

ESPN Navigates a New World Order: Part 3

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The Future of ESPN

On October 18, 2023, the Walt Disney Company did something it had never done before – it reported the financial performance of ESPN. For the first time ever, the investing public got access to ESPN’s financials, which were previously rolled into and publicly reported under Disney and ESPN Media Networks. This was a byproduct of a recent restructuring of the Walt Disney Company, led by CEO Robert Iger, now in his second tenure on the job. The company would have three “collaborative” segments: Disney Entertainment; Disney Parks, Experiences, and Products; and ESPN.¹ As a component of the restructuring, Disney also laid off 7,000 employees, part of significant cost reduction initiatives.² Separating out ESPN into its own operating unit also made it easier to bring in strategic partner(s) to the company, something Iger continued to work toward. A partner could come in to help with marketing and/or content as well as investment as ESPN charted a new era.

As of Q2 FY24, Disney reported the following financial performance for its Sports segment (**Exhibit 1**).³

ESPN Domestic generated revenue of \$3.866 billion at the quarter ended March 30, 2024, up 4% year-over-year. ESPN Domestic also had operating income of \$780 million at the quarter ended March 30, 2024, down from \$858 million a year earlier, a 9% decline. Disney cited the reasons for the year-over-year decline in operating income were airing an additional College Football Playoff game and fewer affiliate subscribers. Offsetting the losses were “contractual rate increases” for affiliate fees and growth in advertising revenue.⁴

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In the same earnings report, Disney also reported on the state of the ESPN+ streaming product. While subscribers were at 24.8 million, down 2% from the previous quarter of 25.2 million, the average revenue per subscriber rose to \$6.30 due to price increases, which also helped offset further losses in operating income compared to the prior year (**Exhibit 2**).

This snapshot of ESPN's business at Q2 2024 represented of many of the issues facing ESPN: decline in cable subscribers, increase in the costs of live rights, and the inability of the streaming business to date to offset losses from cable.

In this environment, ESPN's future would be determined in part by how it managed two of the fundamentals of its business. The first was the rights fee obligations that ESPN had to its various league and conference partners into the future. The second was revenue coming in from affiliate fees/subscriptions. Of course, ESPN also had other business drivers – news and information on the content side, and advertising on the revenue side. But both were secondary to the live rights and affiliate/subscriptions.

First, rights fee obligations were a major driver of operating costs for the company. Below is a table with estimates of ESPN's rights fee payments from its partners on an annual basis (**Figure 1**). It was developed based solely on publicly reported terms of the rights agreements between ESPN and its partners. The specific times during fiscal years when the payments come due/hit the earnings report were not reflected here. The table is intended for educational purposes only.

Figure 1 ESPN Rights Obligations

Estimated ESPN rights fee obligations by property and year/season. All fees in \$m.													
Property	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	2030-31	2031-32	2032-33	2033-34	2034-35	2035-36	Est. Total Owed to Property
NFL	2,700	2,700	2,700	2,700	2,700	2,700	2,700	2,700	2,700	2,700			27,000
NBA	1,400	2,600	2,600	2,600	2,600	2,600	2,600	2,600	2,600	2,600	2,600	2,600	30,000
MLB	550	550	550	550	550								2,750
CFP*	608	608	1,300	1,300	1,300	1,300	1,300	1,300					9,016
SEC	811	811	811	811	811	811	811	811	811	811			8,110
NCAA	115	115	115	115	115	115	115	115					920
U.S. Open	70	70											140
NWSL	15	15	15	15									60
UFC	300	300											600
UFC PPV	200	200											400
AAC	83	83	83	83	83	83	83	83					664
Big12**	100	228	228	228	228	228	228						1,468
ACC	240	240	240	240	240	240	240	240	240	240	240	240	2,880
F1	85	85											170
NHL	400	400	400	400									1,600
Wimbledon***	33	33	33	33	33	33	33	33	33	33	33	33	396
PGA	75	75	75	75	75	75	75						525
WNBA****	25	67	67	67	67	67	67	67	67	67	67	67	762
Est. Annual Total Rights Obligation	7,810	9,180	9,217	9,217	8,802	8,252	8,252	7,949	6,451	6,451	2,940	2,940	
*With the new deal beginning in 2026-27, ESPN has agreed to sub-license some early round College Football Playoff (CFP) games to TNT. Sublicense fee not publicly reported, but it will offset ESPN's total CFP rights obligation.													
**ESPN's share of the rights fee starting in 2025-26 not publicly reported, but ESPN reportedly has 60% of the inventory of this package, so this number reflects 60% of the total commitment between ESPN and Fox (\$2.28b).													
***New agreement runs from 2024 through 2035. Terms not publicly reported. \$33m per year is reported rights fee from previous deal and is used here. New rights fee likely higher.													
****ESPN's share of the rights fee starting in 2025-26 not publicly reported. The \$67m number is 1/3 of the overall \$200m package three partners (Disney/ESPN, Comcast/NBCUniversal, and Amazon) agreed to pay the WNBA over the course of an 11-year deal.													

Note: This table includes information only from publicly reported rights agreements between ESPN and its partners and/or industry reports on these rights agreements.⁵ It is not 100% exhaustive and is intended for educational purposes only. Many reports suggested ESPN's total rights obligations exceeded \$10 billion annually and over \$2 billion to produce that content.

Source: See Endnote 5.

Moving on from the cost side of the equation, revenue generation must also be considered. ESPN had two different ways to drive monthly subscription revenue: affiliate fees and direct-to-consumer subscriptions. The table below modeled both revenue sources in several scenarios to get a total annual revenue number, which was then subtracted from the total rights obligation. It used the estimated total rights obligation from 2024-25 (**Figure 2**).

Figure 2 ESPN Revenue Projections – Subscription Business

Affiliate Subscribers (m)	Average Revenue per Affiliate Sub (\$)	Total Affiliate Revenue per month (\$m)	Total Affiliate Revenue per year (\$m)	DTC Subscribers (m)	Average Revenue per DTC Sub (\$)	Total DTC Revenue per month (\$m)	Total DTC Subscriber revenue per year	Total Sub Revenue (Affiliate + DTC) year (\$m)	Est. Total Rights Obligation 24-25 (\$m)	Net: Sub Rev minus Rights Obligation (\$m)
100	10	1,000	12,000	0	\$0	0	0	12,000	7,810	4,190
70	10	700	8,400	25	\$6	150	1,800	10,200	7,810	2,390
60	10	600	7,200	25	\$6	150	1,800	9,000	7,810	1,190
60	10	600	7,200	20	\$6	120	1,440	8,640	7,810	830
50	10	500	6,000	45	\$6	270	3,240	9,240	7,810	1,430
50	10	500	6,000	35	\$6	210	2,520	8,520	7,810	710
35	10	350	4,200	50	\$6	300	3,600	7,800	7,810	-10
25	10	250	3,000	50	\$6	300	3,600	6,600	7,810	-1,210
20	10	200	2,400	70	\$6	420	5,040	7,440	7,810	-370
0	10	0	0	100	\$6	600	7,200	7,200	7,810	-610
70	10	700	8,400	25	\$7	175	2,100	10,500	7,810	2,690
50	10	500	6,000	45	\$7	315	3,780	9,780	7,810	1,970
50	10	500	6,000	35	\$7	245	2,940	8,940	7,810	1,130
35	10	350	4,200	50	\$7	350	4,200	8,400	7,810	590
25	10	250	3,000	50	\$7	350	4,200	7,200	7,810	-610
20	10	200	2,400	70	\$7	490	5,880	8,280	7,810	470
0	10	0	0	100	\$7	700	8,400	8,400	7,810	590

Note: This table is based on publicly available information and models out scenarios that vary based on number of subscribers via affiliates and direct-to-consumer and the average revenue per subscriber. Average revenue per affiliate sub includes ESPN as well as other ESPN networks (ESPN2, ESPNEWS, etc.) This table is for educational purposes only.

This table represented a few of the scenarios that ESPN had faced or will face in the future. For example:

- ESPN at the height of the cable bundle with 100 million subscribers at roughly \$10 per month for ESPN networks.
- ESPN in 2024 with roughly 70 million Affiliate subscribers and 25 million ESPN+ Direct-to-Consumer (DTC) subscribers.
- ESPN continues to lose Affiliate subscribers and DTC subscribers remain constant or decrease.
- ESPN continues to lose Affiliate subscribers but grows DTC subscriber base to varying degrees.
- ESPN increases average revenue per user for DTC to \$7.

The variables in this model could be changed to explore various scenarios with different subscriber numbers and average revenue per subscriber (for both Affiliate and DTC) as well as different values for total annual rights obligations.

Both the rights obligations and revenue modeling illustrated the opportunities and challenges that ESPN faced in a new era. Could the company increase revenue enough to grow profitably? If so, how? Would it have to make tough choices on which sports properties to invest in? If so, which made brand and economic sense for the company? The golden age of ESPN in the cable bundle was over. Tough decisions about the strategic direction and economic sustainability of the worldwide leader in sports were looming.

Conclusion: Where would ESPN go from here?

In some ways, the challenges facing ESPN were like those discussed about myriad companies and industries in business school classrooms around the world. Amidst rapid technological change, ESPN was forced with the choice to either disrupt itself or be disrupted. The rising costs, declining revenue, changes in consumer behavior, and overheated competitive environment added further complexity to the situation.

For its part Disney remained publicly bullish on the growth prospects of ESPN, even as the brand navigated so much disruption. As Iger pointed out in the November 8, 2023 earnings call:

Another core building opportunity is taking ESPN, which is already the world's leading sports brand, and turning it into the preeminent digital sports platform allowing us to reach fans in compelling new ways and fully integrating key features into our primary ESPN offering.⁶

How could ESPN become the preeminent digital sports platform of the new streaming era? What would be the implications on the league and conference media rights? Team valuations? Player salaries? Agent commissions? The answers would shape the future of the sports world.

Exhibit 1 Disney Q2 FY24 Sports Financials

Sports

Sports revenues and operating income (loss) are as follows:

(\$ in millions)	Quarter Ended		Change
	March 30, 2024	April 1, 2023	
Revenue			
ESPN			
Domestic	\$ 3,866	\$ 3,733	4 %
International	341	366	(7) %
	<u>4,207</u>	<u>4,099</u>	3 %
Star India	105	127	(17) %
	<u>\$ 4,312</u>	<u>\$ 4,226</u>	2 %
Operating income (loss)			
ESPN			
Domestic	\$ 780	\$ 858	(9) %
International	19	19	— %
	<u>799</u>	<u>877</u>	(9) %
Star India	(27)	(99)	73 %
Equity in the income of investees	6	16	(63) %
	<u>\$ 778</u>	<u>\$ 794</u>	(2) %

Exhibit 2 Disney Q2 FY24 ESPN+

Second Quarter of Fiscal 2024 Comparison to First Quarter of Fiscal 2024

In addition to revenue, costs and operating income, management uses the following key metrics to analyze trends and evaluate the overall performance of our ESPN+ DTC product offering⁽¹⁾, and we believe these metrics are useful to investors in analyzing the business. The following table and related discussion are on a sequential quarter basis.

	March 30, 2024	December 30, 2023	Change
Paid subscribers ⁽¹⁾ at: (in millions)	24.8	25.2	(2) %
Average Monthly Revenue Per Paid Subscriber ⁽¹⁾ for the quarter ended:	\$ 6.30	\$ 6.09	3 %

⁽¹⁾ See discussion on page 16—DTC Product Descriptions and Key Definitions

The increase in ESPN+ average monthly revenue per paid subscriber was due to increases in retail pricing and higher advertising revenue.

Endnotes

¹ “The Walt Disney Company Announces Strategic Restructuring, Restoring Accountability to Creative Businesses,” February 9, 2023 (<https://thewaltdisneycompany.com/the-walt-disney-company-announces-strategic-restructuring-restoring-accountability-to-creative-businesses/>), accessed June 11, 2024).

² Jennifer Maas, “Disney Completes 7,000 Job Cuts,” *Variety*, May 31, 2023 (<https://variety.com/2023/tv/news/disney-layoffs-end-7000-1235629809/>), accessed June 11, 2024).

³ The Walt Disney Company Q2 FY24 Earnings Report

⁴ *Ibid.*

⁵ J.P. Morgan Global Sports Advisory and Finance Overview, January 2024; Alex Sherman and Jabari Young, “NFL Finalizes New 11-Year Media Rights Deal, Amazon Gets Exclusive Thursday Night Rights,” *CNBC*, March 18, 2021 (<https://www.cnbcm.com/2021/03/18/nfl-media-rights-deal-2023-2033-amazon-gets-exclusive-thursday-night.html>), accessed June 11, 2024); John Ourand and John Lombardo, “NBA’s Nine-Year Media Rights Deals with ESPN, Turner Worth \$24B,” *Sports Business Journal*, October 6, 2014 (<https://www.sportsbusinessjournal.com/Daily/Morning-Buzz/2014/10/06/NBA-media-deals.aspx>), accessed June 11, 2024); Isabella Simonetti and Joe Flint, “NBA Unveils \$77 Billion TV and Streaming Deals With NBC, ESPN and Amazon,” *The Wall Street Journal*, July 24, 2024 (<https://www.wsj.com/business/media/nba-unveils-77-billion-tv-and-streaming-deals-with-nbc-espn-and-amazon-0a2b81b9>), accessed July 26, 2024); John Ourand, “ESPN Renews MLB Deal Through ’28,” *Sports Business Journal*, May 13, 2021 (<https://www.sportsbusinessjournal.com/Daily/Closing-Bell/2021/05/13/MLB-ESPN.aspx>), accessed June 11, 2024); Andrew Marchand, Nicole Auerbach, Stewart Mandel and Chris Vannini, “College Football Playoff, ESPN Agree to 6-Year Extension Worth \$1.3 Billion Per Year: Sources,” *The Athletic*, February 13, 2024 (<https://theathletic.com/5272749/2024/02/13/college-football-playoff-espn-media-rights-deal/>), accessed June 11, 2024); JP Morgan Global Sports Advisory and Finance Overview January 2024; Chantel Jennings and Nicole Auerbach, “What Does the NCAA’s New Media Rights Agreement Mean for Women’s College Basketball?” *The Athletic*, January 4, 2024 (<https://theathletic.com/5178340/2024/01/04/ncaa-college-sports-media-rights-explained/>), accessed June 11, 2024); John Ourand, “ESPN, USTA Sign 11-Year Deal Worth More Than \$770M To Put U.S. Open Solely On Cable,” *Sports Business Journal*, May 16, 2013 (<https://www.sportsbusinessjournal.com/Daily/Issues/2013/05/16/Media/US-Open.aspx>), accessed June 11, 2024); “ESPN to Broadcast 30 UFC Events Per Year During 5-Year Deal,” *ESPN*, May 23, 2018 (https://www.espn.com/mma/story/_/id/23581729/espn-ufc-reach-five-year-television-rights-deal), accessed June 11, 2024); John Ourand, “ESPN Extends With UFC; ESPN+ Becomes Exclusive PPV Provider,” *Sports Business Journal*, March 18, 2019 (<https://www.sportsbusinessjournal.com/Daily/Closing-Bell/2019/03/18/ESPN-UFC.aspx>), accessed June 11, 2024); Patrick Hipes, “ESPN+ and UFC Extend Deal, Add Pay-Per-View Rights Through 2025,” *Deadline*, March 18, 2019 (<https://deadline.com/2019/03/ufc-pay-per-view-deal-espn-plus-ppv-rights-1202577686/>), accessed June 11, 2024); Michael Smith and John Ourand, “AAC, ESPN Agree To 12-Year Media Rights Deal Worth \$1B,” *Sports Business Journal*, March 19, 2019 (<https://www.sportsbusinessjournal.com/Daily/Closing-Bell/2019/03/19/AAC.aspx>), accessed June 11, 2024); Michael Smith and John Ourand, “ESPN, Fox May Share Big 12 Rights,” *Sports Business Journal*, March 19, 2012 (<https://www.sportsbusinessjournal.com/Journal/Issues/2012/03/19/Media/Big-12.aspx>), accessed June 11, 2024); Pete Thamel, “Big 12 Nears Six-Year, \$2.28B TV Extension Deal with ESPN, Fox,” *ESPN*, October 30, 2022 (https://www.espn.com/college-football/story/_/id/34910144/big-12-nears-six-year-228b-tv-extension-deal-espn-fox), accessed June 11, 2024); Michael Smith, “One Year Later, ACC Ups Its Rights Fees by a Third,” *Sports Business Journal*, May 14, 2012 (<https://www.sportsbusinessjournal.com/Journal/Issues/2012/05/14/Media/ACC.aspx>), accessed June 11, 2024); Anthony Crupi, “Disney’s F1 Renewal is a \$255M Play to Rev Up ESPN+ Subs,” *Sportico*, October 22, 2022 (<https://www.sportico.com/business/media/2022/f1-and-disney-renew->

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⁶ “Disney’s Fiscal Full Year and Q4 2023 Earnings Results Webcast,” November 8, 2023 (<https://thewaltdisneycompany.com/disneys-fiscal-full-year-and-q4-2023-earnings-results-webcast/>, accessed June 11, 2024).