JUNE 10, 2019
OVERVIEW OF RECENT EVENTS

Salem Partners is pleased to present our thoughts on several TMT-related topics that are making headlines.

- **TALENT AGENCY WARS BLOW UP, THAW:** After many months of negotiations and slinging of insults back and forth, the discussions between talent agencies and the Writers Guild of America collapsed in April as the WGA ordered its member writers to fire their agents unless they agreed to a new code of conduct, which mandated that talent agencies no longer take packaging fees and get out of the business of production. However, after over a month of stalemate, there are signs of thawing as talent agencies and WGA have agreed to go back to the bargaining table after UTA co-president Jay Sures reached out via email to WGA West president David Goodman, and negotiations are ongoing. The wild card for the future will be the WGA and SAG-AFTRA elections this summer.

- **STREAMING GAMING COMES INTO FOCUS:** True streaming gaming – where gamers can utilize a high speed wifi connection and a smart TV to play multiplayer games, with all processing handled seamlessly and with no latency in the cloud – has been something of the holy grail of gaming, always the future but never a reality due to the massive technological hurdles and cost involved. The attractions are obvious, including a huge addressable market, the ability to capture a very high value customer base and a deepening of in-home presence for tech giants. Both Apple and Google have recently announced ambitious product offerings in the space. *We take a deeper look at all things streaming gaming later in this newsletter.*

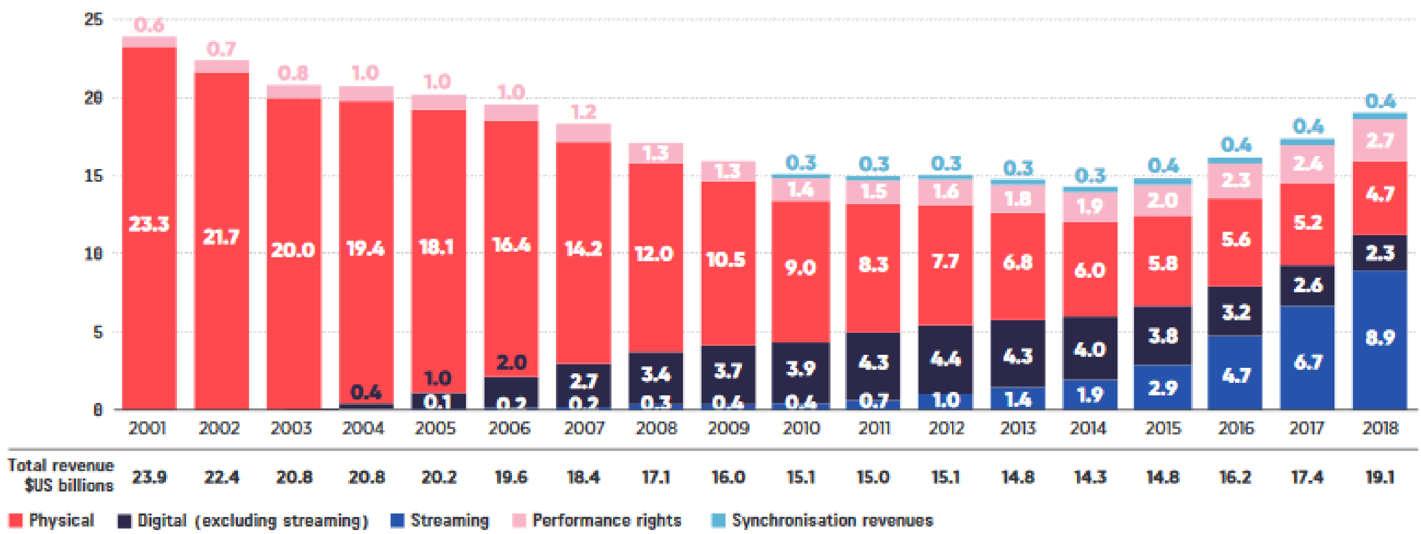
- **LIONS GATE ENTERTAINMENT STRUGGLES:** It's been a rocky road lately for investors in Lions Gate Entertainment, which have endured a painful ride with the stock down over 50% since the start of 2018. The stock was punished in the aftermath of the company's Q4 earnings release on May 23rd, with some analysts concerned that the overall media industry shift to direct-to-consumer streaming would be cost prohibitive and would leave behind smaller players, such as Lions Gate's Starz Play. The company indicated that it plans to invest several hundred million dollars in the Starz Play global expansion, and projects to have 15-25 million subscribers by 2024, as compared to approximately 7 million today. While rumors swirled in May that CBS had offered to acquire Starz from Lions Gate for $5 billion (with Lions Gate subsequently offering so sell it for $5.5 billion), the company refused to comment and rumors have since faded.

- **DISNEY BASKS IN THE FUTURE:** In April, Disney spent its investor day sharing the details of Disney+ with analysts and the public, and the reaction was immediate and overwhelmingly positive. Investors rejoiced, sending the stock over $140 and breaking out of a 4-year trading range. In May, the company put to rest speculation about its plans with Hulu, announcing that it had taken full control of the platform. *We take a deeper look at the latest Disney news later in this newsletter.*

- **SPYGLASS GETS A NEW HOME:** Several quiet months after closing the deal to acquire the assets of the Weinstein Co. out of bankruptcy, Lantern Entertainment and former MGM CEO Gary Barber announced the launch of Spyglass Media Group, with investment from Barber as well as Italian distributor Eagle Pictures and UK exhibitor group Cineworld. Shortly after the formation of the company was announced, Warner Bros. entered into a first look deal and became a strategic investor. The focus of the new company includes the exploitation of the library titles as well as new productions.

- **<u>MUSIC BUSINESS CONTINUES ITS RUN, BUT SPOTIFY SEEKS TO DIVERSIFY:</u>** The chart below tells the continuing story of the success of the global music business, a theme which is by now well documented, but continues to surprise in terms of the magnitude and durability of the growth. For a business that endured 20 straight years of overall revenue declines, insiders can be forgiven for being taken aback by the strength across the industry on a number of fronts. However, all is not perfect in music land, as there continues to be chafing between industry leader Spotify and Apple, which came to a head in March of this year when Spotify filed a lawsuit in Europe arguing that paying a share of ongoing subscription revenues to Apple was anticompetitive and penalized Spotify relative to other apps like Uber. The challenges of operating as an intermediary between two dominant mobile platforms and a handful of major music labels and publishers are front and center, and questions abound about whether Spotify will ever be able get the operating leverage it is aiming for…no matter how big it gets. All of this has validated Spotify's desperation to diversify into areas where it can have proprietary content and control, such as podcasts, where the company has been an early and aggressive acquiror.

Global Recorded Music Industry Revenues 2001-2018 (US$ Billions)



- **<u>YOUTUBE CHANGES STRATEGY ON ORIGINAL CONTENT:</u>** In another sign that the costs to compete in the new media world can be prohibitive, or maybe just another strategy shift from Alphabet, YouTube has cancelled several of its scripted originals and has scaled back any plans for high-end scripted comedies and dramas. Current scripted shows such as the *Karate Kid* continuation series *Cobra Kai* will air for free and ad-supported on YouTube. While YouTube Red was pitched as an eventual competitor to Amazon and Netflix, it has now been rebranded with a focus on the music offering.

- **<u>SONY'S CRACKLE GETS SOLD:</u>** After several months in the market seeking strategic investors or buyers, Sony contributed the Crackle assets to a new joint venture with publicly-traded company Chicken Soup for the Soul Entertainment. Sony received a minority interest in the joint venture as well as warrants, and the companies have agreed to license content to the joint venture. The newly-branded Crackle Plus will join CSSE's stable of other ad-supported streaming offerings.

- **NETFLIX RAISES NEW DEBT FINANCING AS STREAMING WARS INTENSIFY:** Netflix hasn't paused to catch its breath and continues to expand as aggressively as it can ahead of the launch of competitive services at home. In late April the company announced another $2 billion in debt financing. While the company's ongoing content costs and debt load have been raised as concerns by analysts before, investors had no such qualms, with the stock again near all-time highs.

- **DISNEY SELLS FOX REGIONAL SPORTS NETWORKS (RSNS):** Early rumors that Rupert Murdoch would swoop in to acquire the 22 old Fox RSN's after the sale of the Fox assets to Disney were dispelled, but speculation swirled as to who would be the eventual buyer, and at what price. In early March the YES Network was acquired by the Yankees, Blackstone Group, Amazon and Sinclair, which paid $3.5 billion for the 80% of the channel not already owned by the Yankees. Sinclair later announced the acquisition of the remaining 21 RSNs in a deal valued at $10 billion.

- **VICE STRUGGLES, RAISES DEBT FINANCING:** Despite significant restructuring in an effort to stem losses and move toward profitability, the difficulties at Vice have been well documented over the last several years. However, the company received a reprieve of sorts with a $250 million debt financing from investors including George Soros, Fortress Investment Group, 23 Capital and Monroe Capital.

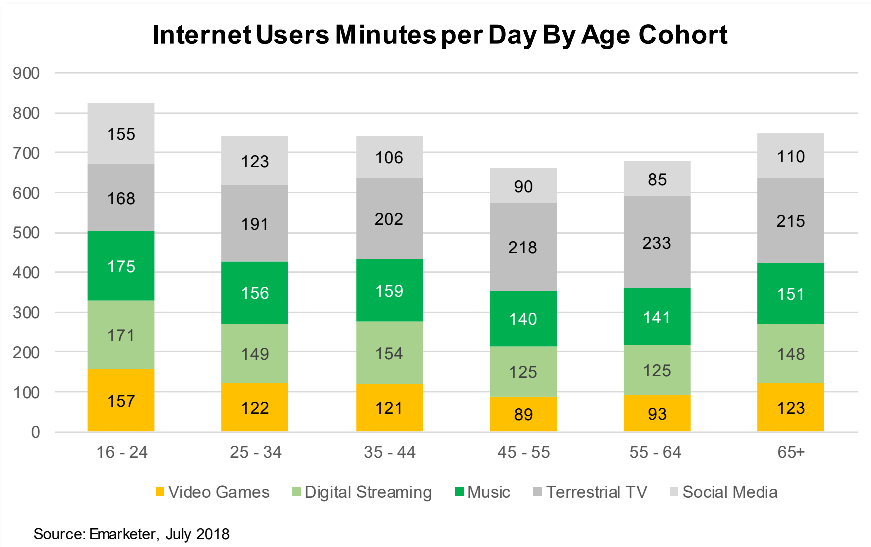
- **STUDIO MOVIE GRILL NABS $100 MILLION INVESTMENT:** The theatrical exhibition business has been a survivor, in part because of the willingness to launch innovative product offerings such as in-seat dining and alcohol, improved seats, assigned seating, IMAX and other large-format screens and other upgrades to the viewer experience. Boutique theater chain Studio Movie Grill, based in Dallas and featuring over 30 locations and 300+ screens, has found success in the in-seat dining concept, and announced a $100 million financing deal with private equity firm TowerBrook Capital Partners.

- **VIACOM WASTES NO TIME WITH PLUTO TV ROLLOUT:** Since acquiring Pluto TV for $340 million in March, Viacom has wasted no time in expanding the service in what is still a relatively wide-open field for AVOD platforms. Noting that the SVOD landscape is, by contrast, quite crowded, the company announced an international rollout starting in Latin America.

In our last newsletter, we discussed how connected devices and the rise of mobile were two conditions that have accelerated the proliferation of gaming and esports. Right on cue, Apple and Google have jumped into gaming with recent announcements for their gaming subscription services, Apple Arcade and Stadia, respectively. While subscription gaming services are not new, Arcade and Stadia are including gaming in a broader content and services strategy that traditional media would be wise to closely monitor.

Apple and Google, long known for their mobile and connected consumer services, have steadily moved into entertainment with music, video, publishing, and now gaming offerings. With each entry, they transition from marketplace (a la carte or ad supported) to subscription business, expand and enhance revenue streams (single purchase vs. subscription), and capture more consumer time on their devices and platforms. After experimenting with social media (farewell Google Plus) and ignoring terrestrial TV, gaming was a logical next step from the perspective of their media strategy in going to where consumer engagement is (see chart below; minutes of entertainment consumption per day, by age cohort).

In addition to being complementary to existing entertainment offerings, both companies have designs beyond just capturing their users' time. Let's look at each new service.



Apple Arcade. Though details are sparse, Apple Arcade will launch in Fall 2019 on iOS devices and will focus on casual gamers, offering ~100 downloadable games, free from in-app upsells. Apple is effectively activating its robust data set of App Store and in-app purchases to inform the offering design and content. And because Apple is proceeding with a closed ecosystem (using existing Apple tablets, phones and other Mac products), more technical and PC based games are likely to be left out. One of the more interesting parts of Apple Arcade is its positioning. Apple describes Arcade as "Where storytelling and design are pushed further than ever before". Time will tell what this means exactly but the implication is that Apple wants Arcade to be viewed as something more than just a place to play, perhaps a destination for deep and unique interactive entertainment experiences.

Google Stadia. Meanwhile, Google's Stadia offering is positioned as a cross platform, multi-player streaming service for AAA titles (high end titles from the top publishers). Google is incorporating its cloud services to stream live games across PCs, select tablets and phones, but not Chromecast as of now. Stadia will also be integrated with YouTube, strategically including a "Play Now" button next to relevant video gaming content and streamers which allows its subscribers to lean back and watch video or lean forward and join a game, and of course share game play to the YouTube platform. While it may be a boon to some publishers, it's unclear how game makers will view Stadia as it competes more directly with their own subscriptions (e.g., Xbox Game Pass and EA Access).

We have included details on other gaming subscription services for reference.

	What to play	Where to play	Related Products / Services	Messaging & Audiences
Arcade Fall 2019 // Est. $9.99	100+ mobile type games	iOS devices (TV, phones, tablets)	▪ Apple Music ▪ Apple TV+ ▪ iTunes ▪ App Store	"Where storytelling and design are pushed further than ever before" Casual gamers on iOS devices
STADIA Late 2019 // Est. $10	Cloud-based streaming games (4K resolution, HDR, 60fps)	PC and Google devices w/ standalone controller ($50-$80)	▪ YouTube ▪ Google Cloud ▪ Chrome browser ▪ Google assistant ▪ Google App Store	"No download, no patch, no update & no install" Casual and avid gamers without consoles
ONLINE Sept 2018 // $3.99	20+ online, multiplayer games, growing catalog of classic NES games	Nintendo Switch Smartphone Apps	▪ n/a	"Play together with family" Casual and young gamers (kids)
XBOX GAME PASS June 2017 // $9.99	100+ download rental games (avoid bandwidth & connectivity issues)	Xbox One Windows 10	▪ n/a	"100+ games, one low price" Avid gamers with console and ample storage space
PlayStation.Now June 2014 // $19.99	750+ console & PC games (streamed or downloaded)	PS4 & PC	▪ PlayStation Vue	"Unlimited access" Hardcore and mainstream gamers
EA access August 2014 // $4.99	50+ download rental games Exclusive early trials before launch	Xbox One	▪ n/a	"Play The Best of EA" Casual and avid gamers of EA games
twitch Prime Sept 2016 // $12.99*	Selected games each month	PC / Mac	▪ Amazon Prime ▪ Free Twitch channel subscriptions ▪ Cloud storage of broadcast streams	"Free games and in-game loot every month" Great for Prime users and hardcore

We expect that Apple and Google will bring their deep resources and experience to bear in these new product launches, benefitting from their massive user bases and their extensive portfolio of complementary services. But we're most interested to see how each company's entry into gaming / interactive entertainment will leverage their portfolio and blur the boundaries of the medium.

It's been an interesting couple of years for Disney, with predictions of cord-cutter doom for perennial cash flow machine ESPN, euphoria over the reboot of Star Wars with *The Force Awakens* in 2015, and ongoing fears that the company could struggle against nimble tech giants in a rapidly evolving media landscape. As the dust has started to settle from the industry-changing acquisition of the Fox assets, investors have decided that Bob Iger has done it again, twice. In addition to pulling off the Fox deal, his vision for the company has been clearly articulated with a focus on streaming and direct-to-consumer, and investors like what they see.

While the Disney+ announcement months ago was a positive for the company, there were few details provided. In April, Disney spent its investor day sharing the details on Disney+ with analysts and the public, and the reaction was immediate and overwhelmingly positive. Investors rejoiced, sending the stock over $140 and breaking out of a 4-year trading range.

Details regarding Disney+ from the investor day include:

- A launch date of November 12.
- Subscription price of $7/moth or $70/year.
- Massive content offering, including library titles, originals created specifically for the Disney+ platform and blockbuster major theatrical new release titles (in the former pay TV window).
- Potential to package the service with Hulu offerings.

Investors embraced the plan in concept, and they also were pleasantly surprised at the depth of detailed guidance provided for a new product offering, coming away with the view that this is a very aggressive product launch and core focus for the entire company.

On the heels of the Disney+ detail, the company in May put to rest speculation about its plans with Hulu, announcing that it had taken full control of Hulu in a transaction with 33% minority owner Comcast. Under the terms of the deal, Comcast has agreed to give up voting rights immediately as the parties entered into a put/call arrangement whereby Comcast can force Disney to acquire, and Disney can force Comcast to sell, the 33% stake based the value at the time (as appraised by a third party, but in no case less than $27.5 billion). In addition, Hulu will carry NBC channels at an increased cost, and will allow NBC to run the same content on its own platform when it launches later this year.

SALEM PARTNERS' TECHNOLOGY, MEDIA AND TELECOM (TMT) PRACTICE

Founded in 1997, Salem Partners is a boutique investment bank and wealth management firm based in Los Angeles, California. It is firmly dedicated to servicing clients in the technology media and telecom (TMT) industry. We provide our clients with a full suite of investment banking and valuation services, including buy and sell-side mergers and acquisitions, capital raising advisory and financial and valuation opinions.

Salem Partners' industry experience and domain expertise provides us with a deep understanding of the values, risks and financing possibilities connected with the industry. We are constantly in contact with key industry participants, including operating companies and strategic and financial investors, and have detailed current knowledge of how buyers and sellers view assets and businesses within the industry. We have a comprehensive knowledge base on the key trends in the TMT industry and how those impact participants around the world.

Since the firm's inception, Salem Partners has completed hundreds of financial and strategic advisory assignments in the TMT space, including advising on more than 40 mergers and acquisitions and financing transactions. Salem Partners also provides valuation and strategic consulting services to clients, including companies, banks, financial and strategic investors and others. Our valuation work is used for a wide variety of purposes, including transaction due diligence, credit facilities, tax, estate planning and support for portfolio valuations.

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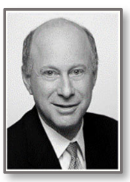

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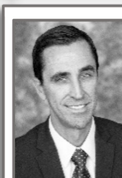

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