Jackie Doherty: Hello, I'm Jackie Doherty with Yardeni Research. Today I'm interviewing Leo Hindery, one of our favorite experts on the cable and entertainment industry. Hindery is the managing partner of private equity fund, InterMedia Partners. Until 2004 he was founder and CEO of the YES Network, a regional sports network and home of the New York Yankees. Prior to that he headed TCI, a cable company that was merged into AT&T. Today we're asking him to look into his crystal ball and tell us how the world of television, cable and streaming will evolve.

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Let's begin!

Leo, how do you think the tug-of-war between broadcast television, cable TV and streaming companies will play out? Who do you think will be the winners, the losers and why?

Leo Hindery: Well, I have the crystal ball, Jackie, but it's a little hazy. Seldom has our industry been in as much flux as it is today. It's been an evolving industry since the post-second-war period. But it's now a revolutionarily evolving industry. One of the phenomena that people forget was so valuable to the evolution of the industry was a concept called vertical integration, wherein the larger content companies--producers of content--owned some distribution, and the larger distribution companies owned some content. And that made for a peace of sorts between the two industries.

Effectively, vertical integration has gone away. We're in a multi-channel environment, obviously, but the content is not owned by the companies that distribute the content; nor do the distributors, Jackie, control inordinate amounts of content as they did in the past. So, it's open warfare. The three industries-broadcast, distribution and content production-are evolving independently, where in the past they evolved jointly and concurrently. Broadcast is probably the weakest of the three. It has very high local origination costs. It has seen the relationships with the major broadcasters, the big four, get chiseled away. They used to get paid for distributing broadcast signals, now they pay for that privilege and that phenomenon is likely to continue.

The distributors are really just broadband companies now. They're Internet providers at broadband levels and they offer programming as one of their services. But it's not the absolute that it was beginning in roughly 1978 through roughly 1998. So, the distribution community will be greatly influenced by this next administration, the current Trump administration, as the FCC revisits things such as Title II net neutrality. One should assume that that will work out to their benefit

more than has been the case the last three or four years. But the place where they will suffer is their ability to influence content and the price of content has been substantially muted. You would think the response to the broadcast comments, Jackie, and the comments about the distributors, would suggest that content is king and generically content now is king. Pieces of content, Jackie, are not princes or princely or even in the royal family. You still have to have good content. It has to be affordable content, and some pieces of content meet that mandate, others fail miserably.

Jackie: So, who do you think is producing the best content? And is it affordable?

Leo: Well, we're seeing awfully good content coming out of the streaming services. We're seeing awfully good content coming out of the sisters of the big four. You take a channel like FX, owned by Fox. In many people's opinion the FX programming is more cutting edge, more responsive to consumer interests than the main net. So, there's a lot of good content being produced. We're struggling as an industry as to how to pay for it and how to distinguish one content producer from another.

We'll get into this later, but viewers don't care who made the content. They simply care, Jackie, whether it meets their interests and their viewing needs at the time.

Jackie: And so if you had a guess, how do you think this will all evolve? How do you think shakes out? Do we end up still getting our TV plus our cable plus streaming content? Or does one of them become the dominant distributor?

Leo: Again, I think the broadband distributors will be fine, particularly in a Trump administration where the Title II overhang, this public utility overhang, will likely be lifted here shortly. And net neutrality will be redefined, Jackie, in a way that is more supportive of their business agendas.

But not all content survives this purge of vertical integration. One of the things that people should reflect on is content right now generally is quite well priced to the consumer with the exception of sports programming. In our major metropolitan markets, the average household, directly and indirectly, is paying well in excess of $30 a month just for his or her sports pieces. Bundled into what we call the Big Bundle. That's an oppressive figure. And we now hear the phrases cord cutting and cord shaving. Shaving is more germane than cutting. Nobody's going to cut their access to good content. They shave it in a sense that stuff that is not meeting their needs, particularly content that is overpriced relative to their needs, may get shaved. But it's the rare young woman or man who will actually cut, as they say.

Jackie: So, will the sports piece of the package survive? Do you think that it will be cut or will people continue to be willing to spend $30 for it?

Leo: I think sports is going to go through a fairly major metamorphosis here, sooner

rather than later. The contracts in place to buy the programming, to buy rights to certain pieces of sports programming, are, in many cases, long lived. But when those contracts roll over, the sports-producing companies are going to look at a fractured audience. Where the Big Bundle that they crawled under comfortably for decades, will be by invitation only on behalf of the viewer that the consumer ...

You'll always have sports, but these numbers for sports rights are in fairness, in some cases, ridiculous. In some cases, they're quite fair, but pieces of it are simply ridiculous in light of the future ahead. This isn't Thelma and Louise where you're going to drive off of a cliff tomorrow, Jackie, but when these contracts roll off and you're confronted with a shaved viewing audience, the rubber will hit the road and the cliff will be more apparent.

Jackie: And you don't think someone like a Netflix or an Apple will go out and compete for that contract to keep those prices high?

Leo: I don't see Netflix or Apple or Amazon or Hulu trying to become the next ESPN. I think they'll look from afar and watch those companies, those entities, make their own bed and try to lay in it.

Jackie: Do you think ESPN just ends up losing more customers, or how do you think that they shrink?

Leo: The audience percentages are high, the cost of giving those audiences content is out of whack. I'm not ever suggesting that people won't continue to watch active sports. It's part of our ethos as a country, as part of Europe's ethos as a continent. What I'm saying is that with the erosion of the Big Bundle, because the cost of the overall bundle is in some households' perspectives risen to be inordinate. The group that will suffer will be the sports-only companies that overpaid for sports rights relative to market size.

Jackie: How does the competition between Amazon and Netflix evolve? How much more money can they throw at developing content?

Leo: Well, Netflix is a brilliantly run company, but so are Amazon and Apple and Hulu. They're very well run. What you can't contemplate is eight to 10 streaming services costing in excess of $10 a month, all surviving as an alternative to the existing bundle. People complain about the bundle's price because the sports piece of that bundle has become inordinate as I've said. And as they shave, they're not going to replace the pieces they shave with eight to 10 streaming services. And so I think Netflix is a tremendously well-run company but I am a great admirer as well of Jeff Bezos and Tim Cook and others who, and Hulu, who are pursuing the same business model. There's enough content out there for all of them to have attractive content in their offering. There's not enough wherewithal in people's wallets to buy the eight to 10 streaming services that are on the landscape today, all asking for $10 to $15 a month. It's ludicrous to think that the cable bundle, the traditional cable bundle, can be substituted with eight to 10 streaming services plus the

remainder of the bundles on sports.

Jackie: How do you think people will end up buying their content? Do you think it will be a shaved cable plus what, one streaming service? Two streaming services?

Leo: Well, the purchase of a shaved bundle is inevitable. Shaved probably to exclude high-priced pieces of the existing bundle, most notably sports.

Jackie: But then where will you get your sports?

Leo: Sports is going go through the catharsis. What's not going to happen is that you're going to be able to buy just one streaming service. My family right now is paying for four. And that makes no sense to me as a family. But right now my spouse is addicted to a piece of programming, and I mean it literally, on Netflix. I've been watching something on Amazon that I like, and we're of a means that we can swallow that. But the average household is not going to find enough solace and enough content in just one streaming service. They're going to look over the fence and say, I want that piece, and that piece, and that piece. And then they're going to say: Well, what will that cost me? Well that'll cost you four, five, six streaming services and I don't know how that breaks down. These are well-run companies all looking out at the same landscape with the same business model. That's not a recipe for obvious success.

Jackie: And where will people buy their sports, if they buy a cable program that the sports is shaved out of?

Leo: Over the top, a la carte. They'll buy their sports, those who want that sports channel will buy it, but the price of that has to be coordinated with the cost of the content that sports channel has acquired. So, you take ESPN just entered into a nine-year agreement to buy NBA rights for $24 billion over nine years, three times the prior cost. The assumption being that every TV household in America will continue to take ESPN. But we learned in the Disney earnings announcements this week that they're not. ESPN has quarter after quarter for the last couple of years, lost viewers. And these are women and men in households, Jackie, that are paying an embedded all-in cost, they're not aware of it, but they're paying about $8 a month to the ESPN suite of services. But that's just $8 or so out of the 30-plus-dollars they're spending overall for sports. The average household in America has no idea that it's paying north of $30 for the implicit and embedded sports pieces. They have no idea. But their wallet is starting to tell them.

Jackie: And so do you think ESPN end up streaming directly to the consumers that want that sports package? Or how does sports get delivered?

Leo: Well, I think they're trying to figure that out. If you listen to Bob Iger's comments, they're wrestling with whether an over-the-top a la carte model at some much, much, much higher price to the consumer household, can make up for a fully distributed service to every television household. And there's a circularity to that

determination, Jackie. If my family opts out, and you still want the service for your family, you have to pick up my lost revenue. Now you can't afford it, so the house next to us, the third house, looks out on the landscape and your home and my home have canceled. Now he or she has to pay for all three. And there's just complete circularity. There is a reason why BBC levies a charge on every household in the United Kingdom at the beginning of every calendar year, and then gives us quality programming like Downton Abbey. That's the old cable model where every household paid, pretty much what was charged, and you allocated among a myriad of services. Except some of those services have become inordinately expensive. Way, way, way too expensive relative to audience size.

Jackie: So if you had to look 10 years into the future, what do you think the average family ends up buying? How do you think they consume their sports and general entertainment?

Leo: They will have a superior broadband connection, upwards of a gigabit per household. And on that connection, they will make some phone calls, that's a de minimis portion, they'll search the web and the Internet and play games. They'll take a shaved bundle of programming. The American consumer still wants a lot of choice on the dial. It won't be a cut bundle, it'll be a shaved bundle. And they'll buy over-the-top programming. Genuine a la carte programming, such as Netflix, arguably ESPN. You need to be more optimistic about those that will stream entertainment content because of the cost of producing that content is more commensurate with audience size and share than the existing sports products.

Jackie: And how much will that cost the average family? Will their bill go up or down for that?

Leo: It better not cost more than about $100. I always spent more time trying to understand what the average middle-class household could comfortably and willingly afford. And I was a very strong advocate for never raising rates in excess of inflation, for responsibly holding down all of our operating costs, so that we never broke the backs of our primary audience, which is the middle class. And again, others will speculate a different number but my sense is if that package that I've described costs more than $100 or so, the average household, the middle-class household, you're going to strain their ability to pay it.

Jackie: All very interesting. Now at your heart you started out as a cable guy. So, we wanted to get your view on what happens with the proposed AT&T/Time Warner merger. Do you think it gets approved under a Trump administration?

Leo: I think it should get approved. I think there is no legal impediment under anti-trust law for AT&T, a distribution company, to go buy TWX, a content company. It's just going back to the era of vertical integration. I think there will be some conditions, and there should be some conditions, imposed on the approval. Time Warner content, which is very important to the fabric of this country, very good programming, needs to be available to all distributors. It shouldn't be isolated in

any undue fashion to just AT&T because it's too important. I don't want to see CNN and HBO and TBS and TNT only available on an AT&T connection. But there's no reason in the world why the government shouldn't approve, with reasonable conditions, AT&T acquiring Time Warner Inc. And I think it'll happen relatively soon under Mr. Trump's administration.

Jackie: Do you think it's a good move for AT&T and for Time Warner?

Leo: I think it's a very good move for Time Warner. I think Jeff Bewkes is a superior CEO who is very sensitive to shareholder value. And he's getting a very full price for his company. In the same breath, Randall Stephenson, like Lowell McAdam at Verizon, has to address the reality that the mobile business is price-challenged right now. You've seen price cutting out of T-Mobile and Sprint. CEOs have a responsibility when they see their main, core business struggle, or stabilize, without obvious, major growth ahead of it, to either give their money back to their shareholders or acquire a sister. And I think that's what Mr. Stephenson's doing in the case of Time Warner. I think it it's an appropriate transaction and should get approved.

Jackie: Fantastic. Well, Leo, thank you so much for all of your time and your wisdom. I can't tell you how much we appreciate it.

Leo: Thanks, Jackie, it's always my privilege to talk to you. Take care.

Jackie: Bye bye.