NOT YOUR GRANDMOTHER'S TELECOM

September 2019

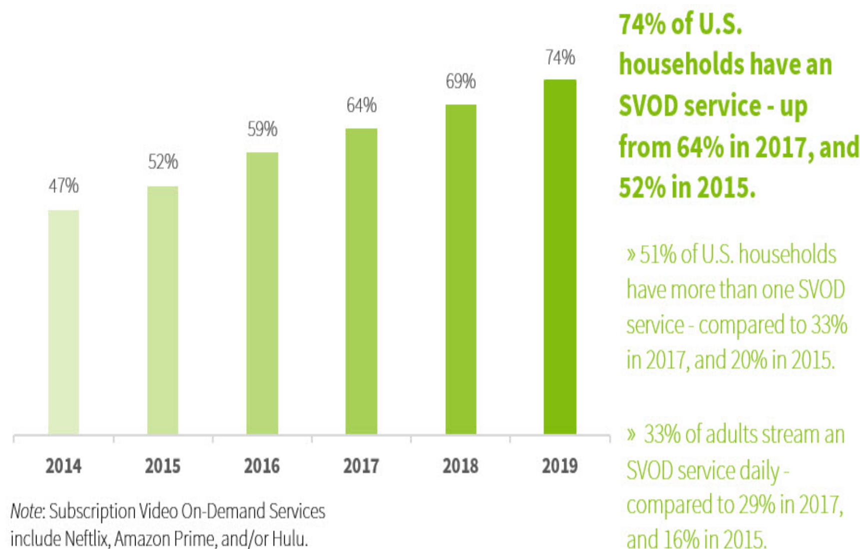
As an equity analyst, you are constantly consumed with the latest sector news and trends. You know that what's common knowledge within each sector, may not yet be fully appreciated by the public at large. And then, you get that one piece of anecdotal evidence that confirms that the public narrative has changed. I recently experienced such a moment from my wife's exasperated reaction to news that Friends and The Office are being pulled from Netflix's library of content. You see, cord cutting is nothing new. In fact, almost 4 million households are expected to drop their pay TV services this year alone. But, these announcements represent an unmistakable escalation in the media battle for viewership.

The media landscape has been undergoing a transformation for several years now. It has been a transition marked by aggressive, debt-fueled merger and acquisition activity. Traditional telecom companies have become media behemoths with wireless and cable carriers now housed under the same roof as Hollywood studios. Comcast's $6.5 billion announced acquisition of NBCUniversal in 2008 jumpstarted this process. And, in just the past couple years, we've seen a new wave of M&A: AT&T has acquired DirecTV and Time Warner for a combined $172 billion, Disney purchased Fox assets for $71 billion, and CBS and Viacom recently announced a merger of nearly $27 billion in market cap, among other deals.

This wave of M&A ultimately led to last year's creation of the Communication Services sector. This new sector is a combination of traditional telecom companies with several widely recognized consumer discretionary and tech companies. Alphabet, Facebook, and Netflix make up ~50% of the sector's market capitalization, AT&T and Verizon comprise ~20%, and Disney represents ~9.3%. It is currently the 4th largest sector, representing ~10.5% of the S&P 500[1]. Far from the static reputation of traditional telecom, this sector is marked by innovation and transformational competition that produces clear winners and losers. More than ever, this is a sector whose trends cannot be ignored. We believe continued disruption and heightened competition will present unique investment opportunities in this space.

Cord cutting is a well-documented trend that is reshaping the media landscape. Consumers are increasingly replacing their expensive cable subscriptions with internet based streaming services. According to Leichtman Research Group, 74% of households now subscribe to Netflix, Amazon Prime, or Hulu, and more than 50% subscribe to multiple of these services.

Figure 1: U.S. Households with SVOD Service



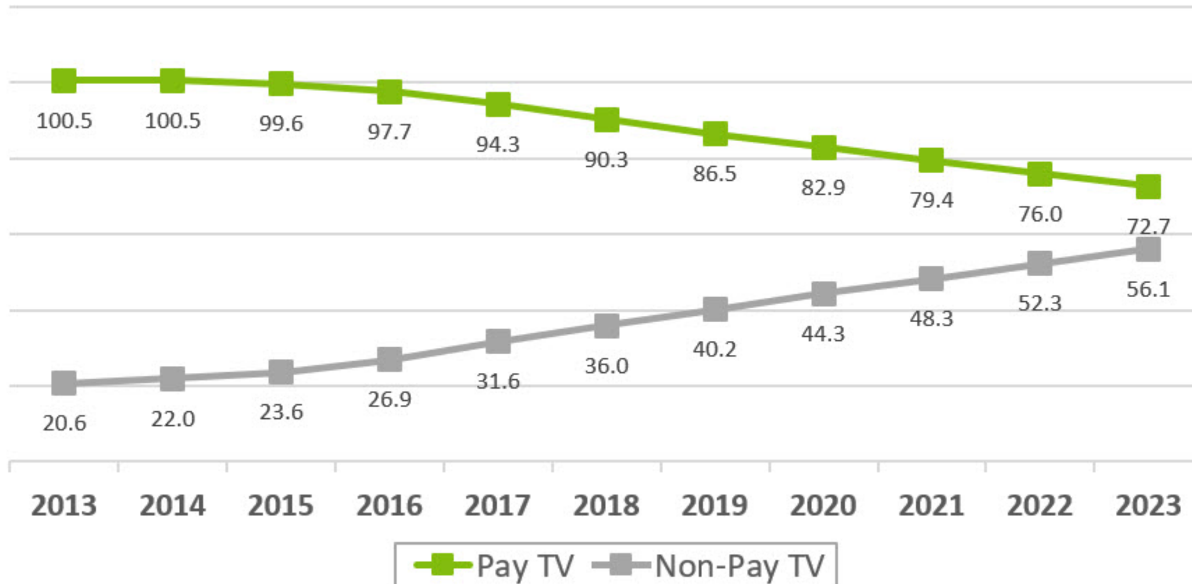
Sources: Leichtman Research Group, RIM

[1]Source: FactSet Data

Author: Carlton Millsap
Equity Analyst, Regions Investment Management

Cord cutting even appears to be accelerating, with nearly 4 million households expected to cut pay TV subscriptions this year, an annual decline of 4.2%. In 2Q19 alone, major U.S. TV providers lost a combined 1.53 million subscribers, more than any previous quarter. The number of households without a traditional pay TV subscription is quickly approaching those that have one.

Figure 2: Pay TV vs Non-Pay-TV Households in the US, 2013-2023, *millions*



Note: Pay TV includes cable, satellite, telco/fiber operators, and multiple system operaters; excludes IPTV and pure-play online video services (ex. Hulu, Netflix, Youtube, etc.)

Source: eMarketer, RIM

The battle is on for viewer eyeballs within the streaming space. As mentioned, NBCUniversal (Comcast) announced it is reclaiming its rights to The Office when its $100 million a year deal with Netflix ends in January 2021. Time Warner (AT&T) also announced it is reclaiming its rights to Friends when its $80 million a year deal with Netflix ends in the spring of 2020. These moves are part of a larger trend of bringing proprietary content in house and offering exclusive viewership through new streaming platforms. There are already over 100 streaming services, including Netflix, Hulu, Amazon Prime, DirecTV Now, HBO Now, CBS All Access, among many others. And the competition is only ramping up with upcoming launches of an NBCUniversal service in April 2020, HBO Max in Spring of 2020, and Disney+ on November 12, 2019. NBCUniversal's platform will house The Office, Parks and Recreation, and a host of other Universal Studios movie and televisions series. HBO Max will house HBO and the recently acquired Time Warner assets, which include Friends, Warner Bros studios content (DC comics, Harry Potter, etc.) and Turner content (TBS, TNT, Cartoon Network, etc.). But as big as the NBCUniversal and HBO Max launches may be, nothing sent shockwaves through the industry like the announcement of the Disney+ streaming service. Disney is a brand in itself and has a variety of ways to monetize its characters and franchises. Its streaming service can afford to lose money because Disney's goal is not viewership, but building closer relationships between its customers and its characters. The Disney content serves as the engine that drives revenues throughout all the other business channels (merchandising, theme parks, music, magazines, etc.)

Disney+ launches on November 12th for $6.99/month or a $12.99 bundle for Disney+, Hulu, and ESPN+. The service will include Star Wars, Marvel, and National Geographic libraries. While Disney+ will house the premium content as a 'destination' service, Hulu and ESPN+ will act as 'filler' services offering Disney's Fox assets (ex. Family Guy) and replays of sporting events. These new streaming services mark a stark departure from previous years in which content owners were happy collecting huge licensing fees from Netflix. There's clearly some remorse among the major Hollywood studios in having allowed Netflix to build such close relationships with their customers.

So, what does the future of television look like? It seems clear to us that traditional TV providers are facing a prisoner's dilemma: They can increase their pricing to improve profitability but risk accelerating cord cutting. Or they can cut costs by removing some of the less watched channels which also risks driving away customers. Either way, we see a traditional TV industry in continual decline. Ultimately, we think cable/internet providers will package their high-speed internet with "skinny" TV packages of news and sports. Interestingly, news and particularly sports continue to be best suited for traditional television. Sporting events have natural breaks in action, which suits an advertising based video model. Sports are also highly differentiated and viewers place a premium on reliability and speed. With the growth in Twitter and other social media platforms, live and immediate discussion of sports complements the actual viewing. Viewers can't afford to miss any big moment in sports and even a few seconds of delay can detract from the viewing experience. Regarding streaming, we believe the next few years will see a continued growth of new streaming options, followed by years of contraction. There are particular services that have either ingrained brand loyalty or scalable customer bases that provide distinct comparative advantages. The question analysts continue to grapple with is whether Disney and Amazon represent direct competition with one another or can exist as complementary products that address different consumer needs. Ultimately, there will be clear winners and losers in these streaming wars and we are focused on positioning accordingly.

ABOUT REGIONS INVESTMENT MANAGEMENT

Regions Investment Management, Inc. is an active investment manager focused on achieving long-term investment goals for our clients through diversified portfolios. We offer a variety of domestic fixed income and equity strategies, as well as several liquidity/cash management products. We look forward to serving you. For more information, please see RIM's current Form ADV Part 2A, a copy of which is available upon request at 205-264-6735.

Disclosure

This publication has been prepared by Regions Investment Management, Inc. (RIM) for Regions Bank for distribution to, among others, Regions Wealth Management clients. RIM is an Investment Adviser registered with the U.S. Securities & Exchange Commission pursuant to the Investment Advisers Act of 1940. RIM is a wholly owned subsidiary of Regions Bank, which in turn, is a wholly owned subsidiary of Regions Financial Corporation.

While the commentary accurately reflects the opinions of the Analyst by whom it is written, it does not necessarily reflect those of Regions Bank or RIM. This publication is solely for information and educational purposes and nothing contained in this publication constitutes an offer or solicitation to purchase any security, the recommendation of any particular security or strategy or a complete analysis of any security, company or industry or constitutes tax, accounting or legal advice. Information is based on sources believed by RIM to be reliable but is not guaranteed as to accuracy by Regions Bank, RIM or any of their affiliates. Commentary and opinions provided in this publication reflect the judgment of the authors as of the date of this publication and are subject to change without notice. Certain sections of this publication contain forward looking statements that are based on the reasonable expectations, estimates, projections and assumptions of the authors, but forward-looking statements are not guarantees of future performance and involve risks and uncertainties, which are difficult to predict. Investment ideas and strategies presented may not be suitable for all investors. No responsibility or liability is assumed by Regions Bank, RIM or their affiliates for any loss that may directly or indirectly result from use of information, commentary or opinions in this publication by you or any other person.

Employees of Regions Asset Management may have positions in securities or their derivatives that may be mentioned in this report or in their personal accounts. Additionally, affiliated companies may hold positions in the mentioned companies in their portfolios or strategies. The companies mentioned specifically are sample companies, noted for illustrative purposes only. The mention of the companies should not be construed as a recommendation to buy, hold or sell positions in your investment portfolio.

Trust and investment management services are offered through Regions Wealth Management, a business group within Regions Bank. Investment advisory services are offered through RIM. In some cases, RIM's investment management services and/or strategies will be utilized by Regions Wealth Management for its trust and investment management clients. RIM receives compensation from Regions Bank for providing certain services, including market commentary. When applicable, RIM receives additional compensation based upon the assets in Regions Wealth Management client accounts managed according to RIM's strategies. For additional information concerning RIM or its strategies, please see RIM's Form ADV Part 2A, which is available by calling 205-264-6735.

Neither Regions Bank, nor Regions Asset Management (collectively, "Regions") nor the Regions Bank subsidiary, Regions Investment Management, Inc. (RIM), are registered municipal advisors, nor provide advice to municipal entities or obligated persons with respect to municipal financial products or the issuance of municipal securities (including regarding the structure, timing, terms and similar matters concerning municipal financial products or municipal securities issuances) or engage in the solicitation of municipal entities or obligated persons for such services. With respect to this presentation and any other information, materials or communications provided by Regions or RIM, (a) Regions and RIM are not recommending an action to any municipal entity or obligated person, (b) Regions and RIM are not acting as an advisor to any municipal entity or obligated person and do not owe a fiduciary duty pursuant to Section 15B of the Securities Exchange Act of 1934 to any municipal entity or obligated person with respect to such presentation, information, materials or communications, (c) Regions and RIM are acting for their own interests, and (d) you should discuss this presentation and any such other information, materials or communications with any and all internal and external advisors and experts that you deem appropriate before acting on this presentation or any such other information, materials or communications.

Investment, Insurance and Annuity Products
Are Not FDIC-Insured | Are Not Bank Guaranteed | May Lose Value | Are Not Deposits
Are Not Insured by Any Federal Government Agency | Are Not a Condition of Any Banking Activity

© 2019 Regions Bank. All rights reserved.