ARCTOS INSIGHTS FLASH REPORT

Bundle Power; or, Reflections On “Spulu” (FOX-Disney-Warner Bros. Sports JV) and Netflix/WWE

March 2024

We believe the two big sports media stories of 2024 – the announcement of the FOX/Disney/Warner Bros. Discovery sports streaming JV and Netflix/WWE – underline the growing need for bundle power *in the contest over who owns the sports bundle (currently called "cable" and owned by the legacy distributors). In our view, whoever has bundle power – i.e., aggregates the broadest, most heterogeneous portfolio of content niches – likely wins. We tackle this dynamic and how it ultimately feeds into sports rights.*

Takeaways & Recommendations

- As we discussed in our 2022 Media Update, we believe the traditional media business faces long-term structural headwinds from fragmentation and competition. This has continued to play out.
- The simple economics of *un*bundling explain why streaming has been so difficult and why the cable bundle has unraveled. Instead, bundling – harnessing ‘bundle power’ – is needed to survive and thrive.
- The key to bundle power is assembling a large, diverse portfolio of heterogeneous content niches.
- But Spulu (the FOX/Disney/WBD Sports JV), in our view, does not have much bundle power. Instead, it is a new player in the fight over the *sports bundle*. This is not a ‘great rebundling’. Instead, Spulu represents continued status quo streaming competition, now aimed at the heart of legacy cable (sports).
- On top of that, we have Netflix entering sports at scale. How they’ve done so is instructive for what the modern sports deal will look like in the streaming era.
- **We believe leagues should stay focused on fundamentals we’ve outlined before:**
    - **Refrain from picking winners in the battle for the sports bundle or the streaming wars: feed all hungry mouths by increasing packages and packaging flexibility.**
    - **Do not “go-it-alone” or become a distributor yourself. Harness bundle power.**
    - **Do not sacrifice reach, relevance, or contracted revenues for headline “AAV” growth.**
    - **Cultivate Big Tech interest in sports programming for the long-term.**
    - **Continue to focus on improving the fundamentals of the game, league, and your IP in a changing media and fan ecosystem.**
    - **Actively cultivate nationally and, if possible, internationally relevant storylines. Make your content about more than gameday outcomes to drive non-traditional followership that can matter to the global streamers.**

Bundle Power

Several of us on the investment team are Star Wars fans.[1] Recently, we were debating what our reservation prices would be for a Disney+ subscription to access the slow trickle of new Star Wars content. Disney+ currently costs the following (in monthly terms):

- Disney+ Basic (with ads): $7.99
- Disney+ Premium (no ads): $13.99

Each of our reservation prices were closer to $35 for a no-ads feed. This is much higher than $13.99, meaning we are earning a significant consumer surplus. Networks have always understood this problem, indicative of the **heterogeneity of consumer preferences across content niches**. For each content niche, there is a power law of reservation prices at which each potential consumer would be willing to buy, i.e., at which they'd pay "full price" for the value they receive. At the top are the *mega-fans*, a small segment who would not churn even at many multiples of the average reservation price.[2] At the bottom are a long tail of *ambivalent tourists*, for whom, if cheap enough, the option to occasionally find something to watch on Disney+ would be worth something, but not much.

As a Star Wars mega-fan, I receive a large *consumer surplus*[3] via Disney+, a surplus that I'd willingly pay away to Disney if they held Star Wars access hostage. But I am an ambivalent tourist for many other content niches – many of those services lose my revenue entirely in a world of streaming hyper-competition. This is the essence of the problem with streaming today (Fig. 1): **Each competing streaming product leaves too many ambivalent tourists while under-monetizing their mega-fans due to price competition.**

We believe the only solution is bundling because it is the simplest strategy that solves this dual problem. Here's an example that illustrates this:

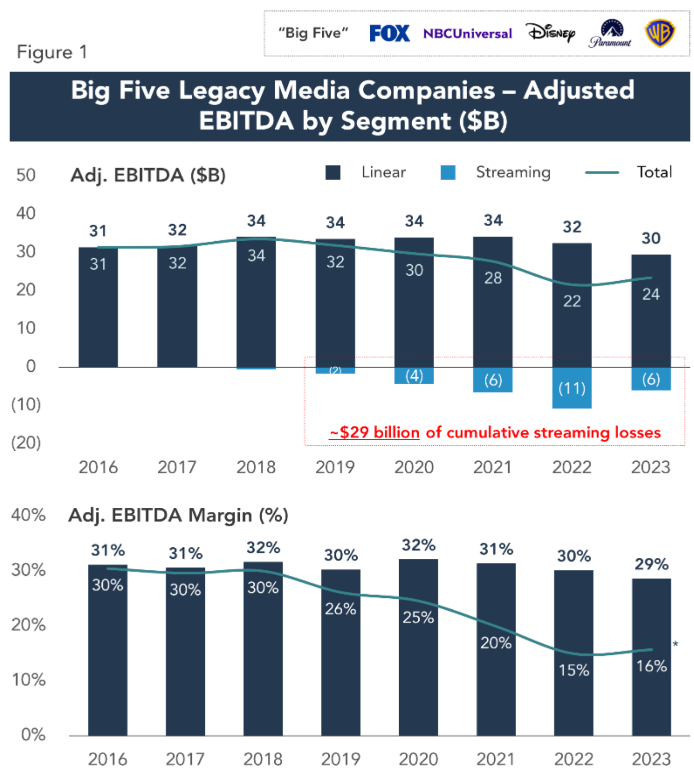
A. Imagine a simple world in which Disney+ has two subscribers: Mega-Fan Mary and Ambivalent Andrew. Mary would pay $35/month and Andrew would pay $10/month. What do you charge?

B. It appears obvious that you would charge $35/month and tell Andrew to take his business elsewhere. That maximizes revenue for Disney+. The alternative, charging $10/month, would yield only $20 in monthly revenue.

C. But imagine there is a channel called InfoNet (24/7 technology news). Andrew would pay $35/month for this, while Mary would pay $10/month.

D. **Now the revenue maximizing play for Disney+ would be to bundle with InfoNet** under the following terms: Disney+ and InfoNet form a 50/50 JV and charge $40/month for their new InfoDisney bundle. Both Andrew and Mary would have paid $35 + $10 for each channel a la carte, so they each earn a consumer surplus of $5. They subscribe to the bundle, and InfoDisney earns total monthly revenue of $80. Under the bundle JV with InfoNet, Disney+ earns 50% of $80 in monthly revenue, or $40, which is $5 more than in an a la carte model.

Figure 1



SOURCE: COMPANY REPORTS, SNL KAGAN, STATISTA, ARCTOS ESTIMATES, GUGGENHEIM, EVERCORE ISI, AND UBS. AS OF FEBRUARY 2024.

[1] We promise this is the final overwrought use of Star Wars in an Insights piece. At least for 2024. In addition, several team members wanted to caveat that this should not be taken as an endorsement of the sequel trilogy.

[2] And within that cohort, there will be "mega-mega-fans"… and so on.

[3] Consumer Surplus is defined as the difference between the price a consumer pays and their reservation price, the maximum price they're willing to pay based on how much they value the product or service.

By commingling two heterogenous sets of content preferences into a single product, both networks were better off.

There are other benefits as well.

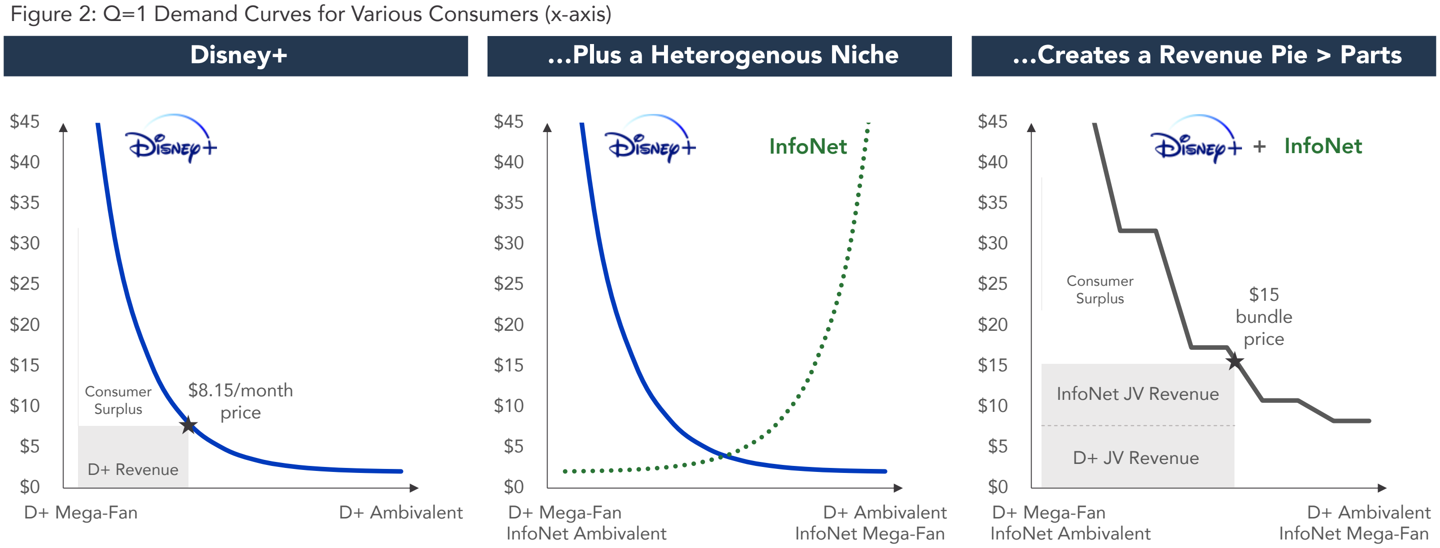
First, for every mega-fan of a genre, there are many more ambivalent tourists. So, the above $5 effect can be multiplied several times over as a bundle grows across more than the two genres.[4] Second, note that *both consumers are better off too*: Their combined consumer surplus is $10; in an unbundled world, their combined consumer surplus is $0.[5] Won't always happen in more realistic scenarios, but often aggregate consumer surplus does not decline significantly – consumers still get significant value. Finally, there's an intangible scale benefit that InfoDisney enjoys. Even if Disney+ cannot guarantee Ambivalent Andrew's viewership with as much regularity as Mega-Fan Mary's, **Disney+ has doubled their subscribers and reach in the bundled scenario**, which benefits the network, their advertisers, and their content partners. The result is a higher likelihood for the mass market relevance and 'watercooler-effects' that result in stickier fan relationships.

How this plays out is illustrated in Fig. 2. Here we use Disney+ and show where it is currently priced ($8.15 ARPU in North America as of fiscal Q1-24) but fill in an illustrative demand curve of reservation prices. A second network, with sufficiently differentiated programming and an identical but opposite price curve is then added to it, also priced at $8.15. A new curve is created by summing the reservation prices across each consumer. The result is a new curve for the bundle that generates >2x the revenue.[6]

The same basic economics of bundles also explains the 'vicious cycle' erosion in traditional Pay TV since 2016:

> *First, networks launch streaming platforms focused on premium scripted. They began by licensing shows to Netflix (c. 2011-2019); then, they launched their own platforms (c. 2019-now).*
>
> *Second, some customers leave the bundle, mainly the "scripted mega-fans", that receive the least value from live programming.*
>
> *Third, those that do not churn, by definition, have higher average reservation prices for content still in the bundle – i.e., live content.*
>
> *Fourth, distributors can and do raise prices. There are now fewer cable bundle subscribers paying a higher average price.*

Figure 2: Q=1 Demand Curves for Various Consumers (x-axis)



SOURCE: ARCTOS.

[4] Just run the same thought experiment with three consumers, each of which is a mega-fan of one of three different channels.

[5] Mary would subscribe to Disney+ for $35 and would not subscribe to InfoNet for $35 (since her reservation price is much lower). Same thing, but reversed, for Andrew.

[6] Sadly, we cannot claim originality for this presentation of the idea. There are many good examples, but our favorite is a 2012 blog post from Chris Dixon that we've shared before.

> *Fifth, networks see these scripted mega-fan sub losses from the bundle and conclude that they need to place more of their scripted content outside of the bundle, repeating Step #1, and the vicious cycle continues.*

The vicious cycle has left the bundle a shell of its former self. Circa 2024, the bundle is now primarily live sports, complemented by national and local news and scripted re-runs.

At the risk of compounding sci-fi references, in *Dune*, Duke Leto Atreides, contemplating the burden of pacifying the desert planet Arrakis, says, "On Caladan, we ruled by sea and air power. Here we must scrabble for desert power." By this he means using the inherent advantages of the planet and its hardened inhabitants to one's advantage.

We believe the traditional media business needs to scrabble for bundle power to reduce streaming losses and stem the vicious cycle. Their largest competitors – Netflix, Amazon, Apple, and Google – all either have or could easily acquire the scale needed to be self-sustaining bundles in and of themselves. Several of them offer bundles beyond content – a heterogeneous content library *and* additional consumer product categories. In Amazon's case, this includes all of retail; for Apple, their bundle can be summarized as 25% penetration *of the human race* with Apple devices – you do not need to stare at subscriber numbers to see that this is gargantuan bundle power and reach.

Given the need for bundle power and the realities of cable today (i.e., most of the value is in its sports content), the critical question is this: who acts as the aggregator for sports? Who owns whatever next-generation sports bundle emerges from the ashes of cable? The answer could well be a boring one: i.e., it continues to be owned by Comcast and Charter – the cable incumbents.[7] The answer could be Google via YouTube TV. In a possible future further off, it could be Amazon or Apple or even Netflix. Or it could be something else entirely. **This is where the FOX-Disney-Warner Bros. "Spulu" sports JV enters the picture.**

The JV

On Feb. 6, Disney, Fox, and Warner Bros. Discovery announced plans to launch a new sports-first, streaming service by late 2024. The JV, which we will affectionately call "Spulu" (Sports Hulu), will aggregate the companies' collective sports portfolios, including all the major pro leagues and college sports.

Spulu will pay market-rate re-trans and affiliate fees for broadcast (FOX, ABC) and cable (ESPN, TNT, FS1, etc.) networks. Hence, Spulu will function like a new virtual MVPD (e.g., YouTube TV). It will also include each partners' sports streaming offerings (notably ESPN+) and be 'bundlable', presumably for an upcharge, with their existing non-sports streaming offerings (Hulu, Disney+, HBO Max).

Deals aren't closed until they are closed. This one is facing DOJ anti-trust scrutiny and a competitor lawsuit. Hence, we will comment on the announcement and the concept more than the specific details of the proposal.

First, the aggregation of sports content on offer here is impressive (Fig. 3), though, without CBS and NBC, it sadly includes only half of the NFL and one-third of Super Bowls until 2027. Neither Paramount (CBS) nor Comcast (NBC) plan to be involved and in fact may team up and launch a competitor. We believe this is a key limiting factor. Anyone churning from the traditional pay TV bundle for Spulu would need to part with ~50% of the NFL and cable news (still a significant draw). And any cord-cutters looking for sports would need to choose this new product over, say, YouTube TV, which has 100% of the NFL at an already reasonable price point. The NFL is a big deal – it accounts for roughly *50%* of the national media rights pie paid to the Big 4. People like to watch it!

Second, all JV content would be licensed non-exclusively – i.e., these channels would still be available across all existing distribution platforms, including cable, virtual MVPDs like YouTube TV as mentioned, and, for the streaming products, on an a la carte basis. In addition, ESPN DTC is still slated to be launched a la carte, as is Warner Bros.'s Bleacher Max – two new standalone

[7] And while cable video is arguably a superfluous technology, keep in mind that we still all use plastic credit cards.

sports products with a narrower selection than Spulu. That limits the bundle power and market leverage of this offering. Lachlan Murdoch recently indicated that they expect Spulu to have 5 million subscribers over the first five years – this is not much. On the flip side, it also dramatically lowers the stakes. (It could flop and ultimately cost the networks little, since they'll still get paid from *someone* – i.e., no one is threatened with losing access to sports.)

Third, regardless of its success, we feel that this move is not surprising. In our 2023 Annual Media Update, we outlined the bleak economics of a hyper-fragmented streaming ecosystem for legacy programmers (Disney, Paramount, NBC, & Warner Bros.-Discovery). In addition, on the linear network side of their business, distributors were starting to flex their muscles; we called the ESPN/Charter dispute an example of "the Distribution Empire Strik[ing] Back". Legacy programmers were getting squeezed from both sides.

Spulu is a notable development, not only because it is a new high-quality sports product, but also because we think it is a bargaining chip in the increasingly fraught distributor negotiations over what's left of cable – basically, the live sports bundle. What happens the next time an ESPN/Charter-like dispute occurs, where a sports channel is blacked out or threatened with such? ESPN will now always be available via this new bundle and eventually DTC, as Bob Iger has made clear. **Spulu is first and foremost a reply to the Distribution Empire.**

Here's why we think all this matters for sports properties:

- Unlike what headlines have suggested, **this is not a Great Rebundling. Not yet, anyway.** We continue to believe there will need to be rebundling to bring back economic stability to the media business. But we don't think it will be so easy. It will likely take a chaotic mix of consolidation, JVs with exclusive offerings, and outright exits from streaming (i.e., conversion to a licensing model). **Instead, Spulu is an attempt to *break away* from the current cable bundle and launch a new distributor with an incomplete sub-set of what's on already on cable – which we view as just more fragmentation and competition, not rebundling**. Why would these programmers do this? In our view, it's not to reach significant new consumers, but rather to compete more effectively with Comcast and Charter in the sports distribution business. The key here is that ***there already is a sports bundle, it is called cable, and this is an attempt to launch a rival.***[8]
- With Netflix entering sports (discussed below), there's also a risk that a wild card new entrant ends up owning the sports bundle of the future, or a really important piece of it, not Comcast/Charter OR the existing TV networks. That should be scary for networks. While not likely near-term, the firepower of Big Tech is enough to effectively buy out all of cable's crown jewels (NFL NFC and AFC packages, Super Bowls, NBA / MLB / NHL playoffs) right now, if they wanted. Defending their existing turf from Big Tech is also a factor.
- The real Great Rebundling requires a genuine mix of heterogeneous content genres, i.e., non-sports as well as sports. Cable has lost subs because of losing scripted; streaming has suffered without the mass popularity, pricing power, and stability that live

Figure 3

Spulu's Anticipated Sports Offering

PRO FOOTBALL	**NFL | UFL**
BASKETBALL	**NBA | WNBA**
BASEBALL	**MLB**
HOCKEY	**NHL**
COLLEGE SPORTS	**Thousands of games and events, multiple sports, across nearly two dozen conferences, including: ACC, Big 10, Big 12, Big East, SEC | 40 NCAA Championship Events | NCAA Men's & Women's Basketball Tournaments | The College Football Playoff**
GOLF	**PGA Tour | PGA Championship | The Masters | TGL**
GRAND SLAM TENNIS	**Wimbledon | US Open | Australian Open**
CYCLING	**Giro d'Italia | UCI Mountain Bike World Cup | Giro Donne**
SOCCER	**FIFA World Cup | U.S. Soccer NWSL | MLS | LALIGA | Bundesliga | UEFA | CONCACAF**
COMBAT SPORTS	**UFC | Top Rank**
AUTO	**Formula 1 | NASCAR | 24 Hours of Le Mans**

SOURCE: WARNER BROS. DISCOVERY.

[8] Cable plus: YouTube TV, Hulu + Live TV, etc.

sports bring. Just bundling a bunch of different sports together – even premium sports – lacks this essential element in our view.

- Rebundling will require the streaming landscape to simplify. When you look at it today, what you see remains highly fragmented, with perhaps some rebundling on the margins, kicked off by the ESPN/Charter dispute (Fig. 4).
- As such, we believe the optimal rights strategy for sports properties vis-à-vis media partners doesn't change. In the face of fragmentation, continuing to feed all hungry mouths and not pick winners in the media wars remains the best approach.
- In the midst of this chaos, **leagues and teams need to harness bundle power as best they can**. This means avoiding the temptation to go-it-alone in DTC and leaning into partners that offer a genuine bundle opportunity with other sports, other non-live content, and scripted. Especially with the decline of cable subscribers, reach is getting scarcer; 'watercooler' effects that sports still enjoys has declined for almost every other content niche.
- Another interesting approach for leagues is to create new kinds of fandom. Sports is a narrative goldmine. By giving non-fans or non-traditional fans, without the legacy of a long-term team loyalty, a reason to watch, you in effect harness bundle power by diversifying "reasons to watch". Our framework above predicts that with more fragmentation, we should get more leagues and sports-focused networks leaning into sports-related documentaries and non-gameday content. This leads us to WWE.

Netflix/WWE: Harnessing Bundle Power

Netflix is arguably the most powerful stand-alone content bundle globally. With the recent introduction of ads, and the strong performance of sports-adjacent programming, they have signaled a willingness to lean into live sports. Live sports was the one content category they were not exploiting at scale until WWE, as they've deliberately avoided it. The issue with premium sports, per Netflix, is its *non-substitutability*, which tilts the negotiating leverage between the content supplier and the network in content's favor. On top of that, league rights are temporary – 5 to 10 years – after which, any value that

Figure 4

How to Watch Sports in 2024?

Type	Distribution	Status or Est. Launch
Traditional	Cable (Linear)	*Active*
	Cable (Streaming)	*Active*
	Over-The-Air (i.e., Broadcast)	*Active*
	Satellite	*Active*
Virtual Multichannel Video Programming Distributor (i.e. vMVPDs)	YouTube TV	*Active*
	Hulu + Live TV	*Active*
	Sling TV	*Active*
	Fubo TV	*Active*
	Others (i.e., <5% market share)	*Active*
Network Streaming Bundles	'Spulu'	*Fall 2024*
	Paramount / Peacock	*Rumored*
Stand Alone Streaming Products with Sports	Disney Bundle	*Active*
	Max Bleacher	*Q3 2024*
	ESPN Direct-to-Consumer	*2025*
	Prime Video	*Active*
	Peacock	*Active*
	Apple TV+	*Active*
	Netflix	*Active*
	Paramount+	*Active*
	Bally Sports+	*Active*
	RSN OTTs	*Active*
League-Owned Out-of-Market Packages	MLB.TV	*Active*
	NBA League Pass	*Active*
	NFL Sunday Ticket	*Active*

Netflix would have generated for the league would not be capturable by Netflix. That focus on *terminal value* has been Netflix's north star. This has resulted in a determined focus on originals and full or partial rights acquisitions in content categories where the content suppliers are more fragmented and hence, where deals with terminal value are available and affordable.

How to maintain terminal value with live sports was Netflix's problem entering live sports. And the WWE deal is one possible solution.

The source of Netflix's terminal value (or nearly that) is the deal structure: they have an opt-out after five years and an option to extend for another 10 years. This is stronger than traditional back-end rights that networks enjoy, which are ROFOs; this is a ROFR at a fixed price (which, while likely higher than the published $500M AAV, is probably not much higher). **This means that Netflix is as close to an equity owner in WWE's content as you can imagine in an otherwise traditional "rights rental" model**. Like an owner, it can pull the plug early (in Year 5) if the ROI isn't manifesting, or, conversely, if there's a positive surprise, it can capture a considerable amount of the upside via the extension.

Why move into sports now? Bundle power. When you consider the growth challenge Netflix has in its core, developed markets, and the potential for sports content to help, it makes sense that they have both added advertising and are considering live sports. Netflix has fully penetrated the U.S. – it has 80 million subs in North America. That's a lot; at its peak in the mid-2010s, cable had 100 million subs. It will be hard to grow subs much more from here. The bigger opportunity for Netflix is growing average revenue per user (ARPU), which is currently just $16.64/month. Compare this to the traditional cable bundle: 71.5 million (not that far below Netflix!) paying $60-$120/month, depending on the service. The difference here is sports. Sports fans are the stickiest, highest-ARPU media customer, as evidenced by the stark difference between cable package prices today (mostly sports) and streaming package prices (mostly non-sports). **Sports, for Netflix, represents the last untouched *heterogeneous content niche* they haven't yet added to their bundle**.

In addition, WWE is not a traditional sports property. It is ultimately scripted, or if you like, a "simulated live sport". This gives WWE careful control over the storylines that surround the main competitive thread of the sport, which provides both traditional sports fans and fans of primarily other genres a reason to watch. This derisks the decision to enter sports for Netflix – WWE is closer to their bread and butter. But unscripted sports can also cultivate storylines that are not singularly about the on-field outcome. This is a way to harness bundle power too.

Finally, this is a great proposition for WWE as well. Netflix has leverage for a reason: **they offer the same intangible value of reach and relevance that comes with bundle power**. In exchange for giving away upside, WWE gets a true shot at *global* relevance that no traditional domestic distribution system can offer – 260 million subscribers in 190+ countries. At the same time, WWE does not lose the long-term contracted rights fees that shareholders value and can monetize the potential increase in reach and mass popularity via its other TV packages (e.g., Smackdown, PPV, etc.) And WWE knows the difficulty of "going-it-alone" DTC (WWE Network) and hence the value of bundling. This is WWE harnessing Netflix's bundle power for itself.

We suspect other leagues should review this model not primarily as an opportunity for rights fee growth, but as an opportunity to regain the reach lost by being anchored to an increasingly *non-heterogenous* pay TV product that is *leaking bundle power*. Netflix is the leader today at delivering non-live content on a global scale. Who wins the race to have this capability for live content is the race that, in our view, Netflix appears willing to enter. They are a serious threat to media incumbents, given their existing firepower in scripted and other non-live categories. The other Big Tech streamers offer analogous bundle power advantages for leagues.

Conclusion: Media Recession, Sports Boom

We have sensed the negative shift in narrative sentiment around the media business. We believe this is a reaction to the 'bad' Nash equilibrium that is industry-wide destructive competition in streaming. This has now limited some of their spending power, but it has not caused a decline in the real value of sports rights. While media companies are doing poorly, this is in part attributable to factors that *highlight the value* of sports. Sports have become more valuable in a world of diverse mini-bundles vs. one monolith, even though the competing mini-bundle world is also less profitable and more precarious for networks. We argue that a rebundling in some form of fashion must occur: losing billions per year on streaming does not work, and we're not optimistic they can all survive on their own. But at the same time, we do not believe that networks will ever return to the 40%+ EBITDA margins common during the heyday of cable. As we've described before, media is basically retailing – its value is in curation of other people's creativity. Since sports rights are their costs, tightening margins for networks means a better split of the pie for creators, like leagues.

This is admittedly an uncomfortable position to be in as a sports league. Wouldn't it be nice to have media partners that were seeing margin expansion as opposed to margin contraction? We know that, outside of the ultra-premium sports we focus on, it has been harder to get deals done with media companies today. So even sports, to some degree, have felt pressure. **But it is important to realize that legacy media companies continue to do incredibly well for what they are (retailers/curators), largely because they own sports rights (which power the last remaining profit center of the media business: the sports bundle, aka cable).**

The only leverage that a network can bring to a league or content creator is scale, or more specifically: bundle power. (We promise that is the last time we use that phrase.) And the new sports media entrants – Amazon, Apple, Google, and Netflix – offer this to a degree unmatched by legacy media. We are as excited about the long-term revenue picture for leagues with partners that can bring global ubiquity and relevance – backed by 260 million global subscribers (Netflix) or 230 Prime subscribers (Amazon) or a *2 billion* active install base (Apple) – as we are about any near-term revenue uplift or rights "step-ups" from Big Tech streamers. Cultivating their interest and buying power *for the long-term* is critical.