MEDIA & ENTERTAINMENT

Mergers, Acquisitions and Cost-Optimization in the Media & Entertainment Industry

Meaningful Steps to Maximize Returns

Rapid Changes, Rapid Upheaval

The Media & Entertainment (M&E) industry is undergoing rapid changes in many different dimensions which are impacting all aspects of the video ecosystem, upending business models and affecting consumer consumption and technology delivery models.

From an economic perspective, the “free money era” is over. Lower interest rates helped to fuel Cable TV expansion with continued MVPD carriage fee increases, escalating sports rights fees, expanded film slates and funded the build-out of streaming platforms. Today, however, all of those drivers that fueled M&E growth are challenged. MVPD carriage fees for linear TV are in decline. The lucrative business of home video, comprised of rentals and purchases which subsidized the film industry, continues to dwindle. Higher interest rates challenge M&E firms in servicing the existing debt on their balance sheets and impact the ability to support growth driven by debt-fueled M&A. Macro-economic issues such as inflation and higher interest rates along with labor strikes, cord-cutting and intense competition among streaming video providers have resulted in significant structural changes to the entire M&E ecosystem.

The industry economics are eroding, consumers are changing their behavior and technology is advancing at a pace at which the industry has never experienced. In view of all of these factors, mergers and acquisitions to drive industry consolidation through cost optimization, the adoption of new target operating models and the execution of carve outs to divest non-core assets will define the M&E business operating agenda for the next 12-24 months.

What Corporate Transformation Initiatives Are Impacting the M&E Industry?

Almost every week, there are significant developments in the M&E industry involving corporate transformation. Large technology companies are purchasing broadcast rights to sporting events that heretofore were only available on major broadcast networks or Pay-TV channels. Streaming service providers are removing programming for lower performing shows and sophisticated algorithms are being used to provide information about how program budgets are sized, authorized and executed across the global marketplace.

Relative to what they were five years ago, many balance sheets are now significantly more burdened. Acquiring long-term content rights, increasing original scripted production and a blank-check mentality for building out global streaming platforms appeared to be a logical strategy to drive growth. But viewers shifted, Pay-TV subscriptions decreased and viewers went shopping for selective streaming subscriptions. However, consumer churn rates on streaming services are significantly higher than historical MVPD churn rates, thus making commitments to long-term sports rights and increased original programing investments challenging to sustain.

The Macro Time Horizons in M&E

Ask anyone who has had a senior level position across any M&E segment—film, television, music, etc.—what the pace of change was over the course of 50 years (1960 to 2010) and the response would probably be the notion that while there were very significant changes during that period, they were also gradual and accretive. Today's changes are anything but that.

- In television, three broadcast channels per market grew to hundreds via Pay-TV services. Network television was joined by cable networks and the expansion of channels via the cable bundle, home video (VHS/DVD), electronic sell through (EST) and video on demand (VOD) all added new content windowing to drive incremental revenue.
- In Film, the box office expanded as theaters evolved into multiplexes which led to the globalization of content with new markets and territories as well as creating additional windows for monetization such as Pay-TV, home video, VOD, EST and Premium VOD for same day and date releases.
- Streaming platforms were assumed to be a further extension of monetizing the video ecosystem on a global basis, through direct-to-consumer, subscription and ad-supported services. However, the technology and the business models supporting streaming have proven to be more transitory than accretive.

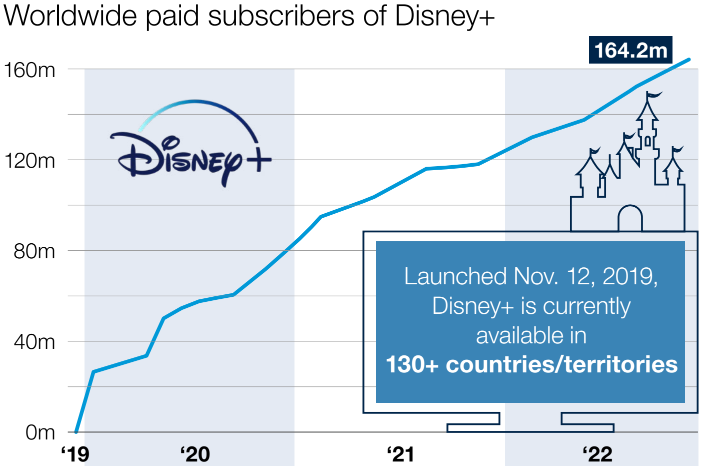
Streaming shifts audiences from traditional "cash cow" businesses such as linear television but it is a lower margin, higher churn and highly competitive offering. Streaming does not currently provide the accretive revenue and margin pathways that prior evolutions in the video ecosystem provided.

The evolution of those accretive windows and technologies for incremental distribution played out over decades. But change is accelerating and M&E is now competing with hyperscaler technology platforms, their significant balance sheets and cash reserves, as well as traditional M&E competitors.

It took Netflix 10 years to reach 100 million subscribers. It took Disney+ 16 months to reach 100 million subscribers. After decades of growth, cable service providers will continue to experience losses in Pay-TV subscribers. According to audience measurement firm Nielsen, U.S. TV-viewing time as of November 2023 was led by Streaming at 36.1 percent followed by Cable at 28.3 percent and Broadcast at 24.9 percent.

Disney+ Hits 164 Million Subs Ahead of Its Third Birthday

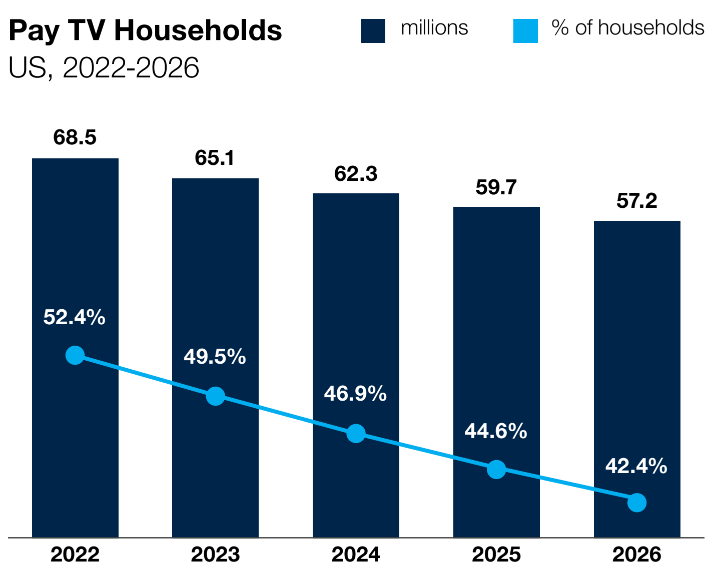
Worldwide paid subscribers of Disney+



The graphic is from Statista based on the source of data from The Walt Disney Company

Pay TV Households

US, 2022-2026

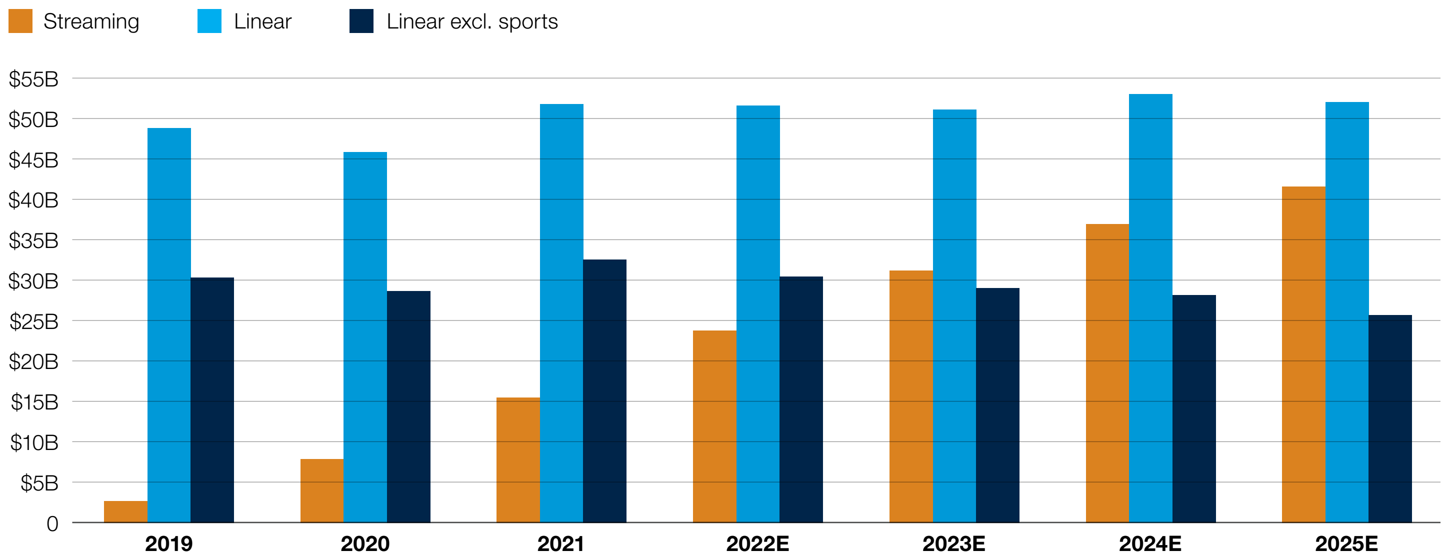


Source: eMarketer, Februrary 2022

Driven by Wall Street's mandate to measure media success via digital platforms and a growth at all cost mentality, there has been an incessant march to create streaming video services and to establish direct-to-consumer relationships. Consumers struggle with having to subscribe to multiple streaming services to watch desired content. The challenge of content discovery is considerable. The onus is now on the consumer to find content as opposed to the traditional television viewing experience where content is programmed and delivered for a passive viewing experience. Over time, recommendation algorithms driven by artificial intelligence (AI) and machine learning (ML) will assist in solving some of these problems. Content providers at first enjoyed the revenue gained by licensing content to streaming providers but then decided to discontinue those licensing deals as they sought to keep their content exclusively on their own streaming platforms to drive subscriber growth. Original content creation and acquisition budgets measured in the billions of dollars, increasing in double digit percentages Year-over-Year (YoY).

The objective was clear: Gain as many subscribers as fast as possible. The result? Hundreds of millions of subscribers worldwide. But the "grow subscribers at any cost" approach resulted in billions of dollars spent on creating original content and building streaming platforms to support global direct-to-consumer services at scale. The lost revenue from no longer licensing their content to third parties has also contributed to billions of dollars of losses in operating these streaming services. The strategy for content exclusivity on owned and operated streaming platforms eroded a proven and necessary content monetization window.

Content Spend Forecast: Linear TV vs. Streaming



Source: Company Reports, Wells Fargo
Note: data reflects only media companies with linear operations

And then, a sensibility switch was turned on by Wall Street and suddenly the new dictum is now profitability over subscriber growth. The industry has come almost full circle in that it:

A. Initially licensed content to streaming services to drive incremental distribution revenue.

B. Recognized that content shouldn't be on a competing service to assist in driving a competitor's growth and should be used to drive subscriber growth on their owned and operated streaming service platform.

C. Re-established third party licensing and the associated revenue as they are important aspects of content monetization and profitability.

D. Evolved their content windowing strategy to address when content should be made available on their own streaming services as well as licensed to other platforms to maximize distribution revenue and audience reach.

According to The Hollywood Reporter, original content spend by streaming providers grew 45% from 2021-2022 but only grew by 14% in 2023 as a result of the renewed focus on the profitability of streaming services.

To be sure, there are companies in the M&E industry that have healthy balance sheets and robust cash flow. There are also numerous companies that are severely leveraged and have flat or decreasing revenue along with high fixed overhead costs. This creates significant challenges to generate free cash flow (FCF) to service the debt, especially in relation to increased interest rates. And, in many cases, EBITDA of these organizations is still predominantly driven by their linear networks' businesses. They may have technical operations that may be better suited for a cloud or streaming provider and are facing challenges from a crop of competitors leveraging the newest technologies and scale to reinvent current operations at far more advantageous operational run rates.

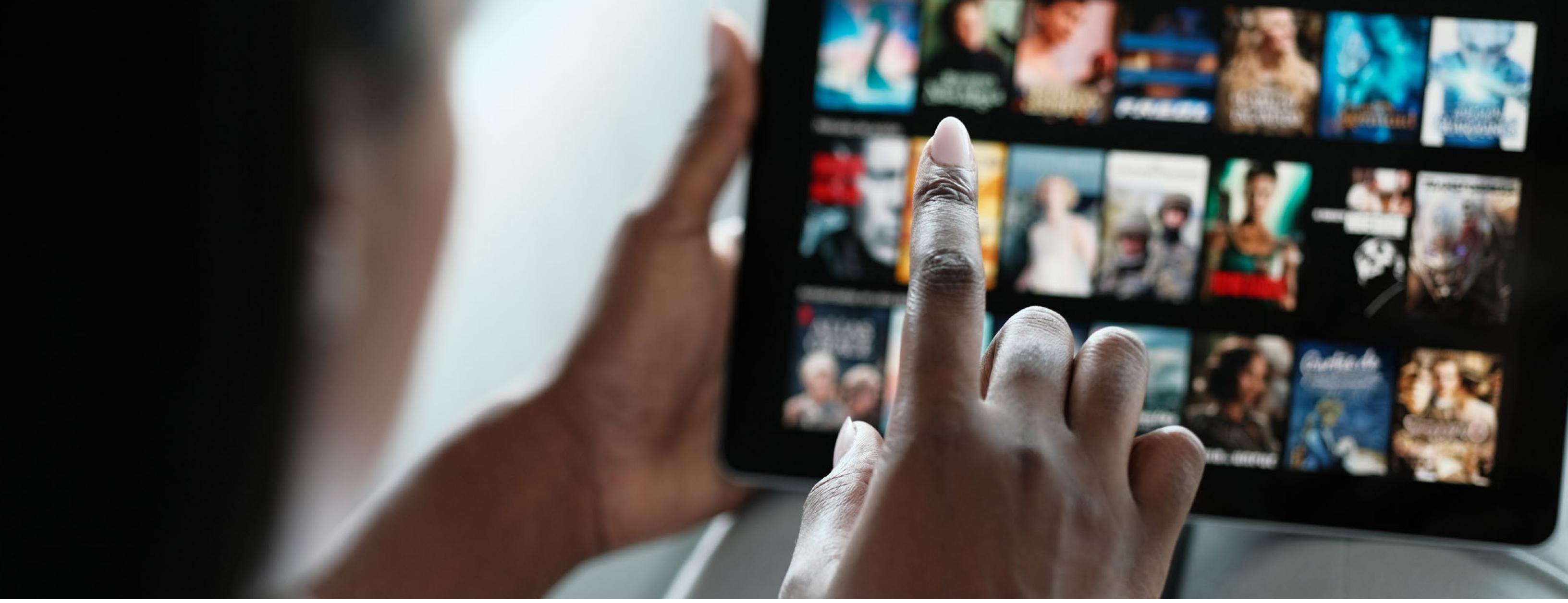
M&E Corporate Transformation: Mergers, Acquisitions and Restructuring

Corporate transformation in M&E is occurring for conglomerates, independents and the structurally challenged. To add to the challenge of growing or, at best, retaining viewers, content distributors have significant technology and infrastructure issues with which they have to contend.

Technical and studio operations were designed and created for very specific purposes: studios, soundstages and on-premise infrastructure for broadcast and cable distribution. Further, many of these technical operations are not optimized for high utilization, shared services and virtual productions. Building and scaling streaming operations for direct-to-consumer business models require enormous investment and engineering talent that are not core competencies for the majority of media and entertainment enterprises.

Further, there are practical questions to address regarding M&A in the streaming era:

- Is the historical industry strategy of growth through M&A consolidation for scale and cost synergies the correct path forward for industry conglomerates?
- Does it continue to make sense to combine organizations just for the sake of "getting bigger" without addressing the fundamental challenges and economics of streaming and direct-to-consumer business models?
- Does it make more sense to combine streaming platforms and services rather than merging two large enterprises with the execution and regulatory risk involved?
- Is it time to refocus on the core competency of content creation and establish partnerships for streaming distribution with the technology players possessing the balance sheet strength and technology talent to achieve scale in streaming distribution?
- With more streaming service providers entering the market, do bespoke streaming operations built in-house make financial sense to continue to operate or is it more logical to out-source non-core operations?
- Do studios require a new target operating model? Should we be consolidating domestic and international television studios that are operating on the same lot? How many functions, processes and systems are duplicative across film and television studios that could be rationalized?
- How much of what is done today in technical and studio operations can be accomplished leveraging a cloud provider, a third-party service provider or through industry joint ventures to optimize capacity for today's new operating environment?
- What is a new model for technical operations to support the next cycle of production volume? Flexibility and scalability are required versus fixed capacities.



Mergers and Acquisitions

When companies merge, there is a false narrative that suggests that “one plus one equals three” because the prospect of that is negatively impacted when the integration tasks, roles and responsibilities are not precisely defined and executed to deliver synergies. Research shows that between 70% and 90% of acquisitions fail to deliver planned synergies in cost reduction, revenue growth or margin expansion.

When a company acquires, what’s driving that acquisition? Acquisitions typically happen for these common reasons:

- For Content: library, physical production capacity, Sports rights and IP franchises
- For Distribution: geographic markets and territories, languages and technology platforms
- For Market Efficiencies: scale, cost synergies and improved competitive landscape

Cost Transformation

In today’s business environment, there are many possible reasons why organizations may consider some form of cost transformation for certain aspects of their operations. Among these:

Business and Operating Model Transformation: Identifying a target operating model for business and technical operations across the entire organization that is aligned to enable growth, scale and efficiency. The core tenets of operating model transformation align the structure, processes and tools, governance and culture of the organization with the strategic priorities of the enterprise.

Organizational Redesign: A thorough assessment of skills that are required for today’s operations and for future operations including the layering of the organization and consolidation of disparate operating groups.

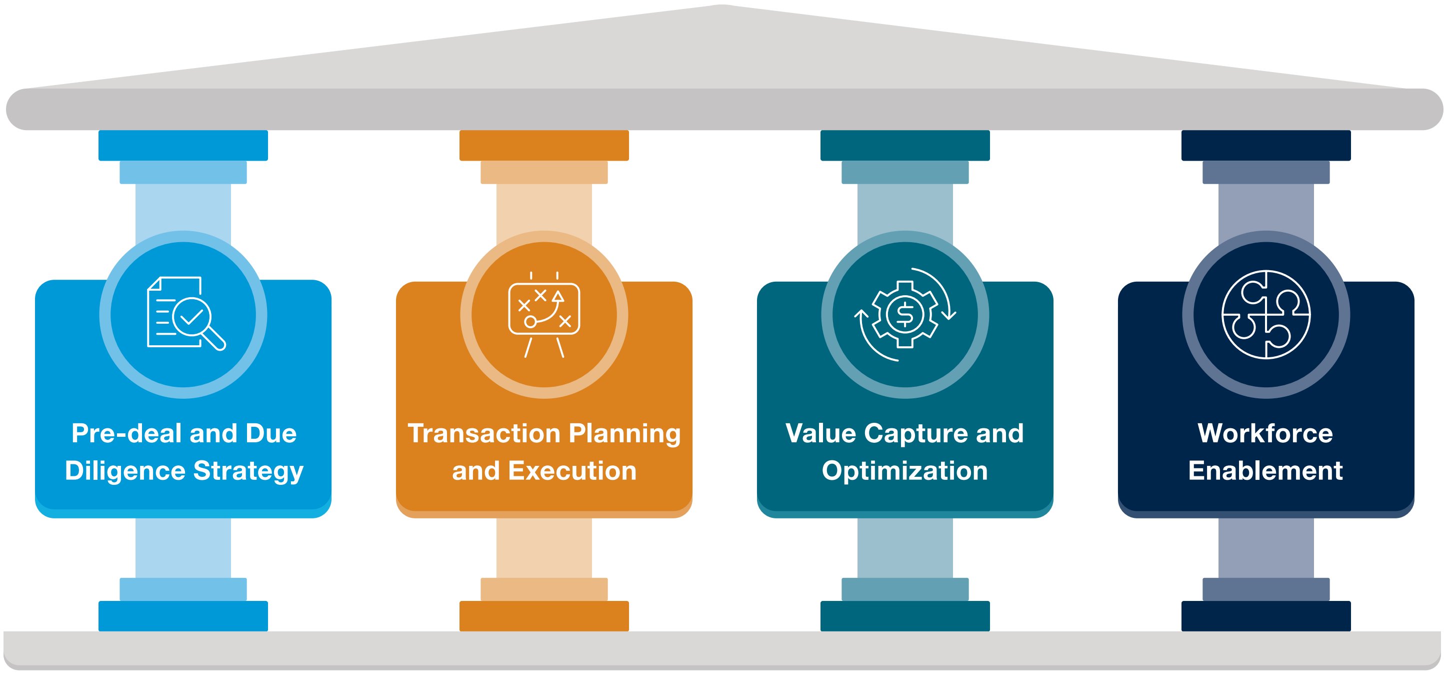
Rationalization of Technology Operations (IT, Broadcast Engineering, Studio Technical Operations and Streaming Platforms)

As software and services continue to grow in use, organizations must continue to virtualize infrastructure, reduce physical footprint and optimize content distribution to deliver cost savings and improve EBITDA. The most obvious areas include:

- Technology platform rationalization to create consistent technology and process standards
- Labor optimization via outsourcing and establishing global shared services for skillset harmonization

Why Do Some Mergers and Acquisitions Prosper and Why Do Some Fail to Deliver on Expectations?

There are four specific areas that have become key pillars to consider when approaching M&A discussions. This list may seem obvious but failing to address these often leads to less than maximum benefits. They are:



What is critical to acknowledge is that these four categories are not accomplished sequentially but in parallel.

Pre-deal and Due Diligence Strategy: Establish the Governance Model

Even before addressing the details of enterprise portfolio optimization or whether shareholder activism may be encountered, it is the governance model that must be established and well understood. How will decisions be made and who will make those decisions? Which functional area owners are empowered to make decisions on their own versus those decisions that must be escalated? In the intricate complexity that is found in massive deals taking place in the M&E industry, understanding what is being done, why it is being done and how multiple ranks of decision making are established are the guideposts for successful examination and execution.

Transaction Planning and Execution

Ensure that there are specific call-outs for roles and responsibilities so that people know what is expected of them. Often, a deal is communicated by highlighting the synergistic savings that will occur in Selling, General and Administrative (SG&A) expense and research and development (R&D). Questions that should be included are:

- What are the synergy expectations and how will they be measured?
- Are there associated risks to those expectations?
- Are there regulatory issues that may be encountered such as mandatory asset divestitures?
- Will these synergistic changes affect the business model?

Value Capture and Optimization

Post-acquisition, it is necessary to continually revisit the goals and the specific measurements and targets that were identified and set during the acquisition process. These are among the areas that need to be systematically examined:

- Deal Value Realization
- Business Optimization
- Interim Management

One of the most vexing problems that an organization's leadership may face post-acquisition is not realizing specific synergies. When the outlined steps are followed, there typically is a realization of those synergies, cost savings and the ability to execute much more expeditiously. But, to purposely use a cliché, "Time is the Enemy".

One of the most commonly encountered items is when integration is delayed. Often, this occurs when the acquired company is allowed to operate somewhat autonomously with the rationale being that the acquisition is doing fine and does not need the distraction of integration activities because, for example, it is working on a crucial fourth quarter revenue push. However, at a later date, the cost structure of both companies begins to become flawed and unsustainable. This leads to other areas being denied operating budget and then may lead to falling behind competitors who are operating more efficiently.

This is why it is so important to not wait. For example, a programmatic, well defined and disciplined way of merging and integrating disparate information technology (IT) operations is best done early and methodically. In this way, you don't experience unnecessary silos of dissimilar technologies and information. Instead, you can then negotiate best-in-class technology and optimal vendor pricing and avoid operating non-standardized and duplicative infrastructure and platforms. More importantly, the result is to have the business operating on a common set of processes, platforms and information to bring the organization together and operating as one enterprise.

As the M&E landscape continues its rapid change and reinvention, careful examination of all aspects of the corporate entity is critical. To be sure, where there are challenges, there are opportunities. Where there is revenue, there are both costs and opportunities to improve margin, EBITDA and reduce operating expenses. The only logical method of approach is to look across all aspects of the enterprise.

Workforce Enablement

A complete analysis is necessary for addressing the workforce of both the acquiring and acquired company. There will typically be a high degree of uncertainty and anxiety at the employee level. Done poorly, one of the most obvious early results is that worker productivity plummets and the output of both organizations decreases. Among the items that should be addressed are:

- Integration and Separation Management
- Change Management and Communications
- Organizational Design
- Cultural Fit and Integration
- Interim Management

The following is a case study that addresses many of the aspects that have thus far been outlined.

An A&M Media & Entertainment Industry Case Study

In the following M&E case study, A&M performed these duties for a global leader in entertainment and sports with 11,000 employees operating in 30 countries. A&M served as the trusted advisor for portfolio evolution as M&A advisor and execution partner. The company was pursuing several acquisition targets as well as a merger with an equally large global organization in M&E.

A&M Role:

Synergy Assessment and Cost Takeout

Under the umbrella of a broad cost reduction and margin improvement initiative, the client sought to identify opportunities for greater control over indirect spend and to drive cost reduction outcomes across the organization. A&M assumed functional ownership of 15 separate workstreams, including Finance, Technology, HR, Facilities, Legal, Marketing, Operations, Production and Revenue Generation.

During the assessment phase, A&M identified $58MM in initial synergies across the primary acquisition target.

Operations and Indirect Spend Analysis

A&M analyzed indirect and third party spend opportunities across multiple priority categories including an assessment of the entire product, technology and operations portfolio. A&M provided negotiation support for commercial and shared services of back office functions, including finance, IT, HR, Legal and Facilities.

As a result, A&M developed a comprehensive set of synergy initiatives resulting in $100MM+ in run rate savings across the combination of the two targeted assets.

Integration Planning and Execution for Value Capture

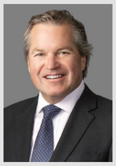
A&M led the integration management office (IMO) for program governance and planning and provided execution leadership across the workstreams for the combination of the two assets to achieve synergy realization and value capture.

Meaningful Steps to Maximize Returns

It is a given that the M&E industry will continue to evolve across business, operational and technical dimensions. In view of all of these factors, mergers and acquisitions to drive industry consolidation through cost optimization, the adoption of new target operating models and the execution of carve outs to divest non-core assets will define the M&E business operating agenda for the next 12-24 months.

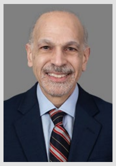
Key Contacts:

Chris Furst
Managing Director
Media & Entertainment
+1 201 362 6191
cfurst@alvarezandmarsal.com



Jeff Mischka
Managing Director
Media & Entertainment
+1 917 653 6854
jmischka@alvarezandmarsal.com

David Wisnia
Managing Director
Media & Entertainment
+1 310 200 1102
dwisnia@alvarezandmarsal.com



Thomas Ohanian
Director
Media & Entertainment
+1 401 935 5410
tohanian@alvarezandmarsal.com

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With over 9,000 people providing services across six continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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