Industry Top Trends 2018

Media and Entertainment

Overview

- **Ratings Outlook:** Rating trends across the global media and entertainment industry remain broadly stable but negatively biased due to ongoing secular shifts in media consumption and advertising spending. Media companies in the print and publishing, radio, and television sectors face the greatest credit pressures. Overall, we believe diversified media companies with global footprints are more favorably positioned to face these secular trends than niche companies with concentrated operations in a few regions.
- **Forecasts**: Advertising spending is highly correlated to overall economic growth and consumer spending. In 2018, we expect mid-single-digit percentage growth in global ad spending, fueled by continued hypergrowth 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 also expect healthy TV ad spending growth in the U.S. and key European markets such as the U.K., Germany, and France due to cyclical events, particularly the Winter Olympics and FIFA World Cup. In Brazil, the FIFA World Cup, coupled with economic recovery, should also boost TV ad revenues in 2018.
- **Assumptions:** We forecast U.S. GDP growth of 2.3% and consumer spending growth of 2.3% in 2018, driven by modest job and wage gains; and eurozone GDP growth of 1.8% in 2018, with significant regional disparities. As Brexit negotiations continue, we expect the gradual economic slowdown to result in overall U.K. GDP growth of 0.9% in 2018, down from the expected 1.4% for 2017.
- **Risks:** The key risks to our industry outlook include global economic uncertainty or shocks hurting consumer confidence and ad spending, increased entertainment options leading to accelerated television audience fragmentation, and continued shift in ad spending to digital media from traditional media.
- **Industry Trends:** In the U.S. and Europe, we expect the secular shifts in viewing consumption and ad spending to digital media at the expense of traditional print-based media to continue in 2018 and beyond. Digital ad spending will remain strong in 2018, driven by mobile advertising, while traditional sectors such as print, radio, and, increasingly, television, will see ongoing audience and ad revenue declines. We also expect further industry consolidation, especially in the U.S., as media, telecom, and technology companies reposition themselves to address these secular trends.

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S&P Global
Ratings

Ratings trends and outlook

Global Media and Entertainment

Chart 1 – Ratings distribution by subsector

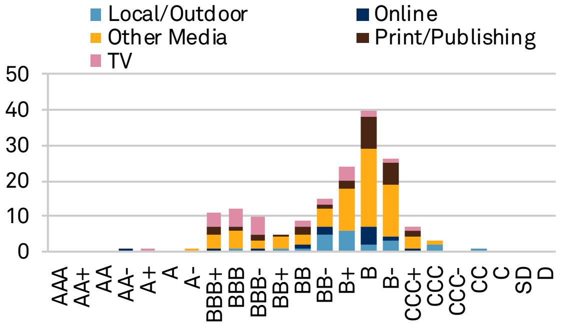


Chart 2 – Ratings distribution by region

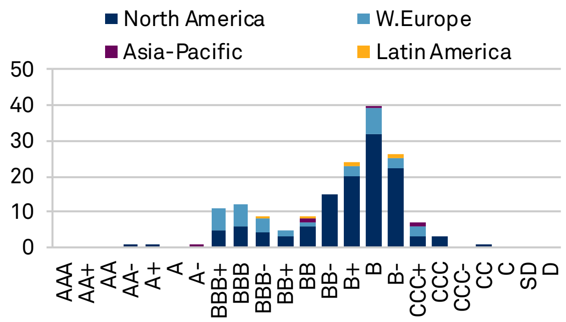


Chart 3 – Ratings outlooks by subsector

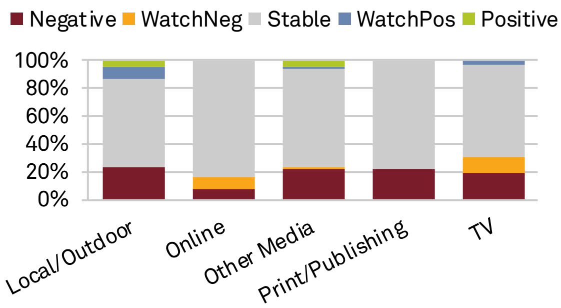


Chart 4 – Ratings outlooks by region

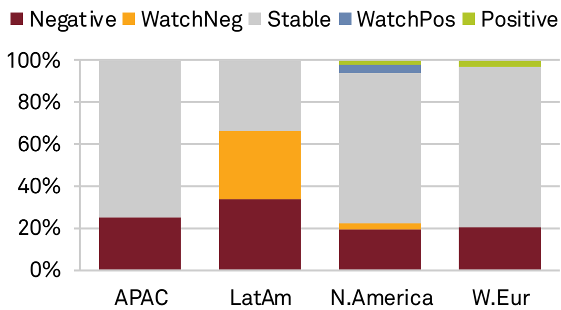


Chart 5 – Ratings net outlook bias by subsector

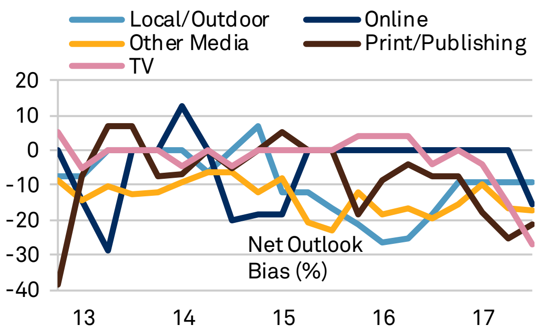


Chart 6 – Ratings net outlook bias by region

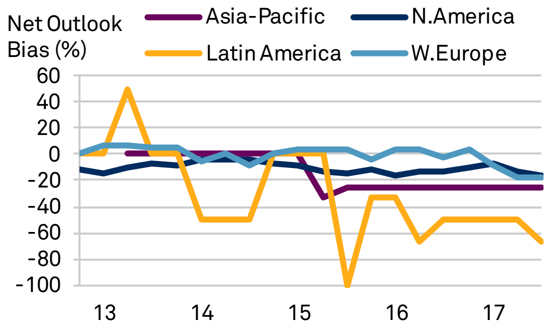


Chart 7 – Ratings outlooks

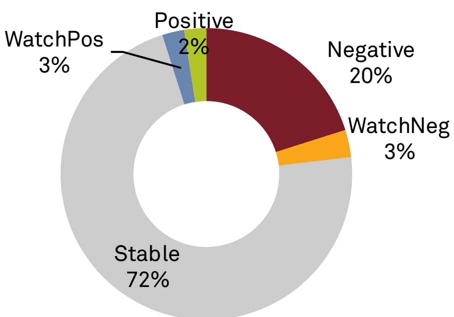
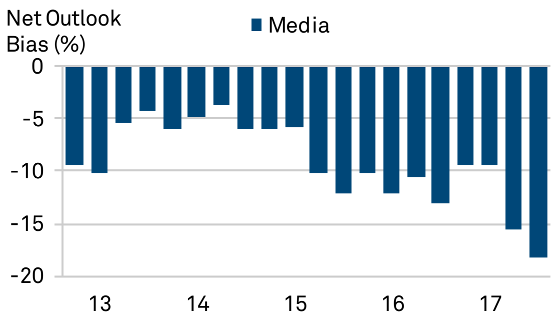


Chart 8 – Ratings net outlook bias



Source: S&P Global Ratings. Ratings data measured quarterly with last shown quarter ending September 30, 2017

Industry forecasts

Global Media and Entertainment

Chart 9 – Revenue growth (local currency)

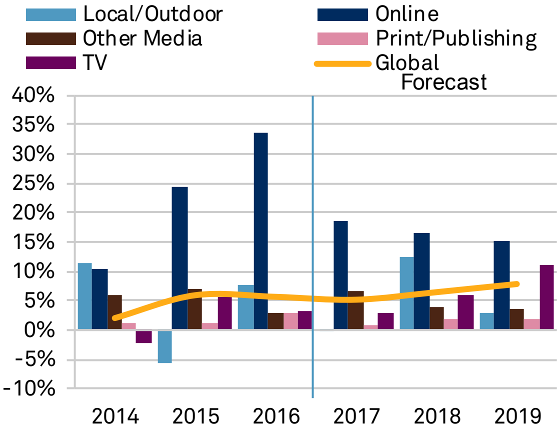


Chart 10 – EBITDA margin (adjusted)

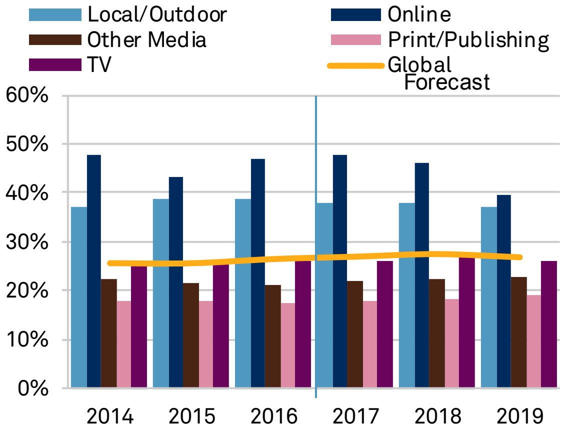


Chart 11 – Debt / EBITDA (median, adjusted)

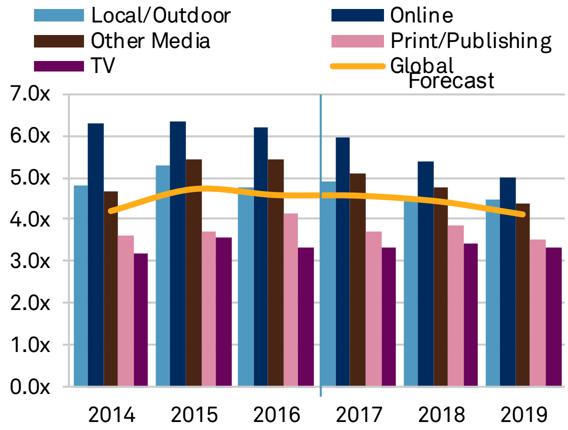
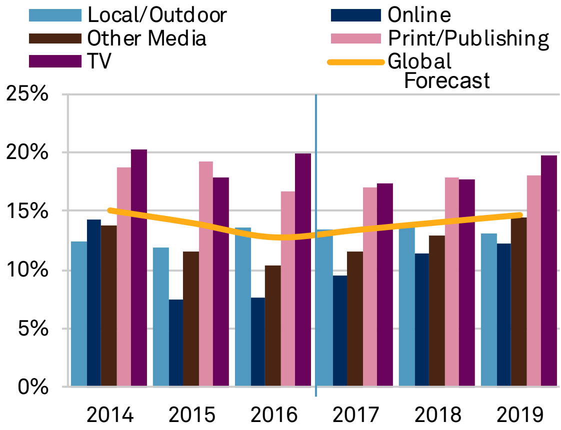


Chart 12 – FFO / debt (median, adjusted)



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	**The bifurcation of U.S. media will continue** For the past few years, U.S. media companies have been evolving into two categories: those that are successfully changing with the shifting dynamics in the television ecosystem, and those that aren't and are thus facing more challenges. We expect these trends to continue. There has been an uptick in video subscriber losses in traditional large-bundle pay-TV subscribers over the past year. And although some of these customers are shifting to over-the-top (OTT) virtual "skinny" cable bundles (such as DirecTV Now and Sling), the total number of consumers subscribing to some form of video bundle (cable, telco, satellite, or virtual) is still declining. As a result, we believe media companies with broadcast networks, major sports programming (NFL, NBA, MLB, etc.), and compelling original content are better positioned to secure their networks among the plethora of skinny bundle offerings that have been launched in the past two years. We expect broadcasters that secure carriage in these virtual bundles will report better affiliate revenue growth and lower subscriber losses than those that don't.
2	**Content is still king, but how it's delivered matters** Compelling content is key to media companies' success, but content delivery is increasingly becoming important as consumers demand more flexibility and choice. Historically, media companies allowed third parties, primarily pay-TV providers and, more recently, streaming video on demand (SVOD) services such as Netflix, Amazon, and Hulu, to control the distribution of their content. However, pay-TV and SVOD providers have both used the data provided from delivering content to create their own original content and deepen their relationships with their subscribers. For instance, in Europe, Sky PLC has announced plans to increase investments in its original programming production by 25% in 2018, which will help broaden its content offering and add more local content in Italy and Germany to attract new subscribers. Some media companies have responded by shifting tactics and creating their own direct-to-consumer (DTC) delivery systems to establish direct relationships with consumers. For example, CBS launched a successful DTC service (CBS All Access) in 2014 that now has over 2 million subscribers, and The Walt Disney Co. has announced it will have a DTC offering for ESPN in 2018 and another for its Disney brands (Disney, Pixar, Marvel, and Star Wars) in 2019. We view Disney's proposed OTT streaming service as a significant move. Although other media companies have launched similar services on a much smaller scale, Disney is unique in both the depth and breadth of its intellectual property. We believe the company's twin launches could pressure other U.S. media companies to follow suit, which would likely accelerate the fragmentation of audience viewing, putting even more pressure on the traditional video bundle. We also believe Disney's propositions will further exacerbate the growing divide between media companies that have strong intellectual property and a deep library of content—and are therefore positioned to survive in this changing landscape—and those that don't.

3	**We haven't reached peak TV yet** Despite the increasing threat of unsustainable growth and oversupply, media companies are producing even more original scripted programming each year. According to FX Networks Research, 455 scripted original TV series were produced in the U.S. in 2016, and we expect production will easily eclipse this number in 2017 as SVOD providers such as Netflix, Amazon, and Hulu continue to make significant investments in original content. Netflix expects to spend over $6 billion in content costs in 2017, up from $4.9 billion in 2016, and we expect this to rise to about $7.5 billion in 2018. We also expect increased spending from Amazon, Hulu, and new entrants such as Apple. And while this will lead to more scripted original TV series, it won't necessarily result in more success for the companies because the added content will compete for attention from consumers who are already bombarded with a plethora of entertainment choices. Many of the newer market entrants appear comfortable with sacrificing short-term profitability to acquire compelling content that they believe will help drive long-term subscriber growth. However, this strategy will likely pressure established media companies' operating margins, requiring them to show considerable discipline in their programming budgets to avoid margin degradation. We also believe that while most media companies will continue to invest in their own content production, those with weaker balance sheets will need other means such as co-production partnerships and joint ventures to gain access to either intellectual property or financing to produce the content.
4	**Consumers will continue to demand increased flexibility and personalization** Pay-TV operators' strategy of offering a limited number of bundles (especially in terms of price points) worked well in the past when watching TV through a pay-TV bundle was the only option. But we believe this one-size-fits-all offer no longer works for everyone. As audiences fragment to alternate entertainment options, consumers are demanding the ability to watch TV everywhere, anytime, and on any device, and new pay-TV competitors are entering the market with heavily discounted offerings. For these reasons, we believe Sky will continue its strategy in Europe of offering skinny video packages, build-your-own-bundle options, and one-off access to its channels through daily passes. In France, Canal+ has both simplified and increased the flexibility of its video bundles, allowing consumers to build their own bundles by adding or upgrading from a cheaper basic bundle. Similarly to Sky's offerings such as daily or monthly passes, Canal+'s OTT offerings come with a no-contract ("cord never") commitment.

Local Media (Radio and Outdoor)

1	**Core radio ad revenues will continue to decline** We expect radio broadcasters' share of audience attention and advertising dollars will continue to decline at a low-single-digit percentage rate for the foreseeable future due to audience fragmentation and broadcasters losing market share to digital media. As ad rates decline, radio broadcasters will find it challenging to maintain stable top-line growth via digital media or other revenue streams. Still, we forecast traditional radio's share of audience attention will decline only slightly in 2018 as audience consume more digital radio and other media alternatives. We also expect the radio industry's operating margins will decline modestly due to stable or slightly lower top-line growth, offset by inflationary cost increases.
2	**U.S. outdoor ad revenue growth will likely exceed GDP growth** U.S. outdoor advertising will maintain its share of advertising in 2018. We believe the growth in digital advertising and the minimal disruption from digital advertising will lead to higher ad rates, increased occupancy levels, and, ultimately, some topline growth. We expect outdoor advertising revenue will grow in line with or slightly faster than U.S. GDP, and industry operating margins will remain robust and relatively stable.

Internet/Online

1	**One-to-one marketing moves closer to reality** "Mobile first" will remain a key business strategy in 2018 as one-to-one personalized marketing moves closer to reality. With their always-on, uniquely identifiable, and personal nature, mobile devices provide the ideal environment for one-to-one marketing. We estimate mobile will account for about 70% of all digital media consumption and just over 50% of the estimated $220 billion global digital ad spending in 2018. Moreover, mobile platform's importance will continue to increase as smartphone penetration grows to the projected third of the global population in 2019, companies increasingly compete for customer moments, and personalization engines that identify the optimum experience for an individual begin to mature. We believe large platform companies, such as Google and Facebook, will continue to benefit from the rapid adoption of the mobile platform and capture most of the incremental mobile ad spending in 2018. However, new innovations in mobile computing, the internet of things, and predictive analytics could create disruptions as new platforms emerge over the next two years.
2	**Context is the new data battleground** Context will be a key competitive strategy for online business and data-driven enterprises in 2018. Context marketing brings meaning to data and underpins companies' desire to develop deep customer engagement and loyalty. It has the potential to improve business and product investment returns and to broaden performance advantages or competitive moats. From a credit perspective, ad monetization rates, particularly particular mobile ad monetization, will improve as advertising becomes more locally focused and relevant. In addition, marketing technology spending will increase meaningfully as a percentage of total marketing budget as companies invest in enterprise customer data management and analytics capabilities. Adopting enabling technologies such as predictive data analytics, cloud computing, and personalization engines is an important element of business strategy, but legacy business challenges are often the bigger impediment to context marketing. Traditional businesses, products, or brand siloes can often prevent organizations from establishing a rich multichannel customer experience or management through the entire marketing process. We expect two themes to emerge in 2018 as organizations better harness their data: an increased emphasis and spending on digital transformation, and the digital advertising technology and marketing technology market places converging as organizations demand centralized customer management and real-time analytics. We believe organizations will continue simplifying their product offerings as they strive to be more client-focused.
3	**Digital video as a tool to connect with consumers across platforms** We expect digital video growth to outpace traditional TV growth in 2018, accounting for 20% of total viewing hours (over 1.45 hours) per day. Digital video monetization will increase across subscription and digital advertising as new social media video ad platforms improve programmatic revenue, shorter ad pre-rolls improve customer engagement, and better designed and targeted ad-units improve mid-roll advertising performance. Additionally, the OTT ecosystem, which is in a constant state of evolution, will continue to grow as companies introduce new bundle packages. We expect consumer choices to expand and audience fragmentation to increase in 2018 as deep-pocket new entrants such as Apple and Facebook invest billions in original content. We also expect traditional media companies will continue to lose advertising market share to digital video. Still, despite strong viewing trends, digital video advertising is just a small portion of overall TV advertising and will likely remain so over the next two to three years.

Ad Agencies

1	**Digital growth is accelerating, but one size doesn't fit all** Digital advertising will continue to drive growth for ad agencies as technology disrupts and creates new ways for brands to connect with consumers. In particular, programmatic advertising and targeted digital marketing will grow as advertisers target narrower audiences with personalized messages aimed at the most receptive potential consumers. Programmatic advertising enables advertisers to buy digital ad space automatically and better target their audience using data from consumers' internet consumption habits, giving them behavioral insights on existing and potential consumers. It can be done in-house, and it's sometimes the preferred route for advertisers that want to have full transparency on their ad spending. However, given the technology and expertise programmatic advertising requires, it is typically outsourced to ad agencies. Still, advertisers also need to address the mass market in order to build brand awareness among all potential customers, not just those who are likely to buy their products. Hence, we believe ad agencies will need to offer more personalized advertising packages to advertisers as well as complementary targeted and mass market ad campaigns, depending on the brands.
2	**Competition is getting tougher…** Ad agencies operate in a tough environment, marked by stiff competition, technological disruptions, and shifting audience preferences. We expect activist investors, zero-based budgeting techniques, and slow top-line growth will continue to pressure companies' marketing expenses over the next two years, leading to lower ad spending and more competition to renew or win advertising contracts. Some ad agencies may respond to the competitive pressures by extending payment terms to their clients to renew or win contracts, which, we believe will negatively affect working capital. Still, we don't expect any significant impact on the companies' operating margins and cash flow generation in 2018 because most of the big ad agencies have responded to these challenges by utilizing their resources more effectively, particularly their creative talents.
3	**… and broader** The competitive landscape has broadened for ad agencies, with IT and consulting firms entering the industry. Earlier this year, ad agency Publicis Groupe partnered with consulting and technology company Capgemini on a contract with McDonald's in August, and consulting and technology firm Accenture acquired Australian creative agency The Monkeys in May. Although not yet significant, this merging of tech and consulting illustrates how companies' digital transition and transformation have become an important part of their marketing strategy and budget allocation. We believe this trend will accelerate.

Key risks and opportunities

Television

1	**Is content being devalued?** Although aggregate spending on original content have been increasing due to fierce competition from new players, consumers' perceived value of that content may be declining. Virtual skinny bundle offerings are priced significantly lower than the traditional pay-TV bundles they are capturing market share from, and the myriad of SVOD offerings are generally priced even lower, at below $10. Additionally, wireless companies such as AT&T Inc. and T-Mobile U.S. Inc. have started using content as a tool to attract and keep customers. AT&T is currently offering HBO for free for life to certain new wireless subscribers and pricing its DirecTV NOW offering at $10 per month—well below its cost of content; and T-Mobile is giving Netflix service for free to its wireless subscribers. Even though the media companies are still paid full price for their content (and are not losing any revenue), to the extent consumers get accustomed to not paying for media content or to getting it at a sizable discount, the value of that content may degrade over time.
2	**Media companies are developing direct relationships with consumers** As the global television ecosystem continues to evolve, traditional media companies have started taking more direct roles in building relationships with consumers. Successful media companies are more effective at insulating themselves from negative secular trends such as cord-cutting, while getting valuable consumer data that can help with digital advertising and other monetization opportunities. To successfully build a direct relationship with customers, we would expect media companies to take one of three paths: partnering with platforms that already have DTC operational capabilities, such as customer case and billing; investing in building their own platforms; or acquiring key technology, such as Disney did with its recently announced acquisition of a controlling stake in Major League Baseball's leading BAMTech platform.
3	**Further M&A is likely** The U.S. television industry saw three significant media mergers and acquisitions (M&A) announced in the past 12 months: AT&T's proposed acquisition of Time Warner Inc., Twenty-First Century Fox's proposed acquisition of Sky, and Discovery's proposed acquisition of Scripps. Although we are skeptical of the merits of vertical integration, such as those proposed by AT&T and Fox, we believe more could occur in 2018 as technology companies consider their strategic options. We also expect more horizontal transactions (such as the Discovery and Scripps transaction) in 2018 as media companies with less ability to navigate the evolving television landscape partner up to increase audience and programming scale to make them more relevant within the television ecosystem.

Local Media (Radio, Television, and Outdoor)

1	**Large M&A unlikely in 2018** We don’t see much prospect for additional radio M&A over the next 12 months beyond the proposed merger of CBS Radio Inc. and Entercom Communications Corp. Few companies have the balance sheet capacity to undertake a sizeable acquisition. However, if media ownership rules loosen under the Trump administration, there could be a resurgence of acquisitions and swaps of local television stations. We believe TV station swaps could be a credit positive for TV station operators if leverage remains similar to current levels, given the potential margin expansion that TV station duopolies (more than one TV station in a particular market) would provide TV station operators.
2	**The GDP impact** With local media revenue highly correlated to GDP and the health of local markets, a recession would cause corresponding revenue declines for local media companies and magnify declines in EBITDA and operating margins. For instance, although television broadcasters and outdoor media advertisers have recovered the revenues lost during the 2008-2009 recession, the radio industry, which saw revenue decline 25%, has yet to recover.
3	**Radio broadcasters' financial woes pose significant credit risks** With two of the largest U.S. radio broadcasters, iHeart Media Inc. and Cumulus Media Inc., facing financial duress and are seeking to restructure their debt obligations, increased volatility could cause larger-than-expected decline in radio advertising rates and revenues in 2018. We expect low-single-digit percentage revenue declines or worse, which would likely result in several downgrades and us reexamining whether radio broadcasters' leverage levels are sustainable.

Internet/Online

1	**Unaddressed ad fraud and fake news could undermine the media industry** Fake news, extremist sites, and ad fraud dominate headlines globally in 2017, making transparency and trust key development needs in 2018. Ad fraud, which includes nonhuman traffic, ads that have no chance of being seen, and ads that intentionally misrepresent, account for an estimated $16.4 billion of wasted global ad spending in 2017, according to WPP. However, because ad fraud is lucrative with minimal risk of punishment, we expect the problem to persist in 2018. Fake news, a centuries old propaganda practice of deliberate misinformation and a common newspaper practice in the late 18th century, has resurged in recent years, undermining consumers' trust of the media. Both ad fraud and fake news are insidious problems with no easy solution, and they have the potential to weaken or even damage media companies and brands. Trust will become increasing important as more companies seek to create compliance and ethics frameworks, accreditation, and risk assessments to address ad fraud and fake news. As a first step, we expect media companies to implement third-party ad measurement solutions to establish trust in their ad delivery capabilities and for search engines to prioritize well-established or branded publishers. Additionally, new technologies such as blockchain could provide a systematic approach to establishing trust. However, practical applications might have to wait until well past 2018. We expect compliance and security costs to increase in 2018 as companies invest in people and technology to strengthen systems and prevent abuse. However, we don't expect a lack of trust to hinder digital advertising or the digital economy in 2018.
2	**Regulation fears increase as jurisdictions pursue uncertain and divergent paths** Online and information services companies, such as Apple, Amazon, Google, and Facebook, face many regulations globally, including ever-evolving consumer and data protection, content limitations, privacy, network security, encryption, and payments laws. The regulations' scope and application vary by country, based on each country's public interest policy goals or desire to encourage growth or competition. These companies also operate with uncertainty as to how some existing regulations will apply as media, tech, and telecom businesses increasingly converge, or how a change in government regimes or new interpretations of laws could lead to retrospective changes (such as the EU's claim that Apple owes $15 billion of back taxes). The EU's recently adopted General Data Protection Regulation (GDPR) is one such change, and it expands the regulation of personal data processing throughout the region and significantly increases penalties for noncompliance. Complying with such regulations is costly for companies, requiring changes in their business practices and restricting aspects of their business operations. From a credit perspective, it is impossible to predict exactly how the global regulatory environment will evolve or the impact the changes will have on the media industry. But given the media industry's importance to local economies and its ability to shape public perception, we can surmise with some certainty that industry regulation will increase in coming years and costs will increase as companies implement new business controls and practices.

3	**The widening skills gap could impede growth** The internet and information services industries depend on attracting and retaining highly skilled workers with science, technology, engineering, and mathematics (STEM) skills. According to ManpowerGroup, about 40% of employers across the globe are facing acute talent shortages, and The Bureau of Labor and Statistics estimates that the U.S. will need approximately 1 million more STEM professionals over the next decade. The industries currently face a shortage of computer science, data science, cyber security, and innovation and product development professionals. We believe companies that adopt human capital strategies to acquire these skills will have performance and competitive advantage. To address this shortage, we expect companies will increasingly use outsourced and offshore talent, retain high-talent women and older workers, and expand workforce flexibility to use independent consultants and freelance work. We also believe employee turnover and the pressure to hire technology talent in a timely manner will result in employee cost inflation and, in some cases, impact small and midsize companies' ability to innovate and scale their business platforms and technology infrastructure. In 2018, we expect these factors will have only a minimal impact on business performance.

Industry developments

Audience fragmentation and shifting ad dollars

The U.S. television industry is facing two key risks, audience fragmentation and shifting advertising dollars. TV audience ratings continue to decline as consumers take advantage of a growing selection of entertainment choices, and traditional media continues to lose ad revenues to digital and mobile platforms as advertisers seek better returns for their advertising budgets. We believe TV networks that broadcast premier sports programs and events will better withstand these pressures over the next four years.

Unlike other TV genres, such as scripted programming, sports are overwhelmingly watched live and audiences generally watch the commercials, making it the best way for advertisers to reach large national audiences globally. Key sports events such as the World Series, the Super Bowl, the Olympics, and FIFA World Cup can be found exclusively on broadcast television because only over-the-air television currently offers broad national audiences, high-quality TV production capabilities, and a dependable viewing platform. For these reasons, among others, audience ratings for key sporting events such as the Olympics, the FIFA World Cup, and the Super Bowl, are less susceptible to declines. As a result, sports programming is critical to the U.S. television industry: It is the glue that holds together pay-TV video bundles and the key anchor that underpins our credit view of the industry.

In continental Europe, these trends are present but less pronounced because television is primarily free and funded by TV advertising. Free TV content is typically local (local language, local actors, and adapted to local audience) and of high quality, and ad break intensity tends to be lower than in the U.S. because EU regulation caps television advertising at 12 minutes per hour (versus 17 minutes in the U.S.). As a result, pay-TV penetration is typically lower. In Germany, for example, pay-TV penetration is estimated at 21% (versus more than 75% for the U.S.), with monthly spending per pay-TV subscriber below $30 (versus close to $100 in the U.S.). In addition, pressure from OTT providers remain moderate because free-to-air TV is protected due to windowing. In France, for example, the SVOD movie window comes after both pay-TV and free-to-air television, on average 36 months after the theatrical release. Whereas in the U.S. the first release window is typically 90 days after theatrical release, and both premium pay TV networks and SVOD providers (Netflix in the case of Disney) get the same window. The conditions are similar in several Latin American countries, with pay-TV accounting for less than 30% of households in Brazil, for example.

Global media companies expand OTT platform experiments

As the pressure on the traditional video bundle increases, media companies in Europe and the U.S. have embraced virtual OTT bundles. Five new virtual multichannel video programming distributor (MVPD) options have launched in the U.S. in the past year, bringing the total to seven (CenturyLink Stream, DIRECTV Now, FuboTV, Hulu Live TV, Sony PlayStation View, Sling TV, and YouTube TV). We expect additional virtual MVPD services to launch over the next year. This and the growing number of DTC, SVOD, and OTT services, such as CBS All Access, HBO Now, and the soon to be released ESPN SVOD service, have resulted in a myriad of OTT options for consumers.

It's still too early to determine whether virtual MVPD bundles will counter the video subscriber losses traditional pay TV operators are experiencing or encourage more 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 all lack a full slate of broadcast stations and exclude many cable networks. Even Hulu's virtual Live TV bundle, which showed great promise due to its ownership by Comcast's NBCUniversal Media LLC, Time Warner, Fox, and Disney, is fully loaded with the partners' owned networks but lack most non-owned networks such as those offered by Discovery Communications Inc., Viacom Inc., and AMC Networks Inc.

Traditional media loses revenues as ad spending shifts to digital

We expect overall ad spending in the U.S. to increase about 4% in 2018 due to the Winter Olympics and, to a lesser degree, the midterm elections. Excluding those two events, core ad spending (local and national) will likely increase by only 2.6%—modestly ahead of our U.S. GDP forecast of 2.3%. In 2018, we expect digital advertising to grow at a mid-teens percentage rate as it takes market share from traditional media, with only the digital, outdoor media, and TV sectors showing solid growth, while other media sectors (newspapers, magazines, and radio) experience continued advertising declines. In the television segment, we believe cable networks will face the largest declines and local TV advertising will be the least affected. Still, we believe TV ad spending will remain resilient despite some investor concerns that television will soon join print media as a declining industry. As long as brand building remains a key component of advertisers' marketing strategy, which requires reaching broad audiences instead of targeting demographics, demand will continue for TV ad spots. Television—especially live (including sports and news) and special events—remains the best media for reaching the broadest audiences, even though we expect audience ratings will continue to decline.

In Western Europe, we expect ad spending growth will remain stable at around 3.5% in 2018, with some disparities among the counties, including uncertainty in Spain due to the political unrest in Cataluña. After a slow down in 2017, U.K. ad spending will likely outpace that of Western Europe in 2018. Meanwhile, at the other end of the spectrum, Italy and France will likely post very modest growth, with the latter improving from 2017 levels due to a better economic outlook. Overall, we expect strong growth in digital ad spending, particularly mobile, video, and programmatic in 2018. We also believe the digital disruption will continue in Europe but with significant differences among the various European markets. For example, digital media spending will likely overtake TV spending in Germany, while TV will remain the dominant media type in Italy, with TV ad spending twice as large as digital.

Financial policy

Vertical integration and subsector consolidation will likely increase M&A

We expect an uptick in M&A in the media and entertainment industry, and between the media, telecom, and technology sectors, during the next few years. The industry saw several major transactions during past 12 months, including two vertical integration deals (AT&T's proposed acquisition of Time Warner, and Fox's proposed acquisition of Sky) marrying content creation and video distribution. The others were horizontal mergers (Discovery's proposed acquisition of Scripps, and Sinclair's proposed acquisition of Tribune).

We are skeptical on the merits of vertical integration because the potential synergies may be more difficult to achieve in vertical integrations, and the clash of corporate cultures could disrupt the acquired company. Although some 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 and opt for vertical mergers, we believe more are likely to participate in horizontal mergers, especially among the U.S. TV station operators as FCC ownerships rules relax. For cable network operators, we don't believe added scale (having more cable networks) is the long-term solution to the secular pressures affecting television, and consolidation only makes sense in conjunction with reducing the number of second-tier cable networks.

In Europe, however, we don't expect any transformational M&A. Instead, we believe 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 TV broadcasters and pay-TV operators will focus on deals that extend their digital offering and content production. Overall, we believe the absence of large M&A will have a neutral to positive impact on leverage for European media companies in 2018.

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Related research

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- The Changing U.S. Media Landscape: What Disney's New Direct-To-Consumer Video Services Could Mean For U.S. Television (Sept. 8, 2017)
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- Complexity And Partisanship Dominate The Media, Telecom, And Cable Industries' Regulatory Agenda (June 30, 2017)
- Credit FAQ: What Are The Key Factors Supporting U.S. Newspaper Publisher Ratings? (May 23, 2017)
- U.S. Local TV Broadcasters Outlook: The FCC's Reinstated UHF Discount Could Spur Mergers And Acquisitions In 2017 (May 11, 2017)
- Ranking The 12 Major U.S. Media, Telecom, And Cable Companies: Who Leads the Pack? (May 3, 2017)
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- Research Update: Discovery Communications Inc. Outlook Revised To Negative From Stable On Scripps Acquisition; 'BBB-/A-3' Rating Affirmed (July 31, 2017)
- Research Update: Discovery Communications Inc. Outlook Revised To Negative From Stable On Scripps Acquisition; 'BBB-/A-3' Rating Affirmed (July 31, 2017)

Cash, debt and returns

Global Media and Entertainment

Chart 13 – Cash flow and primary uses

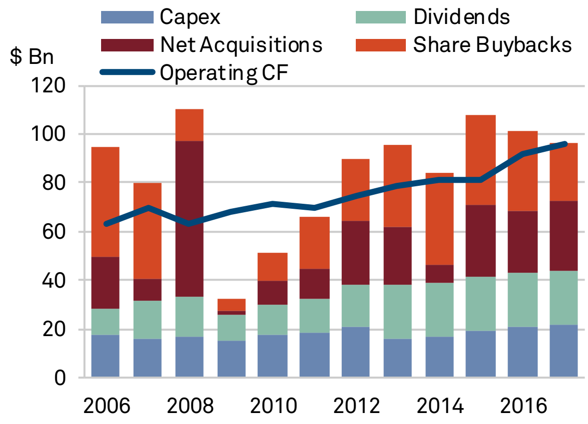


Chart 14 – Return on capital employed

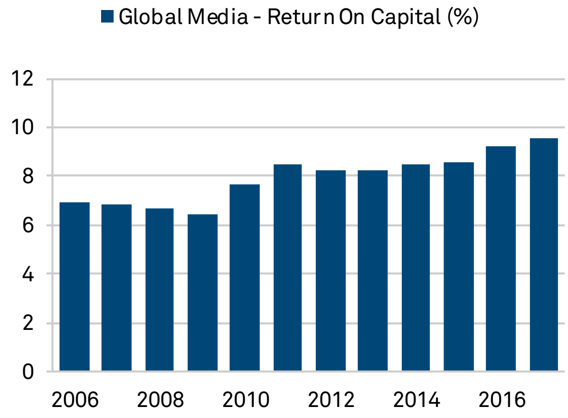


Chart 15 – Cash and equivalents / Total assets

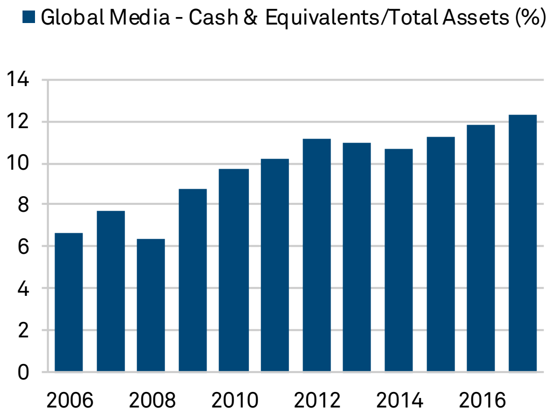


Chart 16 – Total debt / Total assets

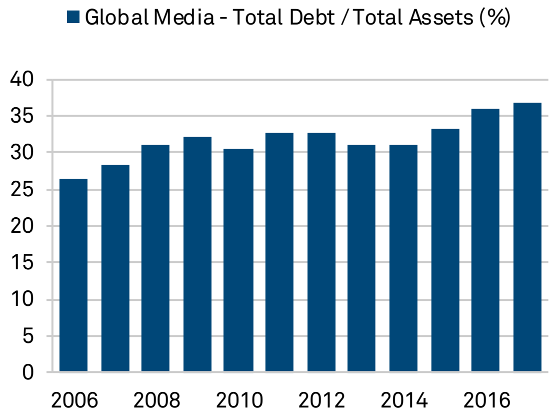


Chart 17 – Fixed versus variable rate exposure

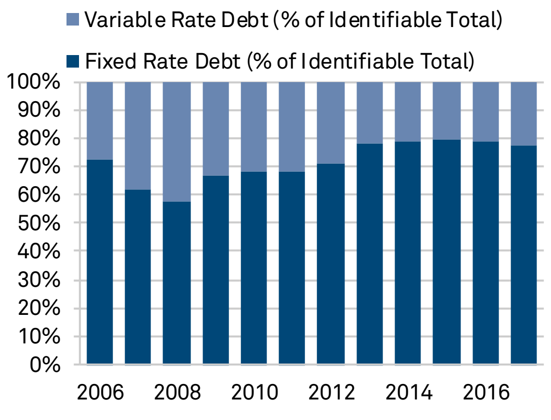
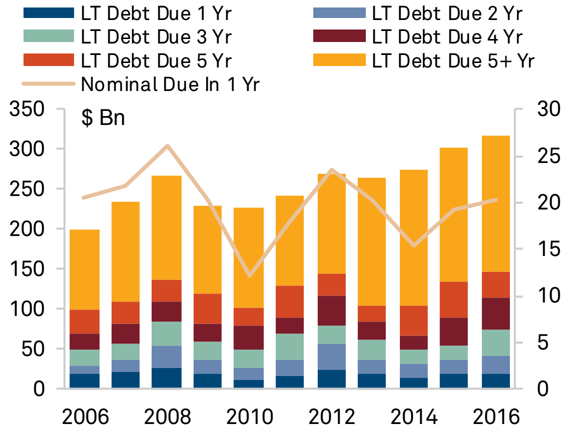


Chart 18 – New debt issuance or maturity schedule



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

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