BANYAN CAPITAL MANAGEMENT

October 11, 2023

Dear Client,

Through the third quarter, Banyan's equity composite gained 11.4% year-to-date versus the S&P 500's total return of 13.1%. Over the trailing three- and five-year periods, our equity composite compounded at 11.2% and 9.6% per year, respectively, while the S&P 500 compounded at 10.2% and 9.9% per year, respectively. For more details about our equity composite, please click here.

Charter v. Disney

On September 1, 2023, a "carriage" dispute between Charter (CHTR), a holding of ours, and Disney (DIS) became a public spectacle. Such disputes are common in the cable-tv industry. Every few years, media companies like Disney demand higher fees and broader carriage of their channels. Distributors like Charter usually accept, and cable-tv subscribers pay higher prices.

This time, Charter balked and offered an ultimatum – Disney would accept the terms of Charter's counteroffer, or Charter would exit the cable-tv business altogether.[1] A showdown ensued. Disney rejected Charter's counteroffer and pulled its channels, including ESPN and ABC, from Charter's network just before football season. Disney played the ace up its sleeve.

At this point, a cable-tv distributor like Charter will usually fold its hand, but not this time. Charter never flinched, and, on September 11th, it was Disney who folded. Under their new "carriage" agreement, Charter dropped Disney's weakest channels, retained packaging flexibility, and, most critically, bundled Disney's streaming products, Disney+ and ESPN+, into cable-tv packages.[2]

This win for Charter would have been unthinkable a decade ago, but the industry's power dynamics have changed alongside the industry itself. There are three reasons for the change:

1. **Rise of Netflix** | Thanks to investments by cable companies, ubiquitous high-speed internet allowed Netflix to offer an online substitute to cable-tv. Consumers loved the "on demand" nature of Netflix, and many canceled their "linear" cable-tv subscriptions. As a result, Mr. Market gave Netflix a fancy valuation, and the valuation of legacy media companies fell.

2. **Mimicking Netflix** | The valuation differential enticed legacy media companies to mimic Netflix. They offered their cable-tv content online and "on-demand" at a lower price, which caused "cord cutting" to accelerate. To sustain their profits in a dying business, legacy media companies endlessly hiked cable-tv prices, which further impaired the business.

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[1] *The Future of Multichannel Video: Moving Forward, or Moving On*, Charter Communications, (September 1, 2023), available at: https://ir.charter.com/static-files/05f899dd-7ef3-40d8-84c1-f16a7acfe318.

[2] *The Walt Disney Company and Charter Communications Announce Transformative Agreement*, Charter Communications (September 11, 2023), available at: https://ir.charter.com/static-files/4cf5b9ad-a374-4154-b1c7-d0deb1246d85.

3. **Cable's Transformation** | Meanwhile, cable companies were transformed by the build-out of America's high-speed internet infrastructure. Owning the last-mile of society's digital umbilical cord turned out to be a far more profitable business. It also provided a base from which Charter and Comcast launched disruptive, yet profitable, mobile businesses.

Thus, while legacy media companies were killing the Golden Goose of cable-tv, legacy "cable" companies were busy becoming "connectivity" companies. As shown below, between 2018 and 2022, Charter's revenues, OIBDA, and enterprise earnings grew 24%, 34%, and 77%, respectively, despite a 9% *decline* in video subscribers and *rising* programming fees paid to Disney and its peers.

Charter Communications (CHTR)

($ in millions)	2018	2019	2020	2021	2022
Total Revenue	$ 43,634	$ 45,764	$ 48,097	$ 51,682	$ 54,022
Programming Expenses	$ 11,124	$ 11,290	$ 11,401	$ 11,844	$ 11,620
Other Expenses, ex. Depr. & Am.	$ 16,736	$ 17,934	$ 18,529	$ 19,638	$ 21,256
Op. Inc. Before Depr. & Amort. (or "OIBDA")	**$ 15,774**	**$ 16,540**	**$ 18,167**	**$ 20,200**	**$ 21,146**
Capex	$ 9,125	$ 7,195	$ 7,415	$ 7,635	$ 9,376
Enterprise Earnings	**$ 6,649**	**$ 9,345**	**$ 10,752**	**$ 12,565**	**$ 11,770**
Yearend Video Subscribers (in thousands)	16,606	16,144	16,200	15,833	15,147
Yearend Internet Subscribers (in thousands)	25,259	26,664	28,879	30,089	30,433
Yearend Mobile Subscribers (in thousands)	134	1,082	2,375	3,564	5,292

Legacy media companies, on the other hand, have never been more dependent on cable-tv. It is funding the costly transition to streaming, which has horrible economics. Binge watching and *al a carte* service are customary in streaming. As a result, content spending is much higher to keep consumers engaged, and customer acquisition costs are no longer outsourced to cable companies.

In 2022, for example, Disney's cable-tv business earned $8.5 billion; its streaming business *lost* $4 billion. Given the fixed cost nature of media, we estimate Charter accounts for up to 40% of Disney's cable-tv profits and 70% of its combined media profits.[3] Back to the poker analogy, Charter put Disney "all-in" knowing Disney could not afford to lose, and Disney smartly folded.

Charter went heads-up with the titan of cable-tv, Disney, and won, illustrating Charter's newfound leverage over legacy media companies. We expect Charter to strike similar deals with other media companies going forward, which should further strengthen Charter's hand. And, whether in poker or investing, having a strong hand when the chips are down is key to ***building permanent wealth***.

Sincerely,

Drew Estes, CFA, JD
Portfolio Manager

[3] According to Charter's September 1, 2023, presentation, Charter pays Disney $2.2bb per year under its current affiliate agreement. Using Disney's average advertising revenue relative to affiliate fees, we estimate $3.3bb of Disney's revenue and, thus, profits are attributable to its Charter relationship.