Media and Entertainment

Many questions on media's future, not many answers

January 23, 2023

This report does not constitute a rating action

What's changed?

Streamers focus on profitability. Streaming's pivot to profitability over subscriber growth has forced media companies to re-evaluate business models.

Secular trends worsening. Linear TV's decline is accelerating with higher cord cutting, declining audiences, and weakened advertising. Can media manage this decline as they invest in streaming?

Advertising hits a recessionary pothole. Global ad spending will likely soften in early 2023, though we expect a recovery beginning in second half of the year.

What are the key assumptions for 2023?

Recession in key markets. 0.1% decline in U.S., 0% growth in Europe, 1.1% growth in Latin America, and 4.4% growth in Asia-Pacific. Our forecast assumes a second half recovery.

2H economic recovery powers advertising recovery. Digital advertising, which was the first to slow in 2022, will likely be the first to recover.

Accountability in content spending. The days of irrational content spending are likely over.

What are the key risks around the baseline?

Deeper macroeconomic slowdown. A prolonged recession, persistent high inflation, and higher interest rates could both hurt advertising spending and accelerate negative secular pressures.

Accelerating secular trends in media ecosystem. Accelerating declines in linear TV along with weak advertising will increase pressure on media companies' credit metrics.

Can streaming show progress toward profitability? Streaming is harder than we thought. Do other media companies pull back on their streaming ambitions?

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Ratings Trends: Media and Entertainment

Chart 1

Ratings distribution by region

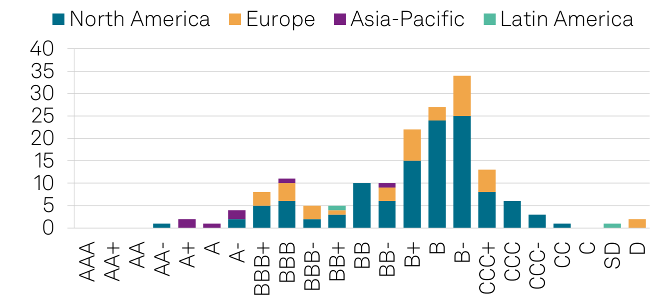


Chart 2

Ratings distribution by subsector

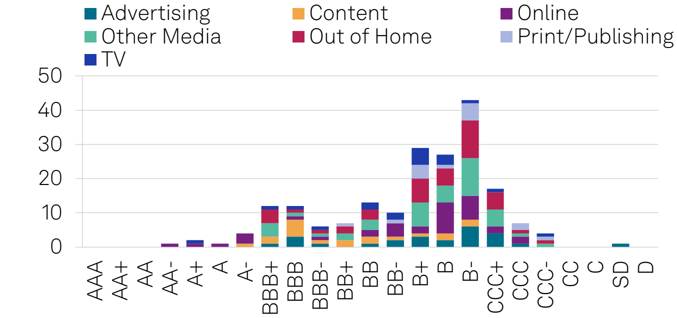


Chart 3

Ratings outlooks by region

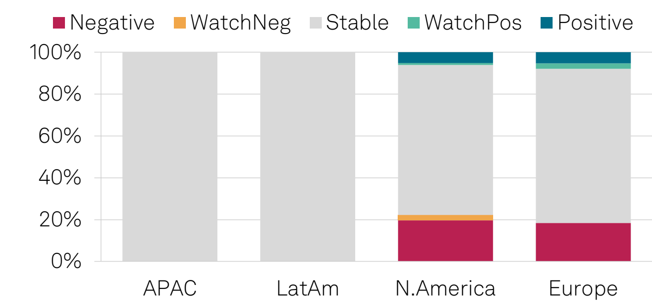


Chart 4

Ratings outlooks by subsector

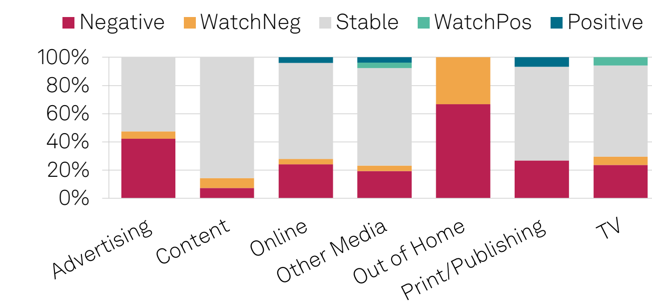


Chart 5

Ratings outlook net bias by region

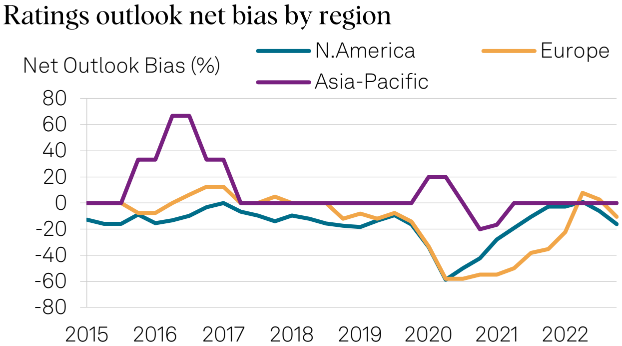


Chart 6

Ratings net outlook bias by subsector

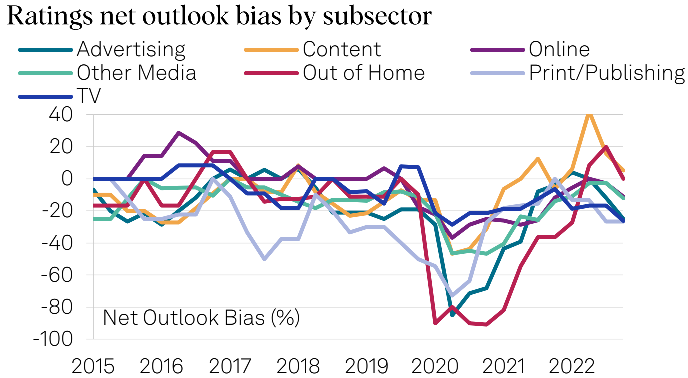


Chart 7

Ratings outlooks

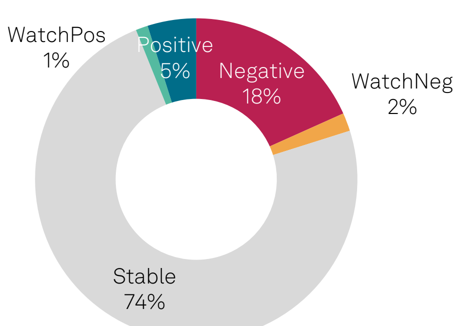
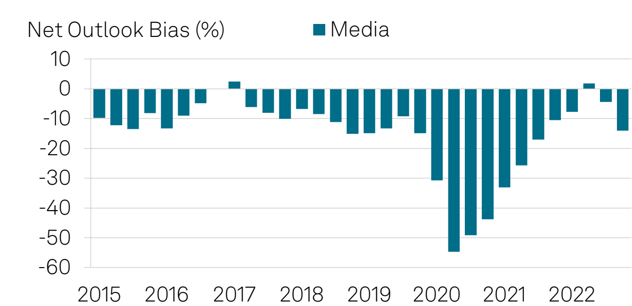


Chart 8

Ratings net outlook bias



Source: S&P Global Ratings. Ratings data measured at quarter-end.

Industry Outlook: Content

Ratings trends and outlook

Our two-year outlook for the global media and entertainment industry is negative. 2023 is a year of significant uncertainty, with many questions related to the long-term direction of the industry, including what the path to profitability for streaming looks like, how long linear TV has before it turns unprofitable, and what happens to advertising over the long term. We are unsure if we'll get any concrete answers to these questions in 2023.

Operating and credit metrics will remain weak as the industry struggles with ongoing secular pressures and business models being disrupted. Film and TV content creators have seen their profitable monetization streams decline significantly as their parent companies prioritize new and library content to their inhouse streaming initiatives. Still, the old adage about media--content is king--remains true, as content remains the anchor of the sector. Distribution of content faces the greatest disruption; linear TV and theatrical cinema are being supplanted by streaming as the primary distribution medium. This decline will take years even in the U.S., where it has been underway since the Great Recession. The credit impact will be felt more harshly by U.S. focused companies as they must wean themselves from high-margin affiliate fee revenues.

With the most economically sensitive revenue stream of any media player, advertising faces significant uncertainty in 2023, though we expect global ad revenues to return to growth as the global economy does. Advertising shifts, for example from linear TV to streaming or digital, may be manageable for the diversified media companies if they have the right asset mix.

Key questions about media in 2023

1. Has the age of peak content spending ended?

No, and we expect global content spending to grow in 2023, albeit at a more moderate pace relative to 2022. Still, we remain convinced that the studio model needs fixing as profitability and cash flows remain scarce even as global spending exceeds $100 billion. This reassessment may already be underway: some companies have taken a hard look at how they monetize content and whether creating content solely for their own streaming services will generate sufficient profits, or should they return to selling some content to third-parties with larger global distribution platforms.

2. What kind of business is streaming?

The realities of the streaming business model are coming into focus and appear to be more challenging than initially assumed, especially the all-important path to profitability. At the end of 2022, AMC Networks and Lionsgate trimmed their streaming ambitions as they realized they didn't have the necessary scale to make their niche services viable. We think this shakeout will continue in 2023.

3. What will be the trends in advertising in 2023?

We enter 2023 with little visibility into advertising trends. This is not unusual during the early stages of an economic downturn as advertisers will delay spending decisions while they try to gauge consumer sentiment. Top-of-mind questions for this specific economic downturn include: how quickly will digital recover? how deeply will linear TV/radio/print decline? which media segments will recover and which won’t? what new secular trends will emerge? what existing trends will accelerate?

Credit metrics and financial policy

Even prior to the start of a recession, we are seeing increased pressure on credit metrics, especially on cash flow metrics, on key segments of the global media industry.

Long-term impact of higher interest rates on the credit quality of lower rated companies. We believe interest rates, for at least the next several years, are unlikely to return to the historically low levels that we experienced over the last 2-3 years. As a result, these higher interest rates will weaken cash flows which will, in turn, hurt credit quality. Weaker cash flow metrics could put downward pressure on credit ratings, especially for lower-rated companies, even in the face of similar levels of leverage. To return cash flow metrics to historic levels, companies may need to carry less debt and thus reduce leverage.

Secular pressures, in particular the streaming evolution, could have negative credit implications for the media industry. We view the rating action that we took on AMC Networks in late December 2022 ("Media Industry Implications From Our Rating Action On AMC Networks Inc.," published Dec. 22, 2022) as an indication of the challenges that the evolution to streaming is creating for companies across the space. We're increasingly uncertain about the ability to generate a positive return on investment from a streaming platform. As we watch the companies try to navigate the need to grow their streaming services, achieve profitability, and keep ahead of the decline in linear TV, we could evaluate our view of the media industry versus other corporate sectors sometime in 2023 and could adjust leverage thresholds and ratings for the industry as a whole.

Even the global media companies aren't immune from this pressure on credit ratings. Investment-grade diversified companies have stronger balance sheets and can offset a moderate deterioration in credit metrics by cautious financial policies. Companies with significant exposure to legacy media that faces structural challenges and are more exposed to cyclicality of ad revenue--for example, linear TV, radio, and print--will see an increasing negative rating bias. These media subsectors will additionally suffer from weaker economic growth and declining consumer spending. In turn, this will result in higher leverage and weakened cash flows in 2023. Concerns about increasingly competitive dynamics, uncertainty surrounding future streaming profitability, and the worsening environment for linear TV drove our November 2022 outlook revisions for Paramount Global to negative from stable and for Warner Bros. Discovery to stable from positive.

Industry Outlook: Content

Ratings trends and outlook

Our two-year ratings outlook for those media companies focused on creating and owning film and TV content is biased negative. TV and film content is the core product of the global media and entertainment industry, and it remains as central today for the future of the industry as when Sumner Redstone stated that "content is king" back in 1996. And demand for both new and library content remains unfulfilled even as the global streaming services reprioritize their short-term goals to prove that streaming can be a profitable business. Despite this strong demand, the content creation monetization model is, in our view, broken and hence the negative ratings bias.

The film and TV content monetization model remains broken. We believe the problem with today's studio model is that content is being under-monetized. Despite record spending on new content, studios struggle to generate adequate returns on their investments. The global diversified media companies are prioritizing locking up their owned content exclusively on in-house direct-to-consumer streaming platforms. This strategy has greatly reduced the highly profitable third-party distribution streams (multiple platforms, multiple windows, and multiple geographies) that the studios depended on to generate an adequate return. We expect many media companies, recognizing the need to revive these revenue streams, will tweak this strategy, offering some content to third parties and reopening syndication streams that they had disavowed only a few years ago. Still, the overall trend is that content will be under-monetized, resulting in weaker operating and financial metrics (lower revenues and cash flow). In our industry ranking, we continue to favor media companies that own film and TV studios with deep libraries and deep intellectual property (IP). Our outlook, however, is modestly negative as we believe the monetization potential for the underlying content and IP Is weaker than it was historically.

Demand for music and video games IP remains healthy. Our ratings outlook for non-film and tv content creators like music publishers and video game companies is more positive. Music, in particular, continues to have strong industry tailwinds that support our ratings outlook. Monetization for music is improving as streaming services like Spotify, Amazon and Apple are raising prices and music publishers strike deals with social media platforms that open new monetization avenues.

Main assumptions about 2023 and beyond

1. Growth of the film and TV content bubble is slowing

We expect 2023 will finally be the year that the growth of the content bubble begins to moderate. We don't expect spending to decrease, but only that the pace of growth will slow down as the streaming services and linear TV networks become more selective.

2. Studios revive third-party revenues streams

It took a while for most media companies to recognize that their studios can't exist without licensing and selling new and library content to third parties. We expect the studios will look to optimize the returns on their content, which could lead to modest incremental cash flows in 2023.

3. Music and videogame content creators are enjoying relative stability

The dynamics for the music and video game sectors are more positive than for film and TV. Music publishers are benefitting from tailwinds in streaming adoption, increasing pricing, the resurgence of live events, and the emerging monetization opportunities from social media. All these tailwinds are occurring even as the overall competition to develop new artists is relatively unchanged. The video game sector remains relatively stable, even as growth has slowed post-pandemic. We expect industry consolidation to pause as the industry awaits the results of the regulatory process for the Microsoft/Activision megamerger. That said, if that deal were to close, it could spur more consolidation as companies look to get more scale and diversity across console and mobile platforms.

Too much content is making it more challenging to stand out. The explosion of new film and tv content, especially since the end of the pandemic, has overwhelmed consumers with too many choices and has made it difficult for any one piece of content to stand out. While this may be great for consumers, it has created significant financial stress for the studios as higher costs to create content and shorter attention spans from consumers depresses the return on investment for each new piece of content. As a result, the streaming services are more quicker cancelling content that doesn't perform strongly after its initial release, which hurts the studios that generally generate little-to-no-margins for the first few seasons of an episodic TV series.

Captive studios can't remain cost centers. We believe the global diversified media companies now recognize that they can't treat their in-house captive film and TV studios as cost centers and will seek to better monetize content across in-house streaming services and third-party sales/syndication. As the media companies launched their global streaming ambitions, they sought to fundamentally change the role of in-house, captive studios. While their role as primary content creators was to remain unchanged, the objective of these studios was no longer to maximize their own returns but to feed all new content into their owned streaming services. This strategy not only reduced studio revenue and profitability but also obscured financial transparency into studio performance, making comparisons to historical financial performance impossible. We believe the media companies will once again consider third-party licensing and sales, which will reopen much needed syndication and licensing revenue streams.

It's not all doom and gloom. The music industry is in a much better position than its film/TV content counterparts as it has already been through its own streaming transition. Industry dynamics favor the music publishers as music streaming services need to include all major publishers as part of their offering. Music publishers also benefit from the content's enhanced replayability and longevity, compared to video, leading to a more stable and predictable core revenue base, as well as enhanced return on investment and profitability. Music is also benefitting from growing demand from non-traditional platforms. Music has become more integral to the social media experience as platforms like Tik Tok explode in popularity, creating new monetization opportunities as social media platforms look to create a more integrated music experience for its users.

Credit metrics and financial policy

As the content model evolves and the transition to streaming continues, we expect credit metrics to remain weak for the studios over the next few years, with pressure on EBITDA and cash flow resulting in higher leverage and weakened cash flow-to-debt metrics. The impact on operating metrics will depend on each studio's business/content mix. Operating metrics for fully captive studios have already become irrelevant and those with hybrid models that continue to sell or license some content to third parties are still experiencing significant margin and cash flow erosion. Independent studios will also likely experience modest margin and cash flow erosion, depending on their content mix and ability to continue to monetize library content. If, as we expect, there is a shakeout in the number of streaming services, we expect studio business models to evolve as companies figure out what strategy works best for their asset mix.

M&A activity could help the smaller studios get much-needed scale and increase efficiency, but we do not expect much deal activity as balance sheets are already stretched for many media companies and the regulatory environment in the U.S. is less favorable for larger players, particularly tech companies, to make acquisitions. We believe there are more acquisition opportunities within the European studio ecosystem as even the larger European studios are far smaller than those studios buried within the global diversified media companies. However, we are skeptical that many of these transactions will occur due to tough financing conditions, as well as likely domestic opposition from those seeking to protect their country's film and TV businesses.

Key risks or opportunities around the baseline

1. Does the content bubble contract as profitability trumps growth?

Subscriber growth has been the north star for global streaming services for the past several years and content has fueled that push. That paradigm has been changing and as media companies shift their focus to profitability over subscriber growth, they could reduce content spending, cutting both the volume of shows/films made and the cost to create/acquire content. This could be further exacerbated by some media companies closing down or consolidating their streaming services.

2. Scarcity of content for non-streamers may reverse

Streaming has inflated the value of original and library content but exclusive arrangements with studios also limit the amount of library content available to license to third parties. As a result, the library value for the few remaining independent studios that are still licensing content to third parties has increased. This could reverse if some streaming platforms are shuttered and studios re-embrace a model that once includes a third-party licensing component as there would be fewer large streaming players to bid on increasing supply, driving down the value of content from these elevated levels. We believe this will place additional pressure on the smaller, independent studios' bottom lines, which are already facing challenges from scarcity of talent, crews, and studio space.

3. Social media monetization reaches its potential

Music has grown at a strong rate on the heels of increasing streaming music service penetration, but that growth will start to slow over the next few years as penetration rates start to plateau. If music companies can achieve monetization rates on social media platforms at rates more comparable to streaming platforms over the next several years, it would likely result in continued double digit revenue growth over the next 5-10 years. The music industry is not immune to fluctuations in its competitive dynamics, and labels will need to ensure their position in the ecosystem remains strong amid changes in how music spend is split between platforms, labels, and artists. That said, we believe that overall growth in spend will alleviate some of the pressure on labels' toplines in 2023.

Industry Outlook: Distribution

Ratings trends and outlook

Our rating outlook for those media companies engaged in content distribution, which includes linear TV, movie exhibitors, and direct-to-consumer streaming services, is negative. This media segment continues to face significant secular pressures as digitalization (i.e., the internet) changes the way content is distributed. S&P Global Ratings' outlook for U.S. national TV and streaming, which are facing the brunt of these changes, is solidly negative while we are neutral on the local TV broadcasters as they have yet to experience the same pressures on operating and financial metrics. These secular changes will eventually affect linear TV across the world and our country-specific views reflect that varied pace. For example, it may be gradual for some markets (like France and Germany where there are strong local language programming options). Conversely, many English language markets, including the U.K. and Australia, are not far behind the U.S. in terms of competitive pressures from streaming services.

The global media distribution landscape continues to fragment, with declining TV audiences and increasing competition between streaming platforms fighting for consumer attention. In addition, rising programming costs are pushing out breakeven profitability for the streaming services, which we believe will ultimately lead to lower consolidated company profit margins. We expect a global recession in 2023 will amplify these risks, with persistently high inflation and weakening consumer confidence fuelling subscriber defections to cheaper entertainment alternatives. Amid these conditions, we expect many media companies, saddled with weaker advertising revenues and continued elevated investments in streaming services, will face weaker margins and higher leverage in 2023, while some could lose their competitive standing if they are unable to adapt their business models.

Main assumptions about 2023 and beyond

1. Streamers will spend more rationally on content, but can they show a path to profitability?

While the global diversified media companies have all pledged to spend more rationally on content for their global streaming services (though still higher than 2022's record levels), we do not expect, outside of Disney, to see any improvements in free cash flow deficits. We would not be surprised to see smaller players that lack content and library scale and the ability to absorb the losses to continue investing in streaming may abandon their ambitions. European linear broadcasters will likely continue investing in streaming in the near term as they face less fierce competition that their U.S. peers and still have capacity.

2. TV model continues to melt in the U.S.

The linear TV model globally remains under increased competitive pressure. In the U.S., where that pressure is most acute and is resulting in weak revenue growth and weakening cash flows, we expect overall pay-TV subscribers to decline by 6.5%, with subscribers to legacy MVPD services declining at 9.7%, somewhat tempered by virtual pay-TV subscribers growing at 5.5%. Overall pay-TV penetration in the U.S. will decline to roughly 55% from 61% as of 3Q22. This decline will not affect all media companies uniformly. Ironically, those with greater exposure to sports may be better positioned to retain revenues but the high fixed costs for sports rights fees means that margins and cash flow may decline faster.

3. Cinemas will struggle to restore historical levels of profitability and cash flows despite a stronger film slate and returning audiences

We think 2023 will be the first year of more-normalized cinema admissions after the pandemic. Despite a modest recession in 2023, higher ticket prices and spending per patron will prop up cinema revenue growth. We believe cinema remains one of the more-affordable options for out-of-home entertainment and will be resilient even during an economic recession. However topline growth won’t be sufficient to offset higher staff and energy costs, and very high debt and cash interest burden that many cinema operators still bear.

Streaming's focus shifts to profitability. 2023 will mark a shift in strategic focus for the global streaming platforms from new subscriber acquisition to subscriber retention, showing a path to profitability. We expect that content spending for the global streaming services will not decline in 2023 but will grow at a more rational mid-single-digit percentage. Tighter cost controls on non-content spending, such as marketing, technology, and customer-acquisition costs, will be key. For some streamers this could lead to reduced content investments, and those that lack scale and sizable content libraries could abandon their streaming ambitions. Over time this could lead better-funded global platforms and those that have already gained sufficient audience reach to win competition.

We think the ability to build a profitable streaming business requires sufficient investments in original content, and a large enough content library to grow a sizable subscriber base with limited churn--and all of this is becoming more and more difficult. Platform-based businesses (Amazon, Google, Apple) with different return-on-investment objectives than pure-play media companies invest heavily in content, making the profitability dynamics more challenging for those without scale. However, we still think there is a path towards streaming profitability for some of the global media companies. While we are uncertain which companies will achieve scaled profitability in the streaming space, we view the path that Netflix has taken as one that other large media companies are hoping to replicate.

Companies that lack scale and sufficient resources to invest in streaming will scale back their growth ambitions, especially in the U.S., where competition is fierce and linear viewing is rapidly declining due to cord cutting; for example, AMC Networks and LionsGate/Starz. Our outlook on such players is increasingly negative, as we think they will struggle to retain audiences and remain competitive over the medium term and it is unlikely that over time the growth in their streaming revenue could offset declines in the linear TV business.

New streaming business models, including hybrid AVOD/SVOD, will be tested. We see linear TV and over-the-top (OTT) distribution models converging, with traditional broadcasters rolling out digital catch up and on-demand platforms and subscription video-on-demand (SVOD) players launching ad supported tiers. In 2023 we expect free and paid ad-supported tiers (AVOD, or advertising-based video on demand) will help global streaming platforms diversify revenue sources and retain subscribers. Ad-supported streaming provides higher CPMs (cost per thousand impressions) compared with linear TV thanks to high-quality audiences and more precise demographic targeting. Lower-priced ad-supported tiers should help retain subscribers in the context of falling real disposable incomes and consumer choices becoming more price-sensitive. At the same time, premium ad-free tiers should support average-revenue-per-user (ARPU) growth. However, it will take time for ad-supported propositions to gain scale to become attractive for brand advertising, especially in local EMEA markets where advertisers will likely still prefer the broader reach of linear TV over the medium term.

U.S. national TV is in crisis. U.S.-based national TV networks face a growing crisis, one in which there does not appear to be a clear solution. Pay-TV subscribers continue to decline at a steep rate, a trend that affects all linear TV networks regardless. The media companies' preferred strategy to somewhat temper these pressures is to focus on sports and news. Sports is the linchpin; it is generally exclusive to TV and cannot be found on alternative distribution media (but this is changing; for example, both NBC and Paramount now make their NFL broadcasts available on their streaming platforms as well as on their TV networks). This sports strategy better protects the topline as these networks can garner bigger affiliate fee increases and capture a greater share of advertising spending. However, what the networks get in topline support they give up in higher programming costs that are likely to grow even as revenues come under greater pressure. Conversely, linear TV networks without sports are increasingly experiencing weaker advertising and affiliate fee revenues but have a greater ability to control programming costs. Thus, we expect greater margins and cash flows degradation for those linear TV networks with significant exposure to sports and weaker revenues and cash flows for those linear TV networks lacking sports. How this plays out is not yet clear.

U.S. local TV performing well but secular clouds are forming. The near-term outlook on local TV broadcasters in the U.S. is less negative than nationally focused TV network and cable network companies due to relatively low content spending needs and less near-term pressures on key revenue streams, in particular retransmission revenue. The local TV broadcasters are not immune from the rising pay-TV subscriber declines impacting the nationally focused media companies. Over the last few years, local broadcasters have been able to more than counter these declines with their ability to raise retransmission fees by double-digit rates, exceeding pay-TV subscriber declines. But we believe this will be difficult to achieve going forward as the broadcast networks are prioritizing content for their streaming platforms, weakening the programming on their broadcast networks and weakening the ability for the broadcasters to command strong price increases. Still, we expect retransmission revenue will remain stable for the next few years as live news and sports remain "must-have" content. Recognizing that network content is becoming less exclusive, the local TV broadcasters are also trying to find ways to shore up additional content, as evidenced by Nexstar's acquisition of 75% of the CW, although these efforts are still in their infancy.

Ratings holding up in EMEA as transition to streaming is more gradual than in the U.S. In EMEA credit quality of rated broadcasters is holding up so far thanks to a slower transition from linear to on-demand viewing, and strong local content that helps keep audiences engaged on television. Linear TV viewing is holding up better than in the U.S. due to supportive regulation and healthy demand for local content that helps retain audiences. TV advertising accounts for about 15%-25% of total advertising revenue in the U.K., France, and Germany, and, as TV still provides the widest audience reach, it remains attractive for brand advertising. Relatively low leverage at the end of 2022 should allow broadcastersto absorb a decline in advertising revenue in 2023 and keep investing in streaming in the short-term. However, over the longer term, it will be Increasingly difficult for the smaller EMEA broadcasters to remain competitive against both the behemoth global technology companies and the significantly larger U.S. diversified media companies, especially as they build up local content libraries. In 2023 these growing secular pressures will coincide with a macroeconomic slowdown, which will lead to a drop in TV advertising revenue, especially in the U.K. and Germany, where we expect deeper recessions. Broadcasters that are also investing in catch-up and on-demand platforms will see near-term pressures on margins and higher leverage.

Can local media companies in Europe compete against the global streamers? In Europe, Netflix, Amazon, and Disney dominate most SVOD markets, but local players are emerging. In the U.K., for example, ITV rolled out its revamped ITVX in December 2022 and expects to invest £200 million in platform development and original content in 2023-2024, which will weaken EBITDA and cash flows. In Germany, Bertelsmann is investing in RTL+, a so-far loss-making broad bundled service that provides access to on-demand video, music, magazines, and audiobooks. Television Francaise 1 (TF1) so far has been more cautious with content spend, and in 2023-2024 will likely focus on developing its MyTF1 platform after the company announced its exit from the Salto streaming joint venture with M6 and state-owned France Televisions. All these European broadcasters benefit from owning production studios that partly offset their exposure to declining advertising revenue and help acquire original content and build broader libraries. However, they lack scale and financial resources compared with global powerhouses and will need to carefully balance investment in programming against reducing profits and cashflows.

Industry consolidation could help smaller EMEA players withstand structural challenges, but we see limited opportunity in the short term. So far attempts for regional consolidation have been unsuccessful--in 2022 the French regulator blocked the proposed merger between leading privately-owned broadcasters TF1 and M6 on market competition concerns. Cross-country consolidation is also unlikely as synergies in content acquisition would be limited. In this context and due to increased cost of funding and macroeconomic risks, we think M&A activity will remain muted in 2023, at least until the second half of the year.

Globo's strategy of partnerships with global streamers boosts its own Globoplay platform. In Latin America, Brazilian TV broadcaster Globo has turned the corner after years of significant programming investments in its streaming initiatives, which depleted cash flows. We expect new content production and co-production to remain strong, with continued growth of the Globoplay streaming platform. Competition should remain high, but Globo has been proving itself capable of growing its customer base through content development, improved customer experience, and relevant partnerships with global streaming platforms. Over the last few years, Globo has announced partnerships with Disney, Amazon Prime, Discovery, and Starzplay.

Global box office disappointed in 2022. Will 2023's film slate come to the rescue? For cinema exhibitors, the 2022 global box office was weaker than we had expected due to fewer film releases and consumer ambivalence towards key film genres (primarily kids and adult). The smaller 2022 slate was driven by media companies' prioritizing non-blockbuster films to their in-house streaming services and by 2021 production delays from COVID, which affected the number of films available for release in 2022. At the end of the year, "Avatar: The Way of Water" provided a much-needed bump with about $2 billion in global box office (through Jan. 21, 2023, and still counting), but overall box office revenue in 2022 was about 35% below pre pandemic levels of 2019.

We expect the sector will continue its recovery in 2023 from its pandemic-driven shutdown, mainly driven by improving admissions, higher ticket prices, and concession spending. Still, cinema operators will have lower profitability and cash flows than historical levels due to cost inflation (especially related to staff and energy) and higher interest costs. We expect several cinema operators that defaulted in 2022 (Vue restructured its capital structure, Cineworld filed for bankruptcy, and AMC Entertainment announced a debt-for-equity swap) will emerge in 2023 with new and more sustainable capital structures, but their leverage will still likely remain very high.

Credit metrics and financial policy

Credit metrics will likely remain weak for the next two years for the media companies that continue to invest heavily in content and their streaming services, as pressure on EBITDA and cash flow result in higher leverage and weakened cash flow-to-debt metrics. These pressures will be exacerbated in the near term by weak advertising revenues. The degree to which credit measures weaken will depend not only on each company's strategic and financial choices but on the pace of broader secular changes in the media ecosystem, especially the continued decline of the linear TV model. Most media companies depend on revenues and cash flow from these legacy media sectors to offset depressed cash flows from their streaming initiatives. We believe financial discipline is key to managing credit metrics, especially in pursuing streaming ambitions within the company's financial capabilities. We may see some media companies reconsider their content spend strategies and curtail or abandon streaming ambitions. This could prop up their profitability and credit metrics for the short-term. However, it would likely harm their competitive standing in the long term.

Key risks or opportunities around the baseline

1. Streamers may see higher churn and weak ad revenues in a recession

As the macroeconomic environment deteriorates, pushing up unemployment and pushing down real disposable income, consumers may reconsider their streaming subscription choices. This could result in higher monthly churn, with consumers shuffling between streamers and reducing the number of subscriptions (currently more than five on average in the U.S. and 2-3 in EMEA), and stagnating ARPU if consumers prefer lower-priced or free ad-supported subscription television (FAST) to more premium ad-free offerings. It also remains to be seen whether AVOD can reach sufficient scale to successfully compete against linear TV for brand advertising and also garner higher pricing per impression than linear TV.

2.Linear TV network declines could accelerate as advertisers leave and pricing crumbles

Linear TV remains relevant to large global advertisers because it still provides unmatched national reach. Networks continue to demand--and advertisers continue to pay--a premium for this reach despite declining pay-TV subscribers and declining audience ratings. At some point, advertisers could change their view of linear TV and refuse to pay those premiums. This could materially accelerate the decline in linear TV revenues and cash flows, especially for those linear networks with significant fixed-cost sports rights.

3. Streamers could finally benefit from sports rights ownership

For several years, streaming platforms have been acquiring the broadcast rights for sports leagues (for example, Alphabet's YouTube TV won the NFL's Sunday Ticket package, Amazon won the NFL's Thursday Night package and DAZN outbid Sky for Italy's Serie A's domestic broadcast package), but in most cases these wins remain opportunistic and it's unclear whether the winning streaming services can successfully and sustainably monetize these rights. However, as they snap up more sports rights in competition with linear TV networks and broadcasters, these wins could accelerate the decline in linear TV and help growth in streaming subscribers.

Industry Outlook: Advertising

Ratings trends and outlook

We expect our ratings on most advertising-dependent companies to remain stable in 2023 despite an anticipated slowdown in real global economic growth and a recession in some parts of the world, but risks to our ratings are tilted to the downside.

Our ratings outlook reflects two key points:

- **We view an economic recession as cyclical.** As a result, we expect media companies' credit metrics to return to pre-recession levels on average, with some media subsegments facing secular pressure in a worse position following each dip. We are less likely to lower ratings and will instead revise outlooks if we believe credit metrics are only temporarily harmed by a short and shallow recession and a company demonstrates a longer-term ability and willingness to restore credit quality.
- **We have already taken a number of rating actions in 2022** as some ad-based sectors showed signs of slowing growth. For example, in the U.S. we revised outlooks and, in some cases, lowered ratings on advertising-dependent companies, reflecting declines in broadcast radio and movie theater advertising, and slowing growth in digital advertising, particularly among digital programmatic advertisers with concentrations in the mortgage refinancing, insurance, and certain retail verticals. In EMEA advertising revenue across the rated universe has so far held up better than in the U.S., but we are cautious with our outlook for 2023, especially for lower-rated issuers that could face rising interest costs and refinancing risks.

Main assumptions about 2023 and beyond

1. Advertising growth rates will be hampered by an economic recession in 2023

S&P Global economists expect shallow economic recessions in key advertising markets (U.S., U.K., and Germany) in 2023. In general, a weak economy, with slowing consumer spending will result in a pullback in advertising spending. However, the impact on the various advertising media will vary greatly, as we expect digital and outdoor advertising to still grow in 2023, TV to modestly decline, and radio to decline steeply.

2. Digital advertising remains the growth engine for the advertising ecosystem

We forecast global digital advertising revenue will grow at a high-single-digit percentage rate in 2023 after a similar growth rate in 2022. Digital was the first ad sector to experience a slowdown in 2022 and is likely the first to see a recovery in 2023. Of the various digital sub-segments, digital video and retail media will be the fastest growing as both benefit from the continued shift to online shopping, digital video consumption, and connected TV and better demographic targeting provided by VOD viewing.

3. Advertising's shift away from traditional media to intensify

Traditional media advertising--excluding outdoor--will decline in 2023. We expect mid- to high-percentage cuts in TV ad revenues in the U.S. and several large European markets. The absence of major global sports events and lower political advertising in the U.S. will hurt TV ad revenues. We expect U.S. broadcast radio advertising to decline 15%, as radio advertising has very short lead times and is one of the first ad media to decline when the economy slows.

A recession in 2023 will impede advertising growth. We expect U.S. GDP to decline 0.1% in 2023, U.K. GDP to decline 1%, and eurozone GDP to be flat as tightened monetary conditions and higher costs for fuel and food cause a slowdown in consumer and business demand. Advertising trends are highly correlated with consumer spending, which is broadly the largest component of GDP (it's two-thirds in the U.S.), and we believe brand advertisers will curtail their marketing and advertising efforts in the face of lower consumer demand. Weakening macroeconomic conditions in 2022 already prompted us to lower our U.S. advertising forecast for 2023 to 2.6% from 8.4% (see "U.S. Advertising Forecast Cut As Odds Of Recession Increase," published Oct. 13, 2022) and it's likely that we'll revise our forecast again once 2023 trends become clearer. Our forecast still has overall advertising growth as we believe larger advertisers will be reluctant, in a shallow recession, to make wholesale changes to their brand advertising for fear of losing their voice with the customer and thereby potentially sacrificing market share when economic growth resumes.

The impact on advertising from a recession will vary widely by medium. Advertising formats that were already facing secular pressures, such as network television, cable television, radio, and print, could see larger declines and a weaker recovery as advertisers reassess the efficacy of these formats given the continued audience ratings declines. Meanwhile, advertising formats such as search, retail media, social, digital video, and outdoor are likely to see solid advertising growth in 2023, but likely slower than historical growth rates.

The timing of decline and recovery will also vary by advertising medium. Short lead-time advertising formats like, radio, digital video, and social already experienced a rapid pullback in demand in 2022. We believe digital and social will be the first to recover from a recession, while advertising on longer lead time channels--such as linear TV--may be delayed in both their decline and subsequent recovery.

Digital advertising will grow significantly faster than GDP in 2023. Digital advertising will continue to drive total nominal advertising growth in 2023 and digital's share of global advertising spend will likely exceed 65% in 2023 (it'll be close to 70% in the U.S.). We believe performance-based digital advertising, retail media, social media, connected TV, and video advertising will grow while programmatic advertising (being more commoditized and more cyclical) will likely slow down in 2023. Auction-based programmatic advertising is sold in real time and tends to react much faster to changes in sentiment. This makes it very easy for advertisers to scale back or halt their ad campaigns, whereas it takes much longer to cancel a television campaign. In addition, auction-based digital advertising is more weighted toward small and medium-sized businesses that are more focused on advertising performance and do not have the financial resources to continue brand-building through a downturn.

Social media advertising, while still likely to grow in the mid-single digits in 2023, continues to face pressure as advertisers pull spending in response to challenging macroeconomic conditions and ongoing privacy changes. For example, Apple's App Tracking Transparency (ATT) feature on its iOS platform still presents a significant headwind to the digital advertising industry.

Shift of advertising away from traditional media to intensify. We expect weaker macroeconomic growth and further erosion in linear TV viewing will lead to TV advertising budget cuts in 2023 in the U.S. and Europe. TV ad revenues in 2023 will also be hurt by the lack of major international sports events such as the FIFA World Cup and Olympics. In the U.S., 2023 ad weakness will be exacerbated by far lower political advertising compared with an exceptionally strong 2022. Brand advertising held up well last year as large producers of fast-moving consumer goods needed to justify price increases as they passed on cost inflation to consumers. If a potential economic recession in 2023 proves to be shallow, as we currently expect, declines in TV advertising will likely be temporary and could start recovering in the second half of the year. But over the longer term, as linear TV's reach continues to shrink, this medium will become less attractive and broadcasters' ability to raise prices per impression could decline. The emergence of new FAST channels and ad-supported tiers of global online streaming platforms, such as Netflix and Disney+, will create more ad inventory in the ecosystem. These new advertising options could further dilute linear TV advertising pricing and attract advertising dollars from linear TV.

We believe print advertising will decline sharply, reflecting a weaker economy, a continued structural shift to digital media consumption, and still depressed urban commuting. Outdoor advertising could face pressure from weak macro growth, especially in the U.K. and Germany, where we expect deeper recessions than in the rest of Europe and the U.S. At the same time, outdoor ads will benefit from the shift from print, continued expansion of digital outdoor formats, and recovery of mobility. Transport advertising will be supported by relaxation of COVID-19 restrictions in China and continued recovery in international tourism.

Access to first-party data becomes crucial. We expect the media companies to continue investing in data capabilities as first-party consumer data ownership and access to such data becomes an increasing competitive advantage. The ownership of first-party data also helps manage changes in privacy rules. For example, whereas Meta Platforms Inc.'s revenue has been significantly impacted by Apple's ATT feature, other digital advertisers who rely more on first-party and contextual data have not been nearly as impacted.

Global ad agency holding groups will likely grow the top line above GDP. For a number of years prior to the pandemic, the global advertising agencies were under considerable operational pressure due to a number of factors, including advertising dollars shifting from traditional media to digital, growing competition from tech and consulting companies expanding outside of their core business, and less ad spending from historically key ad clients, like consumer products companies that were controlling costs through zero-based budgeting. All of this raised concerns that the ad agencies would be disintermediated by the global tech platforms. We believe that the ad agencies have effectively navigated these concerns in part by refocusing and rationalizing their business portfolio mix on faster growing advertising/marketing segments such as sponsorships, experiences, and public relations, and less on traditional advertising functions such as media buying and creative. Additionally, the advertising ecosystem has become much more complicated, with numerous advertising options beyond linear television, radio, and print, each requiring a different approach or creative, and more frequent, targeted campaigns. This complexity has benefitted the ad agencies as the majority of advertisers lack the staff, the expertise, the data, and the analytical capabilities to navigate this new advertising ecosystem.

Credit metrics and financial policy

We expect ad-based media companies’ margins and cash flows to weaken in 2023 due to lower topline growth and continued cost inflation, especially staff costs. Weaker consumer confidence and economic growth globally will weigh on topline growth. Operating costs will increase at rates above nominal topline growth, driven by wage inflation, investments in tech and data capabilities, and data collection. Traditional media will also face higher input costs such as energy, particularly for the print industry. As a result, we forecast leverage will increase across the board in 2023.

We think the investment-grade rated ad holding groups have enough financial flexibility to withstand these risks. They accumulated significant leverage headroom in their ratings in 2021-2022 as they benefited from an exceptionally strong recovery in advertising. Their cost base is also relatively flexible, with staff costs accounting for about 65% of operating expenses, and a relatively high natural rate of staff attrition.

M&A activity remained muted in 2022 and we believe it is unlikely to pick up at least until mid-2023 when the global macroeconomic outlook might start improving. We note however that some large, diversified media companies and ad holding groups sit on large cash piles that they could utilize towards M&A if they find attractive targets.

Key risks or opportunities around the baseline

1. A deeper or longer recession could halt growth in advertising

If a recession is more severe than we expect, advertisers could respond with more dramatic pullbacks in spending. Specifically, if there is a hard landing of the U.S. economy, businesses will likely delay or suspend advertising efforts substantially in short-lead time formats. If the recession is prolonged for the entirety of 2023 or longer, then advertisers are likely to pursue a wholistic reassessment of their advertising campaigns. In either scenario, a more severe economic downturn could result in advertising declines for 2023 and a weaker, more prolonged recovery into 2024.

2. Accelerated drop in scale and reach for linear TV

Faster decline in scale and reach for linear TV due to lower viewing, higher cord-cutting in the U.S., and fierce competition with digital VOD platforms could lead large brand advertisers to reassess linear TV's value and make more severe cuts in advertising and pricing. This could hurt the ability of ad-dependent TV broadcasters, who depend on TV's cash flows to fund their digital streaming ambitions, to adapt their business models quickly enough.

3. Continued privacy and regulation changes

Further tightening of privacy regulation and privacy-preserving measures implemented by the largest tech platforms could limit the ability of ad companies to target users and measure results of ad campaigns, thus affecting digital advertising revenue. This could weaken the credit strength of advertising companies that fail to adapt over the longer term.

Elevated regulatory risks could hamper digital advertising growth and put pressure on ad companies' ratings. Privacy regulation and consumer preferences are changing towards higher privacy and less trackable data available for targeting digital advertising. Changes in privacy measures require ad companies to constantly adapt their business models and change ways in which they collect customer. This makes access to first-party data especially important and requires investment in data assets and technologies. Inability to remain competitive could lead to negative revisions in our ratings and outlook, especially on smaller and less diversified ad companies. For example, in 2022 a change in privacy regulation related to Apple's ATT feature restricted the collection of unique device identifiers without consent. This prevented advertisers from using these data for ad targeting and measuring ad effectiveness, and resulted in a loss of digital advertising revenues in a USD billion area.

Related Research

- Assessing The Impact Of Higher Interest Rates On U.S. Media And Entertainment Companies Rated 'B-', Jan. 9, 2023
- SLIDES: U.S. Media And Entertainment Industry: Key 2023 Themes And Concerns, Jan. 6, 2023
- Media Industry Implications From Our Rating Action On AMC Networks Inc., Dec. 22, 2022
- Warner Bros. Discovery Inc. Outlook Revised To Stable From Positive On Slower Expected Deleveraging Amid Macro Headwinds, Nov. 22, 2022
- Paramount Global Outlook Revised To Negative From Stable On Weakening Macroeconomic Climate; Ratings Affirmed, Nov. 9, 2022
- U.S. Advertising Forecast Cut As Odds Of Recession Increase, Oct. 13, 2022
- Assessing Media's Vulnerability To Today's Macroeconomic Risks, Aug. 3, 2022
- Industry Top Trends Update: Media and Entertainment (EMEA), July 14, 2022
- Industry Top Trends Update: Media and Entertainment (North America), July 14, 2022
- Credit FAQ: Calculating Leverage For Large U.S. Media Companies (2022 Update), March 24, 2022
- Cord-Cutters Keep Severing Ties To U.S. Pay-TV, Feb. 17, 2022
- U.S., Canadian, And European Telecom, Media, And Cable Majors Ranking: January 2022, Jan. 10, 2022
- U.S. Linear TV's Decline Won't Affect Media Companies Equally, Oct. 12, 2021

Industry Forecasts: Media and Entertainment

Chart 9

Revenue growth (local currency)

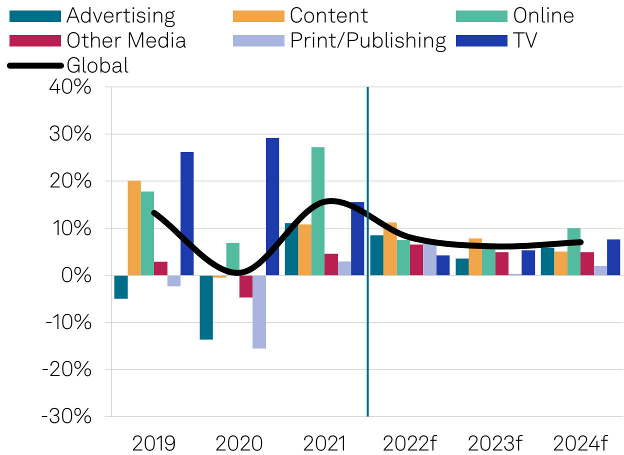


Chart 10

EBITDA margin (adjusted)

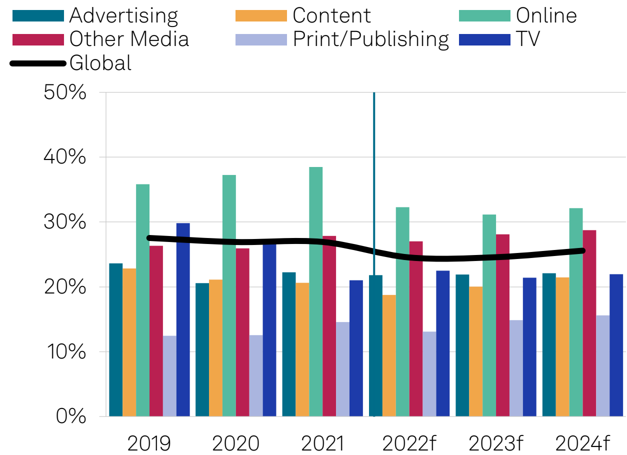


Chart 11

Debt / EBITDA (median, adjusted)

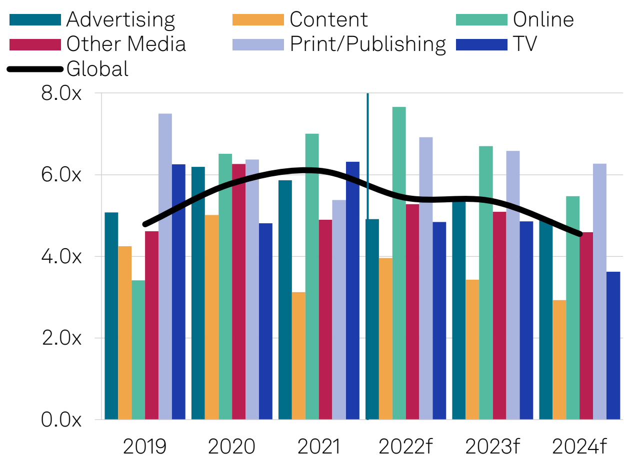
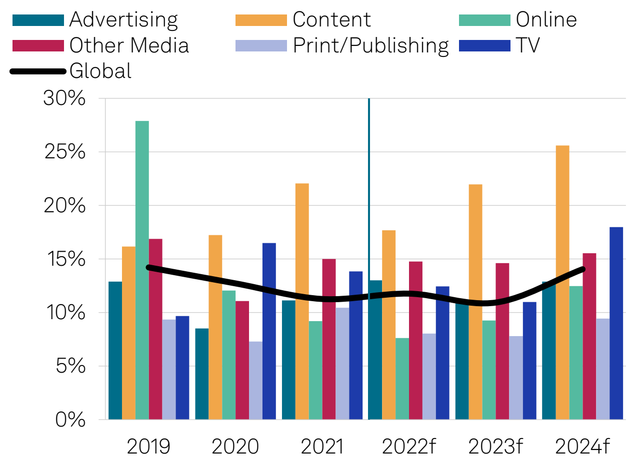


Chart 12

FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = Forecast.
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. FFO—Funds from operations.

Cash, Debt, And Returns: Media and Entertainment

Chart 13

Cash flow and primary uses

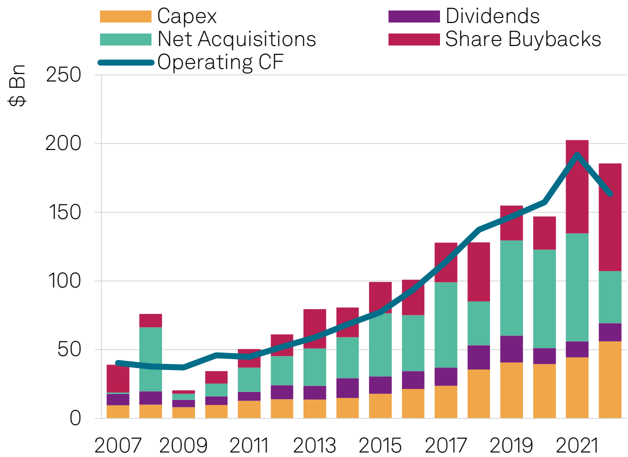


Chart 14

Return on capital employed

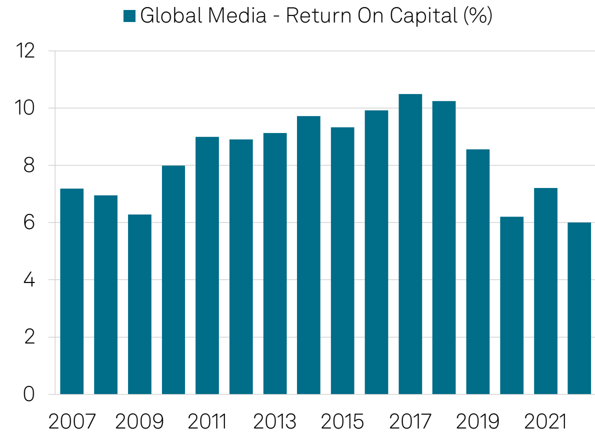


Chart 15

Fixed- versus variable-rate exposure

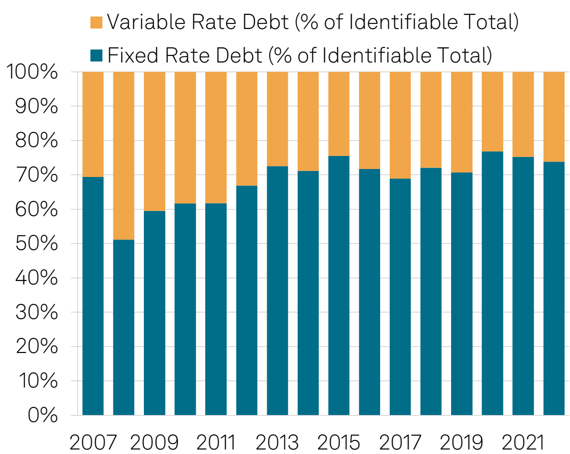


Chart 16

Long-term debt term structure

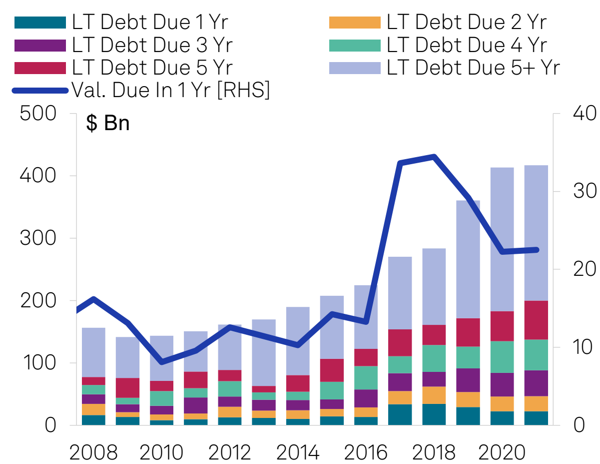


Chart 17

Cash and equivalents / Total assets

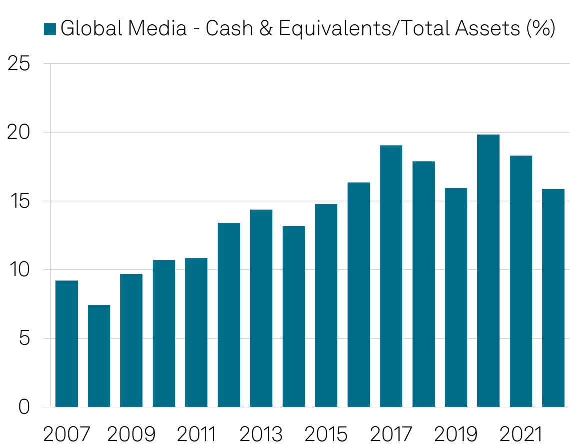
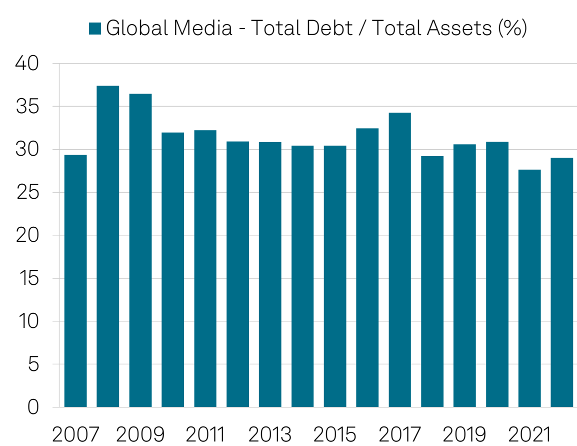


Chart 18

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2022) figures use the last 12 months' data.