MSG NETWORKS

## NEW YORKS LEADING REGIONAL SPORT NETWORK

MSG Networks (MSGN: US, Market Capitalisation US$ 1.3B) is engaged in the production, development and distribution of sports content. The Company owns and operates two regional sports and entertainment channels, MSG and MSG+ in addition to a live video streaming platform, MSG GO. Its most valuable assets include exclusive broadcast rights to the home games of the New York Knicks (NBA) and New York Rangers (NHL). Additional license agreements are held with other leading professional sports teams including the New York Islanders, New Jersey Devils, Buffalo Sabres, New York Liberty, New York Red Bulls and the Westchester Knicks. Affiliate agreements are held with leading market distributors. In 2016, MSGN had an estimated combined reach of approximately 7.2 million subscribers in the greater New York area.

## A COMPETITIVE ADVANTAGE

Regional Sports Networks (RSN's) have long been regarded as the crown jewel of the media industry with access to some of media's most dedicated and loyal viewers. MSGN owns some of the most attractive sports programming rights available with the New York Knicks (NBA) and New York Rangers (NHL) ranked as the most valuable teams in their respective leagues. We remain cognisant of low single-digit percentage declines in MSGN's subscriber base. However, we do not believe this to be reflective of impairment in the value of MSGN's content. Subscriber volatility is currently an industry-wide phenomenon in response to evolving media consumption trends. We expect this trend to stabilise and eventually reverse over the long term as content distribution strategies are realised.

## CONTENT AS A CURRENCY

In an evolving competitive environment, 'content' is emerging as a strong competitive differentiator for distributors. Cable operators, who also provide broadband services, are increasingly looking to video as a means of enticing broadband customers into cable/broadband packages. This increases leverage for MSGN who supplies exclusive high-demand content. In addition, intensifying competition in New York's oversupplied market provides scope for greater pricing power for MSGN further enhancing the value of its content.

## STOCK PRICE WEAKNESS PRESENTS A LONG-TERM OPPORTUNITY

In MSGN's Q1-2016 filings, the Company detailed its revenue exposure to various distributors. Notably, four distributors account for over 85% of the MSGN's revenues highlighting the concentrated nature of its client portfolio and the importance of obtaining favourable terms in affiliate agreement negotiations. The recent adoption of 'skinny' bundles and subsequent subscriber losses has led many to question MSGN's ability to renew existing affiliate agreements on similar or favourable terms. As a result, from November 2015 to February 2016, MSGN's share price declined -28.7% from US$21.52, to US$15.35.

In contrast to popular belief, our analysis suggests MSGN has recently renewed an affiliate agreement leading to significant increases in revenues. Thus, we refute the notion that MSGN is facing a decline in the value of its content and instead view the Company as a long-term growth opportunity. The Elevation Capital Value Fund began to establish a position in MSGN in August 2016, at an average cost of US$17.46 per share.

## AFFILIATE RENEWAL

MSGN has a powerful presence in the New York area and enjoys strong industry relationships with market-leading distributors. In Q1-2016 (post-separation from Madison Square Garden), MSGN experienced a substantial +13.3% increase in revenues from an unnamed distributor (speculated to be Comcast). Such a significant jump in year-over-year revenues from a single distributor is evocative of a one-time payment or a first-year rate increase often seen in affiliate renewals. The above supported a +4% increase in total revenues for Q1-2016 marking an impressive result in the face of tough trading conditions. We expect future revenue growth to be supported by affiliate fee escalators (with subscriber floors) built into pre-existing contracts. Current analysis suggests MSGN has strategically scattered contract maturities, which are long-term in nature, providing reliable and consistent revenue streams and mitigating risks of one-off earnings adjustments *(see Appendix 1).*

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**UNBUNDLING**

Investors have further voiced concerns toward the placement of MSGN's product on 'premium bundles' effectively reducing the Company's ability to drive subscriber growth. Going forward, re-negotiating favourable placements for MSGN's products provides upside opportunity. MSGN has not ruled out the possibility of going directly to consumers which would have the same result as tier optimisation effectively broadening their market. In this regard (and like many media players), we believe MSGN is yet to fully realise the value of its developing over-the-top (OTT) service, MSG GO. Management has indicated that while initial numbers are small, web and application utilisation are rapidly increasing. This viewership is believed to be incremental to linear television, therefore representing a future earnings stream which is presently unrecognised. We note, there is nothing in current affiliate agreements impeding MSGN from delivering a direct to consumer service.

**POTENTIAL M&A TARGET**

The proliferation of 'OTT' streaming services and evolving media consumption trends is challenging traditional business models and providing a powerful motivator for change. Consolidation of distributors has played a large part in the media M&A over the past year. Recent deals include; AT&T's acquisition of DIRECTV (US$49B), Altice's acquisition of Cablevision (US$18B) and Charter Communications' acquisition of Time Warner Cable & Bright House Networks (US$67B). We anticipate the consolidation witnessed in distributors will similarly encourage content providers to drive for scale. In this regard, MSGN is one of only a few, independently owned sports networks and lacks scale seen in larger competitors such as FOX and Comcast. We believe this will provide an impetus for MSGN to strike a deal with a larger media company, while its valuable assets make it an attractive acquisition target. Currently trading at a discount to its peers, we see MSGN as an opportunity for an acquirer to purchase a premium business at a discounted price. We believe FOX, Comcast and DIRECTV represent potential suitors; all of whom have an active presence in the RSN sector.

**INVESTMENT THESIS - SUMMARY**

As an RSN, MSGN operates in an attractive segment of the media industry with access to some of media's most dedicated and loyal viewers. The Company holds highly attractive assets in the New York area which we believe will enable the Company to succeed in both linear and over-the-top distribution channels. Overwhelming evidence suggests MSGN has secured favourable affiliate renewals with leading distributors, aiding revenue growth and in complete contradiction to conventional thought. Finally, given the strength of the Company's assets and its strong market position, we assign a high degree of probability toward MSGN being acquired. We currently estimate MSGN (in normal trading conditions) to have an Intrinsic Value of between US$24.97 and US$27.49 per share. From the Elevation Capital Value Fund's cost basis of US$17.46, this suggests upside potential of between +40.7% and +57.5%**.

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*This summary report was written in March 2016.*
*Intrinsic Value estimates were updated as at May 2017.*



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**APPENDIX #1**
*(Estimated affiliate agreement cycle for MSGN)*

**Time Warner Cable (TWC) – Maturing 31 December 2017**

**2005** TWC and MSGN undertake their first carriage dispute. The dispute over affiliate fees is resolved in September the same year.
*We assume this marks the beginning of an affiliate agreement starting January 1, 2006*

**2011** TWC once again fails to reach a deal with MSGN

**2012** The dispute escalates as TWC drops MSGN from its service - after two months of negotiations a deal is struck between the two companies.
*We assume the February deal marks a renewal of an affiliate agreement intended for January 1, 2012. We assume the deal is for a six-year term as per the 2005-2011 deal.*

**Verizon FiOS - Maturing 31 December 2018**

**2006** Verizon inks deal with AMC Networks (then Rainbow Media).

**2012** November 2012, AMC Networks (AMC) publicly threatens to pull its networks from Verizon FiOS if Verizon does not meet affiliate fee demands – a deal is eventually reached before years end.
*Before 2010, both MSGN and AMC Networks (then Rainbow Media) were owned by Cablevision. We assume that MSGN properties would have been included in any AMC Networks/Verizon deal. This suggested when AMC's deal ended in 2012 so did MSGN's at which time MSGN entered a new contract for a six-year term as per its previous deal.*

**Cablevision – Maturing 31 December 2019**

**2010** MSGN enters into a 10-year distribution agreement with Cablevision.
The deal is evidenced in MSGN's 10-12B filings (dated 11 January 2010).

**Direct TV – Maturing 31 December 2019**

**2009** In December 2009 DirecTV, AMC Networks/MSG Renew Carriage Contract.

**2014** AMC Networks warns it may go dark on Direct TV with its current agreement coming to an end.
*MSGN and AMC were negotiated as a bundle. AMC's announcement indicates MSGN's contract would also be up for renewal. This suggests a five-year term, and we assume MSGN accordingly renewed its contract beginning 2015.*

**Comcast – Maturing 31 December 2020)**

**2015** In December 2015, Comcast and MSGN announce a deal bringing MSG GO services to Xfinity TV subscribers. The deal marks the first cable provider to have access to the OTT service.
*There is very little data on previous Comcast negotiations however we assume the distributor's entrance on MSGN's OTT service pertains to a wider affiliate renewal process. This would result in a new agreement taking hold January 2016. If the above stands true, it will support the notion of Comcast being revenue contributor "C" with the 13.3% jump in revenues reflective of a renewed fee arrangement.*