

OTT TV Myths and Realities: Should You Believe the Hype?

Over-the-top (OTT) video delivery services are the hot topic in most conversations among media executives.

But with all the noise, it is difficult to separate the myths from the realities in this market.

In this new *Executive Insights* 'Spotlight on Media & Entertainment Series,' L.E.K. dispels some misconceptions and challenges perceived wisdom to answer the following questions:

- Should you believe the OTT hype?
- What challenges and opportunities does OTT represent and how can media and entertainment organizations become digital ready?

The Nine Myths and Realities of OTT TV

1. The OTT hype is overblown
2. Millennials are cord cutters and have rejected the cable ecosystem
3. OTT is highly cannibalistic of traditional TV
4. Traditional TV viewing is dead
5. The cable bundle is going away
6. Premium networks will be extinct
7. Live sports is holding the cable ecosystem together
8. OTT is a mature market phenomenon
9. TV organizations are digital ready

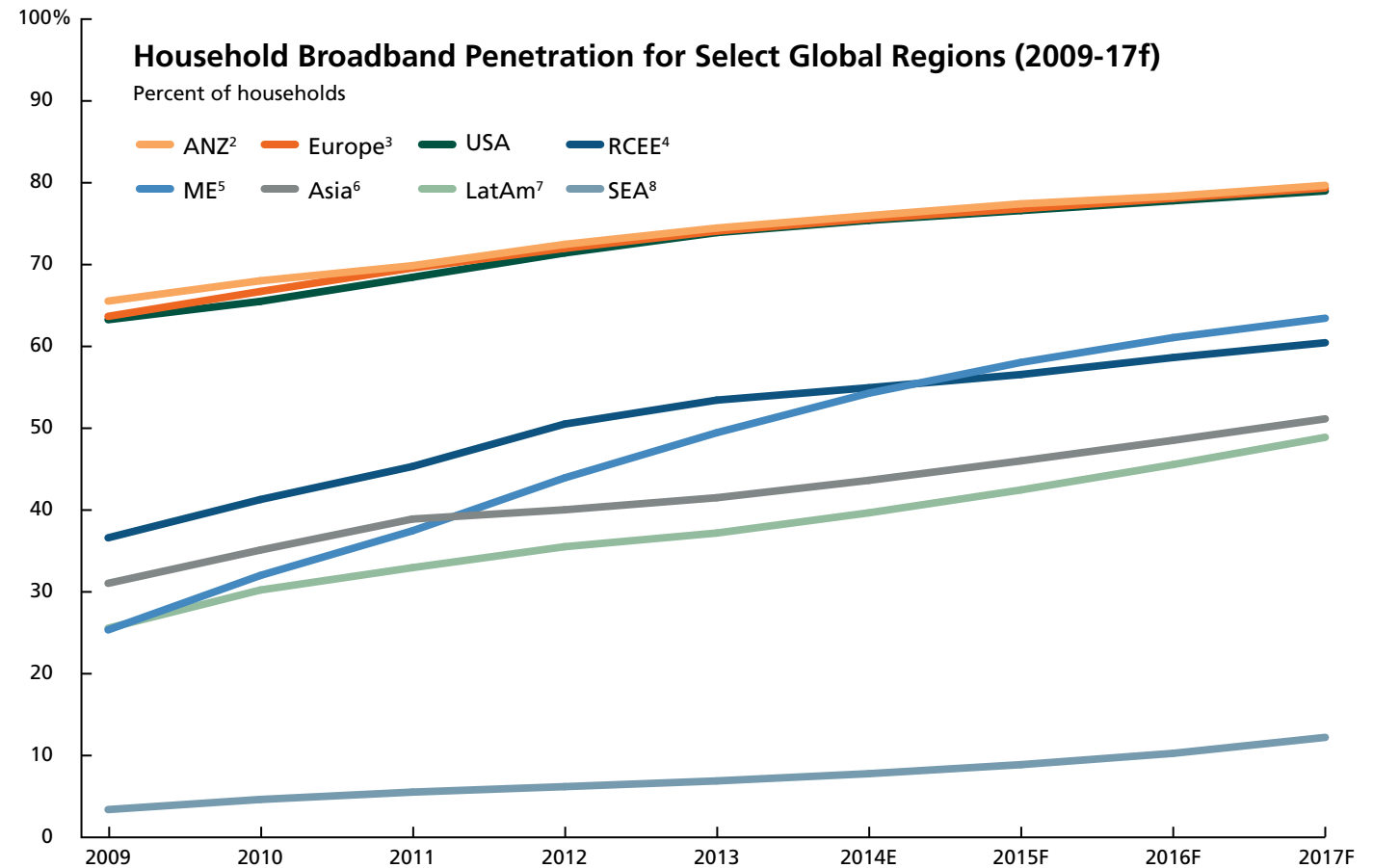
What has spurred the growth of OTT TV? »

The Fast and the Furious: High Speed Broadband Has Enabled OTT TV Content Delivery Growth

The increasing ubiquity and speed of broadband connections have facilitated OTT content delivery growth in the U.S., as well as globally.

Household broadband penetration is up from ~63% in 2009 to ~75% in 2014 and is expected to reach ~80% by 2017. Other Western economies are likely to achieve a similar penetration, while most emerging economies will exhibit even stronger growth.

Given these growth rates, online video services have become increasingly viable options for content delivery.



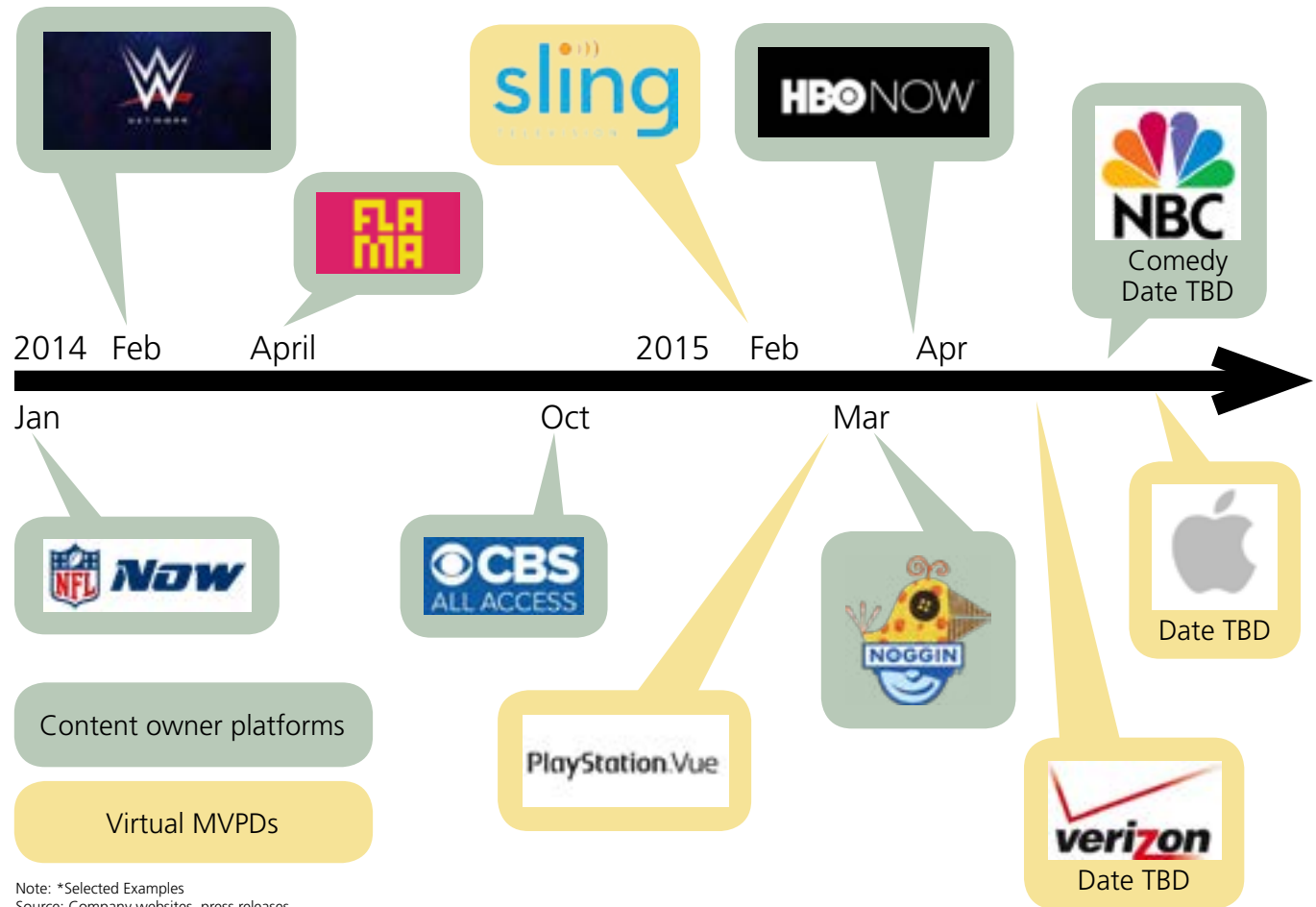
Notes: Weighted based on 2013 population by country; ²Australia, New Zealand; ³UK, France, Germany, Spain, Italy; ⁴Poland, Russia; ⁵United Arab Emirates, Saudi Arabia; ⁶Japan, China, Korea; ⁷Brazil, Mexico; ⁸India, Indonesia

How has this impacted the proliferation of OTT services? »

A Game of Thrones: New OTT TV Services Are Battling to Be King

OTT services have proliferated to cater to the growing OTT demand base, and the rate of new entrants is accelerating in 2015.

These new services range from standalone entertainment-focused offerings (e.g., CBS All Access, Nickelodeon Noggin, HBO Now), to live and sports-centric content (e.g., WWE Network, NFL Now), to virtual multichannel video programming distributors (MVPDs), providing serious alternatives to traditional cable subscriptions (e.g., Sling TV, Verizon), including offerings from electronics players who have entered the fray (e.g., Apple TV, PlayStation Vue).



Note: *Selected Examples
Source: Company websites, press releases

How is the market valuing these OTT players? »

For a Fistful of Dollars: There Are Tremendous Valuations Attached to OTT Players

As the OTT market matures, we are seeing more proof points — both in terms of subscriber and revenue numbers — which highlight the growth potential of online video services.

Increasingly, the market at large is recognizing these new businesses and attaching significant valuations to OTT players.



Market cap grew from \$6.5B to \$27B (~60% CAGR) from January 2013 to 2015; **~54M paying global subscribers** (38M U.S.)



Generated **~\$1B in revenue in 2013**; 6M subscribers as of April 2014



Fastest-growing OTT service – in first year signed up 1M paying subscribers representing **\$120M in revenue** (run rate)



Projected revenues to hit \$1B by end the of 2016; recently closed deal to power HBO's OTT platform



Initial launch leveraged existing **~90M Amazon Prime subscribers**; will launch decoupled ad-supported subscription service in 2015



~45.3M monthly users with **valuation between \$500-950M**



Over **800K shows/350K movies purchased per day**; 2013 estimated yearly spend of \$1.75B on iTunes videos¹

Note: ¹Apple analyst calculated Apple users spend ~\$1.75B a year on iTunes videos
Source: Fierce Online Video, company websites, Asymco, CapIQ

But are content providers simply jumping on the OTT bandwagon, or are they responding to an underlying consumer demand? »

OTT TV Myth #1: The OTT TV Hype Is Overblown

Over-the-top (OTT) is not all hype. There are underlying factors that explain its growing appeal and importance in the media landscape:

- Consumers are increasing their consumption of OTT services, driven by better affordability and a broader content offering
- Major OTT services have grown subscriptions significantly
- OTT has been a catalyst for the “content arms race” to capture new subscriptions

Myth

The OTT TV hype
is overblown

Reality

Not really

What is driving consumer interest in OTT? »

I Want It That Way: Better Pricing and More Content Are Driving High Growth for Online Streaming

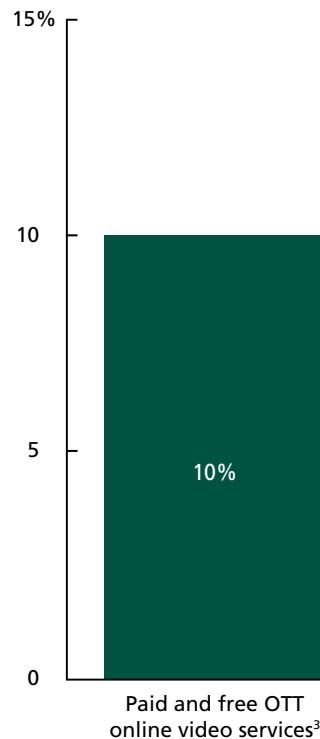
Online video streaming services now comprise ~10% of total media hours consumed.

Consumers cite expanding content libraries (15%) and affordability relative to traditional TV subscriptions (14%) as the key drivers behind increased consumption of paid OTT and online video services.

The bottom line: OTT is becoming more attractive and is increasingly perceived as a viable alternative for entertainment.

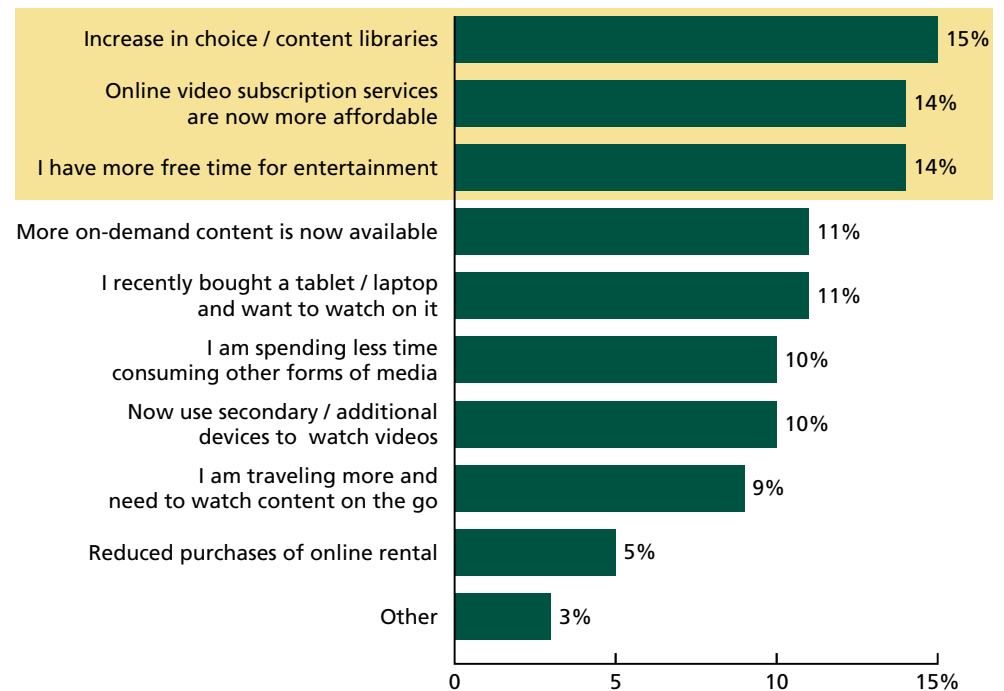
Time Spent Consuming Various Forms of Media Content¹

Percent of total hours



Reasons for Increasing Consumption: Paid OTT/Online Video Service, Streamed²

Percent



Note: ¹"On average, how many hours of the following types of media do you consume in a typical week?" (n = 1,490); ²"You indicated that your weekly media consumption has increased / decreased compared to last year. Please select up to three reasons why you currently consume more / less"; (n = 622); ³Includes free video (3 hours) and paid OTT services (4 hours, mostly streaming)
Source: 2015 L.E.K. Media & Entertainment Survey

The above drivers have driven huge growth. How big is the growth? »

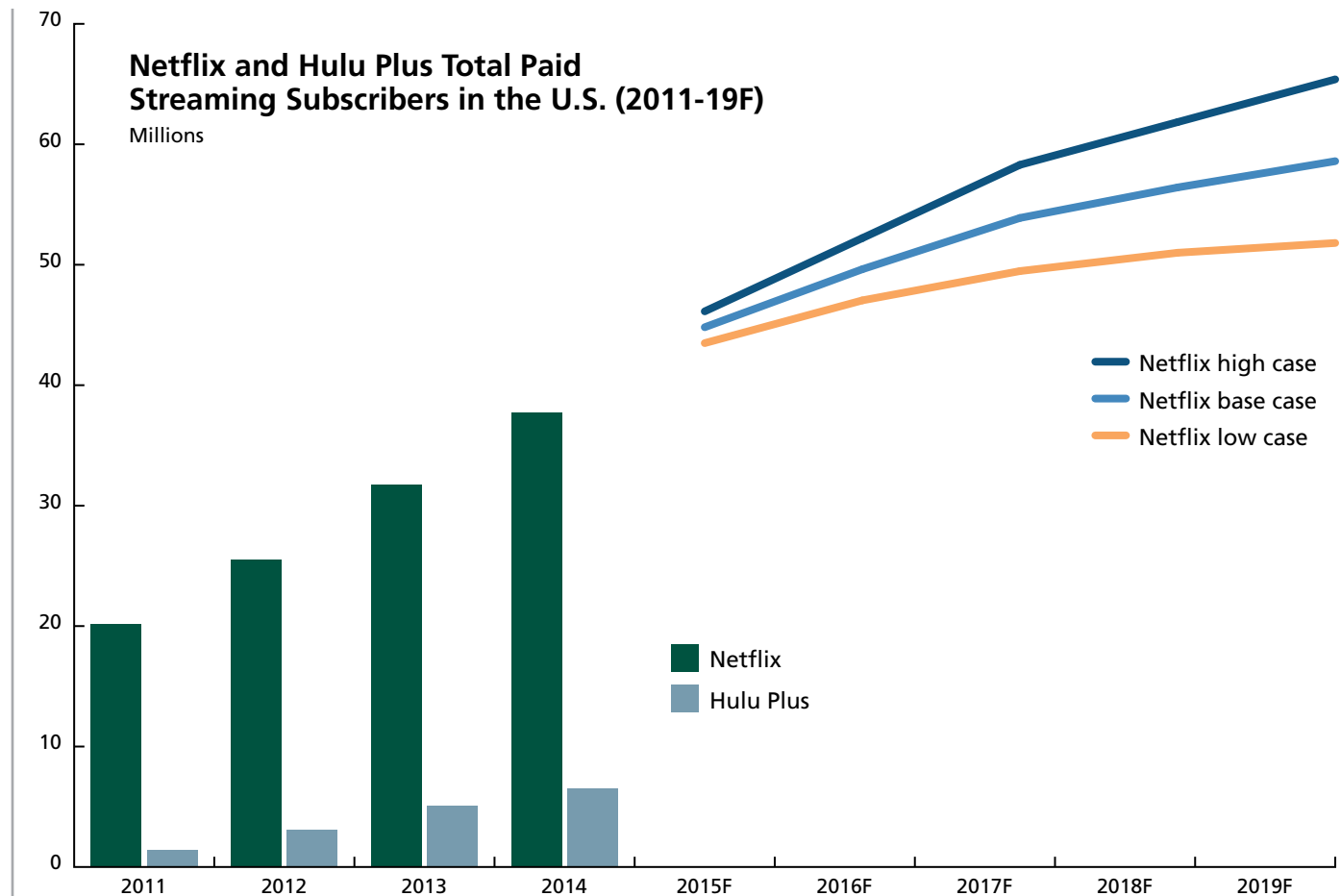
To Infinity and Beyond: Leading OTT TV Services Are Growing Rapidly

Netflix's U.S. paid streaming subscribers are up from 20.2 million in 2011 to 37.7 million in 2014 (~23% growth per year).

Hulu Plus has shown even greater growth (~67% per year) albeit from a smaller base, starting at 1.4 million subscribers in 2011 to 6.5 million in 2014.

While rapid growth is expected to moderate slightly over the next few years, these services will still expand significantly. Netflix is projected to continue growing at ~6-11% per year through 2019, depending on various analyst views.

OTT TV services will likely continue to penetrate the universe of U.S. broadband households.



Source: Analyst reports, SNL Kagan, Company 10-Ks, The Wrap, L.E.K. analysis

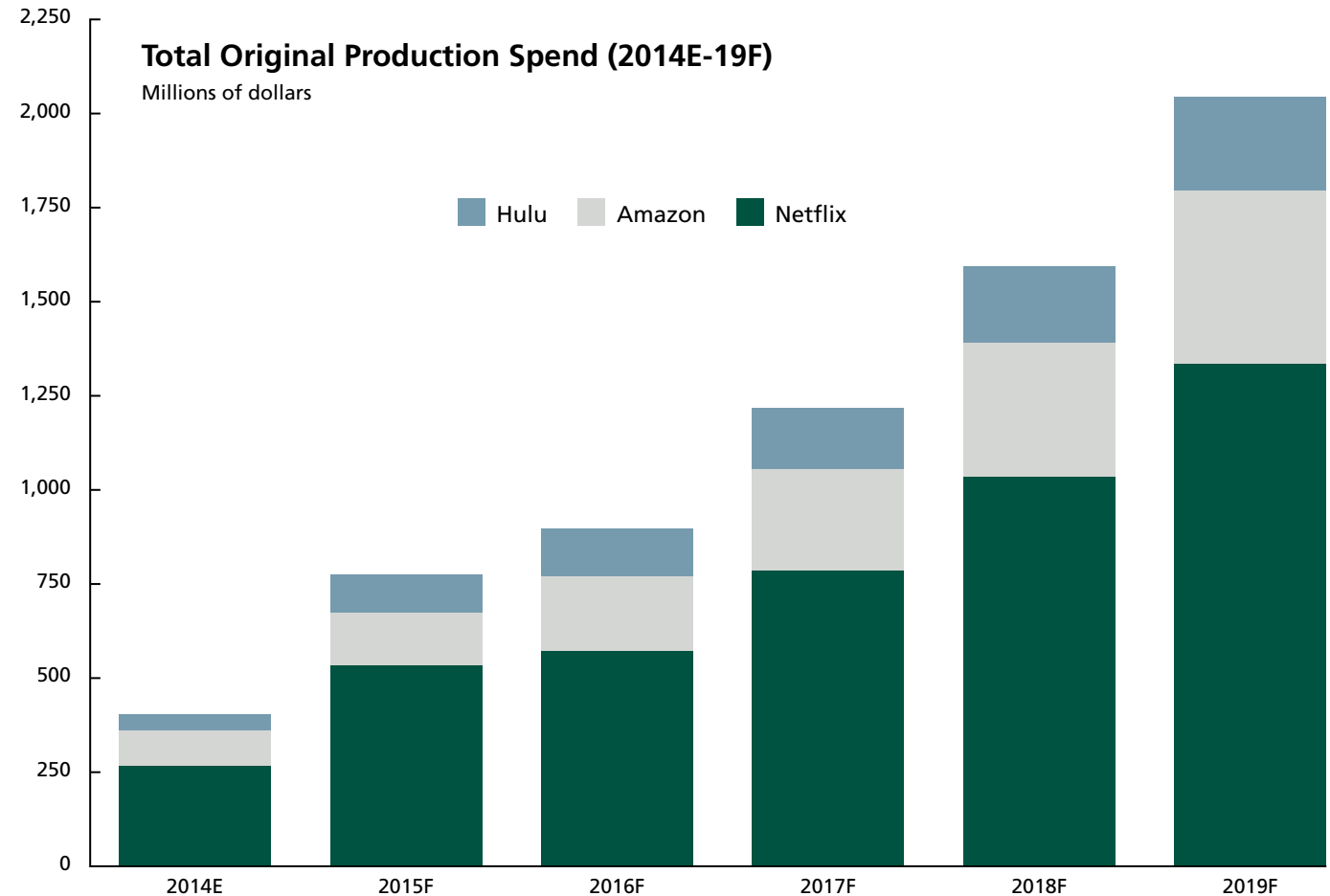
But how are these players driving subscriber acquisition? »»

We're Going to Need a Bigger Boat: The Battle for Subscribers Is Driving a Content Arms Race

Netflix spend on original production is expected to grow at ~38% per year from \$267 million in 2014 to \$1.3 billion by 2019, dramatically outpacing its rivals.

Other OTT players are following suit, with Hulu original content spend likely increasing from \$44 million in 2014 to \$250 million in 2019 and Amazon going from \$92 million to \$462 million over the same period.

This content "arms race" to attract subscribers and manage churn is having knock-on effects on content spend in the linear TV space as traditional players — primarily in cable and premium TV — look to differentiate themselves and claw back viewers from online.



Source: SNL Kagan, RBC, L.E.K. analysis

So who is opting for OTT services and are they cutting the cord? »

OTT TV Myth #2: Millennials Are Cord Cutters and Have Rejected the Cable Ecosystem

The cord-cutting tendencies of Millennials are less dramatic than you think:

- Millennials do watch more online media relative to other demographics
- However, they are still tethered by the multichannel ecosystem

Myth

Millennials are cord cutters and have rejected the cable ecosystem

Reality

Less than you would think

What are the video consumption habits of Millennials? »

The Times They Are a Changin': Millennials Watch More Online Media and Less Traditional TV Than the General Population

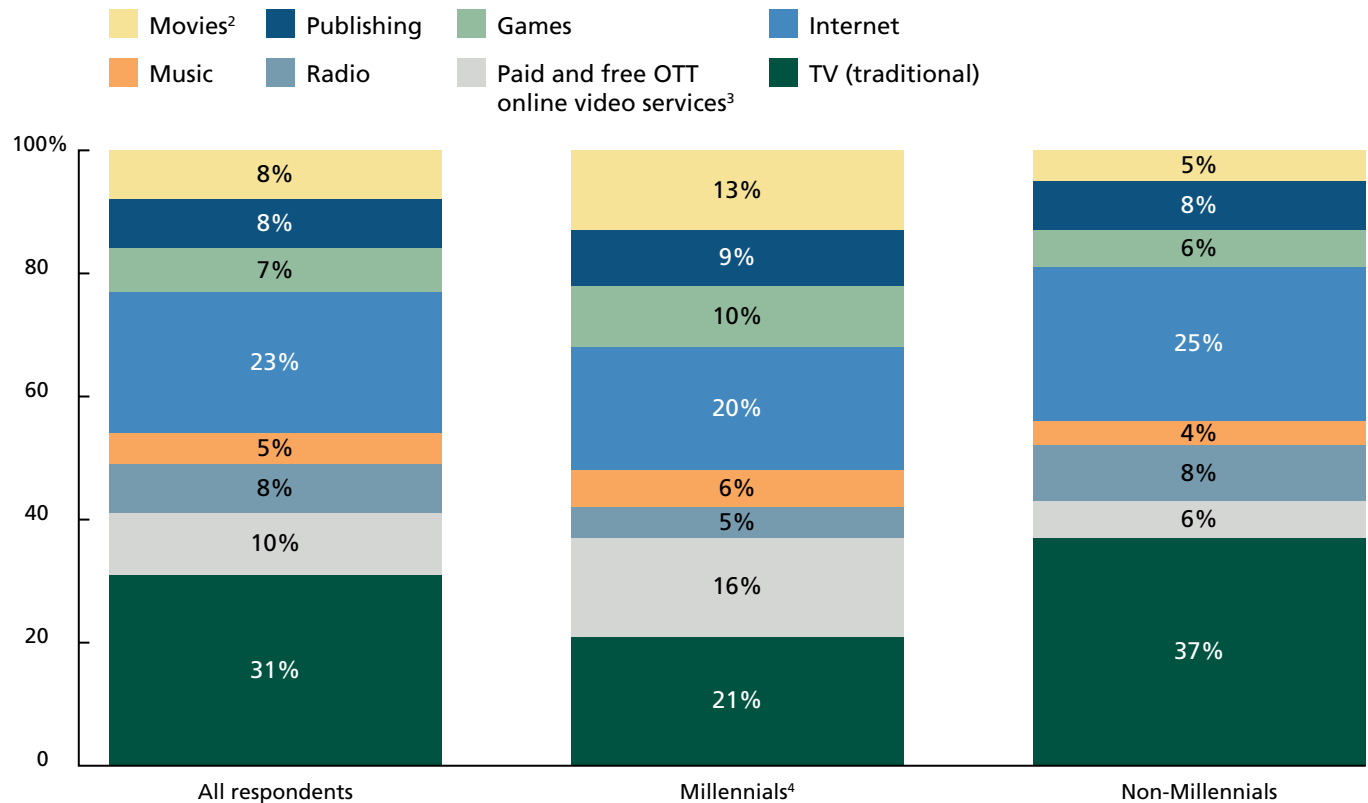
While traditional TV viewing remains the primary source of media consumption in the general population, its importance relative to online media varies by consumer group.

Within the Millennial group, traditional TV viewing is still popular, but OTT video services are making significant headway and online video consumption is almost three times as prevalent with Millennials as in the non-Millennial group.

But does this mean Millennials are abandoning traditional TV viewing and the cable ecosystem entirely?

Time Spent Consuming Various Forms of Media¹

Percent of total hours



Note: ¹"On average, how many hours of the following types of media do you consume in a typical week?"; ²Includes in-theater and physical purchase / rental, and includes TV show box sets; ³Includes free video (3 hours) and paid OTT services (4 hours, mostly streaming); ⁴Defined as age 18-34
Source: 2015 L.E.K. Media & Entertainment Survey

Are Millennials still connected to the multichannel ecosystem? »

The More Things Change, the More They Stay the Same: Millennials Are Still Connected to the Multichannel Ecosystem

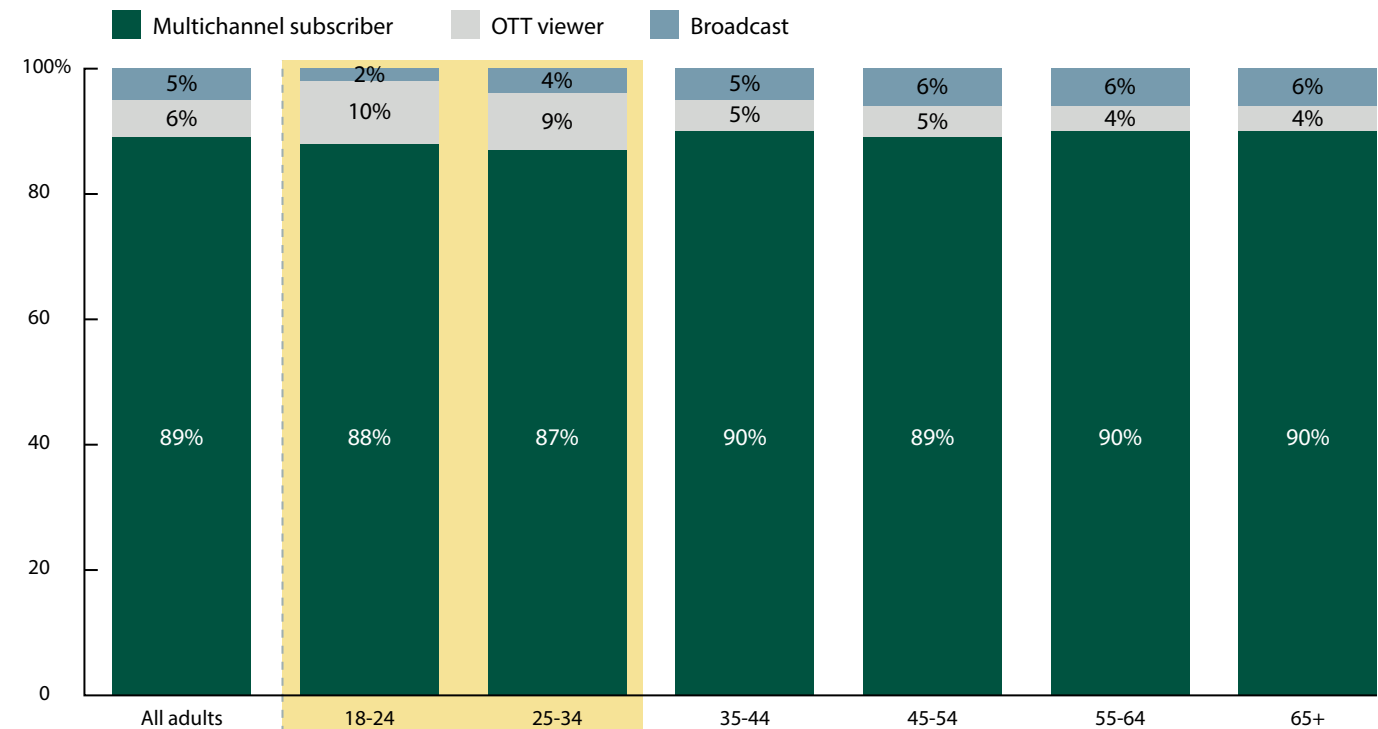
Surprisingly, despite a higher reported propensity to cord cut, Millennials still appear to be connected to the multichannel ecosystem. While this may be due to Millennials sharing their parents' accounts (without having to actually pay for the service), several other studies indicate that cable is not dead.

A March 2014 study by Verizon indicated a similar trend, estimating that 87% of Millennials were multichannel subscribers, compared with 91% of non-Millennials.

Experian estimates that ~12% of households inhabited by a Millennial were non-subscribers compared to 6.5% of total households in 2013.

Media Subscription Rates by Age Cohort (2014E)

Percent of respondents



Source: 2015 L.E.K. Media & Entertainment Survey, Verizon Digital Media's "Millennials & Entertainment - March 2014"; Experian's "Cross Device Video Analysis", 2014

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Is OTT TV cannibalistic of traditional TV? »