Disney/ESPN's Risky Streaming Strategy

Has Disney traded the cable TV model for a handful of magic beans?

By Michael A. Kashmer / *Digital Broadband Programming Consultant*

Late last year, Nielsen announced that the October 2016 ESPN subscriber numbers were the worst in the history of ESPN's existence as a cable channel. This was the biggest business story in American sports last fall. The decline in NFL ratings was serious enough, but the ESPN news reflects a larger issue – the collapse of cable subscriptions in general. According to Nielsen, the worldwide leader in sports lost 621,000 cable subscribers – the most subscribers ESPN ever lost in a single month.

After ESPN challenged the subscriber numbers, Nielsen pulled them and conducted a review. The next month, Nielsen stood by the numbers, and ESPN issued a statement, saying in part, "This most recent snapshot from Nielsen is an historic anomaly for the industry and inconsistent with much more moderated trends observed by other respected third party analysts."

No one was surprised by either the content or the tone of ESPN's rebuttal. If future months continue to show subscriber declines, there will be fresh points of disagreement and counterargument.

Until recently, Disney's cable bundle was a great business, largely because of ESPN. ESPN charged every cable and satellite subscriber about $7 a month, more than three times the charge for next most expensive channel. However, analysts such as Trey Travis at outkickthecoverage.com predict that ESPN programming costs are gaining on revenue.

SNL Kagan says that ESPN is on track to pay $7.3 billion in total rights fees in 2017. That is more than any company in the United States. A very conservative estimate puts ESPN's subscriber losses at about 3 million per year, which would leave ESPN with 86 million subscribers in 2017. ESPN makes $7 a month from every subscriber, or $7.22 billion in 2017. Let's add $1.8 billion in ad revenue for a total of $9 billion. Staff costs, facilities, equipment and so forth cost an estimated $1 billion, indicating that ESPN is still profitable.

But how long will it remain profitable as sports rights costs go up and subscriber revenue goes down? At 74 million subscribers (Outkick's projection for 2021), ESPN would bring in about $6.2 billion a year in subscriber fees at $7 a month or $7.1 million at $8 a month. By that point, yearly subscriber revenue will likely be less than rights fees.

DISNEY MOVES TO STREAMING

To combat cord cutting, Disney just announced plans to launch a direct-to-consumer streaming service for ESPN. Further, Disney will cancel its licensing deal with Netflix and launch a Disney-branded streaming service in 2019. That makes two new streaming services. Imagine this: The largest media company in the world decided that embracing a new business model was more important than hanging on to an existing one. Netflix responded with the comment that the impact on its subscriber base would be minimal.

Is the Disney strategy too little, too late, as argued by BTIG analyst Richard Greenfield? He estimates that Disney will lose up to $2 billion a year as it gives up Netflix revenue and spends heavily to build up content and start two streaming services from scratch. Greenfield adds, "Disney simply waited too long to make this critical decision."

Furthermore, if Disney's direct-to-consumer platforms are successful, Greenfield anticipates that will accelerate ESPN's decline. He continues, "The more content consumers can obtain without a multichannel video subscription, not to mention more and more content without advertising, the less interest they will have in subscribing to the big multichannel video bundle."

RBC Capital Markets, by contrast, calls Disney's move "a rare and impressive pivot." Industry sources claim that the Disney cable channels, which include ESPN, have long been seen as the reason many viewers didn't cut the cord entirely. Every cable operator will be impacted by Disney's new strategy, like it or not.

Will other video content providers now make the same move? If they do, will an unintended consequence be the necessity for consumers to juggle a huge number of streaming services? Initially at least, few answers will be forthcoming.

Some pundits accuse Disney of upending the traditional cable TV business in favor of an unproven strategy. This reminds me of the fairy tale about a poor farmer trading the family cow for a handful of magic beans. We all know how that turned out. ❖

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