A Phased and Unique Investment Model

TV Advertising as Acquisition Currency for Digital E-commerce Participations

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A unique investment approach

The global digital revolution is rapidly changing many strategic playing fields and operating theatres. This is particularly true in the media and TV sector. Therefore, media companies need to adapt and branch out in search of new revenue streams. ProSiebenSat.1 Group (P7S1) has done just that by developing a unique, phased investment model which may well start with a media investment and can end with a cash investment or even a majority takeover. In the process, P7S1 embarks on a steep, low-risk learning curve about its participations and their markets, and frequently ends up building new thematic verticals of fully or majority-owned businesses.

Media companies branch out in search of new revenue streams

The German TV advertising market grew by 3 percent net in 2015. As the market leader, P7S1 is benefiting from this: revenues in its business segment 'Broadcasting German-speaking' grew by 4 percent in 2015. The German TV advertising market is strong, but the digital sector is developing more dynamically: since 2011, external revenues in the Digital & Adjacent business segment[1] – which houses the company's e-commerce and digital entertainment portfolio among other things, have grown by an average of 39 percent, easily 15 times of GDP in 2015. P7S1's digital portfolio was carefully hand-picked on the basis of strategic compatibility: only e-commerce start-ups with a high affinity to TV advertising, whose product ranges could benefit from TV's emotional appeal and ability to build trust, were selected.

1 This segment has grown significantly and has, as of 3Q16, been split into the segments Digital Entertainment and Digital Ventures & Commerce.

DIGITAL VENTURES NEED TO GET BIG FAST AND THEREFORE RELY HEAVILY ON ADVERTISING.

Initial non-cash investment

The digital progress and especially the rising use of the internet is affecting nearly every industry; consumer behaviour is changing. For instance, global e-commerce sales are projected to more than double over the course of the next few years, from roughly USD 1.7 trillion in 2015 to USD 3.6 trillion in 2019. Of course, this trend is creating new business models as the sale of products and services is shifting online rapidly. The combination of available ad capacity on its free TV stations and a demand by digital start-ups for TV ads offers P7S1 opportunities to enhance the entire value chain with investments in e-commerce enterprises. How does this business model work?

TV clearly is the medium with the highest reach. P7S1 uses this advantage by deploying some of its advertising capacity as additional investment currency. Put simply, the company grants TV advertising space in return for a share in the revenues or equity of partnering start-up companies. In the latter case, it is used as an initial form of acquisition currency, a seed investment in kind. P7S1 is thus able to expand its portfolio, initially without making any cash investments or taking on any significant financial risk. On the other side of the equation, and on behalf of these start-up shops, P7S1 deploys available TV advertising time to increase awareness of their products and to build up their brands. This offering, which in 2015 amounted to more than € 1.5 bn in gross value, affords many advantages for both sides, some obvious, some less so.

Win-win for both parties

Cash-strapped newly-formed e-commerce companies generally welcome the opportunity to be able to pay in kind for valuable TV advertising. This is particularly true as digital ventures need to get big fast and therefore rely heavily on advertising, brand-building, instant recognition and credibility. With P7S1, they can achieve this.

There are also benefits for P7S1: for a start, advertising slots which otherwise would lay idle are put to good use at next to no opportunity cost to the company. P7S1 acquires a revenue or even an equity share in a promising, carefully selected, e-commerce venture with the help of an alternative, non-monetary currency. It also carries almost no risk. The leverage, should the venture be successful and take off, is thus enormous and manifests itself in real money. There is a qualitative angle, too: P7S1 learns about new markets, new companies and their management teams and, should the venture gain traction, can take advantage of cross-selling opportunities via digital platforms. Ultimately, the venture can be rounded out with the acquisition of majority interests or even full takeovers, and more acquisitions which may well be international. A new vertical is born.

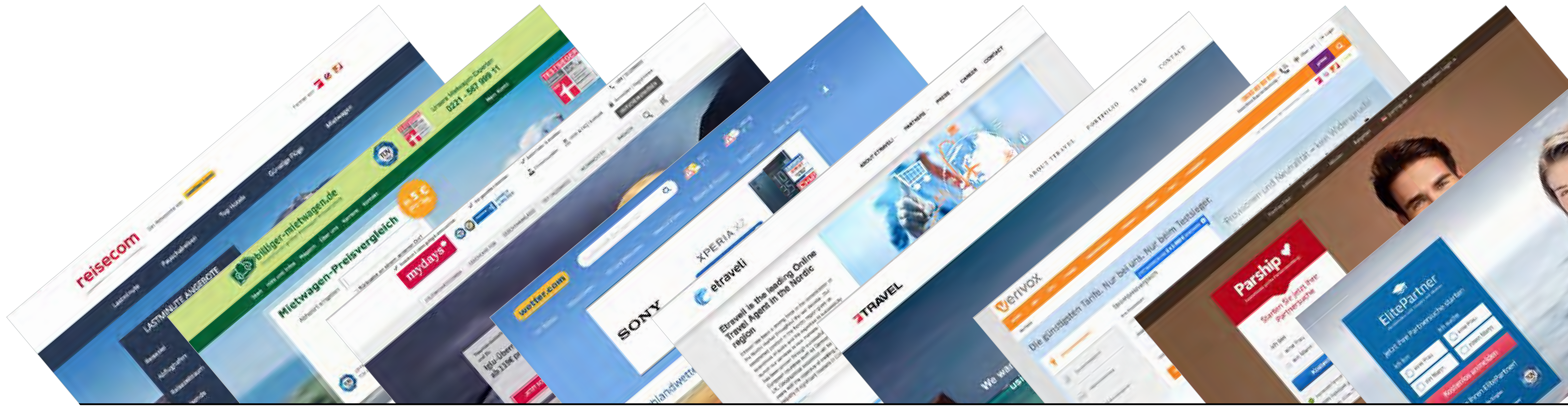
P7S1 establishes successful verticals

The Travel vertical is the most mature. Under the name of *7Travel*, P7S1 is already well positioned in Germany: for instance, clients can browse through the whole customer journey with the online travel agency *reise.com*, the country's largest rental-car portal *billiger-mietwagen.de*, adventure travel specialist *mydays* or weather forecaster *wetter.com*. With *etraveli*, the online air travel portal which already operates brands in nearly 50 countries, P7S1 has recently acquired a platform that opens up international growth opportunities at low market entry cost.

7Travel is a success story. It was built slowly and at low risk, adding portals that complemented each other until a full e-commerce offering was achieved. On a pro forma basis[2], *7Travel* has already generated more than € 300 m in annual revenues. This is the blueprint that P7S1 intends to emulate in its other verticals: more of them are being nurtured. In 2018, the Digital Ventures & Commerce business is expected to make a revenue contribution of close to € 1.2 bn. In all verticals, synergies will go beyond cost and revenue aspects as P7S1 invests exclusively in e-commerce ventures which are particularly leveraged into TV advertising, where the company has a uniquely strong offering.

The impact of this investment approach is evident in the financial performance of the whole group. E-commerce investments made in the past five years have increased their revenue level by around 80 percent on average since their integration into P7S1, and their earnings contribution to the Group's recurring EBITDA by around 120 percent. In particular, recent acquisitions, such as the online air travel agency *etraveli*, the comparison site *Verivox*, or the online dating platforms *Parship* and *ElitePartner*, offer a strong basis for future organic growth. Therefore, P7S1 once again raised its 2018 targets in October 2016: revenues are now expected to reach € 4.5 bn (previously € 4.2 bn), of which over 50 percent will be generated outside of the traditional TV advertising base.

2 Last twelve months, H1 2016.



IN CASE OF FAILURE, LITTLE CAPITAL IS LOST, IN CASE OF SUCCESS, LEVERAGE IS SIGNIFICANT.

So far so good – An intermediate status report

Of course, the media-for-revenue/equity-share model is not the only way P7S1 invests in its future, but it is a very successful one, even after a relatively short period of time. It gives the company low-cost, low-risk access to new markets through participations and allows P7S1 to learn and to adapt its own business model through close cooperation with these minority investments. In case of failure, little capital is lost, in case of success, leverage is significant. Through this approach, P7S1 has been able to generate revenue and profit growth without much up-front capital commitment, meaning that growth has been highly cash-generative and profitable. This, in turn, has enabled the company to offer its shareholders high dividend payouts of 80 – 90 percent of underlying net income. Additionally, from a strategic perspective, P7S1 has been able to build four e-commerce verticals already, most with initial non-monetary investments and subsequent deployment of hard cash to buy majorities or full ownership. But by that time, accumulated industry knowledge had significantly reduced risk and raised the probability for success. Also, as verticals grew, synergy opportunities – be that cost or revenue – did the same. This story is far from over. Watch this space.