Industry Top Trends 2017
Media and Entertainment

Overview

- **Ratings Outlook:** Rating trends across the global media and entertainment industry remain broadly stable but negatively biased due to continued secular shifts in media consumption and advertising spending. Media companies in the print and publishing, radio, and, increasingly, television sectors face the greatest credit ratings pressures. Overall, we believe that diversified media companies with global footprints will be more favorably positioned than niche players with concentrated operations in few regions.

- **Forecasts:** Advertising spending is highly correlated to overall economic growth and consumer spending. We expect mid-single-digit percentage growth in global ad spending in 2017, fueled by strong growth in mobile ad spending. Traditional media ad spending will either slow down or decline, while growth in TV ad spending will vary by market, driven by cyclical events such as sports and elections. We expect lower TV ad spending growth in 2017 in the U.S. and key European markets (e.g. U.K., Germany, Franc), as a result of benefits from cyclical events (sports and political) and strong TV pricing in 2016.

- **Assumptions:** We forecast U.S. GDP growth of 2.4% and consumer spending growth of 2.5% in 2017, driven by job and wage gains and a stronger housing market, and eurozone GDP growth of 1.6% in 2017, with significant regional disparities. For the U.K., we expect the robust economic growth in 2016 to carry over into early 2017 before gradually slowing under the impact of Brexit, resulting in overall GDP growth of 1.4% in 2017.

- **Risks:** The key risks to our industry ratings outlook include global economic uncertainty or shocks damaging consumer confidence and ad spending, increased audience fragmentation, and continued shift in ad spending to digital from traditional media.

- **Industry Trends:** The media and entertainment industry continues to face growing secular shifts in viewing consumption and ad spending to digital media at the expense of traditional print-based media. Internet ad spending is booming, driven by mobility. Meanwhile, traditional sectors, such as print, radio, and increasingly TV, are seeing continued audience and ad revenue declines. We expect industry consolidation to increase in 2017, especially in the U.S., as media, telecom, and technology companies reposition themselves to address these secular trends.

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Ratings trends and outlook

Global Media and Entertainment

Chart 1 – Ratings distribution by sub sector

![Chart 1 – Ratings distribution by sub sector](image1)

Chart 2 – Ratings distribution by region

![Chart 2 – Ratings distribution by region](image2)

Chart 3 – Ratings outlooks by sub sector

![Chart 3 – Ratings outlooks by sub sector](image3)

Chart 4 – Ratings outlooks by region

![Chart 4 – Ratings outlooks by region](image4)

Chart 5 – Ratings net outlook bias by sub sector

![Chart 5 – Ratings net outlook bias by sub sector](image5)

Chart 6 – Ratings net outlook bias by region

![Chart 6 – Ratings net outlook bias by region](image6)

Chart 7 – Ratings outlooks

![Chart 7 – Ratings outlooks](image7)

Chart 8 – Ratings net outlook bias

![Chart 8 – Ratings net outlook bias](image8)

Source: S&P Global Ratings. Ratings data measured quarterly with last shown quarter ending December 31, 2016
Industry forecasts

Global Media and Entertainment

Chart 9 – Revenue growth (local currency)

Source: S&P Global Ratings. Revenue growth shows local currency growth weighted by prior-year common-currency revenue-share. All other figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate.
Key assumptions

Television

1 **Over-the-top (OTT) video services will continue to encourage further audience fragmentation**

With accelerated growth in consumers viewing streaming OTT services such as Netflix, Amazon Prime, YouTube, Hulu, and others, traditional television consumption in the U.S. continues to decline. Although U.S. pay-TV subscriber rates declined roughly 1% in 2016, we expect this rate to increase modestly to above 1% in 2017 as consumers are presented with a growing slate of alternate viewing experiences. To counter this, media and entertainment and video distribution companies (cable, satellite, and telecom) have ramped up their product offerings. For example, AT&T Inc. launched DIRECTV NOW late last year, and we expect Hulu (which is owned by four major U.S. media companies) to launch its online bundled video service in the first half of 2017. Both promise consumers a slimmed down video bundle (so called “skinny bundle”)—but still within the traditional TV ecosystem—that may help recapture customers who have dropped their pay-TV subscriptions.

In contrast to the U.S., we believe the risk of consumers moving away from traditional TV viewing to OTT platforms, and thus hurting broadcasters and pay-TV operators’ revenues, is less pronounced in Europe and Latin America. Due to diversity of languages, cultural, and viewing habits in those regions, many viewers prefer local content, of which OTT providers have limited offering. Overall, we believe European and Latin American pay-TV providers have better U.S. content offering than OTT providers because the U.S. content libraries available on OTT platforms are both smaller and limited compared to those offered in the U.S. Additionally, in Latin America, the still relatively low penetration of broadband Internet service and pay-TV limit, to some extent, the threat OTT video services pose to traditional television, which remains advertisers’ preferred vehicle for ad spending, though at declining rates.

2 **TV ad spending will decline in most regions, including the U.S.**

We expect global TV ad spending to decline in 2017, after growing at a mid-single-digit percentage rate in 2016. After six quarters of solid growth, U.S. TV advertising in 2017 will likely decline due to the absence of political and Olympic advertising this year, continued audience ratings declines, and advertisers allocating more dollars to digital video platforms. Similarly in Europe, TV ad growth will likely trail the 2016 levels, especially in the U.K., due to the uncertainties following the Brexit vote. Germany will likely see 2%-3% growth, though below 2016 levels, due to its still solid economic fundamentals; and France’s growth rate will likely remain flat or increase slightly in 2017, compared to 2016, due to weak GDP growth and political uncertainties. Although secular pressures on audience ratings persist due to the continued fragmentation of video offerings, we expect ad pricing to remain resilient in the U.S. due to the strong upfront and limited ad inventory as declining audience ratings continue to limit overall inventory levels.

3 **Competition for quality content will remain fierce**

Media companies’ ability to innovate, produce, and offer quality content is a key strategy to retaining audiences and remaining competitive against the OTT platforms. As a result, we expect these companies to continue spending aggressively on original content. Additionally, we expect spending on sports rights to remain robust as sports remains a must-have content offering for retaining live audiences. In 2016, according to FX Networks Research, there were 455 scripted original TV series in production in the U.S., and we expect this elevated level to continue due to the increased spend by non-traditional players such as Netflix, Amazon, Hulu, and other digital companies. While these newer entrants are comfortable sacrificing short-term profitability to acquire compelling content which they believe will help drive subscriber growth, this strategy will likely pressure operating margins for established media companies and require them to show considerable discipline in their programming budgets to keep operating margins stable. We also believe that while most media companies will continue to invest in their own content production, those with weaker balance sheets may search for access to content through partnerships.
U.S. local TV could see a resurgence of mergers and acquisitions (M&A)

Coming off of a U.S. presidential election year, we expect that U.S. local TV broadcasters’ advertising revenues will decline in 2017 but remain ahead of 2015 levels due to robust growth in retransmission revenues and modest growth in core advertising. Operating margins will likely decline to below 2016 levels due to the absence of high-margin political ad spending but remain in line with or ahead of 2015 levels. The completion of the Federal Communications Commission’s (FCC’s) broadcast incentive spectrum auction on February 10, 2017 and the possibility of the FCC relaxing or eliminating broadcast ownership caps could increase M&A activity and result in increased leverage in the industry.

Local Media (Radio And Outdoor)

Core radio advertising will continue to decline

Radio broadcasters’ share of audience attention and advertising dollars will likely continue to decline modestly due to audience fragmentation and radio companies losing market share to digital media. Additionally, ad rate declines will make it challenging for radio broadcasters to maintain stable top-line growth via digital media or other revenue streams. We expect that the industry’s share of audience attention will decline only slightly in 2017 as a result of digital radio and other media alternatives. We expect that operating margins will decline modestly due to stable to slightly lower top-line growth, offset by inflationary cost increases.

U.S. outdoor advertising revenue growth will likely exceed GDP growth

With minimal disruption from digital advertising, we expect that U.S. outdoor advertising will continue to hold its share of advertising in 2017, with some top-line growth from higher ad rates and occupancy levels as a result of digital advertising board expansions. We expect outdoor revenue to grow modestly faster than our U.S. GDP growth forecast. Operating margins will likely remain robust and relatively stable.
# Print And Publishing

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<th>Print ad revenue will likely decline by 10% in 2017</th>
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<td>Newspaper and magazine companies in the U.S. and western Europe will likely lose about 10% of their print ad revenues in 2017 as consumers and advertisers continue to adopt new digital media technologies and media outlets. We believe this decline is unlikely to reverse during the next five years due to ongoing reduction in print readership, changing consumer demands, and advertisers’ desire for improved ad measurement and investment returns.</td>
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<th>Publishers will extend their brands, content, and audiences into new revenue streams</th>
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<td>We expect total revenues for newspaper and magazine companies, especially in the U.S., to decline at a low- to mid-single-digit percentage rate in 2017 as publishers extend their product mix and optimize their pricing models. Over the next year, we expect that publishers will make steady progress expanding into areas such as premium and custom content, live events, and marketing services such as customer analytics, creative development, and lead generation. Although many publishers generate only about 20%-30% of revenues from new digital initiatives and new ventures, we expect that percentage to steadily increase.</td>
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<th>Industry consolidation will continue as legacy printing and publishing companies struggle with declining profitability or business transformation challenges</th>
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<td>Over the next five years, as print volumes decline and pricing pressure persist, we expect continued consolidation in the global printing and publishing industry. Print will remain a valuable component of the marketing mix, and we expect that low valuation multiples, along with good print attribution metrics (an advertising channel that is useful for brand awareness or contributing to a sale), will motivate strategic acquisitions. The primary factors driving strategic acquisitions include companies’ desire to quickly obtain technology knowhow or capabilities, or to gain scale in profitable niches; and their need to maintain operating leverage to protect their margins or market positions.</td>
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Online advertising will continue to grow strongly in 2017
Global online ad revenues will likely exceed $190 billion by the end of 2017 due to strong growth in mobile advertising and surpass television to become the largest advertising category globally. Furthermore, Magna Global predicts that strong demand for video, social, and Internet search subcategories will result in compounded annual ad revenue growth in the mid-teens percentage area and lead to online advertising accounting for about half of global ad sales by 2020.

Mobile advertising will boost online display ad growth as focus shifts to user engagement
Advertising on mobile platforms grew about 50% in 2016, representing over 45% of digital ad spending. We expect mobile advertising to increase to 50% of total digital ad spending in 2017 due to increased smartphone penetration and affordability, and improved availability of mobile telephony. Smartphone apps—the preferred method to access messaging and social media content—are redefining how media companies pursue mobile advertising. Apps, which provide a robust set of geolocation and first-party data, are helping to drive monetizing.

Programmatic advertising will increase despite challenges
Programmatic advertising will remain the primary method for buying and selling online display advertising in 2017, despite fraud, viewability, ad-blocking, and complexity concerns. In 2016, programmatic advertising accounted for slightly more than half of digital ad spending in the U.S., and we expect this share to increase to about 60% in 2017. Globally, the trend toward programmatic advertising is becoming the norm. Advancements in ad technology and standards, increased personalization and targeting sophistication, and ad sales and purchase efficiency improvements should support growth.
Other Media Subsectors

1. Ad agencies will remain healthy despite foreign exchange headwinds and concerns over transparency

We expect organic revenue growth of 2%-5% for global ad agencies in 2017, supported by accelerating growth in digital media, above-average growth in emerging markets, and improved economic growth in the U.S., tempered by a challenged ad spending environment in Europe. We expect that ad agencies’ operating margins will continue to expand, albeit at a more modest rate than in past years, despite pressure on fees due to growth in higher-margin analytical services and continued focus on tight cost controls.

2. Film studios face growing risks from increased dependence on tent-pole films

Despite a record box office year in 2016 due to increased ticket prices (premiums for IMAX, 3D, etc.), the U.S. domestic box office is in a long-term secular decline because consumers have access to an expanding slate of entertainment choices. This has led to low-single-digit percentage audience declines, which will pressure domestic exhibitors’ earnings. However, for film studios, healthy growth in international box offices, primarily in developing markets, should more than offset these domestic declines. Overall, we expect that U.S. domestic box revenues could grow at a low-single-digit percentage rate in 2017, compared with 2016, partly due to a new Disney Star Wars film. However, with any film slate, significant risks exist. Specifically, the major film studios have steadily increased their reliance on big-budget tent-pole films, and we believe this strategy will likely raise earnings volatility and significantly increase business risks.

3. Music is turning the corner on growth

The recorded music industry continues to face secular shifts as music consumption moves to higher-margin digital sales from lower-margin physical sales, and, within digital music, the shift to a streaming model from a download model. In 2015, global music revenue grew for the first time since the early 2000s. We believe the industry has finally reached an inflection point after over a decade of digital disruption, and digital revenue growth is now outpacing the decline in physical music sales.

In the digital music segment, strong growth in streaming revenues, which is far outpacing the decline in download revenues, is fueling the improved growth in revenues. Streaming music now accounts for almost 43% of total digital sales industrywide. We expect the healthy growth prospects for streaming music to continue, given the still relatively underpenetrated streaming markets in Europe and, to a lesser extent, the U.S.

We believe the shift toward digital streaming is inevitable, but continued experimentation in the various subscription-based models could slow its growth prospects. Service providers such as Apple, Pandora, Spotify, and Tidal continue to experiment with models such as album or artist exclusivity on their streaming services, and this may lead to a rationalization for smaller, less financially sound subscription-based services. Furthermore, changing revenue-sharing agreements between labels and artists or songwriters may result in higher fees or royalties distributions, which could adversely affect digital operating margins.
Key risks and opportunities

**Television**

1. **More M&A likely to come in 2017**
   After a lull in large-scale M&A activity over the past few years, we saw two significant deals announced at the tail end of 2016, AT&T’s proposed acquisition of Time Warner Inc. and Twenty-First Century Fox Inc.’s proposed acquisition of Sky PLC. While both deals bring together content and distribution, it isn’t clear what benefits vertical integration brings beyond diversification. Still, we believe these two deals will likely accelerate the merging of content and distribution.

   For U.S. local TV stations, in addition to the prospect of loosening media ownership caps and clarity following the completion of the FCC’s broadcast TV incentive spectrum auction on February 10, 2017, we expect TV stations M&A to accelerate in 2017. Although there likely will be some rationalization in acquisition multiples following disappointing election revenue generation in 2016 and much lower-than-expected spectrum auction values, M&A will likely lead to an increase in debt leverage for acquirers.

2. **Global economic pressures could hurt TV advertising**
   We expect that weaker economic recovery in the U.K. triggered by uncertainty regarding Brexit, potentially weakening economic prospects for the U.S. and EU, and declining consumer confidence could pressure advertising budgets and negatively affect broadcasters’ TV advertising revenues and depress their profitability margins. Conversely, we expect that, as a whole, Latin America’s GDP growth will recover in 2017, reaching 1.7% on average, after a likely contraction of about 0.5% in 2016. Specifically, in Brazil, after two years of recession, we believe that GDP growth and improving economic conditions might support a gradual recovery of ad spending in 2017 after a disappointing 2016 (despite the Summer Olympics in Brazil).

   Continued economic pressure will likely increase foreign exchange volatility. For companies that have significant currencies mismatches related to their revenues (because their debt are denominated in currencies that differ from their generated revenues), foreign exchange volatility can hurt their credit metrics if they haven’t hedged exposure through forward contracts.

3. **More favourable regulatory and government policies in the U.S.**
   With the start of the Trump administration, we expect significant changes in the U.S. regulatory environment which could favourably impact the media and entertainment industry. During the election, Trump gave mixed signals on various issues affecting media, such as consolidation, net neutrality, and privacy. However, we expect that regulatory conditions will be less intrusive under President Trump than during the Obama administration. We believe this bodes well for consolidation in the industry—among media companies and between content and distribution companies. Additionally, reduced oversight regarding privacy rules could help media companies, specifically television, use data to increase targeted advertising to consumers.

4. **Companies will continue to make sizeable investments in programming**
   Television companies’ continuous effort to offer high-quality content—either by acquiring third-party content or producing their own so as to attract and retain audience—exposes them to increasing programming investments and higher working capital needs. These factors can negatively weigh on the companies’ credit metrics and ultimately harm their credit quality because they reduce the companies’ free operating cash flow and constrain their liquidity.

5. **Opportunities abound in digital advertising**
   As video content distribution expands beyond traditional platforms to include digital and mobile, broadcasters and pay-TV providers stand to benefit from significant growth in digital advertising, especially in the mobile space. The trend of rapidly growing video and TV content consumption over alternative media such as mobile devices is driving digital and mobile advertising growth. The relative ineffectiveness of ad blocking technology in the mobile environment is also driving this growth.
### Local Media (Radio And Outdoor)

**Balance sheet capacity will limit radio M&A prospects**

We don’t see much prospect for additional radio M&A in 2017, beyond the proposed merger of CBS Radio Inc. and Entercom Communications Corp. Few companies have the balance sheet capacity to undertake a sizeable acquisition, and there is a significant discrepancy between buyers’ and sellers’ expectations. We also believe that any outdoor media transaction will depend on Clear Channel Outdoor Holdings Inc.’s need or willingness to sell additional markets.

**The economic impact**

Local media revenue is highly correlated to GDP and the health of local markets. A U.S. recession, though not contemplated for 2017, would cause corresponding revenue declines for local media companies as well as magnified declines in EBITDA and operating margins. For instance, radio revenue declined 25% during the 2008-2009 recession. And although television broadcasters and outdoor media advertisers have recovered that lost revenue, the radio industry hasn’t recovered most of its lost revenue.

**U.S. radio broadcasters’ financial problems pose significant credit risks**

With iHeart Media Inc. and Cumulus Media Inc., two of the largest U.S. radio broadcasters, facing financial duress and are seeking to restructure their debt obligations, we see the possibility of irrational pricing behavior that could cause larger-than-expected decline in radio advertising rates and revenues across the industry. Industrywide mid-single-digit percentage revenue declines or worse would likely result in several downgrades and us reexamining whether U.S. radio broadcasters’ leverage levels are sustainable.

### Print And Publishing

**Ongoing cost reduction will be required to support a sustainable publishing business model**

Over the next few years, traditional publishers will need to carefully balance their investments in growth initiatives with cuts in their legacy print and distribution platforms. Failure to carefully manage the transition, which requires implementing cash flow harvesting strategies to maximize the print readership base’s residual value, could result in sharp declines in profitability as volumes decline. However, we expect that some companies will fail to make the transition, given the transformation’s complexity and the need for continuous investments in the business.

**Improved customer engagement should boost ad rates**

We expect publishers to use the strength of their content and brands to establish deeper engagement and customer relationships around targeted interest areas. Increased personalization should help to improve audience conversations and brand differentiation. Additionally, increased engagement should improve ad relevance, response rates, and lead to higher ad rates. Technology investment such as improved data analytics and content management capabilities will be required. Equally important will be a fundamental redesign of business alignment, how content is created, and how businesses connect with audiences.

**To succeed, publishers will need to publish and monetize their content on multiple third-party platforms**

The rapid increase in content consumption on third-party platforms and the continued dominance of companies such as Facebook Inc. and Google Inc. in news and content aggregation are forcing publishers to rethink how their content is distributed, consumed, and monetized. As content marketing strategies mature over the next five years, we believe publishers will become more agnostic about which platform they monetize their content as long as their brands and content remain relevant. We also expect that publishers will increasingly rely on social media and other new media platforms to promote their content, and that they will use a combination of online and offline multimedia channels to engage their audience in broader conversations.
### Internet/Online

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<th>A few powerful technology platforms will dominate digital ad spending; scale and ability to collect robust first-party data sets matter</th>
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<td>Despite the rapid growth of the global digital ad market, only a handful of information technology and social media companies (Google, Facebook, Baidu Inc., Yahoo Inc., Microsoft Corp., etc.) control most of the digital ad spending flow. We expect this trend to continue despite rapid changes in ad technology and new entrants, given these companies’ dominant market positions, powerful technology platforms, vast technology development resources and expertise, broad user base and networks, and significant financial resources. Furthermore, these companies’ ability to collect and accurately structure first-party data to build effective user profiles and predict user behavior provide them with a meaningful competitive advantage.</td>
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<th>Data privacy regulations could impact content personalization</th>
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<td>Companies’ ability to provide personalized online user experiences at scale and to personalize ad communication has the potential to revolutionize online marketing. However, concerns about compromises or inappropriate use of personal data are causing regulatory authorities around the world to consider a number of restrictive legislative and regulatory proposals. We expect that a patchwork of new data protection frameworks and regulatory regimes will increase compliance costs, information security needs, and operational complexity. Furthermore, stricter rules or increased marketing complexity could impair personalized users experiences and new product developments.</td>
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<th>Messaging and ChatBots offer growth potential</th>
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<td>We expect that messaging app development will provide a new platform to support advertising and ecommerce growth in 2017 and beyond. Messaging apps, which historically offer users the ability to chat and exchange pictures and videos, is evolving to provide a one-to-one computer-simulated interaction over the Internet. Use cases include retail and voice search, and ecommerce transaction support. Over the next few years, we expect a sharp increase in investments in development tools to boost platform utilization and app growth. In Asia, for example, the companies that provide the WeChat (Tencent Inc.) and KakaoTalk (KAKAO Inc.) messaging apps have broad user bases, robust ad platforms, and are leading innovation.</td>
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### Other Media Subsectors

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<th>Ad agencies face advertiser backlash in the short term but will benefit from advertising's increasing complexity long term</th>
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<td>Over the past few years, advertisers have increased the number and frequency of agency reviews as they seek to consolidate advertising contacts, especially the purchasing of media inventory (&quot;media buying&quot;), to reduce fees paid to ad agencies. Thus far, the financial impact has been minimal due to ad agencies' holding-company structures, which create both geographic and client diversity. Longer term, ad agencies face more competition for advertisers’ dollars from digital giants such as Alphabet Inc. and Facebook, media companies with developing in-house capabilities, and technology companies ranging from Oracle Corp. to IBM. Still, we believe long-term disintermediation risk is likely contained due to the advertising landscape’s increasing complexity and ad agencies' independence and broad capabilities, which other companies, such as digital ad agencies and technology companies don't have.</td>
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<th>The music industry is reaching an inflection point as digital growth outpaces physical declines</th>
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<td>We expect that growth in paid subscription music streaming services will outpace secular declines in physical music sources, such as CDs. The number of paying streaming subscribers worldwide has reached an inflection point, such that many streaming services have reached scale and now achieve economies of scale. We believe the services streaming companies provide (such as the ability to create a playlist and easy access to the latest hits or music news) and the relatively low price for monthly streaming subscriptions (typically at or below €10/$10) have enabled the music industry to reduce its exposure to piracy versus download sales.</td>
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<th>Demand for quality TV content continues to fuel film studios' growth; but will the TV content bubble burst as audiences shrink?</th>
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<td>As growth in the U.S. box office continues to soften, healthy growth in the international box office is changing the definition of &quot;success&quot; for film studios. These changes include the film studios' growing reliance on a smaller number of very big-budget films which, with greater and less diversified financial risk, increase earnings volatility. Film studios have sought to reduce this volatility by entering into co-production deals that diversify risk among partners, especially for second-tier studios. Although film production grows increasingly risky, studios are benefitting from the increased demand for quality original TV programming from pay-TV networks seeking to differentiate from their peers and online distributors that are building their brands. Still, longer-term monetization of this content is uncertain due to shrinking TV audiences and the decline in the U.S. syndication market. Last year, FX Networks Research estimated that there were 455 scripted original TV series in production in the U.S. We believe this content bubble will eventually burst because as audience fragmentation increases, film studios face the risk that viewers may not watch these increasingly expensive TV shows.</td>
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Industry developments

Audience fragmentation

In the U.S., fragmentation of television viewing is gaining speed as audiences continue to migrate away from traditional television to alternate sources of entertainment and as traditional video service providers face increased pressure to offer skinny video bundles with fewer cable networks (and, in the longer term, OTT content options). As the skinny bundle gains market share, we believe cable network operators’ traditional bundling practice will become unsustainable. Cable network operators have historically used the video bundle to both push and protect weaker cable networks by tying carriage of their flagship networks with their lower-rated networks. We believe that video service providers will either reposition those lower-rated networks to second-tier specialty bundles or transform them to online digital networks (like Comcast Corp. recently did with its Esquire network). We expect that television and, to a greater extent, cable network audience ratings will remain under pressure as a result of ongoing video fragmentation, with some protection for those providing must-watch content and live sports programming.

These trends are less clear-cut in continental Europe, however, where television is primarily free and funded by TV advertising. In France, for example, the number of freeview channels has increased to 26 in 2016 from six in 2005. And although the resulting market fragmentation has shrunk the incumbent channels’ audiences, it has also led to average TV consumption (including catch-up TV viewing) remaining fairly stable at about 3 hours and 45 minutes daily for the key advertising target of women under age 50 who are responsible for purchasing decisions. This fragmentation has resulted in the smaller channels (some of which the incumbent players own) becoming more focused on one particular audience, while the incumbent channels remain generalist and a way to reach the masses.

In Europe, pressure from OTT remains moderate for now because OTT providers are constrained by the same local regulation as broadcasters (such as the minimum time lapse to release a movie from its release at the box office), while local content, including local language and references, remains key. In the U.K., where pay-TV has the highest penetration rate in Europe, skinny bundle offers and OTT pressure are less pronounced than in the U.S. due to the importance of local content.

Meanwhile, in most Latin American countries, the penetration of pay-TV and broadband is still low, accounting for less than 40% of households in Brazil, for example. In Asia Pacific, secular trends vary significantly across the region, though pay-TV and free-to-air television operators in some developed markets, such as Japan, South Korea, Singapore, and Australia, are under increasing pressure from OTT content providers.

Global media companies expand OTT platform experiments

As pressure on the traditional video bundle increases, media companies in Europe and, more reluctantly, in the U.S. have begun participating in virtual bundles. For example, although U.S. media companies are concerned that launching OTT options will undermine the existing domestic TV ecosystem, they have launched a number of virtual multichannel video programming distributor (MVPD) options (including Sling TV, DirecTV Now, and the soon to be launched Hulu vMVPD service) or offered their own subscription video on demand (SVOD) OTT services (such as CBS All Access, HBO Now, and the soon to be released ESPN SVOD service).

Still, it’s too early to tell whether these services will stem the audience losses traditional cable and broadcast networks are experiencing or further encourage consumers to move outside the traditional television ecosystem. We view the current selection of OTT virtual bundles as incomplete and unlikely to fully satisfy consumers. Virtual bundles such as Sony’s PlayStation Vue, Dish’s Sling TV, and AT&T’s DirecTV Now all lack a full slate of broadcast stations and exclude certain cable networks. Even Hulu’s proposed virtual bundle, which we had high hopes for due to its ownership by Comcast’s NBCUniversal Media LLC, Time Warner, Twenty First Century Fox Inc., and The Walt Disney Co., appears to be fully loaded with the partners’ owned networks but lack most non-owned networks such as those offered by Discovery Communications Inc., Scripps Networks Interactive Inc., Viacom Inc., and AMC Networks Inc.
Advertising trends

We expect that overall ad spending in the U.S. will grow at about 2% in 2017, which is slower than in 2016, due to the absence of the Olympic Games and the presidential election. Excluding those two events, core ad spending (local and national) will likely increase by 3.2% in 2017--ahead of our U.S. GDP forecast of 2.4%. We believe digital advertising will grow at a mid-teens percentage rate as it continues to take share from traditional media. We expect that only the digital, outdoor media, and TV sectors will show solid growth in 2017, while other media sectors (newspapers, magazines, and radio) will experience continued advertising declines. Although TV ad spending has shown surprising strength since the second half of 2015, we believe this recovery is cyclical and will begin to reverse in 2017.

We expect low- to mid-single-digit percentage growth in ad spending in Europe, the Middle East, and Africa (EMEA) in 2017, despite a slowdown in economic recovery and the uncertain prospects surrounding the U.K. given its impending departure from the EU. We anticipate that the main factors for this growth will be digital ad spending, particular in the mobile area, and that TV ad spending will decline from 2016 levels. In the U.K., ad spending will likely grow at a mid- to high-single-digit percentage rate, thanks to the digital expansion; while ad spending growth prospects will likely remain subdued in France, with flattish growth. In Germany, TV ad spending will likely grow at a 2%-3% rate due to the market’s still solid economic fundamentals, and digital ad spending will likely grow at significantly higher rates than TV ad spending due to expansion of nonlinear offers (video, search, social media, etc.).

Financial policy

Vertical integration and subsector consolidation will likely increase transformational M&A

We believe M&A activity in the media and entertainment industry could step up during the next few years. For the past several years, we have discounted the possibility of a large-scale industry consolidation, despite growing pressures on the U.S. television business due to audience fragmentation and the shift in advertising away from traditional media to digital platforms. Most media companies have been developing strategies to address these trends, and few, in our view, saw themselves as vulnerable to the changing U.S. media landscape. However, we believe industry changes regarding video distribution and the proposed AT&T and Time Warner merger might make vertical integration of content creation and video distribution more attractive, leading other media executives to seek partnerships or sell their companies. This could result in meaningful consolidation of the industry because many media, telecom, and technology companies may feel strategic pressure to emulate the integrated platforms of AT&T and Time Warner, Fox and Sky, and Comcast and NBC Universal.

In Europe, however, we don’t expect any transformational M&A. Rather, we expect that European media companies will focus on smaller bolt-on acquisitions to bolster their existing operations and improve their geographic footprint, and fund these acquisitions with generated cash flows. We also expect that TV broadcasters and pay-TV operators will focus on deals that extend their digital offering and content production. The absence of large M&A will, in our view, have a neutral to positive impact on leverage for European media companies in 2017.

M&A opportunities could temper shareholder-friendly actions in the U.S.

We believe the seven investment-grade U.S. diversified media companies we rate will return less cash to their shareholders in 2017 than in any year since 2010. The increasing possibility of sizable M&A opportunities has, or could, lead many of these companies—CBS, Discovery, Scripps, Time Warner, Fox, Viacom, and Disney—to scale back or temporarily suspend their share repurchase programs in 2017 or 2018. As a result, we expect many of these companies to start building acquisition capacity and reduce shareholder payouts. We estimate that the companies will return $16 billion to shareholders ($11 billion in stock repurchases and $5 billion
in cash dividends) in 2017, which is less than the $21.6 billion annual average ($17.6 billion in stock repurchases and $4 billion in cash dividends) distributed during the 2010-2015 peak years. Our forecast doesn’t include additional M&A beyond those already announced. Nonetheless, we believe additional M&A would likely result in the participants suspending their share repurchases, leading to further reduction in our shareholder payout forecasts for 2017 and 2018.

We don't expect media companies’ reduced shareholder returns to have any impact on our credit ratings, unless that change is associated with M&A. Additionally, we don’t expect any of the companies’ adjusted leverage to exceed the thresholds we have set for the assigned credit ratings. More than likely, any upgrades or downgrades would occur as result of M&A.

Instead of making shareholder-friendly actions, we expect European media companies--contrary to their more aggressive U.S. media peers--to exhibit a relatively disciplined approach to shareholder returns in 2017, invest in the development of future revenue streams, and replace their structurally declining businesses with faster growing operations.

Related research

- Investment-Grade U.S. Media Companies' M&A Plans Will Reduce Shareholder Cash Payouts In 2017, Jan. 13, 2017
- The U.S. Media Industry’s Toughest Casting Call: The Next Generation Of CEOs, Oct. 13, 2016
- Research Update: Viacom Outlook Revised To Negative From Stable On Weaker Operating Performance; ‘BBB-’ Rating Affirmed, Jun. 21, 2016
- Ratings Implications For Participants In the Broadcast Incentive Auction, Apr. 5, 2016
- Conversations On The Road: U.S. Media Companies And Distributors Work To Create A Win-Win Path To The “Skinny Bundle,” Mar. 18, 2016
- Research Update: Nexstar Broadcasting Group Upgraded to ‘BB-’ From ‘B+’ On Pending Acquisition of Media General; Outlook Stable, Feb. 25, 2016
Cash, debt and credit measures

**Global Media and Entertainment**

**Chart 13 – Cash and equivalents / Total assets**

- Global Media - Cash & Equivalents/Total Assets (%)

**Chart 14 – Total debt / Total assets**

- Global Media - Total Debt / Total Assets (%)

**Chart 15 – Fixed versus variable rate exposure**

- Variable Rate Debt (% of Identifiable Total)
- Fixed Rate Debt (% of Identifiable Total)

**Chart 16 – New debt issuance or maturity schedule**

- LT Debt Due 1 Yr
- LT Debt Due 2 Yr
- LT Debt Due 3 Yr
- LT Debt Due 4 Yr
- LT Debt Due 5+ Yr
- Nominal Due In 1 Yr

**Chart 17 – Cash flow and primary uses**

- Capex
- Dividends
- Net Acquisitions
- Share Buybacks
- Operating CF

**Chart 18 – Return on capital employed**

- Global Media - Return On Capital (%)

Source: S&P Global Market Intelligence, S&P Global Ratings calculations