Content Remains King, but YouTube Builds the Throne of the Future

Content creation may have the lowest of all barriers to entry. Anyone with access to a smartphone and wi-fi can create and distribute endless GBs of content. However, replicating this process at scale, demonstrating audience reach, authentication and measurement and then syndicating this content, that same list of creators contracts to a few. Fewer still are the options available to a producer to reach a mass audience in today's increasingly fragmented, device agnostic world. Available platform alternatives include obtaining distribution with a major cable television or satellite operator, partnering with an over the top (OTT) provider such as Netflix, Hulu or Amazon, or joining one of thousands of multi-channel networks on YouTube.

Distribution Alternatives

National Cable Distribution

Nirvana for any producer or content creator is signing a distribution agreement with a cable, telco or satellite provider. In October 2013, music mogul Sean Combs launched Revolt TV, filling the void of music television left by MTV. Revolt launched on both Comcast and Time Warner Cable to 25 million subscribers. It is rare for a new, non-repurposed cable channel to obtain national distribution. In addition to Combs' celebrity (he produced a number of hit shows for MTV in the 2000s), the fledgling network looks to rely upon a strong online and social presence. The hope is the latter could help mitigate the cable TV boogieman of "cord cutting" or removal of cable service for other online or OTT alternatives. Since 2012, the cable industry has seen approximately 3% year-over-year decline each quarter in total cable subscribers, which is due in part to customers moving to substitutes like Netflix, Hulu and Amazon. As cable packages continue to escalate, it is anticipated that more consumers will cut the cord going forward and switch to alternative services. However, if you are not one of the most recognizable and successful music executives on the planet and have little hope of landing a 25 million household carriage deal with two majors, then what are your distribution alternatives?

Over the Top (OTT)

Broadband penetration, new video compression technologies enabling faster online streaming, proliferation of mobile devices and access to premium content have enabled Netflix, Hulu and Amazon to give content creators effectively a viable competitor to traditional TV. At least that is the argument that Comcast and Time Warner Cable will likely proffer in defense of their seemingly monopolistic $45 billion merger – linear TV is under siege from OTT providers and the market is much broader than traditional cable subscribers. With its stock appreciating ~130% LTM and critical acclaim from its original programming (House of Cards, Orange is the New Black), Netflix surpassed the 30 million member mark in 2013 and maintained similar net subscription additions as it achieved in 2012. Netflix's success has only intensified the competition with Hulu and Amazon for original content. In 2013, Netflix relied on original programming to attract new subs as it lost content to higher bidders (e.g., Amazon's bid for Viacom content). As a result, content costs will continue to escalate for filmed entertainment, syndicated TV shows and talent for original programming (e.g., stars experimenting with the OTT model such as Kevin Spacey in House of Cards). One could argue that the recently announced Comcast-Netflix interconnection agreement serves to ensure that Comcast remains the undisputed, last mile gatekeeper to the connected home. While well-known content creators likely salivate over this distribution dynamic, the vast majority are relegated to outsider status. Their passion, talent and persistence will be outweighed by obscurity. The question for those excluded from insider Hollywood is how to gain exposure, at scale, in order to be "discoverable" by agents and studios.

Multi-channel Networks (MCNs)

MCNs have garnered significant attention with the promise of producing content, partnering with third party content owners for distribution and representing thousands of channels to bring scale to advertisers. If you are 30+ years old and lean back to watch your 50-inch screen at home, the leading MCNs may not be household names (Maker Studios, Machinima, Full Screen, ZEFER, Defy Media, Awesomeness TV). However, they aggregate tens of billions of video streams, billions of subscribers and hundreds of thousands of channels and are found on YouTube, the world's largest online video platform. This is good. This is bad. This will change. Maybe. For MCNs, YouTube is not without its limitations and pitfalls. The video platform demands a reported 45% share of advertising, as much as $2.50 per 1,000 views their clips generate and requires repayment of any funds provided before the MCN and content creators see a penny. To date, YouTube does not have a dedicated sales force for video ads, relying largely on Google's overall ad sales efforts – arguably depressing CPMs. For fledgling producers, these economics are disquieting at best. Further complicating the calculus are the questions of "who owns the audience – YouTube or the MCN?", "how does the MCN expand distribution?", "when will video supply and demand equate to drive attractive CPMs? To address these issues, we examined noteworthy M&A transactions among MCNs to extract strategies to guide other participants in the space.

M&A Strategies of Multi-Channel Networks

Strategy #1: Online Channel Diversification

MAKER + blip

Maker Studios claims more than 340 million subscribers globally, generating around 5.5 billion monthly video views. According to management, Maker aims to be the online video version of the original Hollywood talent aggregator, United Artists (UA). Like UA, Maker provides a means for talented, unknown artists to build their own reputations through the power of Internet video channels. In August 2013, Maker acquired Blip, a long-time distribution network. While, the purchase price was undisclosed, Blip had received $24 million in venture funding. Since its founding in 2005, Blip pivoted from a formidable YouTube competitor, to a distribution partner, to a platform streaming videos and finally to a standalone distribution site. The transaction is notable as it provides Maker a distribution channel outside of the YouTube ecosystem. Theoretically, Maker can funnel its content to the Blip.tv site to attract higher CPMs, harnessing Blip's dedicated ad sales force. Similarly, Maker could choose to distribute Blip's content through its YouTube channel or other platforms (game consoles, smart TVs) and mobile devices. Given Maker's scale and engagement, the Blip acquisition enables the MCN to become omnichannel at scale. Big studios are recognizing the potential of omnichannel. Reportedly Disney is mulling a $500 million acquisition of Maker. To date, Maker has received $66 million in venture funding from Time Warner Investments and Greycroft Partners, among others.

Strategy #2: Amass Scale for Advertisers

alloydigital + BREAK MEDIA

In October 2013, Alloy Digital merged into a 50-50 partnership with Break Media, a network of youth-oriented entertainment sites, forming a newly created Internet video studio called Defy Media. Founded in 2004, Break Media is a digital media leader in male-targeted content creation and distribution. At the time of the transaction, Break reached more than 85 million unique visitors per month across its digital properties, including the #1 comedy video site Break.com and top men's lifestyle property MadeMan.com, and maintains a growing presence on emerging platforms with more than two million YouTube subscribers and five million mobile app installs. Seeking greater economies of scale and providing a uniform media buy for advertisers focused on content and distribution to the key 12-34 demo, Defy will reportedly generate $100M+ in revenue and be profitable. Of particular note to advertisers is Defy's combination of compelling content, audience reach and omnichannel strategy. Defy intends to migrate its sizable audience offline while maintaining its YouTube presence. Defy will seek to extend Alloy Digital and Break Media's channel acceleration agreements with YouTube and bolster multi-platform content development relationships with new and existing partners, including Freemantle, MTV, Fuse, BBC Worldwide Productions, New Regency Productions and 20th Century Fox.

Strategy #3: Offline Channel Diversification

DREAMWORKS SKG STUDIOS + AWESOMENESS TV

There is a school of thought in the technology community that acquisitions are always failures. The thesis is that entrepreneurs found companies to create and/or disrupt a marketplace that has not adequately solved a problem. Once acquired, the DNA of the startup is fundamentally altered and cannot thrive within a different, larger or established organism. The counter to that argument is that the strategic underpinnings, as well as integration/execution, will largely dictate success or failure whether it is organic or inorganic growth. Under this construct, DreamWorks Animation's acquisition of Awesomeness TV will be one to watch. The $33 million acquisition (could be significantly higher based on achieving milestones) of Awesomeness TV, a teen-focused MCN founded in 2012 by veteran TV and film producer Brian Robbins, would seem a perfect complement to DreamWorks. At the time of the transaction, with 55,000 channels, aggregating over 14 million subscribers and 800 million video views, the Awesomeness TV brand has extended beyond the mobile platform into television and film, signaling continued omnichannel expansion plans. As part of DreamWorks, Robbins will continue to grow the company and assume an executive role at the studio to develop a DreamWorks Animation branded digital family channel, harnessing the studio's resources, technology and vast IP portfolio. In the press release announcing the transaction, Robbins explained, "The acquisition of Awesomeness TV by DreamWorks Animation speaks to Jeffrey [Katzenberg]'s vision for the future of entertainment, the immense appetite for new kinds of storytelling and the power and reach of YouTube." The acquisition underlines Hollywood's interest in tapping into massive online audiences that can be funneled to TV and film, e.g., a potential Disney-Maker Studios combination. Robbins' theory is that until digital advertising CPMs increase, TV and movies remain the preferred monetization platforms. "If we were building a business today solely on advertising revenue from YouTube, I'm not sure I'd be so bullish," he said. "Eventually, yes. But the opportunity to create IP that's valuable and that could be valuable downstream in all the other platforms that exist, that's a big revenue stream."

Implications

In 2013, Maker Studios, DreamWorks Animation and Alloy Digital aggressively pursued acquisitions to broaden reach and attract advertisers seeking access to coveted audiences. Meanwhile, in September 2013, Machinima, a gaming focused MCN, reported its second round of layoffs in as many years. With a reported 2 billion monthly video views and 11 billion monthly minutes watched worldwide as of December 2013, scale is not the likely cause of Machinima's troubles. The combination of channel and category concentration, YouTube and gaming, respectively, appear to be the principal issues facing Machinima. Consequently, Machinima's monetization opportunities are limited. With nearly $50 million in venture funding from Google, MK Capital and Redpoint Ventures, solving the monetization problem is of primary concern. Implementing the strategies highlighted above, Machinima has begun to invest in owned and operated websites and original programming with an eye towards mobilizing its audience base through cross channel promotion. Reportedly, the company is in dialogue with major studios and video game manufacturers hoping to leverage its Mortal Kombat and Rise franchises to develop film and TV revenue opportunities. Machinima and similarly situated content creators could then release a sponsored trailer on YouTube directing subscribers to their standalone channels (or other designated destinations, e.g., social media platform) for additional revenue partnerships with brands or licensing deals with studios. This model is analogous to celebrities directing Twitter or Facebook followers to a specified platform for sneak previews, promotions, etc. In this regard, YouTube becomes an audience acquisition funnel enabling MCNs to monetize either online or offline. The importance of managing the ad sales process on destination sites becomes paramount until CPMs reach a more attractive equilibrium for content creators. Pundits continue to signal that death is near for MCNs. For those participants failing to navigate channel, audience and category diversification effectively, those pundits may indeed prove to be prophets.

Recent Private Financings: Online Video Platforms

Date	Target	Acquirer	Transaction Value	Description
Mar 14	Machinima, Inc.	Redpoint Ventures; Warner Bros.; MK Capital; Google Capital	$18.0	Video entertainment network for video gamers
Feb 14 A	ZEFR, Inc.	Institutional Venture Partners; U.S. Venture Partners; et al.	$30.0	Solutions for professional content owners on YouTube
Jan 14	PlanetDaily Network, Inc.	NBCUniversal Media, LLC	-	Short video news clips for broadcast over the internet
Dec 13	iROKO Partners Limited	Investment AB Kinnevik; Tiger Global Management LLC; Rise Capital	$8.0	Online distribution of movies, and music
Oct 13	DanceOn, Inc.	AMC Networks; Klass Capital; Launchpad LA; and Plus Capital	$4.2	Dance video entertainment network
Oct 13	SB.TV Global Ltd	Miroma Ventures	-	Online music and lifestyle media platform/channel
Sep 13	Divimove GmbH	FremantleMedia Limited	-	Youtube partner network for content creators
Aug 13	TasteMade, Inc.	Redpoint Ventures; Raine Ventures LLC	$10.0	Media company for food lovers
Jun 13	BroadbandTV Corp.	RTL Group SA	$36.0	Media and technology company
Jun 13	Fullscreen, Inc.	Comcast Ventures; WPP plc; The Chernin Group, LLC	$30.0	Digital media company
Mar 13	Alloy Digital, LLC	ABS Capital Partners; ZelnickMedia LLC	$30.0	Digital media company
Jul 13	VEVO LLC	YouTube, LLC	$50.0	Online syndication network and platform
Apr 13 A	Bigframe, Inc.	N/A	$2.3	Marketing and production for YouTube influencers
Jan 13 A	StyleHaul Inc.	Bertelsmann; RTL Group; Siemer Ventures and RezVen Partners	$12.5	Online makeup video community
Nov 12 A	Maker Studios, Inc.	GRP Partners; SingTel Ventures; et al.	$62.0	Media company specialized in YouTube.
Aug 12	AwesomenessTV, Inc.	New World Ventures; MK Capital; Greycroft Partners LLC	$3.5	Media company that operates a YouTube channel
Aug 12	Movieclips, Inc.	U.S. Venture Partners; MK Capital; Shasta Ventures et al.	$18.5	Solutions for professional content owners on YouTube
Aug 12 A	My Damn Channel, Inc.	N/A	$1.1	Entertainment studio and media platform
Jun 12 A	TasteMade, Inc.	N/A	$5.4	Media company for food lovers
Jun 12	Bigframe, Inc.	Anthem Venture Partners; New World Ventures; et al.	$3.4	Marketing and production for YouTube influencers
May 12	Machinima, Inc.	Redpoint Ventures; Google Inc.; MK Capital	$36.0	Video entertainment network for video gamers

Source: Capital IQ and Crunchbase database. Amounts in millions of U.S. dollars.

Recent M&A Activity: Online Video Platforms

Date	Target	Acquirer	Enterprise Value	Description
Mar 14	Studio Bagel Productions SAS	Societe d'Edition de Canal Plus S.A.	-	A YouTube channel
Feb 14 A	Hulu Japan LLC	Nippon Television Holdings, Inc.	-	Online video distributor in Japan
Feb 14	Reelhouse Media Ltd.	Gener8 Media Corp.	$7.8	Online video distribution platform
Feb 14 A	Tube One Networks GmbH	Ströer Media AG	-	Online video network on social websites
Jan 14	Reelhouse Media Ltd.	Gener8 Media Corp.	-	Online video distribution platform
Jan 14	Supernova Inc.	Fullscreen, Inc.	-	Mobile video creation, discovery, and sharing
Dec 13	DWA Investments, Inc.	Yahoo! Inc.	-	Video content production and distribution
Nov 13 A	Splay AB	Modern Times Group Mtg AB	-	Entertainment content on YouTube
Oct 13	Break Media	Alloy Digital, LLC (nka:Defy Media, LLC)	-	Digital entertainment content
Sep 13	Blip Networks, Inc.	Maker Studios, Inc.	-	Digital media company
May 13	DeFranco Creative	Revision3 Corporation	-	Video channel for Youtube networks
May 13	AwesomenessTV, Inc.	DreamWorks Animation SKG Inc.	$150.5	YouTube channel geared toward teens
Apr 13	Digital Broadcasting Group, Inc.	Alloy Digital, LLC (nka:Defy Media, LLC)	-	Video content production and distribution
Jan 13	Pipewave, Inc.	ZEFR, Inc.	-	Online video optimization platform

Source: Capital IQ and Crunchbase database. Amounts in millions of U.S. dollars..

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Managing Director

212.485.5873

elgin.thompson@marcumcronus.com

Elgin Thompson is a Managing Director at Marcum Cronus Partners with expertise at the intersection of media, technology and brands. Mr. Thompson has over 17 years of experience representing clients on a variety of assignments including sell-side, buy-side, fairness opinion, special committee, divestiture and merger transactions in both the public and private domain, as well as equity and debt financing. He has executed over $40 billion in transaction value. Prior to joining the firm, he served as a senior member of Williams Capital, a boutique investment bank where he led efforts in media and technology. Previously, Mr. Thompson was the Vice President of Corporate Development for GridNetworks, Inc., a venture-backed video technology provider. Prior to GridNetworks, he was a Vice President in the Media Investment Banking Group at Bear Stearns where he executed transactions for a wide spectrum of clients, including global media and entertainment companies, private equity firms, and digital media companies. Mr. Thompson began his career as a mergers and acquisitions attorney. He serves on the advisory board of Sprezzat, a mobile technology company. Mr. Thompson received an M.B.A. from the Kellogg School at Northwestern University, J.D. from Temple University and B.A. from Northern Illinois University.

MARCUM CRONUS PARTNERS LLC
www.MarcumCronus.com
New York | New Haven | Boston

Andrea Chase
Director, Marketing and Business Development
212.485.5876
andrea.chase@marcumcronus.com