Viewpoint

Premium Sports Broadcasting

The silver bullet to win the broadband game?

Traditional pay-TV operators across Europe compete fiercely for exclusivity of premium sports broadcasting rights. In a context of maturing fixed broadband markets, an increasing share of bundled offers and the roll out of super-fast broadband networks, also telecom operators are looking at these rights.
Content is gaining weight in the consumer buying decision for bundles and operators cannot ignore this in order to maximize the share of connected households of new built super-fast broadband networks. However, the acquisition of sport broadcasting rights has become very expensive, resulting in squeezed margins and in potential arbitrage versus network investments. Is the acquisition of sport broadcasting rights a sound long-term strategy for telecom operators?

Why telecom operators are increasingly looking at exclusive sport content

Triple-play bundles are becoming a commodity

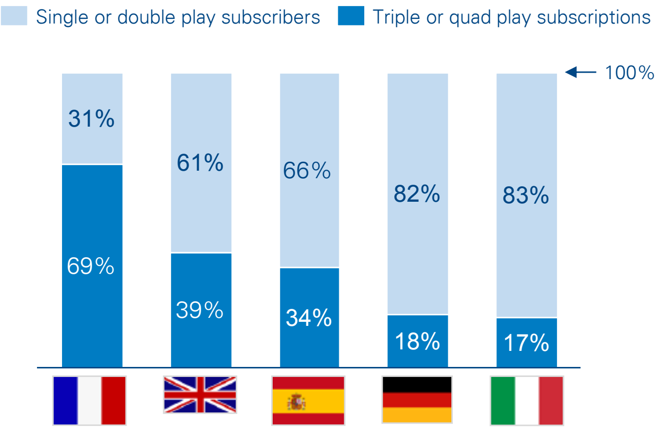
At the age of fixed broadband market saturation and fixed-mobile convergence, the increase of triple-play penetration is a proven means to reduce churn. In some Western European countries, triple-play bundles are sold as a commodity product *(e.g. UK, Spain, and France).* In these markets, consumers cannot choose a naked broadband connection from most providers anymore, but have to buy the triple-play product as a whole.

In that context, consumers take three key decision criteria into consideration:

- Quality of the broadband connection
- Quality of the user interface
- Content proposition of the pay-TV offer

Other second-order decision criteria exist and can be leveraged to differentiate an offer, for instance a specific type of set-top-box (e.g. Android box), the use of a specific technologies (combination of fixed line and mobile networks), or other advanced services. However for equivalent broadband connections, exclusive content could be the ultimate differentiator to drive the core business of a telecom operator.

Triple-play penetration as a % of total broadband connections



Source: Arthur D. Little

Sport-centric households are gaining share among pay-TV households

Historically, pay-TV operators have been providing both (a) exclusive movie content and (b) live sport content.

The former has been increasingly preyed upon by OTT players (e.g. Netflix). OTT players have been successful for three main reasons: offering an abundant catalogue (available anywhere at any time), at an affordable price, and with a simple user interface. Therefore, the perceived value of the filmed entertainment content value proposition of pay-TV operators has come under pressure.

Thus, pay-TV operators are shifting their buying power to premium sports and Free-to-Air (FTA) broadcasters find it increasingly difficult to retain such live sports rights.

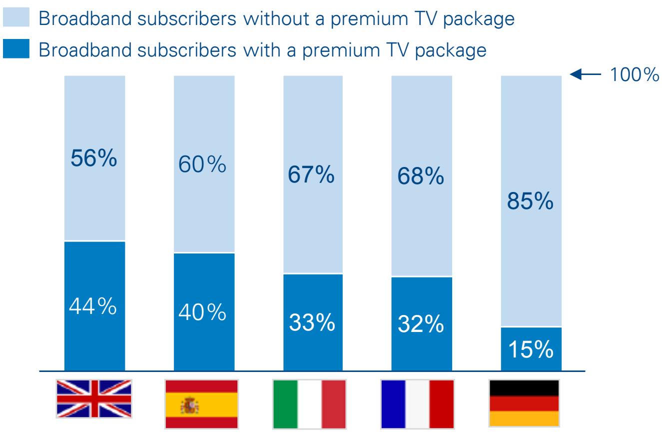
In France TF1 used to air the UEFA Champions League and Formula 1. Within only two years (2011, 2012) TF1 lost their rights to two pay channels Canal+ and BeIN Sport.

In 2011, the BBC lost part of their formula 1 broadcasting rights to SKY, being able to broadcast only half of the races live. Due to budget cuts at the BBC, Channel 4 picked up these rights subsequently. But starting with 2019, Sky will have full exclusivity on Formula 1 in the UK. Same in the Netherlands, RTL7 lost Formula 1 broadcasting rights to Sport1 in 2013.

- FTA channels' advertising revenues are increasingly under pressure due to macro-economic head wind and a beginning decline in their overall reach
- Increasing interest of pay-TV and telecom operators for sport content pushing up prices

To illustrate this trend in figures; between 2010 and 2013 broadcast advertising revenues have decreased at a CAGR of 1% across Europe, while cost for premium sports rights has increased in excess of 20% - 30% annually for key rights properties.

Share of broadband subscribers having a premium[1] TV package



1 Premium package is defined as highly valuable and partly exclusive content, e.g. in the UK it takes into consideration all SKY subscribers, in France all Canal + and Bein sport (excl. double counting) subscribers
Source: Operator financial results, press release, Arthur D. Little

In the UK, for close to 50% of broadband subscribers exclusive sport content offered by the operator plays a key role. Therefore, the acquisition of exclusive sport broadcasting rights becomes essential, especially when deploying a next generation network. Similar importance is attached to sports in Spain, Italy and France.

The dilemma of FTTx roll-out

FTTH/FTTC roll-out business cases are highly sensitive to the share of connected homes

FTTx broadband investments are very sensitive to the conversion of broadband households. Investment related to the acquisition of exclusive content has the potential to increase the share of connected households, thus leading to a reduced payback period for a large sunk investment. For an additional 10% investment and a resulting incremental 5 percentage point conversion of homes passed to homes connected, the payback period can be reduced by up to ~1 year.

Sensitivity of the investment pay-back period to (a) the conversion[1] of household passed and (b) additional investments

Additional investments as a % of total FTTH investment	Additional points of conversion[1] after 10 years: -	+5%	+10%	+15%
-	-	(1.5) years	(2.5) years	(3.3) years
+10%	+0.8 years	(0.8) years	(2.0) years	(2.8) years
+20%	+1.5 years	(0.2) years	(1.4) years	(2.3) years

1 Conversion rate is defined as the total number of connected homes over to total number of homes with the potential to be connected
Source: Arthur D. Little

After many years of declining market share and increasing competition from alternative operators, all major European incumbents (re-)engage in long-term FTTx deployments again. Furthermore, a number of regulators have refrained from imposing wholesale regulation on fiber connections in order to encourage investments. This situation is resulting in increased attractiveness for Telefonica, Orange and British Telecom to build FTTx networks in their respective home markets. They all also acquired at least part of their national soccer league broadcasting rights.

Telecom operators follow different strategies in positioning their broadband investment

In order to make a case for sports content investment, a number of parameters have to be taken into consideration. First, the respective market's consumer appetite for premium sport content, secondly the investment capacity of the individual players.

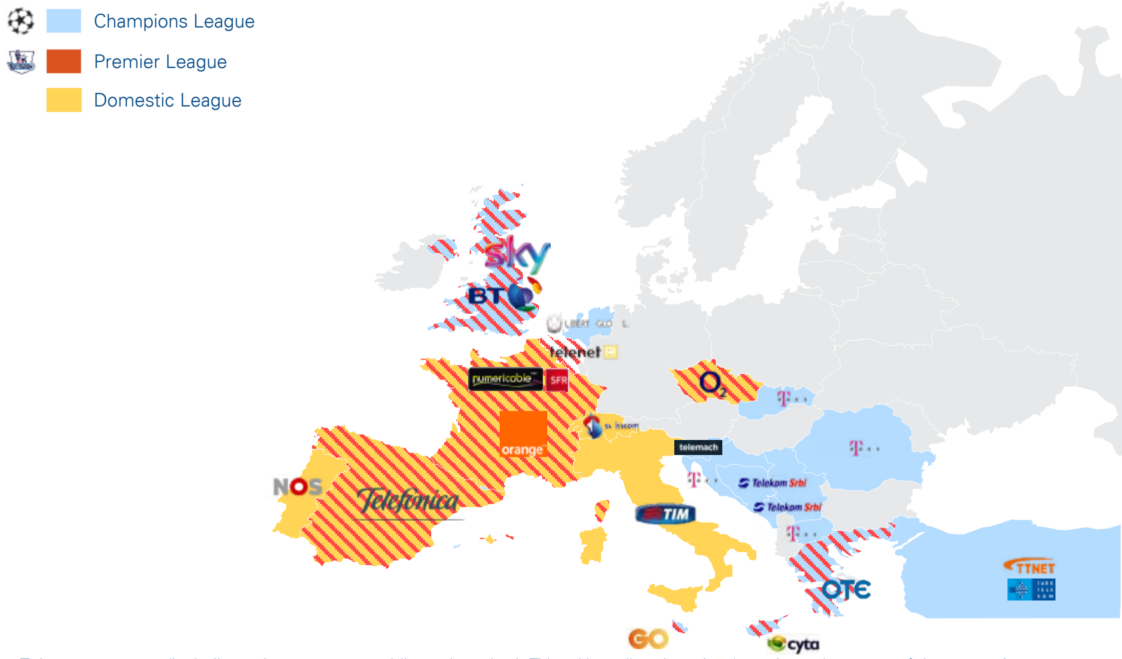
Thirdly, the competitive intensity is a key driver for investment and differentiation. This competitive intensity is driven by the number of players, the presence of strong cable operators, regulation on the incumbent's copper network, and government incentives for network investments.

The individual market situation results in 6 typical positioning themes a broadband operator can choose from.

Exclusive content can be used either to:

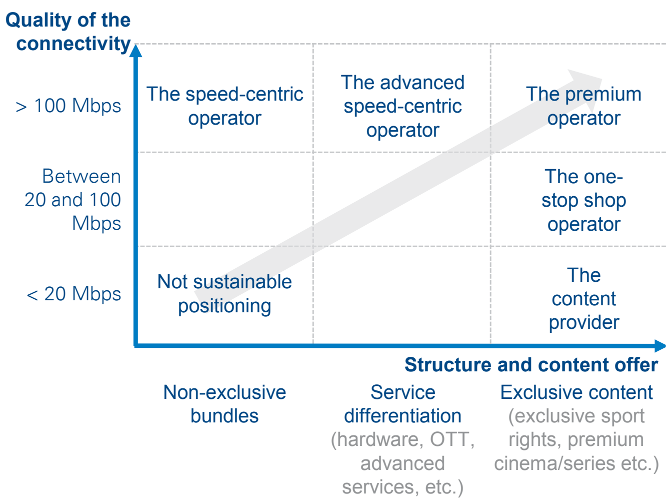
- Provide a positioning itself (rich content portfolio)
- Support the roll-out of a super-fast broadband network
- Provide an additional differentiation in a competitive market

Telecom operators owning all or part of the football broadcasting rights in Europe[1], 2016



1 Telecom operators (including only operators providing at least both TV and broadband services) owning at least part of the season's games or through at least one platform (DTH, IPTV, DTT, mobile devices)
Source: UEFA, Premier League, Arthur D. Little

Positioning matrix



Source: Arthur D. Little

Acquisition strategies in premium sports content

The hegemonic strategy

The hegemonic strategy is built on having a monopoly on all major sports events. The content provider positions itself as the only place to offer an exhaustive sport content package. This suggests to consumers a two-sided pay-TV market, one player is premium the others are commodity. Due to this unique selling proposition, the pay-TV provider can afford to charge a market premium. This had been the case in the UK with Sky until British Telecom entered into direct competition on the Premier League rights, leading to a 70% increase in content cost per season. This has also been the case in Greece with the hegemonic positioning of Nova, before OTE TV entered the competition forcing Nova to decrease price instantly.

Feasibility: Affordable only when being the incumbent owner of rights.

The monopoly-breaker strategy

The monopoly-breaker strategy is mostly a reactive approach to a hegemonic player. This strategy typically leads to a bidding price war. In the UK, to usher in its fibre-optic roll-out, British Telecom (BT) has undertaken aggressive bidding for one of the most valuable Premier League packages, obtaining 18 first-choice games out of a possible 38. In 2013 BT has also won Champions League broadcasting rights starting in 2015, thus winning one of SKY's most attractive assets.

In Greece, incumbent telecom operator OTE has broken the sports rights monopoly of Nova by first acquiring rights to all major international soccer leagues, followed by a number of other underexploited sports properties, finally taking Champions League off the hands of their competitor. With this strategy, OTE TV has been able to secure 100% of market net adds and 70% of gross adds in 2015, while at the same time increasing its blended ARPU. In France the Qatari-funded sports channel BeIN Sport and Altice Group are eating into Canal +'s hegemony step-by-step.

Feasibility: Requires significant financial resources of the new entrants, as this strategy has long pay-back times. Some regulators even intervene and force sublicensing to reduce concentration of rights.

The game-changing strategy

The game-changing strategy is a response to the increasing costs of content-rights when the value of exclusivity no longer supports positive business cases. Belgium's incumbent and cable operators made a joint non-exclusive bid for Belgium's football league using sport content as a differentiator against international OTT players. Furthermore, a number of challenger pay-TV players are currently considering strategies around secondary rights (e.g. highlights, OTT) with the aim to build a competitive proposition at the fraction of the cost of the live linear rights. Digital media focused Perform Group has recently outbid Sky for the live and on-demand rights to Premier League for German speaking markets and is expected to participate in the Bundesliga auction. Also pay-TV channels like Discovery or ESPN could be tempted to bypass their current platform operators and go Direct-to-Consumer with sports focused OTT offerings.

Feasibility: Sound strategy that needs the commitment of multiple players or an eye for innovative packaging of secondary rights

Excesses are eventually reined-in by regulators

In 2010 in the UK, Ofcom forced Sky to wholesale its major sports channels Sky Sport 1 and Sky Sport 2 to other pay-TV platforms like IPTV or digital terrestrial TV. This led to all major TV platforms providing access to these channels to their subscribers. In 2015, Ofcom removed the must-offer regulation as Sky Sports was judged to be already widely available to other pay-TV providers through regular commercial agreements.

Recently in Spain, the regulator approved the acquisition of Canal + by Telefonica under a specific condition obliging the telecom incumbent to wholesale 50% of its premium content to pay-TV competitor at a price fixed by the regulator.

Live sports content will be a key battle ground for new and old pay-TV operators and ultimately drive consolidation

Direct-To-Home (DTH) pay-TV operators that currently own significant parts of the premium pay-TV rights will increasingly get under pressure from broadband operators. The latter are still cash-rich, by now have a sizeable number of pay-TV households (through IPTV and in most cases also DTH) and with the current fixed broadband roll-out a large-scale business case to defend or improve.

Telecom and cable operators will employ the monopoly breaker strategy, aiming for the Premier League and Champions League first. Once these are secured, national soccer leagues and other secondary sports rights will be added. However, only operators that can secure a long-term funding of this strategy will be successful. Furthermore, similar to spectrum auctions, operators will need to carefully prepare for sports rights attributions.

However, bidding for premium sports rights provides only a relatively short-lived window of opportunity to differentiate, as auctions are typically repeated every three years. Furthermore, during this period of exclusivity, new entrants can acquire only part of the subscribers of the incumbent rights holders as in many cases the pay-TV subscription is based on family consensus.

This increased competition for premium sports will accelerate further consolidation in the pay-TV industry, in DTH in general and the CEE region in particular, as a number of successful bidders might "bet the house" and eventually fail. Telecom operators will be key drivers of this consolidation, as besides rights portfolios and customer base, they also get their hands at another key asset: long-term experience in Pay-TV.

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Arthur D. Little

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