 saw increased momentum behind brands known as linear channels first and foremost making plans to go direct to consumer. The single most dramatic example was Disney's bombshell announcement outlining plans to create an ESPN-branded OTT venture next year and even bigger plans for a global Disney-branded entertainment effort seen as a competitor to Netflix. Few details on the products are available, but Disney has made it abundantly clear on what little has been said about its plans for original content alone, that there will be great ambition fueling these efforts. Disney spending $1.6 billion to acquire the portions of BAMTech it didn't already own are indication enough of how critical this strategy is to the future of the company. There's more OTT efforts on the way from Disney, which will likely lean on its Marvel and Lucasfilm brands as their own direct-to-consumer plays. CFRA analyst Tuna Amobi went so far as to hail Disney's move as nothing less than the "beginning of a new paradigm" for major content owners. "A huge amount of revenue is at stake here," he wrote. "It goes back to the deconstruction of the traditional model. You're going to see a lot more companies trying to experiment and have a more direct relationship with the consumer."

CBS All Access also made big strides in 2017 by putting its first original content out there, with extensions of "The Good Wife" and "Star Trek" franchises just the first of an originals slate intended to roll out in 2018. Plans to take All Access global are also afoot.

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All three major premium channels — HBO, Showtime and Starz — are in market with their own OTT efforts, each reporting strong growth. Discovery has also made noises about expanding its effort behind its Crime and Paranormal apps on Amazon. That said, not all media companies have moved as aggressively into the direct-to-consumer space. Fox sat on the sidelines, as did AMC Networks and Scripps.

12 STACKING RIGHTS CAN BE A SOURCE OF NEW REVENUES

An interesting variation on the direct-to-consumer model that emerged in 2017 was a pair of linear channels that sprouted subscription add-ons offering viewers additional content and other features, but only available to pay-TV subscribers. AMC Premiere and FX+ employed slightly different strategies but both are looking to squeeze incremental revenues from its most highly engaged fans that could offset inevitable subscriber declines.

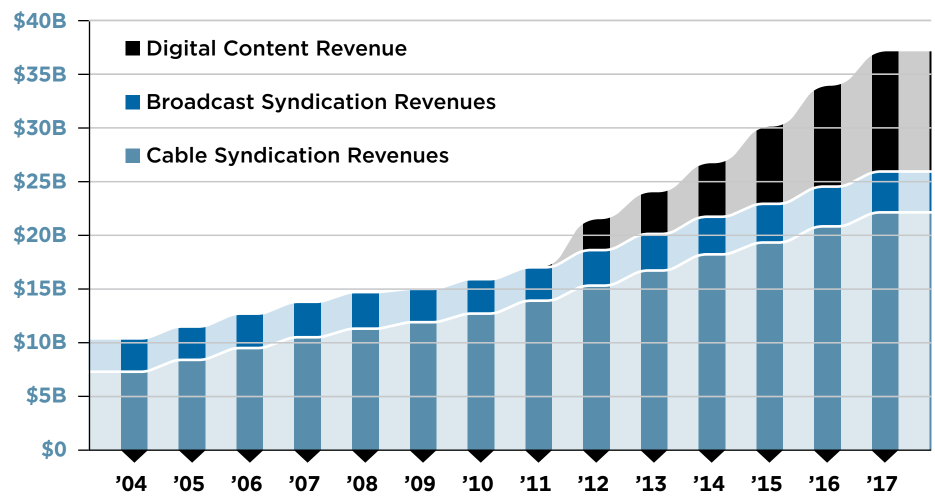
Industry critics contended that while studios made a pretty penny on those licensing deals, that ended up empowering SVOD firms to cannibalize linear TV ratings, depressing ad revenues and driving up programming costs that they could barely afford. It could be argued this amounts to just a futile attempt to put the genie back in the bottle when it's already too late.

But a big part of making this strategy work is networks retaining the stacking rights to as much content as possible. That would mean foregoing lucrative licensing revenue opportunities that would otherwise send library content to SVOD services like Netflix. It's not a trivial concern: While traditional syndication of content to cable networks continues to represent a significant market valued at around $26 billion annually by RBC Capital Markets, SVOD giants are now notable participants in syndication, with digital distributors representing another $11 billion in annual syndication value.

That's no small price to pay for re-training consumers to expect content not to drift out of pay TV into SVOD the way HBO in particular is able to hold onto its entire library and make it available via HBO Now.

U.S. SYNDICATION REVENUES

Historical and projected linear and digital U.S. syndication revenues



SOURCES: SNL KAGAN, INDUSTRY SOURCES, RBC CAPITAL MARKETS ESTIMATES

13

Data Will Transform the Art of TV Advertising

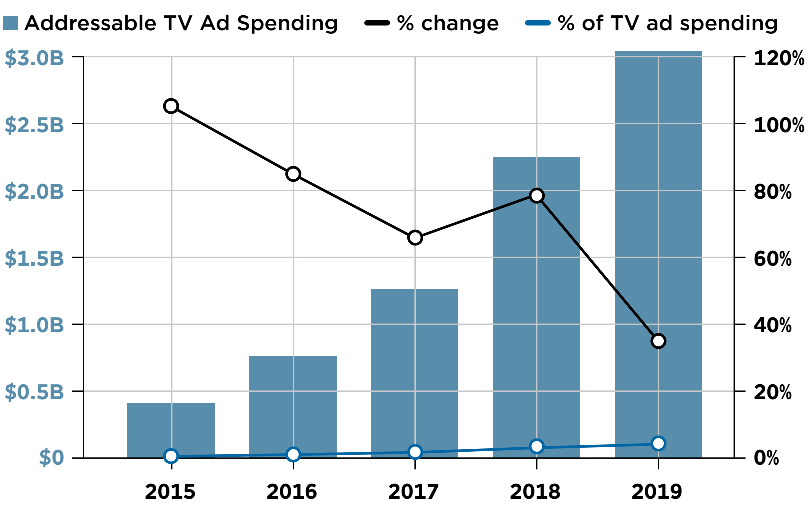
The death of TV advertising is greatly exaggerated. Data from set-top boxes and IP-delivered devices provide endless data that drive the kind of hypertargeting previously reserved to digital. Adding relevance to the medium's reach will allow TV to stay healthy and compete with digital. Credit Suisse estimates it "will allow networks to grow domestic ad revenues both faster than in recent years and faster than investors currently expect."

With digital giants set to siphon TV ad dollars, networks are banding together to fight back. Viacom, Turner, 21st Century Fox are forming consortiums like OpenAP that pool their data capabiilities. Fox and iHeartMedia are even pooling audio and video data together. Fox Networks Group is also currently doing addressable ads with Comcast set-top boxes and Hulu. TV programmers are joining forces on Thor, a new initiative aimed at proving to marketers TV's "attribution" prowess, or the ability to link customer purchases to marketing. Advanced advertising could pave the way for ad tech firms to unlock TV ad dollars instead of just fighting for what few digital dollars the duopoly doesn't take itself. It could become the standard in a few years but shouldn't entirely replace existing budgets. Measurement of targeted ads is limited.

An estimated 42 million TV homes can receive addressable ad campaigns by the end of 2016, totaling $450 million in marketing spend. eMarketer says addressable TV ads will be a $1.26 billion market in 2017 (broadcast and cable, excludes digital),or 1.7% of total TV ad expenditures this year.

U.S. ADDRESSABLE TV AD SPENDING

Growth is expected, but not much more than a fraction of total ad dollars



SOURCE: EMARKETER

14 INNOVATION RESHAPING TV, DIGITAL ADVERTISING

With DVRs and SVOD making it easier to shrug off marketing messages, viewer resistance to commercial interruption on TV continues to be a challenge networks and marketers are trying to innovate their way past. The move away from the traditional 30-second spot has already been in motion in recent years thanks to the increasing usage of 15-second spots. Now TV is looking to shrink even further with the six-second format YouTube pioneered last year online; Facebook and Snapchat have followed suit. But it's moving to TV fast, where the programming shifts to a smaller window on the left side of the screen while the six-second commercials plays on the right. Fox will do same across digital and VOD, and eventually linear, having already tested with NFL. AMC sold the miniaturized spots during "The Walking Dead."

After years of the ad industry trying multiple, futile attempts at reforming digital ads, digital media brands hungry to maximize monetization like Buzzfeed and Vox are getting over their reluctance toward traditional banner ads, which fueled ad blocking, and programmatic buying on desktop and mobile. Programmatic appeals to digital buyers eager to match TV's size, but the problem is it's not built for more customized messaging. We are headed toward a world in which the traditional broad-based demographics like age, gender and household income will be rendered obsolete by the massive amounts of data that will be generated by a wide range of screens that has just begun to extend to things like cars and home assistants, enabling incredibly granular targeting. Think of a thermostat like Google's Nest, for instance, noting how often a home owner uses their heating system and serving up ads for sweaters and knowing what size they wear. In that instance, it's not just about advertising knowing so much more about what kind of people they can surgically deliver a customized ad message to but also a broader range of devices beyond TV and phones bearing those messages.

15 DON'T WRITE AN OBITUARY FOR BROADCAST TV YET

At first blush, the broadcast TV business looks to be in trouble. There was trouble from the start of the 2017-18 season, with the percentage of adults 18-49 who watched primetime TV during premiere week fell to 25.5%, down 8% from a year ago.

It's only gotten worse as the season has wore on: C3 ratings in November dropped 16% in the demo from the same month last year, the seventh month in which those numbers dropped by double-digit percentages, according to an Advertising Age calculation. Fox dropped pretty precipitously due to year-ago World Series comparisons.

But there's also a robust counterargument building that attests to hidden strengths the market may not be accounting for.

First, most of the doom-and-gloom statistics cited against broadcast TV are based on live viewing trends, which are clearly falling off a cliff. However, delayed viewing via DVR and VOD is gaining ground, and most advertising deals monetize that C3 or C7 viewing. What's more, the networks are making progress monetizing the viewing of their content on digital platforms.

For all that's made of the declining fortunes of network advertising, there's still plenty of evidence that no digital alternative can match the unparalleled reach that broadcast TV provides. Ironically, it's the biggest tech companies out there who seem to propping up the TV economy by still spending plenty on the medium because of that reach power. In addition, broadcast TV is just starting to fully monetize the trillions of impressions it generates as new initiatives take flight to improve measurement and monetization.

While network advertising has its struggles, it's too easily forgotten that broadcasters still have a very robust revenue stream going in retransmission consent fees, which are on base to approach $13 billion by 2023, according to Kagan. While MVPDs paying those fees may feel the walls closing in thanks to cord-cutting, the growth of the virtual MVPDs is a positive for broadcasters, who are a must-have in these skinny bundles. Then there are the direct-to-consumer strategies like CBS All Access, which give broadcasters new revenue streams.

As for the viewer, as discouraging as the trends are among the younger viewers, there is still hope based on existing data that millennials will following the pattern of previous generations and watch more TV as they grow older.

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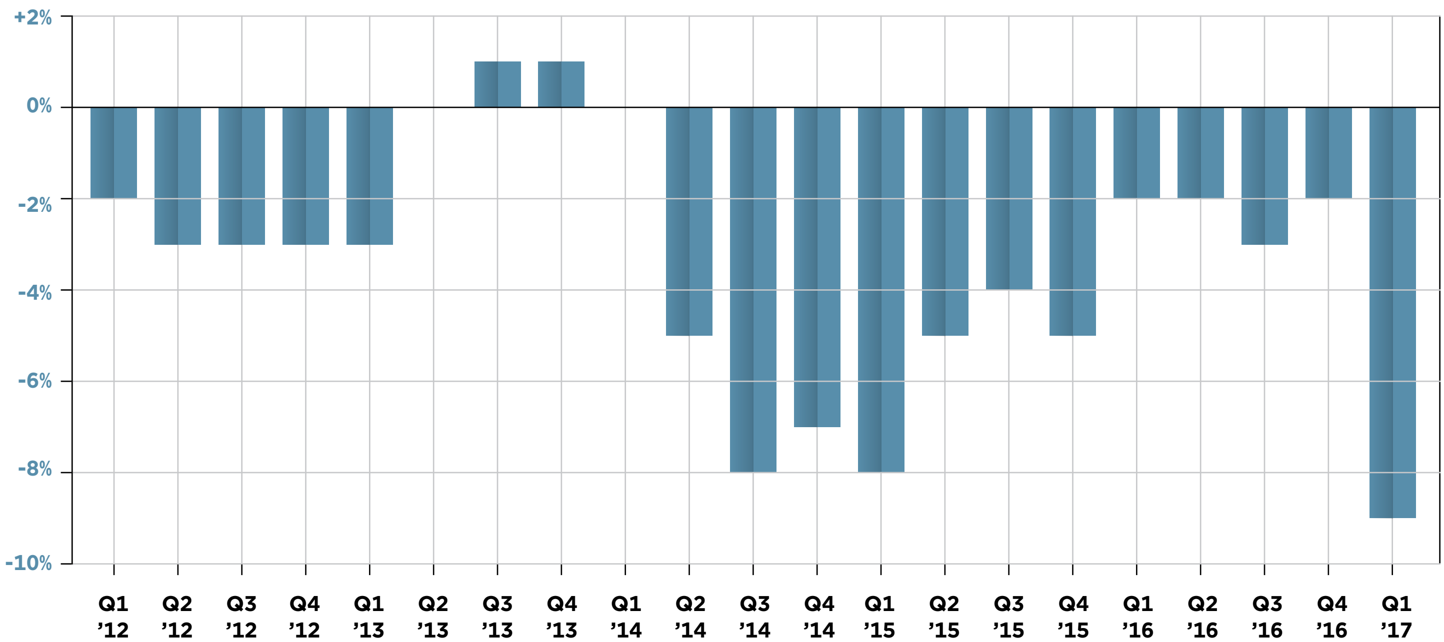
2017 TV RATINGS START SOFT

Year-over-year aggregate A18-49 C3 viewership growth



SOURCES: COMPANY REPORTS, UBS ESTIMATES

16 TV RATINGS DROPPING AS CONSUMERS GO DIGITAL

Just as 2017 saw a clear acceleration in cord-cutting, a similar phenomenon played out in TV ratings. There are worrisome indicators everywhere you look: Total live-plus-same-day viewership at broadcast and cable combined for adults 18-49 was down 12.2% in the second quarter, nearly twice the size of the decline registered in the previous quarter. Only one broadcast show on the entire primetime schedule didn't register a decrease in the 2016-17 versus a season prior. Cable network ratings for adults 18-49 declined by 9% in the second quarter of the year versus the same year prior—the biggest decline of the past three years. Nielsen's second quarter audience report demonstrated that live viewing fell 6%, to 3:55 hours per day among adult viewers. The younger the demographic, the worse the decline: the average audience for kids networks, for example, is half of what it was in 2011 from 2.5 million in total-day C3 ratings to 1.25 million.

Not coincidentally, Nielsen is seeing growth in the amount of usage of apps and the web on smartphones, which is moving up from 1:43 a year to 2:27. PCs are being eclipsed as media devices, with Zenith finding people on average spend twice as much time watching video on their phones (36 minutes per day) than on non-mobile devices.

Mobile is where it's at...and where it's going to be for quite some time. Deloitte Global recently predicted that owners will interact with their phones an average of 65 times per day by 2023, a 20 percent increase over 2018. No other kind of device is going to be able to come anywhere near that kind of usage. And their ability to generate video consumption will be greatly enhanced by the advent of 5G networks.

While the stereotype of the mobile user is the Generation Z consumer, there's data to support the notion that users of all ages will be diverted from TV usage. Adoption rates could actually be inflated by older users, according to Deloitte, which is forecasting that ownership among 55-to-75-year olds will reach 85 percent in developed countries by 2023, a 10-percentage point increase over 2018. This is the demographic expected to keep the linear TV audience afloat.

The trends are pretty unmistakable: viewers are migrating to digital platforms. That will in turn drag down advertising revenues, though there is hardly a 1:1 correlation there. What gets easily lost though is the notion that much of what is being watched outside the TV set is still TV programming; the measurement just isn't in place yet to properly monetize it.

THE YOUNGER THE DEMOGRAPHIC, THE WORSE THE DECLINE: THE AVERAGE AUDIENCE FOR KIDS NETWORKS, FOR EXAMPLE, IS HALF OF WHAT IT WAS IN 2011, FROM 2.5 MILLION IN TOTAL DAY C3 RATINGS TO 1.25 MILLION TODAY.

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Wallenstein has been with Variety since 2011. He oversees daily and weekly coverage of the entertainment industry, with a focus on technology. He was at The Hollywood Reporter from 2002 to 2010, where he held various top posts including editor of THR.com. He has a master's degree in journalism from Columbia University and has taught undergraduate journalism at several universities.