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21st Century Fox, Inc. (FOX)

Morgan Stanley Technology, Media and Telecom Conference

MANAGEMENT DISCUSSION SECTION

Benjamin Daniel Swinburne – Analyst

Okay. We're going to get started, if everyone can please grab their seats that would be great. Please note that important disclosures including my personal holdings disclosures and Morgan Stanley disclosures all appear as a handout available in the registration area and on the Morgan Stanley public website, just to remind you, I'm Ben Swinburne, Morgan Stanley's Cable, Media Advertising Analyst. And I'm really excited about this next conversation, we're going to talk about sports. To my left is Eric Shanks, Eric is the COO and Executive Producer at Fox Sports. Prior to joining Fox in 2010, he was Executive Vice President for entertainment at DirecTV. Eric currently oversees all entities within Fox Sports, including Fox Sports 1, Fox Sports 2, the Fox's regional sports networks, Fox Sports has an all digital ventures. Eric, thanks for coming to San Francisco and spending time with us.

Eric Shanks

Thanks. Good evening.

QUESTION AND ANSWER SECTION

Benjamin Daniel Swinburne

Q

Why don't start off with how the company views sports programming. It's obviously a place where advertisers appreciate the product, because it's live, but there is also a lot of focus in the market about the cost of sports rights. So why are sports so important to the Fox – 21st Century Fox strategy?

Eric Shanks

A

Ben, I think the sports has been really one of the – got it.

Benjamin Daniel Swinburne – Analyst

Q

Here we go.

Eric Shanks

A

Sports has been one of the key drivers of this company building businesses of backup for a long time and not just really in this country. So the power of sports and the fact that it connects people and the passion that it drives is something that we have found to be a really important part of our overall entertainment portfolio mix. And the fact that today even after we've helped, sports has helped to build businesses around the world. Today it's live and it is growing. So I think that's kind of a key takeaway as sports is live and growing and I think over the last 10 years, sports -- consumption has grown by over nine billion hours, up 41%. So, it's one of the key areas that is not only historically been a key component of driving growth for our business, but it's one of the sectors within the entertainment portfolio that is clearly growing.

Q

May be you can help put sports in context for us at Fox and how big is the business at Fox and how much is it contributing to the growth that you're just referring to.

A

Internally we look at sports contributing roughly 40% of the revenues globally for Fox. And I think that from an external perspective, we look at market share and across our competitive set, the market share, usually people, it is easy to look at kid of the national market share statistics, a big part of our business and really important of our business is the regional sports network and we take into account the total consumption of sports minutes throughout the year. The market share is actually much closer than you would think. So the leader is about 30% and Fox is at about 26% of total market share of sports and then the next closest is down to about 18%.

Q

Great. You mentioned global for Fox. You have been a global company for a long time. How do you look at securing sports rights in terms of the opportunity and the risks in different parts of the world that Fox operates in?

A

So I think that whether it's different countries or continents or really even just different regions within this country, I think that we're – we're experts at determining kind of the risk rewards in each market and a lot of it – a lot of the analysis is the same whether it's domestic or international, which is how exclusive can the content be, how fractured is the market, how mature is the market and we take all of that really into account.

I think that internationally, we see a lot of opportunity not only because there's probably more runway for growth, I think in certain territories, but also this country is sports mad. There's – there's no country where there is greater supply or greater demand year-round for sports. And you take a look at other countries, and it's just not there yet. They're either singular or maybe only the premier sports and then a true secondary sport. And I think that there's real opportunity to kind of get higher in the food chain and the value chain as it comes to sports in other countries.

Q

Is there any particular market or region you'd call out as being sort of the best growth opportunities for the company on the sports side?

A

Well I think, we – depending on kind of macroeconomic factors and exchange rates, Brazil has – was a real area of growth. I think that it's yet to be seen how that market will shake out. But we're also really, really high on India. India is a market where dominated by one central sport, but it's a sports hungry country. So there's opportunities like what we're doing to build completely new sports and take ownership positions in those sports in countries like India.

Q

Yeah. You mentioned moving upstream recently that James and the team talk a lot about, what does that mean in the context of sports for people here less familiar with it?

A

Well, so for example, in India, we actually had a global sports conference and we were searching around on YouTube for interesting things about each country and kind of the sports traditions in each country and we found on YouTube, an ancient Indian game called Kabaddi, it's played in villages, on dirt fields, and it's probably one of the oldest sports known to man, 3,000 years old.

And really nobody had ever done anything with it professionally. And so at this conference, we said, let's make a goal of it. And Uday and Nitin, running sports and running Star in India quickly professionalized this sports league, which we own now in India, and it's averaging in its second season about 135 million people per game, it's doing a 0.13 in India, that's how big the country is, but – and then the final is next week. So, we have high hopes for things like that. We own an equity position in the Indian Soccer League, the Indian Super League. So, there is real opportunities in that country to try things, to see what's fixed.

Q

Yeah, interesting. Coming back to the U.S. market, as you know, there has been borderline obsession with the state of cord-cutting, cord-shaving in this market, mainly been focused on ESPN and Disney and whether they're being included or not included in certain bundles, things that Verizon has been doing. So the question of course comes out with Fox all the time, which is – how do we think about the risk around Fox's domestic sports networks in the context of how the bundles evolve and what can you tell us – what's your perspective on that, sitting where you sit?

A

Well, I think there is a couple of aspects to that, in that we have said for a long time that we're big believers in the broadcast business and sports as a component of the broadcast business. So our biggest events, our biggest contracts, the majority of those, we still put on broadcast and I think that it's pretty clear that the notion of chord shaving or chord cutting is not affecting the broadcast business, as much and as it is others.

And then what that does for us is it helps, it causes us to really balance our portfolio, so that we're not kind of over scheduling more events either on Fox Sports 1, or on the broadcast network. We really try to find a balance between those businesses, and I think that's one of the reasons why probably, relative to our peers, we've been able to have real kind of price strengths and retrans because of the majority of sports that we've put on broadcast.

And then we have a still growing Fox Sports 1 business. And the combination of Fox Sports 1 and Fox Sports 2 as we increase the level of penetration of those, I think the combination of those two since launch has increased 8 million homes, across the two of them. So I think that's how we look at it, and then looking at the distributor business in and of itself, we don't see cord-shaving, cord-cutting being an accelerating trend at the moment.

I think And two years ago, you saw I think 1.7, last year 1.2 and I think that you are starting to see it not accelerating, but decelerating if not leveling off.

Q

Yeah. Those are the sub, percentage sub losses that you are calling.

A

Those were the gross sub loss, right, or the net sub losses.

Q

Okay. For the industry or for...

A

For the industry.

Q

Okay.

A

Yeah.

Q

It's interesting that you've launched Fox Sports 1 and I think you've had some recent successful renewals with the back dropping the assumption that MVPD, they are trying to reduce the distribution in sports now. It's obviously between your RSNs and Fox Sports 1, sounds like those conversations are different for you.

A

Well I think it's a balance, we don't go out, our distribution group doesn't go out with just a sports offering, right...

Q

Right, right, right.

A

And it's not just the single RSN offering, it's the portfolio of brands that Fox has. And each distributor comes from a different place of where they've had levels of penetration either of Sports or FX or National Geographic. And then each distributor has different goals, whether it be a focus on SVOD or OTT, driving their – their ability to have different packages or different consumer offerings. So, I think we've come at it from a place where, we've had I think strength in driving new penetration for the channels that we're investing in...

Q

Yeah.

A

And holding the penetration levels for the valuable content around, entertainment or the RSNs.

A

You had a – you and your team and the Fox Sports sort of over the long term and a lot of experience negotiating with teams and leagues and colleges and conferences in both regionally and nationally. It always comes up in conversations I have about leagues going direct, watching direct [indiscernible] 00:11:16 and scenes, maybe experiments here and there, but why – why do you think that hasn't happened, you think it's a risk and what – when you talk to your partners on the sport side, the leagues what is it that Fox brings to the table, that clearly, they believe works for them besides money?

Q

Right, good luck as well. The nature of the contracts at least the cycle that we're in, kind of keep the status quo of a rights seller and a rights buyer for our major packages, probably at least for seven years -- five years to seven years in our major packages. So there's kind of limited ability for the large packages to do that. I also think it's – there are a lot of smart people, running teams, running leagues that really do take a look at the idea of their risk profile as they go it alone.

Q

Okay.

A

We are – we have been able and I think a lot of guys really or a lot of teams, and leagues really believe that they can create more value with less risk, having a relationship with the media partner, who is focused on promoting the sport through its -- not only sports assets, but entertainment and digital assets. There's a consistent commitment on cash flow and that I think allows some of the leagues to do things on the digital side that are additive to their business; UFC Fight Night for example. We're the exclusive media partner outside of pay-per-view of the UFC and then they wanted to go out and build their international business and those international fight that off-hours, they do on fight next. And I think things like that are additives. Now as time goes on, we truly want to be much more aligned with our partners than not aligned. We would like to be able to say that we're creating these businesses whether it would be digital or linear, really together so that, as that -- we all know that the line between digital and linear is getting more gray every day and as that really starts to go away and there is no difference. I think you want to be much more aligned with your partners really on a global basis.

Q

You mentioned that your big rights deals are sort of in place now for a while, but I know you are still investing in the business. Where you guys spending your time and money in terms of making the broad Fox Sports portfolio better?

A

Well, I think, on the national business, you're right, we've – the initial investment phase has slowed and we have the portfolio set that we want to go into the future with and there is probably only a couple of opportunities in the next few years to even really look at. So, we feel really good about our rights portfolio, and then it's got a good mix of what we would call kind of growth, stocks, Blue-Chip stocks and mutual funds within that that portfolio. I think that what we see is based on some consumer viewing trends, consumption habits, we really are starting to put a focus on kind of our non-event programming.

Q

Yeah.

A

So having a reason to come to our national sports channels outside of live events, and I think we're seeing is a clear sign from the consumers, what they want in those off-hours that you are not doing a pregame show, postgame show or a live event and I think that's the focus we've brought in a new team to really focus on that. Jamie Horowitz and his team are some of the best in the business and that's on the a national sports side, and I think internationally, we reorganized recently to try to have the capability to really exert our scale kind of globally, a little bit more and truly be better partners to say that our 10 biggest global partners around the world. So those are the two areas that were probably spending the time on right now.

Q

People like the Premier League for example, things like those?

A

At Premier League, FIFA, Bundesliga, the NFL.

Q

Yeah.

A

So yeah.

Q

Got it. We just went through the Thursday Night Football process and we had Comcast speaking earlier today talking about NFL moving over there. What was Fox's strategy in the bidding process, can you open a little window and then sort of how you guys thought about the cost and value of those rights?

A

Well, and – we'd like to have long-term partnerships with folks to drive both kind of predictability in the business and again we talked about retrans value and so the advertising marketplace for the NFL is somewhat consistent across networks – different maybe slightly different pricing, slightly different enhancements, slightly different shoulder programming but there is a band in there. So I think our analysis was, A, we'd love to have long-term deal on Thursday Night with the NFL, so that it provides leverage in some of the discussions around retrans and other things.

And so the short-term nature of it, you really – you look at the economics and the return on the investment over those two years and I think that we came out where we did and we'll live to fight another day. I mean the reality is that they'll probably be having discussions right as soon as the seasons over for the future.

Q

Right.

A

And at the same time – at the exact same time, all that was happening Los – or St. Louis is moving to Los Angeles, right. NFC package moving from a smaller market to a bigger market where we have an O&O and so looking at the value that the pure move of St. Louis to Los Angeles and the value of a short-term Thursday Night deal, we think it actually it worked out, okay, for the near-term for us.

Q

Sure. Absolutely. When you look at the Fox Sports – Fox Sports 1 thesis that you and the team put in place a few years ago at a rebrand speed as FS1 and you made a big debt, I think you've reached profitability no w recently, can you tell us sort of what any more in part in the sports analogy, but in getting that affiliate, Peter, where you wanted to be and kind of how we should think about the profit opportunity for that network?

A

Yeah. It was interesting kind of doing a launch rebrand investing, known that you have to invest in sports rights to be able to drive distribution and drive the pricing power, really. And so, I would say we're probably out of the third inning, right. We've kind – we've maybe back gone through the lineup once, batted around once...

Q

But not an official game yet?

A

Exactly. Right. And so, we think that Fox Sports 1 is undervalued, underpriced right now in the market relative to where we started and the value that it has. But again, we look at our sports business really is a portfolio business. So, sure there is a value for Fox Sports 1, Fox Sports 2. But in the context of the entire Fox portfolio, and the goals at the time, it really – these relationships with distributors are getting larger and more complicated. And so what you want to do is you want to simplify as much as you can the relationship and make sure that everybody is getting out of the economics, out of the value, exactly what they want out of the total relation ship. But we do believe that Fox Sports 1 is ramping, and as we go through the next cycle there is no question that Fox Sports 1 will have the pricing power it needs to get the value.

Benjamin Daniel Swinburne – Analyst

Q

How are – how has and how are [indiscernible] is looking at the network. I mean, it's – it's to some extent, they don't want to pay for more networks I'm sure and at the same time, it's there is real competition, ESPN maybe for the first time ever. So how – what's the conversation like at this point around the network?

A

Well, I think that the portfolio of rights that we have really kind of dovetail well with what a lot of the distributors want to do with some of their future packages. We have – we have really young sports with a lot of volume. So, we have the largest soccer portfolio in this country. Soccer fits really well with distributors that want to launch either new streaming services, new OTT services. UFC is a really young sport. And so, I think that what they do is, as you look at the – what we have to offer on a total brand basis and also really the growth of the network – I think that

Fox Sports 1 was up 30%, total day rating. So that's growth that you really can't ignore. And we always say how long does it take somebody, how long does it take a normal customer to learn the channel number, right.

Q

Yeah.

A

We think it takes about three years for somebody to actually start to remember a three digit channel number to get into their rotation. And so, we're at about that timeframe, where you're seeing really good organic growth, even in the Big East and our college football. So, we think that there will continue to be consumer demand for the products that we have and inside of the portfolio, Fox Sports 1 will continue to play a more important role in the portfolio.

Q

How do you look at driving viewership across particularly the Fox Sports 1 and a younger network? You mentioned, you're rights are sort of there. People are learning where the network is. What else can you do, you mentioned before a little bit out of [indiscernible] shoulder program and you sort of drive viewership. What are you doing?

A

Yes, the data is telling us the consumption is telling us that consumers are finding certain parts of sports programming in very different ways and it's accelerating. So the news and highlight genre is quickly changing.

Q

Yeah.

A

News and highlights, I think were down 12% last year.

Q

For you or...

A

Kind of industry wide...

Q

Yeah.

A

...and you take that over a five-year span it's almost 40% for news and highlights and it makes sense...

Q

Right.

A

...because you get everything you need before you even get home, and so what you're looking for really is context.

Q

Yeah.

A

You're looking for context. You're looking for something to go have a conversation about sports or an opinion about sports from personalities that you enjoy watching. And so I think that's kind of guiding some of the decision-making that we're doing at Fox Sports 1.

Q

Makes sense. I just was talking to Discovery before I came here, and we had CVS yesterday. Everyone is talking about ad markets strength. How is the sports market from an advertising perspective?

A

The sports market, well, like I said, the ad market in general is I think seeing some strength at the moment especially good news as we're going into the upfront season.

Q

Yeah.

A

But the sports market, what we're seeing really, I think is an acknowledgment that of all of the different places that people can advertise, their really is a trust and a safety inside of sports. You know – you know where your brand is next to. You know that is being consumed 95% live.

Q

Yeah.

A

And we're also finding that people are starting to acknowledge the new measurement by Nielsen, which is the out-of-home measurement. And it's still, something you're going to negotiate for, but just as they – advertisers have acknowledged that there is value and the impressions in TV everywhere. There is value in measuring out-of-home now.

And so, you look at NFL viewership, if you take into account, the out-of-home people meters, so it's an impression, where somebody in a bar, hotel, or somebody else's house, is actually seeing and hearing that advertisement NFL ratings to be up 30%. U.S. Open Golf would be up nearly 40% and the UFC would be up about 30% as well.

So, as Nielsen starts to take into account out-of-home viewing into its standard reporting structure, you're going to see some sports have fairly significant bumps in viewership and that's going to I think also start to drive more value in that live communal consumption of sports.

Q

That could actually drive ad revenue share for sports?

A

Right. Like I said I think it's a negotiation, right?

Q

So, the agency ...

A

I think that is the agencies are going to immediately say oh, charge me 30%, I'm going to sign up for that. So it's going to be – it's going to be a discussion really, but I think there's no doubt that the way it is being measured is true and if those impressions are real, and if you go even further kind of into recall of out-of-home, the setting that you're in, when you're in with a group of people, you need to get the recall is as good, if not better and the engagement is as good, if not better.

Q

Sure.

A

Then when you're watching in a singular living room by yourself.

A

Let's turn, I'll make sure we have enough time to get through this and get some questions. Let's turn to the RSN business, which, I will guess, if you pulled 100 media investors about who is at risk around the bundle, the RSN though has come up pretty quickly. So it's hard, when you don't have local ratings to sort of understand how these networks are doing good or bad, maybe you could just talk a little bit about, first just the viewership and the relevance of these networks in their local markets and why that the business for you guys.

A

I guess, I would of the 100 analysts, I would say which channel that they watch the most, right. And if they're in a market where, we have an RSN, more than likely. One of the top three channels, they watch is in RSN.

Q

Right.

A

So, I think our – is there a dog in the – I really want no know who you have that assigned to...

Q

More importantly, they don't want to know...

A

Right, exactly. Look where we have that the largest – the difference between own RSN business some of the others is really our scale.

Q

All right.

A

Scale matters in this business, and we have rights relationships with half of the professional teams in this country. So 44 teams to 88 teams we have their rights locally. And we've tried to make sure that we have the breadth of those local relationships, so that you – you know try to all – you don't want to have a single team RSN. So strategically we have at least baseball team, an NBA team, you'd like to have a winter sport, if not two baseball teams like in the case in Florida. So scale and the ability to actually own a territory when you are going into those discussions.

We believe matters and I think we've been very, very good at not only concentrating in certain markets and avoiding markets that kind of same trouble signs, whether it's been Los Angeles or whether it's been Houston. I feel like we've been very disciplined.

Q

Yeah.

A

Not saying that we have to do something, because we're not reliant on any one single team, we're not reliant on any one single market. But we view the portfolio as a whole and we've also -- really to my point earlier we've become much more aligned with our local partners. So that we actually share some of the risk and some of the reward with equity positions or profit participations in those markets. So we are very aligned on the cost base of an RSN. We're very align on league relationships with some of our biggest partners and I think all of those combined make us feel really good about the health and stability of the RSN market and I think we've said, look the RSN market is the – because of our other investments in some of the new channels, both domestically and internationally growth is – extreme growth is what, you are not going to see out the RSN.

A

That's right.

A

But it is a very, we've take a very stable and predictable business and is must have content especially when you are moving into that kind of one-to-one OTT space.

Q

Yeah. Part of the people have been focused on and of course it is the Comcast situation with the YES Network and maybe you can step back from that and just help us think about subscriber risk or not across the RSN portfolio, looking out over time, do you expect subscriber trends of the – in the RSN to be better, worse, in line with sort of the overall extended basic bundle?

A

Well, up until now, they've been pretty much in line.

Q

Yeah.

A

Right, with the rest of the bundle. The Comcast, we have actually prided ourselves, getting a lot of renewals done in the very recent past without having these kind of flare-ups. I mean nobody wants to have them. You want to be – you want to have productive relationships with your distribution partners. I think this was – this was an opportunistic moment for this particular distributor to do this and we'll work through it. I mean the season is coming up soon and we're going to put every effort we can into making sure that not only gets back on, but Comcast ceased the value in carrying the Yankees for its customers in that market.

Q

Right. Makes sense. You mentioned before aligning with your partners, what's the trend in like in sort of equity positions for your teams and if you look at the business holistically, Fox's equity in the RSN, is that growing over time? And do you think this is a net positive for your business to have these partners, essentially own part of the network now or more and more?

A

Yeah. We think it's a net positive. We also think that it's being a good partner in that. Certain teams want to have that relationship. I think that they want to be more in business with us to share goals for the long term. The RSN deals are still for the most part longer than national deals. So, you really are true partners with these teams and again being able to manage the business, so that you are managing the business with shared goals. So it's really not just – it's really not just the team saying I want you to have 22 cameras on my local baseball game. Now when you're in business, you say actually we want to manage the cost base of the RSN. We want to manage the profitability and God forbid, we do you get into disputes that team is really right there with you, I mean they are not – they are not saying this is your problem. This is our problem.

Q

Right.

A

If something like that actually does happen.

Q

Yeah it makes sense. In the minutes we have left will open it for the audience. We want to come to international because Fox is unique in its global scale. So how do you use that scale to make sure you get the best deal you can get in markets outside the U.S.

A

Well, I think that there is an acknowledgment internally that we can do a better job of that and we've recently, Peter and James have recently reorganized our entire international business to really look like each territory being an operating entity like the U.S. So between Asia and Europe, Latin and South America and the U.S., those are really four equal operating entities without a layer in between. And so it's bringing us closer to the product and I think closer to exploring our scale, not just on the buy side on sports, but also on the revenue side in sports. So we can now -- we're now organized in such a way where we can actually truly represent to a sponsor who wants to buy or be the presenting sponsor and activate around the Bundesliga in 90 countries on Fox.

And again going back to advertisers knowing, that it's a safe place to be. Because we have the boots on the ground in all of those countries, we can guarantee the execution, both locally and globally for a sponsor.

Q

Got it. Actually one more, and then we'll open up the audience. Please wait for the mic, if you have a question? I found myself spending more time with apps and other new services on sports, that's why technology has made engagement in sports. Not even further than it already was before, how are you guys – is that an opportunity for Fox Sports and is there money there in terms of monetizing, engagement outside of just watching games?

A

Yeah. I think that there is much more engagement out of – there's much more engagement besides just watching the games on digital platforms. TV Everywhere and other platforms. They don't account for a lot of consumption, right now.

And we all know that the product needs to improve, but that there's going to be other consumer offerings on other devices in the near future, but there's no question that sports accounts for something like 2% of all entertainment hours, but it accounts for 50% of [indiscernible] traffic. Okay.

Q

Okay.

A

So, sports absolutely outpunches its way as far as engagement goes. Because people are engaging and thinking and debating and communicating about sports, much more than just when a game is going on. So, the engagement is there. I think that you need to figure out the monetization part of it, because, we know that sports drives quality impressions as far as engagement goes.

Q

Yeah.

A

But, I think that people are still struggling with the measurement of those impressions, the value of – the quality of those impressions because there're so many of them across Facebook, across Twitter, across your owned and operated platforms. So, we've had some good success recently like around the Super Bowl. We actually drove more engagement around an event that we didn't even have the rights to, than any other sports media network out there. And GoDaddy was our sponsor and we over delivered impressions for them because we have a focus on not just taking the content that we produce on television and putting it out on Snapchat, or putting it out on Instagram. You really need to understand I think the unique capabilities of these platforms and have both personalities and the expertise to produce content that the users of those platforms want to see and want to engage with.

Q

Yeah. Makes sense. Okay. Any questions for Eric before we run out of time? So I could take one, so there's one. Yeah. Go ahead.

Q

This question of do you see like reality TV and sports that combination? I think you're doing something with The Ultimate Fighter there or things like that. Is that something where you see more potential or some more in more traditional sports fields?

A

Okay. I mean think that that genre has been tried of reality competition around whether it's been the NBA or the NFL. I think that what we're seeing though is at least based on consumption, there's probably other genres that we're investing in right now that people are telling us that's what they want to watch and they want to watch more of it. Plus, you want to be in – you need to be in that every day mode of producing shows and that genre of content, its labor intensive, you are producing episodic things rather than a two hour block of studio programming with great personalities around sport. So, the return on that stuff is really kind of the hit driven model and you don't really want to be in the hit driven business in sports.

A

Okay. I know you have a flight somewhere to run to so. Thank you very much. I appreciate it. Thank you everybody.

A

All right thanks, bye.