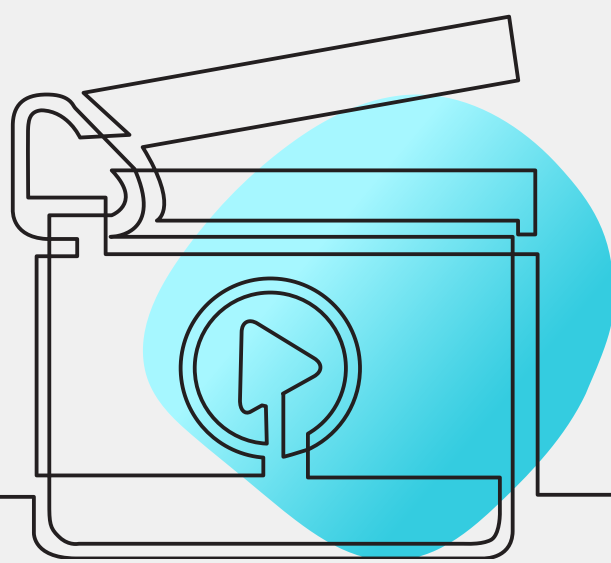
What COVID-19 means for the media and entertainment industry

A look at the Canadian landscape



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Foreword

No one would have ever expected that, abruptly, in March 2020 the NBA and NHL would suspend their seasons, concerts would be postponed or cancelled, casinos would be closed, releases of blockbuster movies would be online, productions would come to a halt, and most of us would need to stay home. It is clear that the pandemic has had a drastic effect on the media and entertainment (M&E) sector and turned many companies upside-down.

The M&E sector has seemingly moved swiftly in response to COVID-19 by producing online concerts virtually, ramping up e-gaming, offering free entertainment subscriptions (i.e. telecommunication companies have offered free access to a rotating selection of channels[1]), releasing big blockbuster movies directly online, and animation studios adopting a fully remote working environment, to name a few. As we move into our recovery phase, we need to consider what the new post-COVID-19 era will look like. It's easy to predict that the most tangible effect on the M&E sector will be technology adoption and the general versatility that comes along with digital commerce and content, but there are likely to be other intangible long-lasting effects too.

Since the onset of the pandemic, screen time is up and there has been a corresponding increase in media consumption – news, TV, digital, social media, and gaming especially – as people have remained homebound. Monetization of this trend could prove challenging, compounded by a decline in advertising revenue due to the economic impact from other industries such as travel, hospitality and automotive.

On the other hand, entertainment subscription revenues for the sector could improve over the medium-term, as people continue to see a greater variety of content and become accustomed to it. This would be contingent on new content continuing to be made available quickly once the restrictions are lifted.

It's no surprise that the M&E segments most affected by the pandemic are those that rely on social gatherings – films and events – and the recovery here might take longer than anticipated. Certain sections of consumers – particularly those residing in COVID-19 hotspots – are likely to remain apprehensive of crowds and display a preference for at-home media and entertainment options over live in-person experiences.

More generally, there could be a shifting of priorities as we progress to a new normal. The balance between work, family, health, and well-being might be re-evaluated, with leisure – of which media and entertainment is a large part – playing a greater role in our lives. Read on for a closer look at how COVID-19 is affecting the M&E sector.

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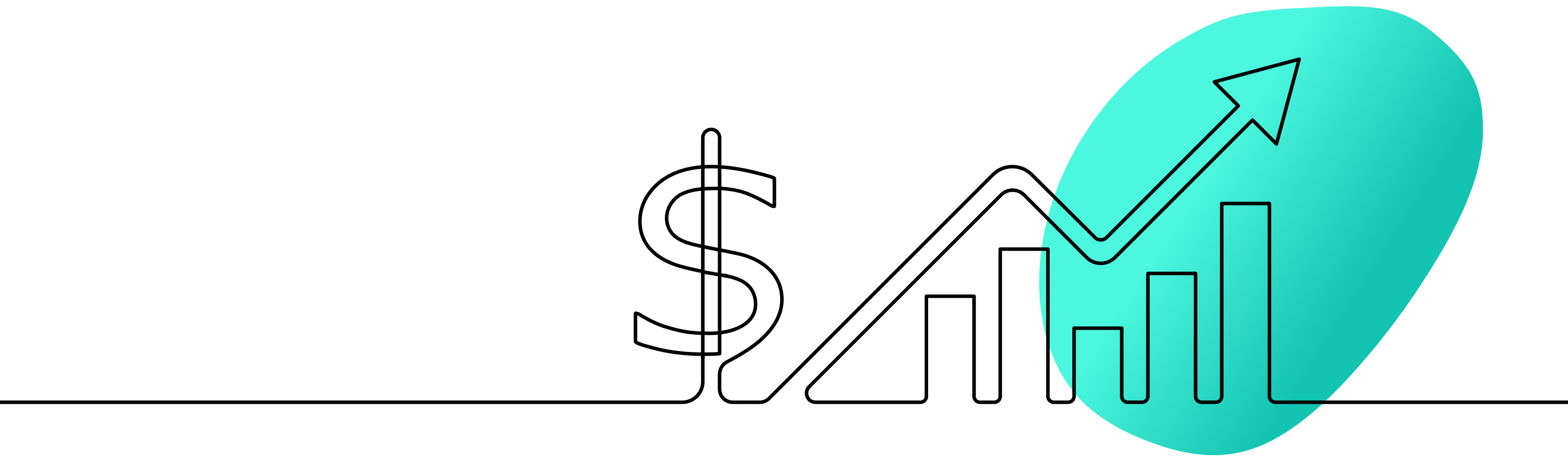
[1] https://mobilesyrup.com/2020/03/22/free-tv-sports-watch-covid-19-coronavirus-canada/

COVID-19: A macro-economic context

The COVID-19 pandemic has caused widespread economic hardship through input constraints, declines in consumer confidence and spending patterns, and market shocks.

Canada's real Gross Domestic Product is expected to contract by four percent this year[2]. The COVID-19 pandemic, and resultant shutdown of non-essential businesses and social distancing measures, brought many industries to a standstill. Along with lower consumption levels and higher unemployment, the Canadian economy is likely to face a particularly challenging time in the months ahead.

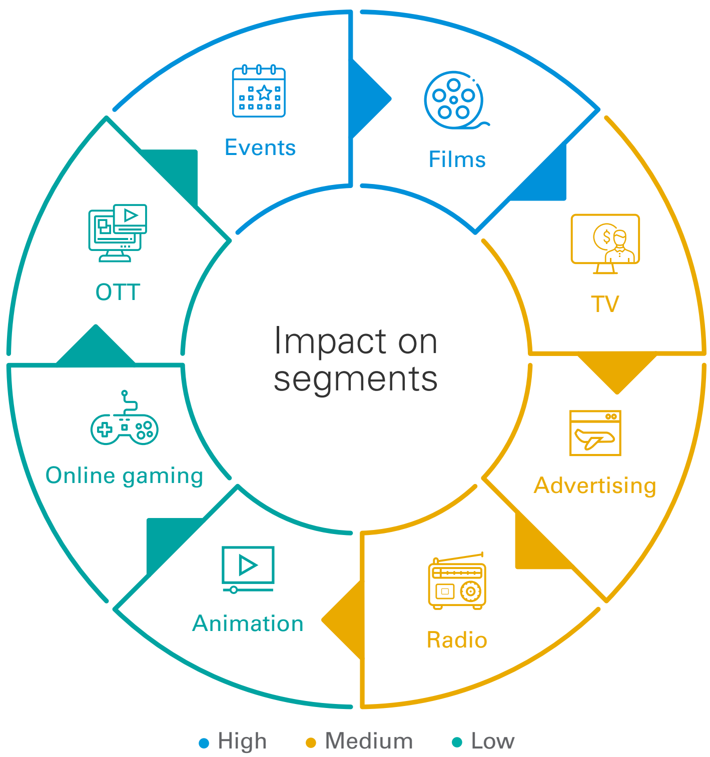


[2] https://www.conferenceboard.ca/e-library/research/sof/2020/10692

What COVID-19 means for the media & entertainment sector

The current environment is unprecedented and has had significant impacts on certain segments in the M&E sector.

- Productions in the film and television segment have been put on hold and new content will be delayed. The Canadian Media Producers Association has projected that there is a risk that COVID-19, as a result of production shutdown from mid-March to the end of June, will have an impact of $2.5 billion in production volume and impact up to 172,000 jobs across Canada[3]. Furthermore, outdoor consumption models – such as films, events, and theme parks – are witnessing a dramatic fall with physical distancing norms in place. The Canadian National Exhibition will be closed this summer for the first time since World War II[4].
- Other M&E segments, such as news, TV, gaming, digital and over-the-top (OTT) media services, have seen consumption growth.
- Aside from news-related business and some animated video production, most segments are unable to offer new content.
- Many M&E segments are dependent on contract employees/freelance agents and consequently, the impact of the pandemic on livelihoods in this sector are significant.



Monetization in the M&E sector is predominantly reliant on advertising, which has seen a major contraction. Overall ad-spend is determined by the performance of sectors such as fast-moving consumer goods, e-commerce, automotive, financial services, and real estate, all of which currently face their own challenges and could therefore take time to recover.

[3] https://cmpa.ca/press-releases/canadas-film-and-tv-production-sector-faces-2-5-billion-hit-due-to-covid-19/
[4] https://theex.com/2020-cne-message

A closer look at what's going on in the different segments

Events: Lights out	– Multiple events cancelled including sporting events, concerts, and awards shows – Earlier recovery more likely in business-to-business events than business-to-consumer events as people continue to remain wary of crowded places – Given dominance of small players, the segment could come under severe cash flow pressures
Films: Disaster at the box office	– Foot traffic and therefore overall revenue has dried up with movie theatre closures – Rental cost savings anticipated due to invoking of force majeure clause – Recovery process may be different across segments and demographics based on specific COVID-19 experiences and perceived risk from social gatherings and the ability to start filming
TV: Glued to the telly but where's the money?	– Overall TV viewing has increased – with news channels being popular as viewers follow COVID-19 updates in real time – but there is an absence of fresh content, especially due to the elimination of live sporting events – Content producers are worried about delivering shows to broadcasters on time
Advertising: New lease of life	– Monetization is a serious challenge as advertisers scale back expenditures – Higher credibility in the face of proliferation of fake news on social media – Digital presence is now more critical and could translate into greater monetization opportunities
Radio: Tuning in	– Radio jockeys operating from home so content continues to be refreshed – Local and topical content is popular as people look to follow COVID-19 news relevant to their specific area – Drop in transit audience listeners as people are working from home
Animation: Back to the drawing board	– Although companies have shifted to remote work, stay-at-home measures have affected content creation as remote working poses infrastructural challenges for some companies – Animation and visual effects (VFX) work more long-term so demand could hold up despite the pandemic – Segment has high fixed and capital costs so cash flow is likely to be an issue
Online gaming: A dream run	– Monetization gap due to lowering of ad-spends – Paid models could see growth as online gaming gets more entrenched into overall time spent on M&E, which has increased since mid-March – Fantasy sports and e-Sports may be adversely impacted with a stalling of sporting activity, as well as potential aversion to social gatherings in certain demographics
OTT: Silver lining	– Secular rise in OTT consumption in duration, and across demographics and devices – Content pipeline may be dried up. OTT players with a large, legacy library have an advantage – OTT players offering extended free periods to drive subscription pick-up through habit formation

A whole new world?

Insights into the pandemic and its aftermath

Significant and lingering adverse economic fallout

- The global economy is likely to see a sharp decline
- The impact on Canada's economic growth will be a result of both global trends and the extent of proliferation of the virus

COVID-19 impacted locations and demographics to present further differences

- Locations and demographics that have witnessed a higher concentration of COVID-19 cases are likely to be risk-averse in the near-to-medium term with regard to spending and social gatherings

Short-term and risk-averse organizational behaviour

- Organizations are more likely to focus on the 'here and now' and cash conservation, rather than look for aggressive spends to catalyze growth in the longer-term

> In the months to come, the entire M&E value chain will face the challenge of overcoming the disruption caused by COVID-19. Let's take a closer look at the role that innovation, cloud solutions, and working capital will play in this new reality.

How to manage your input resources

Innovations in the pipeline

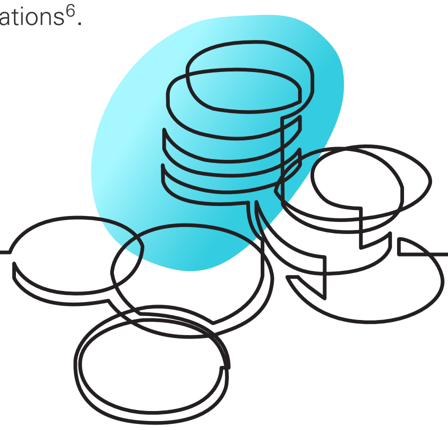
- Limited content banks have severely constrained broadcasters and platforms. Current resource options offer limited opportunities for remote collaboration, require longer lead times, and lack technology integration. Going forward, these gaps will need to be addressed.
- A focus on building a stronger content bank may result in working capital being locked up across the value chain, leading to higher cash financing requirements. Companies should look for innovative ways to produce and repurpose content. In the meantime, they may seek merger and acquisition opportunities to access additional content.
- With out-of-home (OOH) entertainment and recreation facing challenges in the near-term, innovative outreach and delivery models are likely to evolve. Virtual live events and film exhibitors could be expected to leverage technology to reach consumers directly. Aspects such as remote collaboration for creative ideation and scripting could last well beyond COVID-19 and alter the way the industry creates content forever.
- For professional sports and live entertainers who rely heavily on fan attendance, implementing digital solutions, re-thinking the business model, and finding new ways to engage fans will be integral to future success.

Cloud solutions and remote working

- With greater harnessing of cloud and remote working solutions, companies may look at efficiencies in the way they conduct business, even across revenue generating functions such as sales.
- While remote working might not be for everyone, it may become the new norm as our time spent at home because of COVID-19 has offered more time for reflection, allowed people to spend more time with their families, and has put an emphasis on self-care.

And finally… cash is king

- There is likely to be a near-term focus on sustenance at current levels by companies. We may see a drastic fall in the capex/investment cycle by companies, which could constrain supply and the growth of the M&E industry in the near-term. The Canadian government has pledged $88.8 million to The Canada Media Fund and $27 million to Telefilm to help companies keep their doors open and mitigate the effects of the pandemic[5]. The Canadian government has also pledged $500 million to the COVID-19 Emergency Support Fund to help support Cultural, Heritage and Sport Organizations[6].



[5] https://www.cmf-fmc.ca/en-ca/news-events/news/may-2020/the-canada-media-fund-and-telefilm-canada-welcome
[6] https://www.canada.ca/en/canadian-heritage/services/funding/information-covid-19/emergency-support-fund.html

Understanding your audience and customers

At-home entertainment, particularly OTT and gaming, to see continued accelerated growth

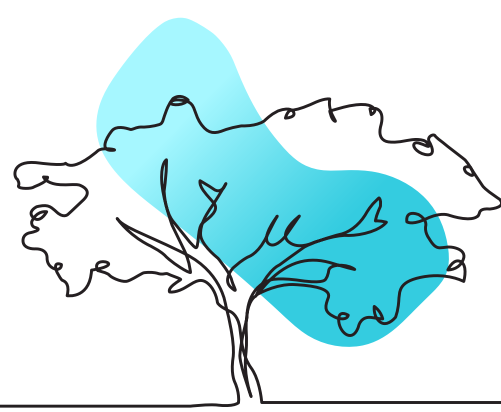
- Digital media consumption, particularly OTT, has seen a surge during this period in terms of both time spent and newer audiences. This habit formation is likely to result in a new higher normal once the situation around COVID-19 comes under control.
- OTT consumption in Canada could start seeing a shift from mobile screens to large TV screens, as viewers spend more time at home with social distancing policies in place. This will slow-down the process of cord cutting/shaving in the medium-term, benefitting broadband internet and fiber-to-the-home companies.
- Gaming as a segment could be one of the major beneficiaries in the overall digital ecosystem, especially around the younger demographic. Media companies, including OTT platforms, could seriously look at gaming as an extension to their ecosystem offerings.

OOH media consumption

- M&E segments such as films, events, and theme parks are looking at a prolonged recovery cycle, owing to social distancing policies and risk-aversion towards social gatherings, particularly in COVID-19 affected cities and hotspots.
- The releases of big budget films could be severely impacted due to the same, and could lead to a sub-par fiscal 2021 for the segment, but could provide the opportunity to change delivery models from in-theatre to online streaming services.
- Pent-up demand behaviour by certain sections of the population may provide some respite for the industry.

New trends for gratification

- Canada's media consumption remains upbeat during this period, with digital news consumption increasing to 40 percent[7]. Indulgent expenses such as the purchase of new hardware and technology upgrades could be postponed for a while.
- There is likely to be a greater emphasis on domestic markets in the services space, particularly in the animation and VFX segments, as global pipelines come under severe pressure.
- Companies could place an increasing amount of reliance on artificial intelligence (AI) and machine learning (ML) to predict consumer behaviour and audience trends in these uncertain times.



[7] https://mobilesyrup.com/2020/04/02/time-on-social-media-70-percent-increase-covid-19/

React to cope, respond to thrive

The economic recovery can be expected to present its fair share of complexities, as organizations respond to pressures on multiple fronts. With a hard reset for a number of businesses, all aspects of operations would need urgent attention.

This is where we may start to see an up-tick in mergers and acquisitions. Startups and small companies struggling to find the necessary capital to stay afloat but with a strong content library become prime targets to get bought up by the larger players. Organizations might need to be risk-focused and innovate existing business models and processes to survive and emerge stronger.

Technology and innovation

- Digitization and building strong integrated digital models will become essential rather than optional in the post-COVID-19 era.
- For digital companies, increased focus is required on strengthening the technology backbone, as digital penetration is expected to become more widespread once we regain normalcy.
- Digital media consumption provides the opportunity to build faster and more nuanced profiles of users. The trend of using technology to enhance customer engagement – recommendation engines, personalization, feedback loops, data analytics – will only accelerate and deepen.
- Apprehensions around individual privacy online could become stronger and companies can expect to face a backlash should they not have credible measures in place for data protection.
- OOH offerings, and outreach in particular, will need to innovate to rebuild customer confidence. Building innovative experiences may combat increased competition and mindshare from ‘in-home’ entertainment options.

Building resilience

- Building a culture of agility through the organization will be increasingly important.
- Companies will need to balance upskilling employees to meet the challenges of working in a transformed environment, while at the same time securing the independent contractors needed to ramp-up operations quickly when the time comes.
- There will be an emphasis on flexibility as companies look to move to a variable cost model and reduce fixed costs. As this pandemic has shown, the ability to remain agile during downturns is a valuable asset.
- Most content producers are paid in advance to allow them to manage their own working capital but as upfront contractual payments are re-negotiated to avoid locking up cash, this puts stress elsewhere in the M&E ecosystem.
- As our recovery begins to occur, there will be a huge demand to produce content very quickly – strong relationships will prevail in the ‘who gets served first’ decision tree.
- There will be a focus on deepening the content pipeline, building content banks and reducing lead times by leveraging technology and its associated tools, such as telecommuting, cloud, AI and ML.
- Compaines would be wise to enable recommendation engines to showcase less explored parts of the content library and gamification of content when production is hampered in exigencies.

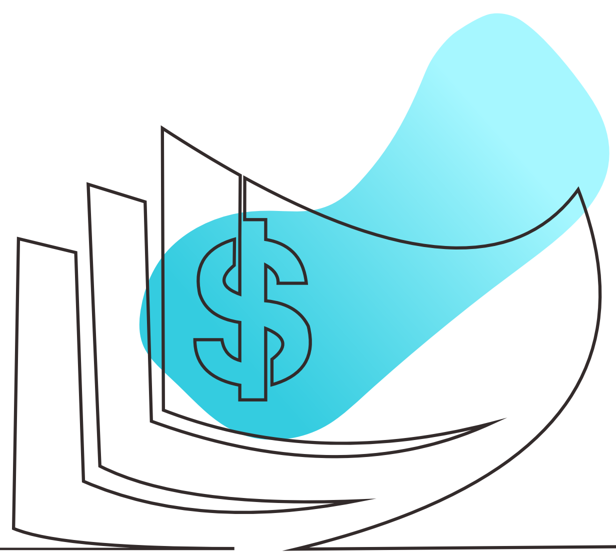
Cash regains supremacy

- The trend of risk-aversion will be evident in consumers but also for organizations as liquidity allows for a greater degree of comfort and confidence during stressful times.
- Innovative financing products from the private sector could be introduced to M&E companies providing relief as segments emerge and return to 'normal'.
- Media spend by companies across sectors might be subject to a higher level of scrutiny and therefore M&E companies might need to offer more accurate return on investment calculations in traditional media and greater programmatic advertising options on digital platforms.
- M&E companies might be more inclined to review the cost of acquisition of new users, resulting in some downward pressure.
- Capex and expansion plans would need to be reassessed to balance cash requirements, growth ambitions and consumption dynamics.
- Interesting merger and acquisition opportunities will appear for those players with an appetite for risk or who are required to restructure.

In the short-term, organizations should have open communication with their workforce, their external vendors and partners, and their consumers. Leadership should focus on the physical and mental well-being of their workforce, outline organizational priorities, and provide a fair assessment of the impact of the pandemic on the business. Organizations should identify short-term cash flow challenges, access available government funding where applicable, and enable cost levers for savings opportunities. It is important to be honest with vendors about any financing issues. Focusing on value preservation and protection also brings forward an opportunity for organizations to build and protect their brand by being good corporate citizens. This means reimagining your business to create value in a time of need.

The medium-term is an opportunity to assess current systems and processes to implement a recovery plan that will create value and better insulate your business from such shocks in the future. Organizations should look at what gaps have been identified by COVID-19, how to streamline processes, and where teams need upskilling to adapt to the new normal. It is also important to devise tactical working capital projections in acknowledgement of the changed environment.

Long-term, organizations will need to focus on value realization. They should look to identify strategically aligned inorganic growth opportunities, develop deep and credible succession plans, and carve-out of non-core businesses to unlock value.



Do you want to become part of the 9%?

From the three previous recessions, only nine percent of public companies were able to grow from the downturns and come out ahead[8]. While traditional media could face some challenges in the near-to-medium term, digital media businesses have fared relatively better, albeit only on the consumption side. There is likely to be a long-term – upward – shift in the integration of digital technologies into our everyday lives, and media and entertainment will be an immediate beneficiary.

As you work your way out of the Reaction phase of this pandemic, you should consider a strategic response across three coordinated actions to better position your organization for long-term success:

- **Resilience:** Immediate actions that preserve cash, give confidence to customers and employees and ensure business continuity - the "four C's" (Customer, Cash, Cost, Capital):
  - Customer examples: proactive contract or subscription renewals, guaranteed price locks, early content releases, longer free trial periods
  - Cost examples: model cost and cash flow of tent pole events based on changes in ticket pricing, attendance and incremental costs such as safety and security
- **Recovery:** Performance improvement actions to maximize options in the face of uncertainty:
  - Re-allocating resources towards direct-to-consumer or digital offerings, or in other cases to those provinces that are opening up first
  - Consolidating silos and common functions (ad sales, marketing, etc.)
- **New Reality:** Actions resulting from assessing new opportunities that arise as customer and market disruption settles into a new normal, such as:
  - Opportunities to inspire confidence and accelerate the return to large live events and experiences through safety protocols and other measures
  - Opportunities to reach expanded audiences through direct-to-home content releases at the same time as theatre launches and/or on other platforms
  - Potential for expansion of content and audiences through combined live and virtual experiences
  - Resetting valuation expectations in mergers and acquisitions

We know the M&E sector has not been immune to the effects of COVID-19, even though many organizations are still keeping the lights on. We are here to help as you recover and prepare for the New Reality. Now is a time to pause and assess long-held assumptions, challenge your organization's status quo, collaborate in new ways, think differently and do differently to become part of the nine percent.

[8] https://hbr.org/2010/03/roaring-out-of-recession

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Ask a question

For more information visit the KPMG COVID-19 Resource Centre.