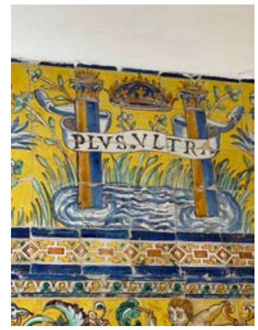
December 2019

"Scale Players in Motion"

Dear Colleagues,

On a recent trip to Seville, I saw a beautiful ancient tile mosaic, painted in bright blues and yellows, with an ancient but clearly legible Latin inscription carved into it – "Plus Ultra," the national motto of Spain. It means "further beyond."



The process of writing this letter is an annual ritual of reflection and more importantly, a look towards what lies ahead. It is a personal effort to make sense of our environment and to think strategically about that something beyond, the inspiration and provocation offered by that mosaic in Seville. Last year, I discussed the idea of **"scaled intimacy,"** the network of close relationships that powers the breadth and closeness of our reach. The idea of **"work in progress"** was a critical theme for me personally and for LionTree as a firm. As we close 2019, I am focused on a theme I call **"scale players in motion."** Can incumbent players (companies, governments, even people), who have survived the rapid disruption over the last decade, move to an offensive posture and continue to innovate - to take risks and strive for excellence?

The answer, of course, is that they must. The next decade will be the stage for a clash of titans, as battle-tested platforms that have emerged stronger than ever will compete against one another for consumers' attention. As advisors first and foremost, we must be cognizant of the fact that each scaled player's "motion" will be different. These may include varied pathways to innovation, patterns of investment, changes in capital structure and return of capital strategies, realigning of assets, vertical integration, all in the face of a changing regulatory environment. There is no "one size fits all" approach, and the status quo is no longer good enough.

A period of fragmentation over the last decade has given way to these scale players (see **Appendix** Index chart). The pressure placed on traditional business models by tech platforms and startups, funded by almost unlimited access to capital, at near-zero cost, has defined the past decade in media, communications and consumer businesses. Up to this point, these trends have played out to the benefit of the consumer, at the expense of incumbents. I think that this trend has now peaked and we can see cracks in the growth-at-all costs mindset. Profitable, scaled businesses that have persevered through the onslaught of a thousand new companies and adapted to evolve their business models are well positioned to be the winners of the next cycle. It is unlikely that any of these players will be replicated in the next five to ten years. Their scale also affords them a cost of capital advantage, as they will have the best access to the credit markets, even if interest rates rise.

Video and audio content companies are reasserting themselves by building out direct-to-consumer streaming platforms, underpinned by their own software infrastructure. This is not meant to suggest that the major technology platforms will cease to drive change across the media industry, but their impact on media *business models* is abating. Tech innovation will continue to blossom at scale in core areas like software, security and artificial intelligence, as well as gain ground on the frontier of emerging areas like fin-tech, insure-tech, and food-tech. The effect of these shifts is that technology is increasingly receding into the background of our lives; a must-have input that all media companies are learning to harness. As

Satya Nadella of Microsoft noted, "As computing gets embedded in the world, it becomes indistinguishable from the world." This might be one of the defining paradoxes of the digital age; at the very moment of technology's triumph and at the apex of its influence, it disappears into the background.

While these changes demand attention, it is important not to lose the forest for the trees. For me, art provides insight not available through words or numbers, speeches or spreadsheets. Last month, Umberto Boccioni's ***"Unique Forms of Continuity in Space,"*** a Futurist icon, sold for a record price of $16.2 million at auction. The sculpture is aerodynamic and propulsive, and exemplifies the Futurist commitment to speed, scale and forceful movement. It serves as a metaphor for the tension and synthesis between scale and motion that we are seeing right now.

LionTree is an investment and merchant bank focused on creative industries and the digital economy. We are invested in every sense; as advisors, partners, and capital providers. This manifests in concrete ways; from creatively navigating the changes shaping our clients' strategic journeys, executing transactions and always at the table to see the difficult ones through. The merger of Viacom and CBS, the sale of Sotheby's to Patrick Drahi's BidFair USA, Live Nation's acquisition of CIE in Mexico, the acquisition of Shutterfly by Apollo, and the sale of Presidio to BC Partners, are just among a few of the transactions of which we are proud.

As the third decade of this century is about to begin, we continue to aspire to guide the strategic posture of vital players and sectors and to help identify what is around the corner. LionTree might be best known for our work on core sub-sectors of global media, such as content creation and distribution, but we are also devoting our focus and balance sheet capital to areas that are becoming the mainstream of our industry, including video gaming and sports betting, e-commerce, CPG, financial technology, health and wellness, and audio. Our confidence in the podcasting medium drove us to create KindredCast, LionTree's own podcast, listened to in 148 countries, that explores insights from the leaders shaping our world. Our Kindred Media business, led by Chris Peterson, services our clients as a digital and audio media advisory and production company. We see Kindred as our vehicle to simultaneously analyze industry trends and hear from the innovators and thought-leaders who can help us contextualize, challenge, and reimagine our world and our work.

We look ahead to a new decade with excitement and unparalleled focus. I love the line from the band Mumford & Sons, "I had been blessed with a wilder mind." More than ever, imagination is a prerequisite for collective wisdom. We are in the midst of a content renaissance in both video and audio, a signal feature of the next evolution of consumer platforms, what I call "Media 2.0."

I. 2020 Vision

Scale-Ups + Start-Ups: Size Matters

The biggest players of scale in global media and communications are also the most dynamic. Disney and Netflix to ViacomCBS and Discovery, AT&T and Verizon to Comcast, Charter, Altice and Liberty Global, Alphabet, Facebook, Twitter, and Snap to Amazon and Microsoft - all are in active transition. Surviving the financial crisis and an onslaught of new startups and business models made these companies stronger and more creative. LionTree borrows from this phenomenon too. The financial crisis of 2008-2010 loomed large as we sought to imagine and build a different kind of firm, established in 2012. In his famous book *Antifragile*, Nassim Taleb writes, "Some things benefit from shocks; they thrive and grow when exposed to volatility, randomness, disorder, and stressors and love adventure, risk, and uncertainty." Many of the companies that we define as scale players in motion have either lived through or were born out of this chaotic period and, as a result, have a steely resolve encoded in their DNA. We see the same dynamic in individuals who have stood the test of time. I like to think of Cal Ripken, Jr - the Ironman - baseball legend and champion of youth sports (an area we believe in). This coming year marks the 25th anniversary of Cal breaking what was thought to be an unbreakable record by playing in 2,131 consecutive games. Strong fundamentals stand the test of time, irrespective of market cycles.

For most of us, innovation is key to surviving. However, as we are constantly reminded, proper execution can be no less of a challenge. Cable pioneer Dr. John Malone has lamented how the cable companies missed their opportunity to create their own internal version of Netflix. Did they lack the risk appetite, the incentives, the foresight, or the agility that innovation requires? While they maintained the status quo, dozens of direct-to-consumer streaming services were born (from Netflix and Spotify to YouTube, and more recently - Pluto TV and Cheddar).

History often repeats, and there is once again a chance for the scale players to seize the day. Disney+, HBO Max, Apple TV+ and Comcast's Peacock are good examples of traditional media companies evolving their own business models in response to industry dynamics. Cable distributors are focused on the value of broadband connectivity, to mitigate the impact of cord-cutting and the evolution of the pay-tv model, which has further enhanced their pricing power. This is true for wireless players as well, who are in the early days of a capital and innovation cycle. Their focus on bringing nationwide 5G networks and connectivity, which revolutionize both enterprise and consumer applications by bringing down latency, allows for the creation of hitherto unthinkable applications. Management, scale, and access to capital (both from internally generated cash flows as well as from capital markets) are critical to determining the winners and losers.

The willingness to realign and pivot does not guarantee prolonged success. Constant internal disruption is a required part of the fabric of the companies who will survive and grow into the next decade. Many media companies are battling to become the next great must-have consumer platform, but they alone are internally responsible for a self-reflective ability to evolve. This disruption does not necessarily mean companies should sacrifice their core values and identity to make way for the "new." For example, Disney's headlong leap into the streaming future is built on the strength of its catalog and the potency of brand nostalgia associated with its content. HBO's is underpinned by content quality and curation. Amazon is focused on value and built on an e-commerce driven family of users.

To be sure, the competition between scaled players will be fierce, even as there will be multiple winners. The "streaming wars" have only begun and all of these platforms will be vying for consumer mind-share with other forms of entertainment like music, podcasting, video gaming, social media, and of course, live entertainment and sports. The latest Nielsen data suggests that US adults spend over 11 hours connected to media every day, a number that has grown just 3% over the last year, even as entertainment options have multiplied. AT&T's John Stankey said it well in a recent interview, when referring to HBO Max, "...We're just a little company trying to eke out an hour of customer time a day." Scale players need to assess the possibility that the proliferation of so many streaming video services could be "too much of a good thing," as the overwhelmed consumer, faced with choosing between hundreds of platforms and a vast array of content that requires active selection, spends their precious 11+ hours elsewhere.

Every company, of every size, will have to reckon with this new environment. It is true, however, that the scale of incumbents will limit the development of some start-ups, and complicate their paths to maturity while also limiting the number of buyers available down the road. Funding for some will be more challenging and will grow more expensive. The differentiated cost of capital for scale players relative to smaller companies, driven by more discerning capital markets, bodes well for larger companies. This reality will likely force mergers among sub-scale companies and sharpen distinctions between winners and losers.

At the same time, we see several verticals where younger companies can still take share. Growth opportunities exist in sectors that are in transition, like audio (music and podcasting) and video gaming, as well as, beauty/ fashion/ luxury, food technology, and health and wellness. Overall, the renewed attention to scale is visible all around our industry, particularly in the forces of consolidation that have dominated the headlines this year. These deals are the perfect illustrations of scale in motion, combining size with imaginative blueprints that allow for the emergence of new possibilities. Rather than preventing innovation, consolidation demands it, as companies of similar sizes will be differentiated based on leadership and vision.

This perspective impacts our view of acquisition activity by scale players and the broader M&A market. We think large cap M&A will stabilize and will be highly opportunistic. The bar for deals will be higher for core areas, but scale players are also bound to act bolder in adjunct areas like video gaming, audio, and core content where there will be a battle for the few best assets and remaining scarce brands (e.g. MGM/ James Bond franchise). There will also be realignment activity as assets have to be in their rightful homes and portfolios have to be optimized.

It is an existential moment for globalization. We are at a point in time that will be characterized by fewer cross-border deals and more in-market focus, as true globalization trends become choppier and markets place more of a premium on “geographical integrity” over global diversification. However, I think there are still consolidation opportunities within Latin America and Europe. In Latin America, recent changes in political leadership could hopefully signal the beginnings of more open and business-friendly environments in many countries, possibly even including Venezuela. Pursuing this market will require bold and farsighted investors whose creativity and perseverance stand to be rewarded. In Europe, the convergence between fixed and wireless has been a trend for a few years, although further consolidation opportunities might remain in some markets, with the possibility for the emergence of a pan-European player.

Leadership and Succession: Higher Stakes, Fewer Winners, Longer Views

As the scale players have consolidated and pivoted, leadership teams are also in transition and new teams must make their mark. This trend is intimately related to the theme of internal disruption; in fact, the former will drive the latter. The next generation of leaders is either here or waiting in the wings, and these changes at the top will have profound implications for risk-taking and future growth. In some cases, founders have stepped aside in favor of new CEO’s, reflecting the maturity of their firms. Sundar Pichai taking the helm from Larry Page and Sergey Brin at Alphabet is only the most recent example. The shift in business models has demanded new directions, new perspectives, and new stewards of these assets. We have also seen leadership changes driven by deal-making activity, such as the mergers of The Walt Disney Company and 21st Century Fox assets, Viacom and CBS, and Discovery Communications and Scripps Networks. In addition, over the next three years, the long-serving CEOs of AT&T, The Walt Disney Company, and T-Mobile plan to step down.

The aforementioned new generation of leaders, who will define the future of media and communications, have the chance to chart their own course, unencumbered by their predecessors’ decisions. There is a great explanation of this challenge from the makers of the documentary *Free Solo,* which spotlighted the practice of mountain climbing without ropes or harnesses for safety. To paraphrase, when you climb with a rope, it makes you feel secure, but it is limiting because it forces you to work in a linear way. Without a rope, you have so much more flexibility and choice, which can make it easier to achieve the ultimate goal.

The shift in perspective that must accompany evolution and succession is a crucial component of harnessing both the wisdom of maturation and the fresh thinking of transition. Evolutions in perspective are not liabilities; they unlock constraints and unleash new potential. That said, bold vision alone will not determine the companies and models that thrive in the years to come. Strong balance sheets, low costs of capital, and scaled infrastructure are crucial elements as well. Hence, we see the scale players who stay in motion, those who continue to adapt to and shape their environments, as the ultimate 'winners' in the next decade.

The New Gatekeepers

A result of the last decade's disruption has been a change in power dynamics across industries and governments. Specifically, influence has moved from the "gatekeeper" to the "wisdom of the crowd." There was a time when the gatekeepers and "launchers" – of products, services, capital, or political campaigns – held all the power. They defined the content, decided what the range of possibilities were, and dictated the form those possibilities would take. Since Netflix started streaming, there have been 130 direct-to-consumer video platforms launched in the US, of which 108 still exist. But power is moving from the launcher to the receiver, from corporations to consumers. A fragmented content landscape is leading to subscription fatigue; according to Fluent, nearly half of US consumers say the growing number of services needed to watch what they want frustrates them. How things are perceived by the general public has superseded how they are launched by the gatekeeper. I am reminded of this quote from Ben Thompson's "Stratechery" blog: "The likelihood any particular message will 'break out' is based not on who is propagating said message but on how many users are receptive to hearing it. The power has shifted from the supply side to the demand side." This applies to social media and politics, but also to retail and the pay-TV ecosystem – the other industries impacted by direct-to-consumer enablement. Power and influence have become decentralized but accrued to companies like Facebook, Google, Apple and Amazon.

At the same time, however, new gatekeepers loom, ready to harness this motion and bring their scale to define a new reality. In media, Roku is functioning as a new video aggregator, utilizing free, ad-supported content to revolutionize access to movies and television. In social media, Facebook demonstrated its ability to amplify the voice of its users in elections, which in turn granted them tremendous influence on political outcomes for millions. The crucial question is how these power shifts will be managed. Roku's success has shown how aggregation can be a positive, acting as a curator of credibility and bringing together disparate audiences with content that appeals more broadly (in contrast to more fragmented SVOD platforms that serve niche audiences).

In the IPO arena, bulge-bracket banks used to serve as gatekeepers for private companies wishing to tap into the public markets but, now, the investor/ buyer side is exerting greater influence and sway. Recent IPOs have only dramatized this dynamic and highlighted its ascendance. Companies and sponsors are pursuing alternative paths to the public markets with direct listings, and special purpose acquisition companies (SPACs) also continue to gain some momentum. LionTree's IPO advisory service solves for exactly this dynamic by focusing on the core nucleus of investors who dominate an IPO's value creation, linking directly back to the issuer, dramatically improving on the incumbent banks' "broadcast" model.

The Absent Center

As gatekeepers turn over and the forces of scale and motion make themselves felt, a "centrist view" has become ever more vital yet also increasingly vulnerable. These developments affect politics, culture, and business, and the media has a huge role to play in the vanishing "center." Broadcast television and radio used to concentrate and unify audiences around content that was the least offensive to most people, but that aggregation has fallen apart, and instead people are gravitating toward platforms that reflect their emotions and biases. These new platforms, at the edges rather than the center, are thriving because of the architecture of the direct-to-consumer model in media as well as politics. These economic incentives drive cultural realities, as subscription models cater to niche audiences and sometimes encourage extreme views, replacing the advertising-supported paradigm where the center was an anchor and sweet spot.

One of the crucial questions going forward will be how to balance the realities driving the shift to a-la-carte services (a desire to be heard, for voices to reflect the preferences of their audiences) with the continued importance of the center as a bulwark against fragmentation driven by the voices that play to bias rather than accuracy. In my view, the media has played a role in the loss of the center, and it is our best hope to rebuild it. The most important step in doing so is to develop new standards for media responsibility. This involves not just important conversations about government regulation but also internal industry developments of standard practices, vital in an age of global reach.

This process needs to be integrated into the new models that emerge from the turn towards streaming. The ad-supported streaming video model – whether in the form of aggregators like Hulu and Pluto or a curator like Roku – passes responsibility back to the content provider, which usually shifts the message towards the center. The challenge is to make this center not only unbiased, but also compelling and responsive to the energies that pulled audiences towards the edges in the first place. New ecosystems are constantly being created, and form and content are rapidly changing. There are great opportunities to reimagine and rebuild the center.

I believe the new center will be local and see great potential in locally focused digital and streaming services. Local digital media and direct-to-consumer are closer to the ground, and can bring together audiences and curate credibility in ways that solidify rather than splinter. Local content production centered on sports and broadcasting, all delivered in local language and attuned to regional sensibilities, seems ripe for growth and expansion across the globe.

The Streaming Future is Here: Video, Audio, and Video Gaming

In a recent article in the *The New York Times* entitled "The Streaming Era is Finally Arrived. Everything is about to Change," journalist Brooks Barnes writes, "The long-promised streaming revolution- the next great leap in how the world gets entertainment- is finally here." Both Bob Iger of The Walt Disney Co. and John Stankey of WarnerMedia are quoted as using the same phrase in reference to their turn towards streaming - "We're all in." They were referring to streaming *video*, but I would extend their proclamation to include *audio* (music and podcasting) and *video gaming* as well.

Video trends are poised to reshape key elements of this media landscape, where the scale players have pushed all their chips to the middle of the table. The "streaming wars" between subscription-video-on-demand ("SVOD") services will result in a renewed emphasis on ad-supported video platforms, even as consumers become loyal to brands and curators within these platforms. Attention to the consumer will be crucial over the next decade as it can unlock fundamental insights into supply and demand. The rise of video streaming was catalyzed by 'the view from the boardroom,' as executives perceived consumer frustration with the state of cable and anticipated the need for a different model. While this bet seems well placed, providers will have to be attentive to the capacity of consumers; how much money they are willing to spend, the volume and dimensions of the choices they are willing to make, and their tolerance for adapting to a changing landscape. Time is the most precious commodity, and as streaming options proliferate, we need to remain aware of the ability of consumers to absorb these options. Optionality and happiness are not always directly correlated.

Video gaming trends and user-bases should continue to expand as the industry is one of the few bastions of growth that is not in direct competition with the scaled global content and distribution players. It is a fragmented market, poised for consolidation and organic growth. Mobile, instant games, and e-sports will continue to drive player growth and engagement, as gaming is becoming as much about playing as the social experience around it. Subscription models and streaming gaming from the cloud are particularly exciting as they have the potential to make gaming accessible to even more people, which could greatly expand the total addressable market, giving game publishers a new audience and distribution channel. Google recently launched its streaming platform, Stadia, Microsoft's Project xCloud is in beta and will launch in 2020, and Amazon reportedly plans to announce its own service linked to Twitch next year.

Audio should be a greater focus for more of the scaled players, as we continue to believe the market is "undervaluing" audio content and platforms relative to their video analogs. Companies like Spotify, iHeart, and Sirius/Pandora that play for the long term and innovate while deepening their storytelling capabilities are poised to thrive, and the development of non-music programming speak to the worlds of opportunity being unlocked by the bold and creative. Audio is no longer just music- it is an entire universe of content. We expect to see industry-wide increases in consumer bases and content production as more and more listeners realize the power of 'the ear' in a world seemingly dominated by 'the eye'.

E-Commerce Comes of Age

E-commerce is another direct-to-consumer mega-trend that I foresee accelerating into the next decade. Retail business models have already begun to shift away from wholesale and bifurcate between brick and mortar stores and DTC e-commerce. We would urge more media companies to focus on e-commerce, and indeed some have already started to capitalize on the opportunity. Discovery's new Food Network Kitchen streaming video platform will let its subscribers shop for ingredients and cooking utensils they see used by the talent in its programming. The Chernin Group has invested in Food52 and MeatEater, both media platforms with an e-commerce element. Tastemade was one of the first media brands to integrate purchases into its digital video content.

To be sure, the integration of content and commerce is easier said than done, and it must be authentic to gain traction. Media and social platforms are engineered to maximize time spent and engagement, while e-commerce sites are optimized to drive a quick, frictionless journey from product discovery to checkout. Still, I believe this integration is a goal worth pursuing. A revenue stream trifecta of e-commerce, subscription and advertising could be the panacea for a media industry grappling with increasing competition for ad dollars from digital platforms and audience fragmentation. Social media networks have long been used by consumers for inspiration, so it seems natural for them to incorporate "buy buttons" and other ways to shop into their platforms which act as a bridge between brands and the consumer. (See Facebook Marketplace, Instagram's in-app checkout feature, Pinterest's Shoppable Pins.) And for scaled tech companies who may be more constrained by the regulatory and political environment from pursuing M&A around their core businesses, building out e-commerce capabilities is a way to accelerate growth organically.

What Will The Next 10 Years Bring? 1970s Redux

Taking a step back, I sense that we are at a moment that is both radically new and reminiscent of another one from half a century ago. Just as the movement from the 1960's and early 1970's involved cultural paradigms that shifted alongside new economic realities, we are in the midst of transformations no less decisive and dramatic.

The 1960s was a period of massive change for the media industry, marked by a spate of corporate takeovers - MCA acquired Universal, Gulf+Western took over Paramount, and Transamerica's purchase of United Artists. Science-fiction novels gained widespread popularity in the 1960s too, with the notable publications of *The Clockwork Orange*, *Do Androids Dream of Electric Sheep?*, and *Dune*. More broadly, opposing cultural values seemed poised to tear our country apart, with a new generation rebelling against their parents' more conservative values, rooted in the austerity of the Great Depression and WWII. The Vietnam War loomed large.

Amidst the upheaval of the 1960s, a new era of creativity emerged in the 1970s that embraced Americans' longing for sweeping tales of morality. Take, for instance, a few of the winners of the Academy Award for Best Picture in the 1960s - *West Side Story*, *My Fair Lady*, *The Sound of Music* - and contrast that to those in the 1970s - *The Godfather I & II*, *Rocky*, *Annie Hall*. The first series in the *Star Wars* trilogy, *A New Hope* was first released in theaters in 1977. The documentary *Empire of Dreams*, available on Disney+, makes the point that *Star Wars* could only have been created in the 1970's, as society looked toward the oddball, the creative, and the unusual for inspiration and entertainment and a kind of escape.

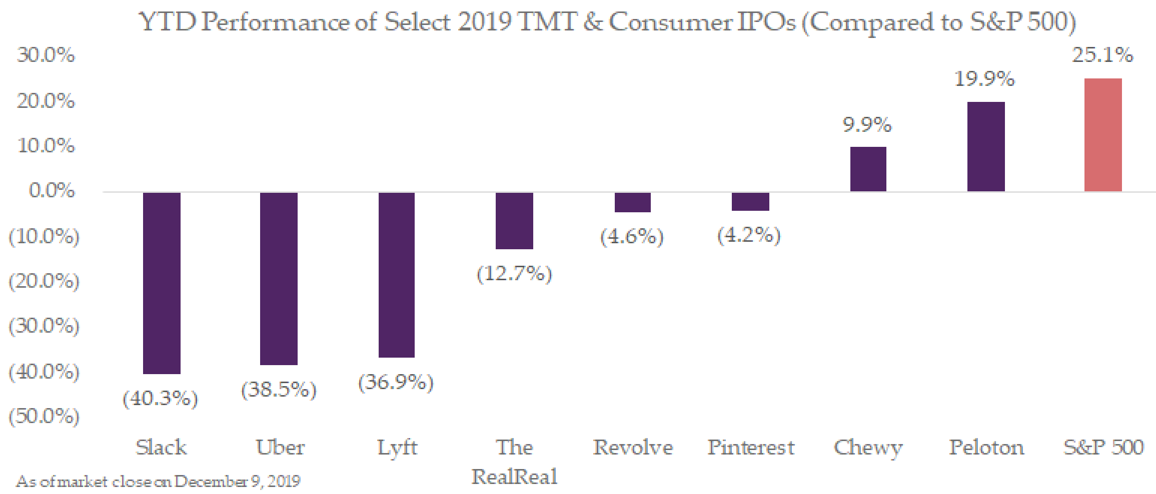
Just as the heaviness and tension of the 1960s led to a period of revitalization of the creative industries in the 1970s, I believe we could be headed for a similar dynamic in the years ahead. We are emerging from a decade that began with a global recession and has seen much change. Political fragmentation, class divide and fundamental challenges facing the global capitalist system are all top of mind as we begin 2020. The video streaming wars have kicked off alongside US presidential impeachment proceedings and Brexit battles. To be clear, the 1970s were characterized by severe economic challenges that I do not expect in the near-term - defined by high interest rates, stagflation, a global recession, a global oil crisis, and significant stock market volatility. But the theme of change and realignment, borne of the ashes of fragmentation and division - from business models, to leadership, to politics and beyond - resonates as I think ahead to the next 10 years.

II. Market Musings

The Public View Always Wins

One of the major developments of 2019 and a trend that we highlighted in last year's letter is the tension between the private and public markets. In particular, it seems as though the entrepreneurial sensibility and modus operandi that is the lifeblood of private markets does not always translate to public markets, which deeply value security and stability. What has emerged is a culture clash between the "achieve-the-impossible" ethos of the private markets and the fundamental frameworks of the public markets who want to see an eventual path to profitability. As such, we have seen the public markets reject several high-profile "unicorn" companies that they considered "overvalued" or "fully-valued" in the private market. Since 2006, the median Series D+ valuation has grown 6x while the value of the Russell 2000 equity index is up approximately 2.5x over the same period. There is a public-private disconnect.

That said, I do not think the lesson of 2019 is that the IPO market is closed for start-ups. It will remain open for private equity-driven companies and exits, especially early in the year and in the run up to the election. 'Discernment' is the new buzzword, however. Private companies need to do the internal work to reassure the public markets that they are to be trusted and have line-of-sight to profitability and free cash flow generation. What we have seen is the public equity investor rejecting the "growth at all costs" mentality of the private markets in favor of a more grounded approach to valuation, rooted in fundamentals and intrinsic value.



Source: FactSet

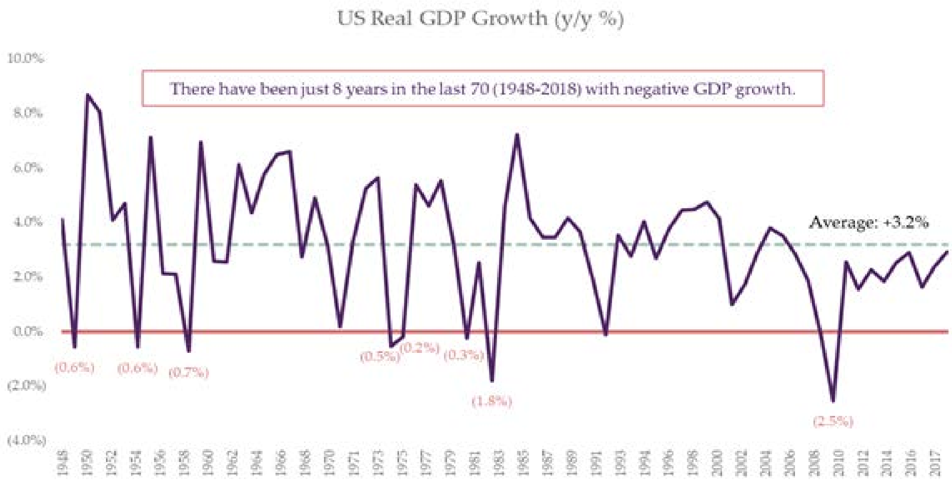
This upheaval is not necessarily a bad thing. It creates a higher bar for start-ups with public market ambitions which should strengthen their business models over time, improve corporate governance, and lead to more predictable outcomes for stakeholders. In the end, the public market view always wins because it's the bigger and more efficient consensus market, offering the capital and liquidity the private company and its stakeholders seek.

On the M&A front, given the public-private disconnect and IPO dislocation, there is likely to be an uptick in private exits/sales. Start-ups in this environment need more than an IPO advisor or a capital markets expert; they need a "private exit" advisor that can counsel them on a broader set of outcomes.

Recession Fears (Again) and Trade War

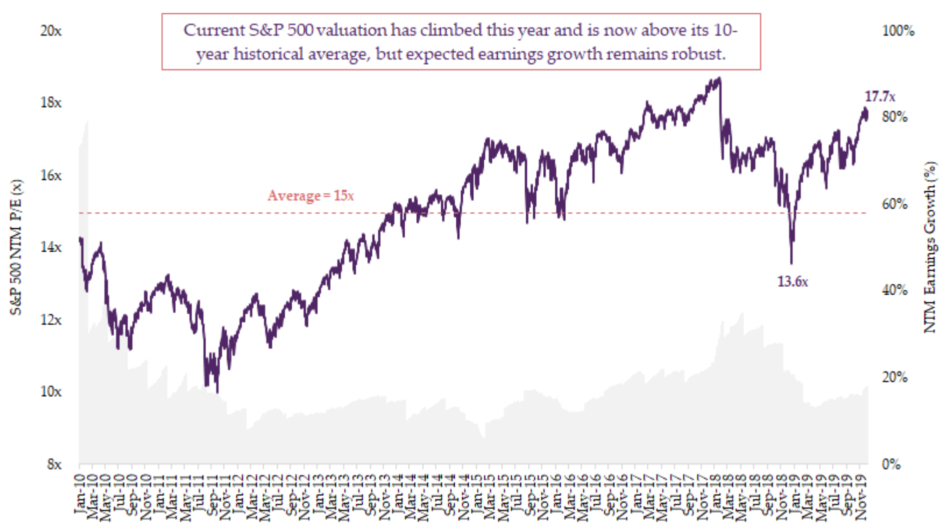
From news reports to clients to political pundits, it seems that everyone is asking when, not if, a global recession will happen. This question was asked last year and the year before – and yet the consumer-led economy continues to be strong. As the year draws to a close and China trade talks continue to stall, Congress is on the verge of passing USMCA (United States-Mexico-Canada Agreement), which is essentially 'NAFTA 2.0.' Getting this deal done would be a positive development for the US economy and give the country leverage in its trade negotiation with China. All in all, it's a bullish macro datapoint for the US economy and its future growth prospects.

On that note, I am doubtful about the likelihood of a near-term recession, given the US economy's continued growth. It is far more likely that we will see continued – albeit decelerating – US GDP growth in 2020. Just eight out of the past 70 years saw negative GDP growth in the US, with the most recent being -2.5% in 2009. The US economy is still growing, but that growth is slowing, and this could be its near-term reality. We could see companies become more conservative with their cash, retaining dry powder rather than spending it on buybacks, as they anticipate a potential market slowdown or recession next year. We need to pay attention to *shifts* in the marketplace that do not fit into a neat bear or bull narrative, as these movements might ultimately prove of long-term significance. For example, differences in cost of capital, marketplaces, and economic factors will be crucial. And while the markets continue to be focused on the US-China trade war, I am of the view that the market is less focused on a *specific outcome* but more on *any resolution*- which means it should be easier to satisfy investors on this front and thus remove this overhang.



Source: FactSet

This sustained period of growth and stability has pushed US equity values ever higher over the past decade. The S&P 500 forward P/E multiple entered the year at ~13.5x, and now sits at ~17.5x, which is also above its 10-year average (15x). I wouldn't be surprised, therefore, to see some stock market volatility next year driven by the re-rating of some of the underlying assets as public market investors turn towards a more fundamental approach to valuation, risk, and returns. Even so, earnings expectations are driving the market, and consensus forward EPS growth forecasts across the S&P 500 remain robust (up double-digits y/y, on average), so until those reset, I would not anticipate a material downward revision in market valuations.



Source: FactSet

How Low, for How Long, Can Interest Rates Go?

We are currently in a luxurious state of trough levels of inflation, corporate taxation, and interest rates. Predictions around the slope of increases in these three factors will determine the pressure points facing many of our clients and the economy overall. Perhaps the most important variable affecting macro forecasts is the interest rate environment. There are two pressing questions; how long can interest rates stay this low, and what happens when they change? We are in uncharted territory in many ways. For context, the 10-year Treasury yield has been 3% or lower over the past decade, the first time that's happened since the period from the mid-1930s to the mid-1950s, proving that low rates can be sustained over a longer period of time. But rarely have we seen rates go this low before. Since January 1871, there have been only five multi-year periods in US history where the 10-year yield slipped below 2%, and 4 of those 5 periods occurred in the last decade. Companies are wary that the low interest rate, low tax environment may not be around forever and that is potentially driving more conservative decision making around these pressure points from management teams. It is a risk factor for all US companies in 2020 and beyond.

Despite this historically low rate environment, veering into negative interest rate territory in 2020 is on everyone's mind. President Trump this year urged the US Federal Reserve to drive rates down to zero or less, and while this would be unprecedented in US history, it is not unheard of in the global economy; several of the Fed's counterparts have introduced negative rates recently, including central banks in Denmark, Switzerland, Japan, Sweden and the European Central Bank. The idea behind negative rates is that they penalize commercial banks from holding reserves at central banks, encouraging them to lend more, and consumers earn less interest on their savings accounts, incentivizing them to spend more; these moves, in theory, *should* stimulate the economy. Given that the US Federal Reserve is presiding over a strong economy (+2.5% expected GDP growth in 2019), I would not expect to see negative interest rates in the near-term. I believe our country's low interest rate environment will likely persist in 2020, which is a risk in and of itself as it leaves policymakers with less room and fewer tools to stimulate the economy via future rate cuts.

The (Macro) Environment and the Election

As the media and retail industries have begun to pivot towards serving the end-customer directly, our politics have too. In the US, we are on the verge of a "direct-to-consumer" presidential election that illustrates the core truth of Media 2.0; every industry will be "media-fied." Recent political dynamics have illuminated a simple truth that can be applied to entertainment and leadership as well - if your 'content' cannot be broadcast through a media outlet, it simply does not exist. The message is merely a whisper without the power of a platform.

Political candidates need a message that will both resonate with and travel to the masses. Incumbents have the advantage of brand recognition, and challengers will test out a range of strategies that will have to marry the insights of scale and reach with the depth to connect. The lyrics from a song by the English pop rock band Tears for Fears hit the nail on the head: "Nothing ever lasts forever, everybody wants to rule the world." Media is increasingly the driver for change and how the world is governed.

The upcoming US presidential election will likely happen against the backdrop of historically low interest rates and slow but solid GDP growth and, historically, that combination bodes well for the incumbent. At LionTree, we are not in the business of calling elections, but history teaches us that in eight of the last eleven times when a sitting US President ran for reelection, he won the race. Notably, the three years in which the incumbent lost were characterized by high interest rates (10-year US Treasury yield ranging from 7% to 12.5%) and in one of three years, GDP growth was negative. In general, the equity markets perform well in US Presidential election years, exhibiting a positive return in approximately 80% of the last 18. It is also worth noting that, in the year following the election, the market's average performance tends to be much higher if the incumbent wins (+9.7%) than if he loses (-4.7%), potentially reflecting investor preference for stability and continuity.

III. LionTree Reflections and 2020 Vision

Scale players in motion. Inflection points of succession and transformation. An absent center, a powerfully imagined return to the local. The tug of war between launchers and receivers, gatekeepers and consumers. These are just some of the themes that we are developing here at LionTree, and that are poised to define the next chapter of the twenty-first century. We have to track the headlines but see beyond them. What are the stories we are missing, the trends that will go from whispered to deafening overnight? Curiosity needs to take us to the boundaries of the possible, where we can see and touch and create the "something beyond."

LionTree moves in multiple worlds. Even as we are attuned to the global markets and the ways industries touch each other and are interconnected, we also remain grounded in the tech, media, and telecom thematics and are cognizant that trends there demand their own expertise and insight. The technological and digital are now at the vanguard of the changes that will shape who we are, what we want, and how we get it. Our commitment to connectivity and intimacy is matched by our aspiration to scale. The two inform the other, just as the local is the true gateway to the global and the climate of the macro is always determined by patterns observable at the micro.

In partnership with former SONGS CEO and LionTree special advisor Matt Pincus, we created MUSIC, a joint venture focused on music investments and strategic advisory. With the global adoption of streaming, we believe that companies in and around music will be at the forefront of the creation of the Media 2.0 entertainment business. MUSIC sits where technology, audience, and artists converge, and has enabled us to invest in a digital media and podcast company like Gimlet Media, a creator-focused music tech platform like Splice, and a global live music experience platform like Sofar Sounds.

Our partnership with Ocean Outdoor illustrates that in a world where even billboards – one of the world's oldest forms of media – can be digital and even take share from the tech platforms, the rules have been rewritten. Everything and anything you can do on your iPhone can be programmed on one of Ocean's screens - with full motion video, dependable measurement systems and embedded technologies for enhanced targeting in the real world. Outdoor advertising is striving to truly create "digital cities for digital citizens." LionTree's investments in Dot Dot Dot Media, Community, The Pattern, and Brut, all of which explore the complex and enduring connections between technology and our evolving humanity, signals our position at the beating heart of this ongoing drama.

LionTree's place at the future's frontline is possible only because of the quality of our team. Everything we have achieved this year is because of them, and nothing would be possible without them. I am proud that we come from all over the world (20+ countries) and bring the warmth and insight of so many cultures and languages. What we have is the real deal; a team of smart people who think globally. Our team's drive, curiosity and passion are our greatest assets. It is a joy to embark on another year together.

We imagine the future by inviting in the wisdom gained from experience. This was an incredible year for LionTree and with our clients we are evolving and executing all at once. The musician James Blunt has a line from his song *Champions* that I'll be taking with me into the new year- "Can't keep lookin' backwards, runnin' from the light, 'Cause this could be the greatest moment of our lives." I am looking forward to the year ahead with great excitement.

Aryeh B. Bourkoff
CEO | LionTree LLC

READING LIST

I generally read as a kind of time travel - and frankly, a way to pause time for a bit. It adds new dimensions of perspective. This year for me, however, was all about being in the present. The sheer volume of travel undertaken, deals completed, and relationships deepened grounded me in the moment - and I'm afraid, less time was spent reading. Therefore, what follows is a mix of what I did manage to read and learn from, as well as a few remaining books that are currently waiting to be enjoyed during the upcoming holiday break.

Drawdown: The Most Comprehensive Plan Ever Proposed to Reverse Global Warming - Paul Hawken and Tom Steyer
The Hundred Year Marathon: China's Secret Strategy to Replace America as the Global Superpower - Michael Pillsbury
The Laws of Human Nature - Robert Greene
Range: Why Generalists Triumph in a Specialized World - David Epstein
Revolutionary Constitutions: Charismatic Leadership and the Rules of Law - Bruce Ackerman
The Ride of a Lifetime: Lessons Learned from 15 Years as CEO - Bob Iger
Scale: The Universal Laws of Life, Growth, and Death in Organisms, Cities, and Companies - Geoffrey West
The Smartest Kids in the World: And How They Got That Way - Amanda Ripley
The Surrender Experiment: My Journey into Life's Perfection - Michael A. Singer
State of Play: The Old School Guide to New School Baseball - Bill Ripken
Taking of Getty Oil: Pennzoil, Texaco, and the Takeover Battle That Made History - Steve Coll
Trailblazer: From The Mountains of Kashmir to the Summit of Global Business and Beyond - Farooq Kathwari
What It Takes: Lessons in the Pursuit of Excellence - Steven A. Schwartzman

PODCASTS

Against the Rules with Michael Lewis *listen*
The Bill Simmons Podcast *listen*
Dope Labs Podcast *listen*
The Joe Rogan Experience *listen*
Masters of Scale with Reid Hoffman *listen*
Powering the Movement by Global Citizen (produced in partnership with our very own Kindred Media) *listen*
The Rewatchables listen *listen*

LionTree Scale Index

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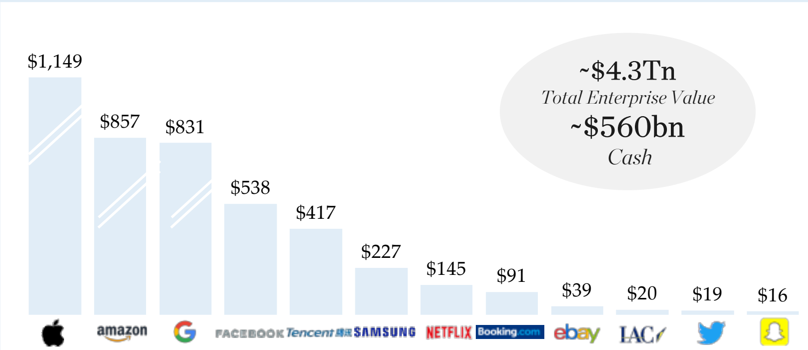
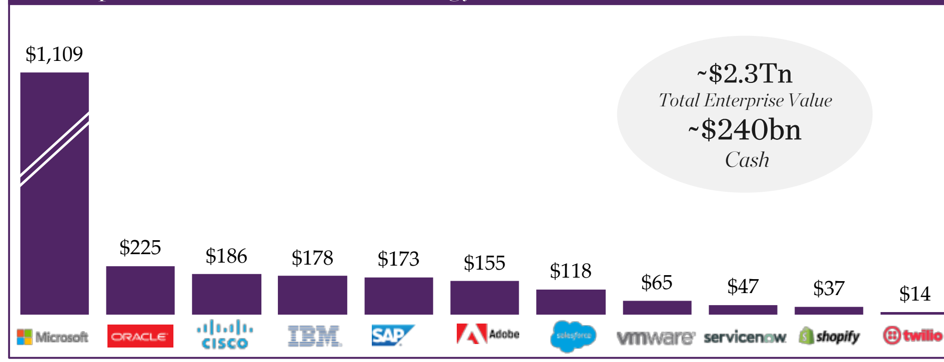


Enterprise Commerce & Technology



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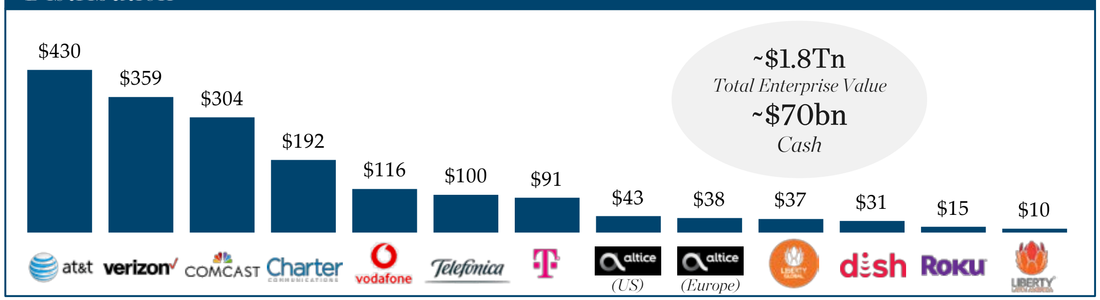

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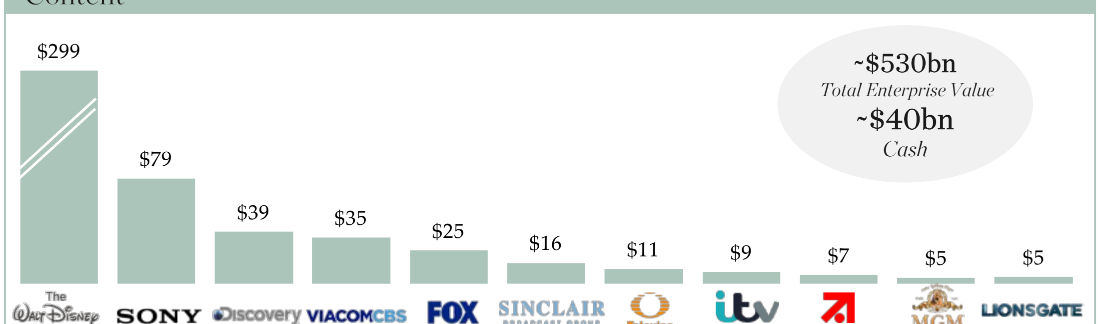
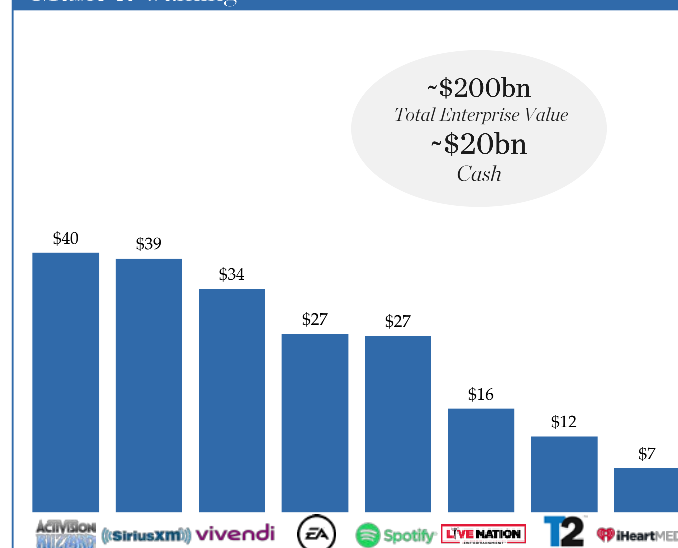


Music & Gaming



Note: Market data as of 12/9/19
Source: Factset