The fast pace of change in UK media

Challenges and threats to the UK television advertising trading mechanism

A report by Oliver & Ohlbaum Associates for ITV plc

3rd August, 2011

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Executive summary

Overview

The internet has had – and continues to have – a profound impact on many areas of the economy

These changes have often started in a relatively unheralded manner, sometimes as an adjunct to other activities – yet over time they have overwhelmed what seemed almost impregnable established businesses

With the benefit of hindsight these impacts now seem inevitable – at the time few predicted the scale of change they would bring

In recent years the internet has finally begun to fulfill the expectations raised during the first dotcom boom – this pattern is likely to continue – and other media sectors are unlikely to remain immune

The TV advertising market remains robust – for now – but faces future threats. And with VOD and connected TV still in their infancy, it is difficult to predict their disruptive impact on models of traditional TV advertising beyond the short-term

Profound changes – long term impacts

Response Advertising

1999: Google introduces search advertising

2008: 66 Local newspapers close in 18 months; Press classified revenues down 56% from 2004

Music Retail

1998: Napster launches
2001: Apple introduces the iPod

2008: Zavvi goes into administration
2011: HMV to undergo restructuring

Book Retail

1998: Amazon UK launches

2009: Borders / Books etc closes
2011: Waterstones bought out from HMV

Executive summary

Forces for change

O&O Advisory

There are three broad categories of forces for change which are impacting on UK media: technological innovation and adoption, changing consumer behaviour and changing advertiser behaviour

Forces for change in UK media in the Internet age

	Digital Age →		Web 2.0 Age →	
	1995 - 1999	**2001 - 2005**	**2006 - 2010**	**2011 - 2015**
TECHNOLOGY	• Browsers • Digital TV	• Broadband adoption	• Broadband mass market • Smartphones and mobility	• Mass market adoption of connected devices?
CONSUMERS	• Viewing fragmentation	• The rise of e-commerce	• The rise of social media	• Two-screen interactivity • Location based services • Personalised consumption
ADVERTISING	• The growth of display	• The rise of search	• Recession • Recovery	• Targeted display advertising • Mass reach online services

Executive summary

TV is the next battleground

Whilst the TV advertising sector remains robust, forces for change are enabling the internet to make further, just as profound, changes to the media industry writ large

Technological developments have increased the capacity and capability of home networks and mobile devices, allowing delivery of rich video content

Consumer behaviour is changing – with leading social networks now reaching as many people as television networks

Advertiser behaviour is altering, as online video becomes a viable medium, and the targeting the internet offers can improve the efficiency of advertising

These changes are only just beginning to take effect – but as other sectors have seen, their long term impact could be significant, however difficult to predict

Why online services pose a threat to traditional broadcasting

Video now commonplace

A narrowband internet required content to be text, stills and some limited audio. The near-ubiquity of broadband networks means that the internet is now a video medium

Display advertising now mainstream

Internet advertising has been dominated by response, primarily search, but also classified advertising. With the growth in video has come the ability to use the web as a display medium

TV no longer the only mass reach medium

TV has traditionally been the only way that advertisers can reach large sections of the population quickly and efficiently. The development of both advertising networks and high reach destinations such as Facebook offers alternatives

Targeting improves advertising efficiency

The ability of the internet to track a user’s movements and the ability to use this information in real time allow adverts to be targeted at consumers where they are most likely to influence behaviour – removing some of the “hit and miss” nature of display advertising

Global players increasingly important

The drivers of these changes are no longer local operators; Google, Facebook, Amazon and Apple are global players with user bases of hundreds of millions

Executive summary

Key findings

The TV advertising market remains robust currently, but subject to future threats

Technological innovation and adoption, predominantly related to the Internet and new connected devices, has led to dramatic shifts in the way people consume media. Consequently advertisers have changed where and how they spend their budgets

Rather than slowing, the next 3-5 years is likely to see an intensification of change as the Web 2.0 age develops at pace, driven by adoption of smartphones and tablets, connected TVs and super high speed networks to feed content to them

These trends are enabling the emergence off powerful new global players who are now challenging incumbent and often nationally focused media and content-based organisations

The result for UK broadcasters is that television net advertising revenues may well begin to enter some level of decline leading to at best flat levels of original UK content investment and the development of a vicious circle of decline in the longer term

What are the key forces for change affecting media industries?

1. Technological innovation and adoption have led to significant changes in the delivery of media – the Internet and connected devices are now central to the delivery of media services
2. As a result of new technologies and associated services, consumer behaviour is changing rapidly and altering relationships – with content and its providers
3. The result of shifts in consumption patterns has meant a change in where advertising expenditure goes, with new media players increasingly squeezing traditional advertising funded media

What are the resulting macro trends that are emerging as a result of these forces for change?

- Fragmentation of consumption has occurred across virtually all media sub-sectors, weakening traditional incumbent providers, whether this be broadcasters, music labels or newspaper publishers
- Polarisation has occurred where the difference between success and failure is ever more stark
- Globalisation – of content, as the hits become dependent on a global rather than local audience – and of operations, as industries converge around a small number of international operators
- Re-aggregation has also occurred and new players have been able to rapidly emerge and dominate their sectors, bring global scale advantages in competition versus nationally focused and content based organisations and even starting to invest in content

How great is the threat to advertising funded broadcasters to 2020?

- There ism as yet, no evidence to suggest that the TV advertising market is anything but robust – there appears to be little structural threat to TV advertising in the next 3-5 years
- However, there is now a growing body of evidence to suggest that advertising funded broadcasters will not remain immune to the macro shifts of advertising expenditure to new online players beyond 3-5 years
- Facebook and Google are now proven to successfully drive traffic to leading brand websites and these leading global properties control a significant proportion of all online display advertising inventory
- This emerging strong position in online display advertising is now driving rapid growth in the display advertising revenue of Facebook and Google
- The result is likely to be a squeeze on display advertising expenditure with traditional display media - television is unlikely to prove immune to this pressure
- If current display advertising expenditure trends are extrapolated, let alone intensify, UK television advertising revenue is likely to decline in real terms to 2020 - however it is difficult to predict with any level of certainty beyond the next 3-5 years, such is the pace of change, and the considerable impact of disruptive, innovative new models and applications of technology

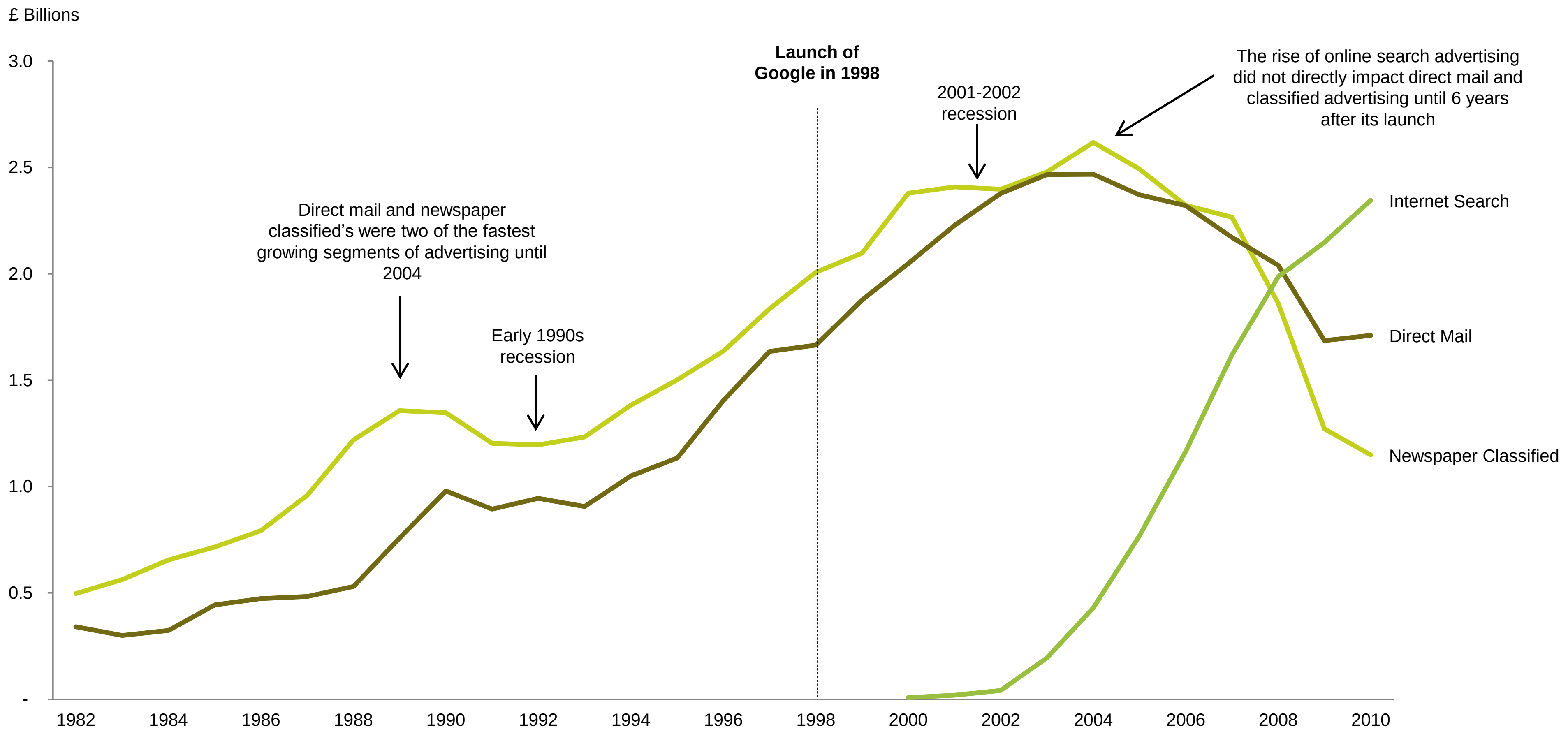
Executive summary

Delayed effects

O&O Advisory

Historical evidence suggests that current trends may be building up in the background but may not burst through for another 3-5 years – it was not until 6 years after the launch of Google that direct mail and classifieds entered decline

UK direct mail and newspaper classified advertising expenditure (nominal terms), 1982 to 2010



Note: All data is in nominal terms (current prices)
Source: Advertising Association / WARC

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Forces for change – technological innovation and adoption

Summary

New technology promises to revolutionise the media landscape – and the pace of change is accelerating

Both consumer technology and more importantly the infrastructure to support this technology is on the cusp of significant increases in capacity and capability

The pace of change is accelerating

- Successive generations of media technology have shown ever quicker adoption curves – the time taken to become mass-market mainstream is shortening
- The speed of adoption of web-based technology is remarkably short – TV on the PC and Facebook have each taken only 4 years to reach 50% of the UK population

Connected TV sets will account for the majority of household viewing

- Connected TVs – a satellite box with a broadband connection, a cable box, IPTV or a YouView / other hybrid / OTT device – will be in the majority of homes in the next decade
- These devices allow even more choice and easy access to many more services, including extensive on demand video
- New entrant global content players will more easily be able to provide content through connected TV sets direct to the living room and potentially disintermediate channels

Two screen viewing is becoming widespread

- The adoption of tablets and other connected devices has led to many consumers adopting “two screen” consumption habits – with web-based content / interaction supporting the main broadcast stream – particularly among younger age cohorts

Smartphones are becoming universal

- While the majority of device shipments are now highly capable mobiles, there is still a battle for the device and operating system, leading to inter-operability issues and requiring content suppliers to have many versions

Next generation networks

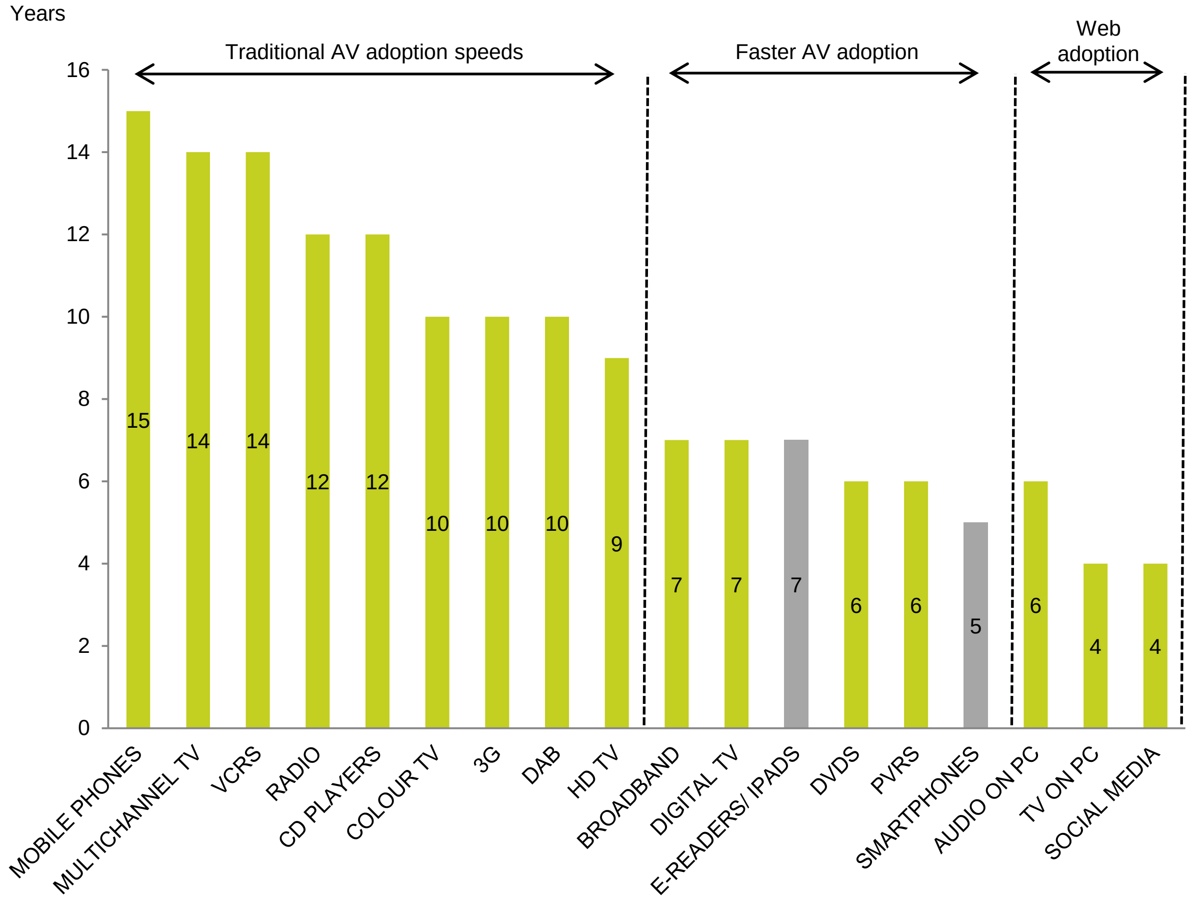
- Although the UK lags in the adoption of high-speed networks, roll out is accelerating

Forces for change – technological innovation and adoption

Accelerating pace of change

The Internet has accelerated the pace of change in media sectors – new players have been able to become market leaders in a much shorter length of time

Number of years taken to reach 50% penetration of relevant universe, by device / application in the UK



Audio visual/telecom products took 8 to 12 years to reach 50% penetration, but timescales to mass adoption have shortened over the last 10 years:

- Web based innovation takes 4 to 6 years to reach 50% penetration
- Smartphones and e-readers/ iPads likely to reach 50% penetration of relevant universe in 2012 and 2016 respectively

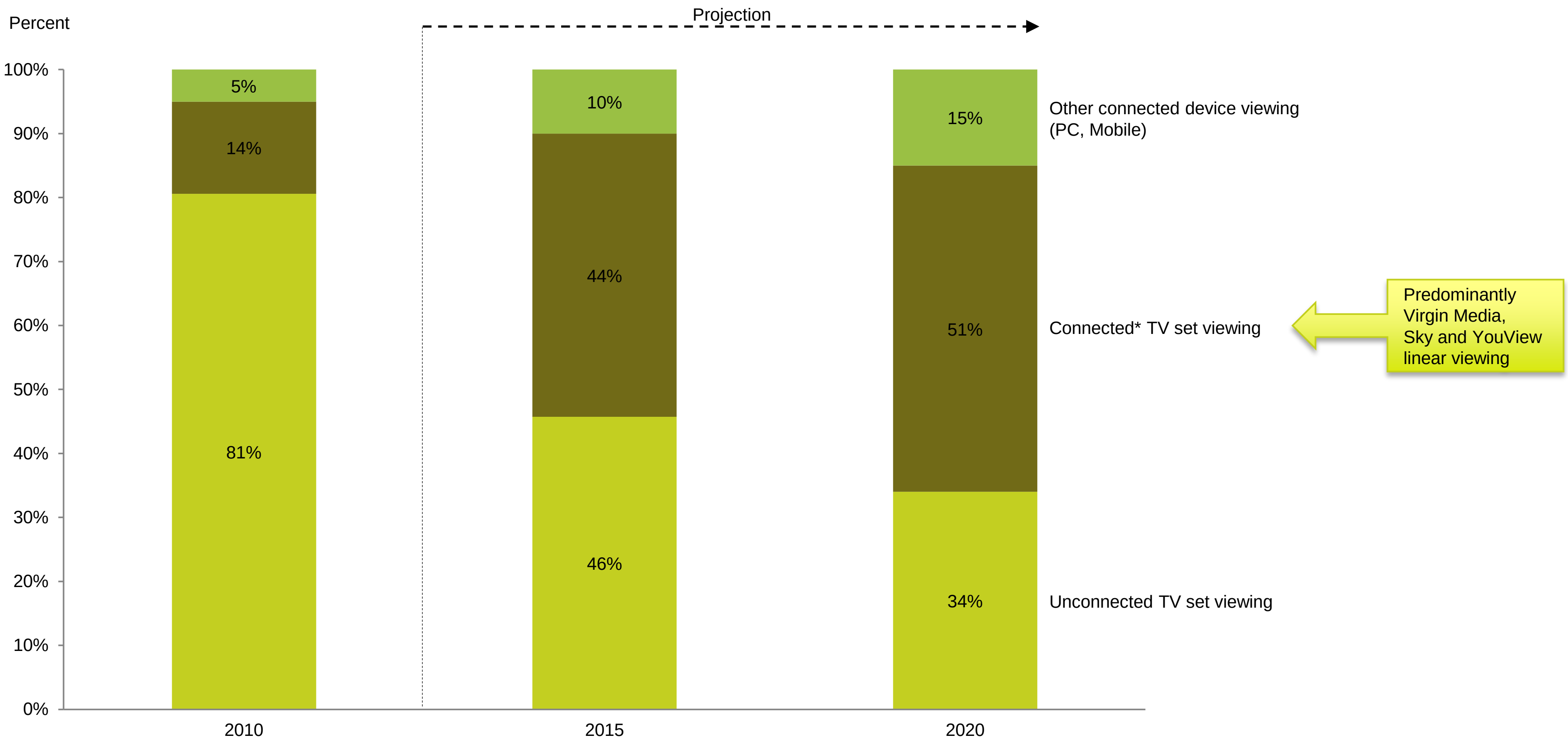
Source: Oftel, Screen Digest, ITC, BVA, BBC Audience & Consumer Research, Lexis Nexis, *The Slow Pace of Fast Change,* Bhaskar Chakravorti

Forces for change – technological innovation and adoption

Connected TV growing rapidly

By 2020, around two thirds of all UK television viewing will be to broadband connected TV sets – the on-demand viewing this will enable will increase rates of audience fragmentation and allow the collection of much richer audience data

Total UK audiovisual viewing hours by type of connectivity; 2010, 2015 & 2020



Note: Connected TV sets are TV sets / set-top boxes directly connected to a broadband Internet service enabling the direct delivery of on-demand content to the TV screen via an EPG

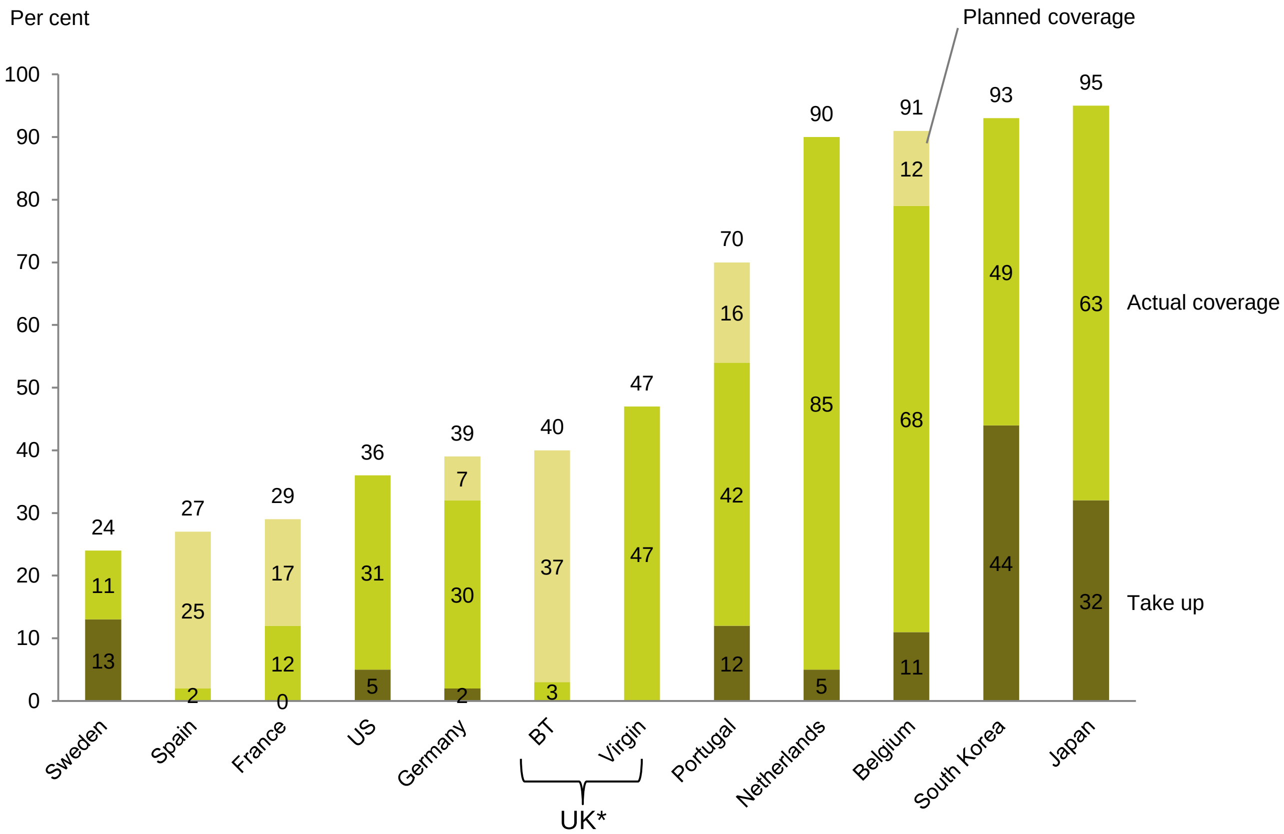
Source: Oliver & Ohlbaum Analysis

Forces for change – technological innovation and adoption

Next generation networks

Governments and network owners are now investing in and rolling out high-speed fibre broadband networks to meet future demand for bandwidth intensive Internet video services to the TV set

Current and targeted super fast broadband coverage, February 2010



Deployment plans and current take up levels of super high speed broadband services in the UK are behind those in other major developed markets:

- However, demand for super high speed broadband services is likely to be high in the UK given demand for HD and 3D television content**
- UK networks will have significant duplication – the drivers that make fibre roll out attractive are, in many cases, are likely to mean that cable is already deployed

Note: *The future overlap between Virgin Media and BT super-fast networks is currently unclear making it impossible to provide overall UK metrics
**'*There is a major role for content publishers to help drive demand for broadband*', James Meadway (2009) BSG/NESTA: Getting up to speed: making super-fast broadband a reality)

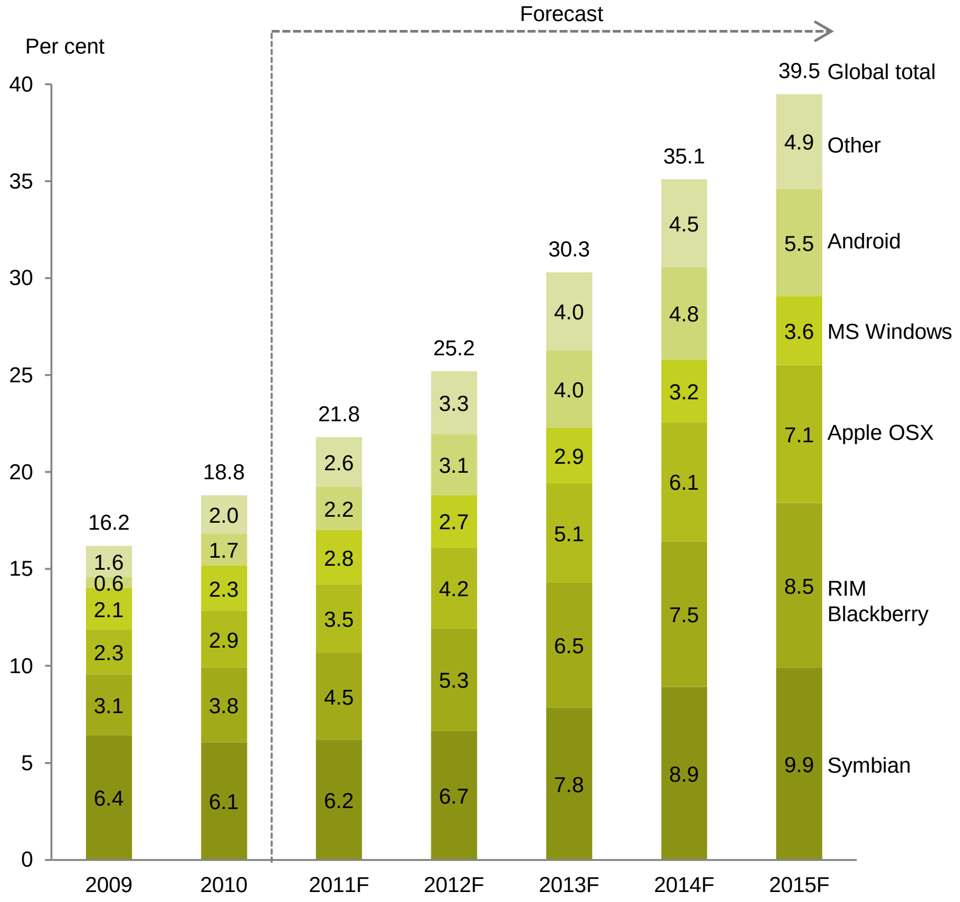
Source: Cullen International February 2010, Ofcom "Super-fast broadband Context" March 2010

Forces for change – technological innovation and adoption

Rapid adoption of smartphones

The rapid adoption of smartphones is also creating a new connected global platform which will allow advertisers to target individuals and new "4G" mobile broadband technologies will allow the mass market viewing of video while on the move

Global installed base of smartphones as proportion of all mobile phones, segmented by operating system, 2009 to 2015



Mobile technology peak data rates

Technology	Downlink (Mbit/s)	Uplink (Mbit/s)
GSM+	0.384	0.384
EDGE	1.6	0.5
HSDPA	14.4	5.76
HSPA+	56	22
LTE 2x2 ("4G")	100	50
LTE 4x4 ("4G")	300	75

Note: Acronyms as follow: GSM: Global System for Mobile Communications, EDGE: Enhanced Data-rates for Global Evolution, HSDPA: High Speed Data Packet Access, LTE: Long Term Evolution (3GPP 4G technology)

Source: AT&T, 3GPP White Papers, IMS 2011, Oliver & Ohlbaum Analysis

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Forces for change – consumer behaviour

Summary

New technology has enabled radical shifts in consumer behaviour

Online services have finally fulfilled the hopes and hype of the first dotcom boom, accounting for significant portions of consumer spend and time, and achieving near ubiquity in many cases

Online consumption continues to rise

- Time spent online has continued to grow strongly

This consumption is increasingly of video content

- The higher speeds offered by broadband in recent years have allowed the widespread distribution of video content in real time – in direct competition with traditional TV

This market is increasingly global

- The online market is dominated by global – principally US based – players. Apple, Google, Facebook and eBay dominate their sectors, and UK players – bebo and QXL, for example - have been overwhelmed

Consumer spending is also moving

- In all forms of media the internet now provides a significant retail channel

And – more slowly – so is delivery

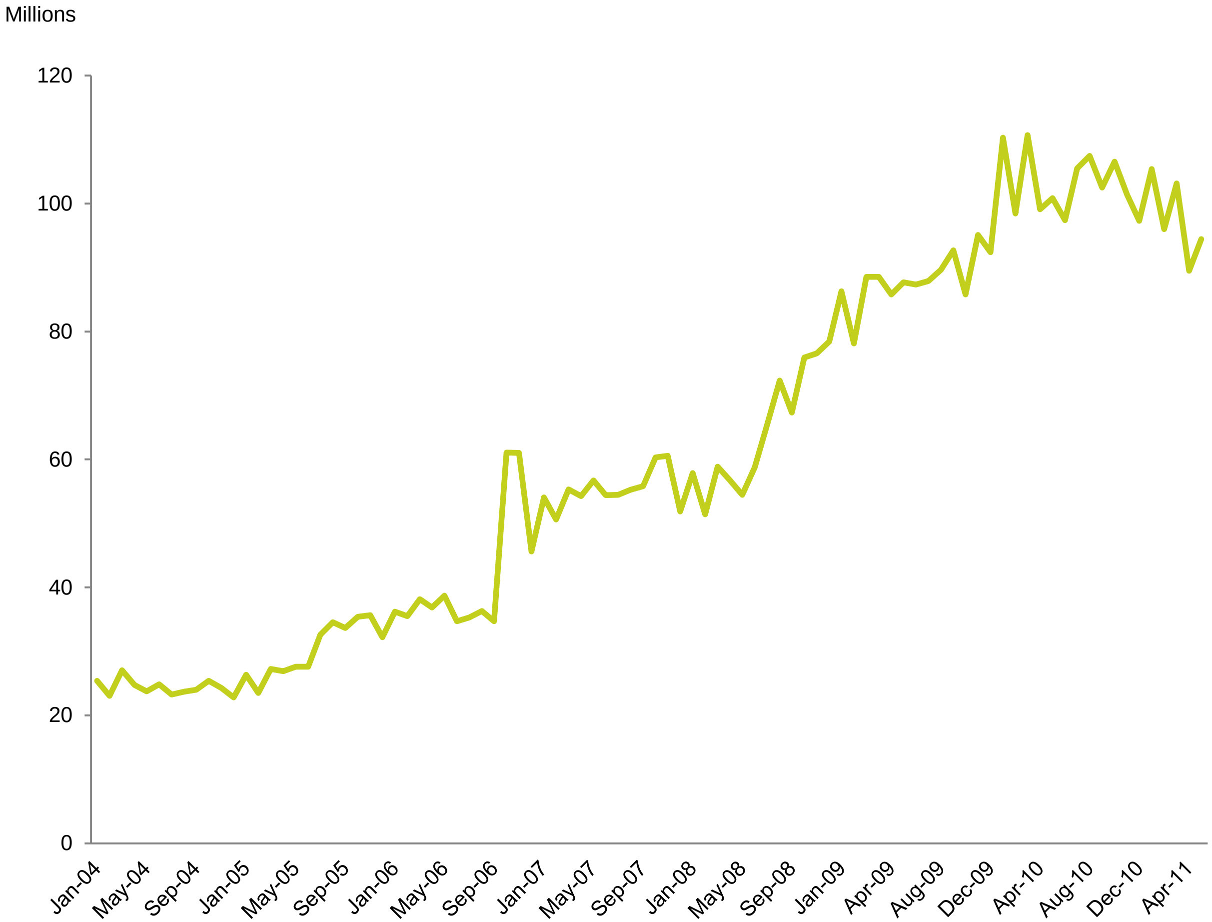
- High speed networks increasingly enable the switch from physical to digital form. Given the relative file sizes, music has seen the most inroads, but high-speed broadband networks increasingly permit the delivery of TV and film content

Forces for change – consumer behaviour

Online consumption

Online consumption has continued to grow fast in recent years – consumers are spending more time online and via a wider range of new connected devices

Total UK Internet page impressions, January 2004 to May 2011



The total number of pages consumed has continued to rise rapidly:

- Time use of online services is still growing rapidly as the quality of and range of online content continues to improves rapidly
- Consumption is also increasing through non-PC devices included connected TV's and smartphones

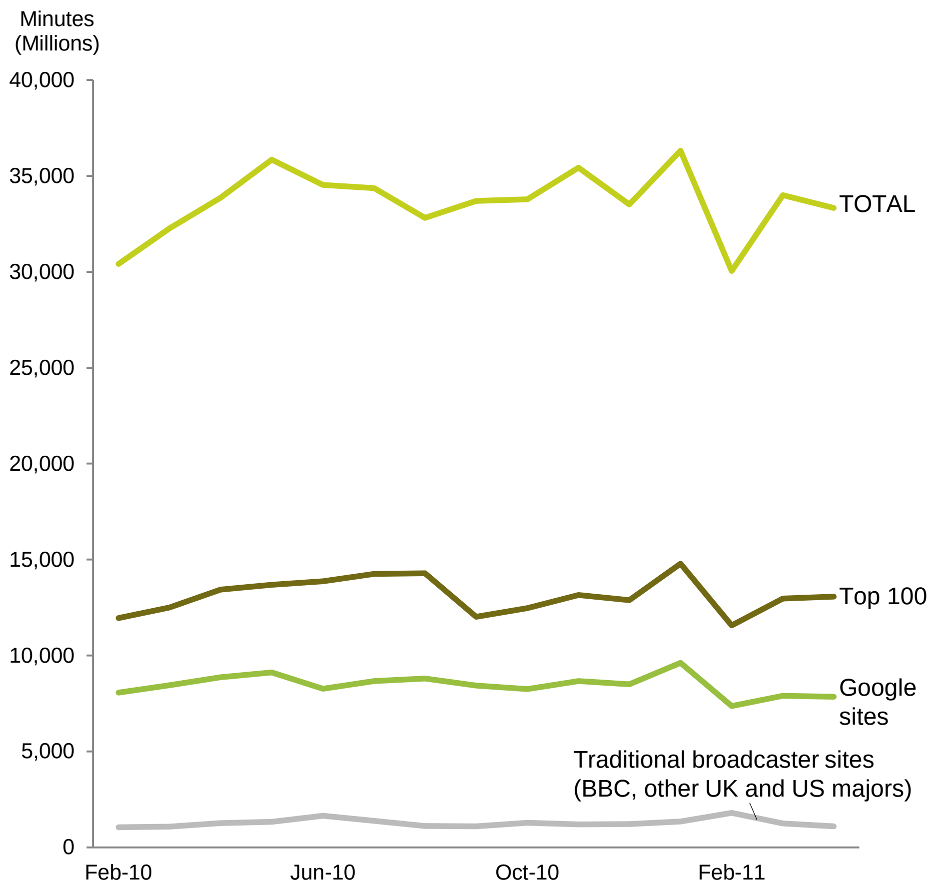
Source: Neilsen

Forces for change – consumer behaviour

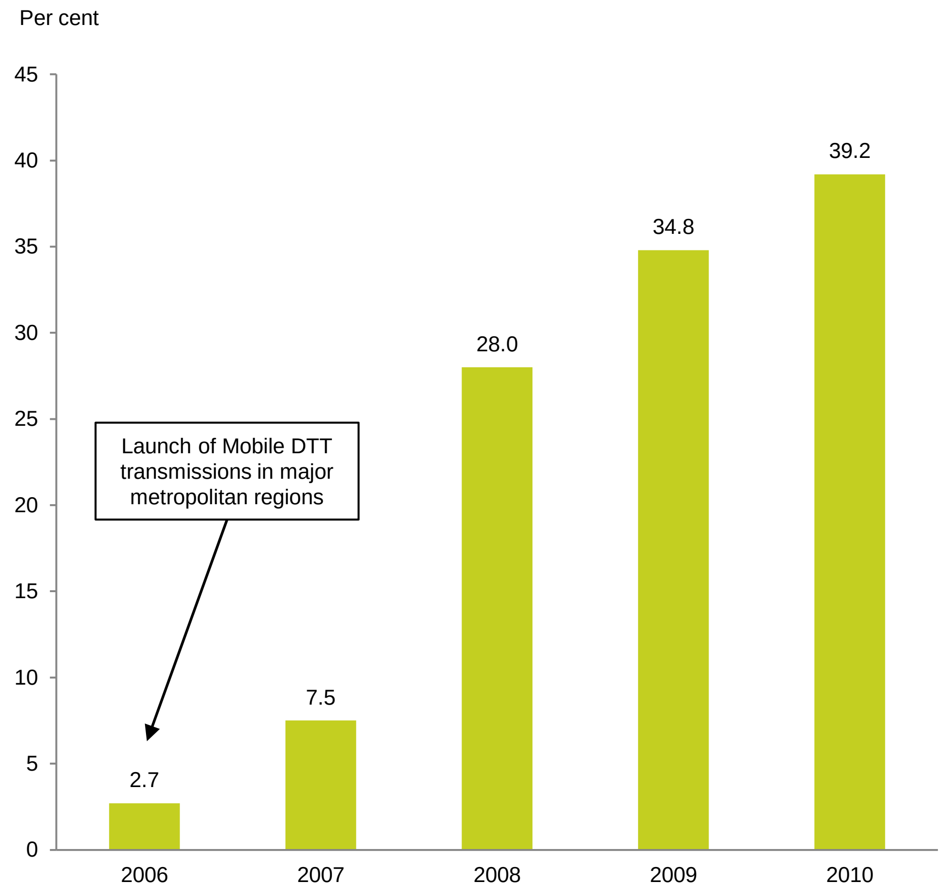
Overall online audiovisual content consumption

Broadcaster's share of all online video viewing is low, and evidence from Japan suggests that when the right devices and delivery technologies are put in place there is strong demand for mobile video viewing: this will worsen fragmentation

Total volume of UK online video viewing minutes by website type, Feb 2010 to Feb 2011



Japan: proportion of all respondents that use mobile TV daily, 2006 to 2010



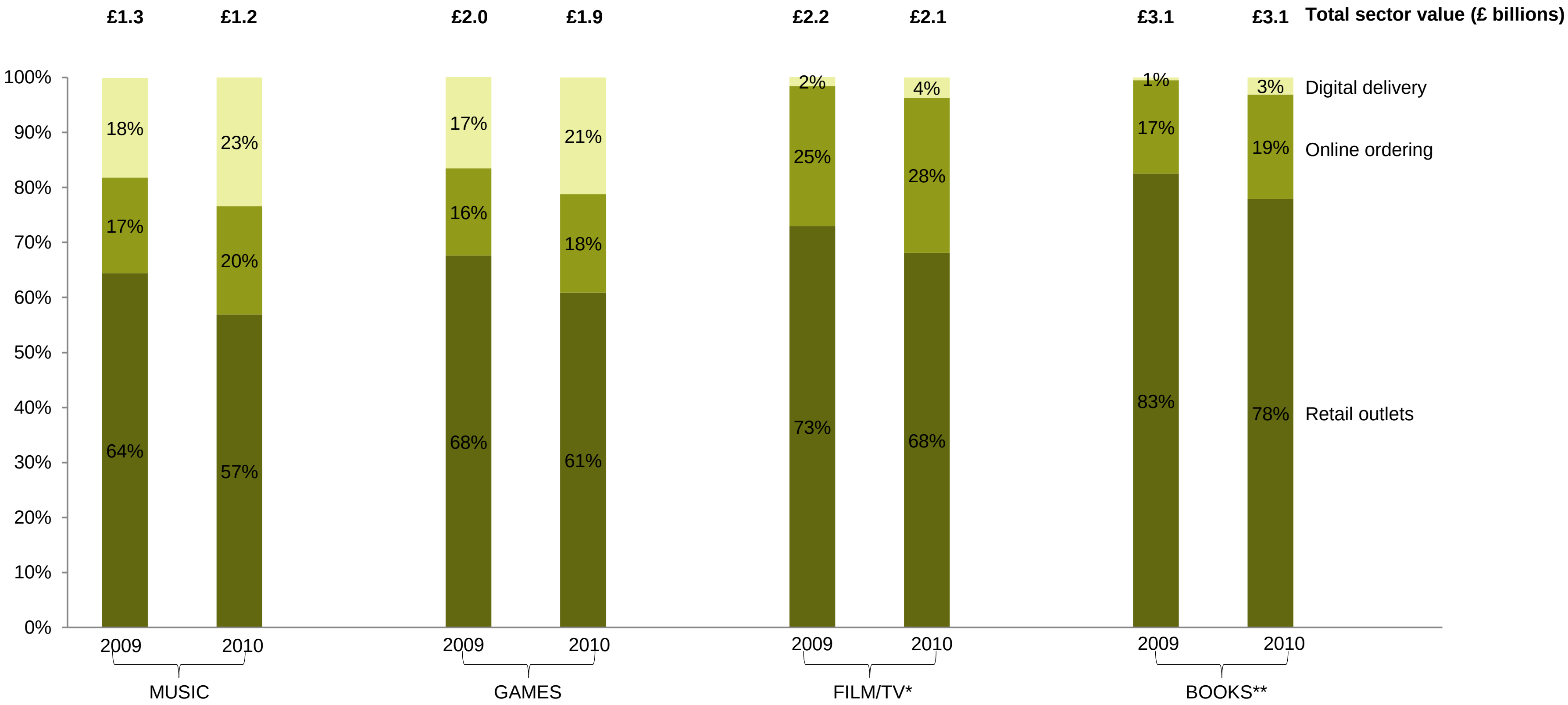
Source: ComScore

Forces for change – consumer behaviour

Shift of consumer spending online

Spending on media goods has shifted online, but initially through searching for and ordering the physical products online – the move to direct downloading and streaming, aside from music and games, has only just started

UK entertainment markets: total value of sectors and share by distribution channel, 2009 and 2010



Note: *TV and film revenue relates to recorded content market only (DVD retail, DVD rental, online downloads etc.)
**2010 online ordering figure estimated using O&O Consumer survey – November 2010

Source: Publisher's Association, Entertainment Retailers Association, ONS, BVA, PRS, O&O Consumer Survey October 2010

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Forces for change – shifting advertiser behaviour

Summary

The internet has also caused fundamental changes in the advertising market, with new channels, more accountability and models that are now incorporating integrated social media campaigns as standard

The primary driver of this has so far has been search and response based advertising – but video display and mobile advertising are the next major growth areas

We classify two types of potential threat, a market threat and a substitution effect.

The market threat is a general reduction in brand building expenditure across the market as a whole. The substitution effect sees a shift in brand building spend from TV to other media

Advertising is now a slow growth sector

- For much of the last century, advertising grew faster than GDP. However in recent years this growth has slowed - even after accounting for any cyclical effects

Traditional display advertising accounts for less of the industry

- Other activities – marketing services such as PR and viral – now account for a significant portion of advertisers' spend
- Response media – principally internet search and classified – have grown strongly, reducing growth in other segments

Much of this growth has been driven by e-commerce

- As more spend has moved online, the advertising to support and generate this has also shifted

The impact on traditional media has varied

- The result of reduced overall ad expenditure growth rates and a shift of budgets to response media has put pressure on display advertising expenditure budgets
- Those media whose characteristics have been emulated and bettered by the internet (typically transactional) have suffered the most – so local press classified revenues have been particularly hard hit
- Those media more suited to mass reach brand building campaigns – TV, cinema, outdoor – have to date suffered less
- However the availability of online video advertising with the accountability that the internet offers – and the emergence of mass reach channels such as Facebook – means that online advertising will start to compete strongly in this segment too
- The mass market adoption of smartphone will also intensify the pressure on traditional display advertising funded media

Forces for change – shifting advertiser behaviour

Delayed impact of new disruptive business models

It can take several years before a tipping point occurs with an impact on traditional business models – Facebook may now be about to compete directly for display advertising budgets, putting television broadcasters under pressure

Launch of major online services and potential future developments, 1994 to 2016

	WEB 1.0						WEB 2.0					
	1994	**1996**	**1998**	**2000**	**2002**	**2004**	**2006**	**2008**	**2010**	**2012**	**2014**	**2016**
Browsers	Netscape	Explorer			Firefox	Apple Safari		Google Chrome				
Search	AOL	Yahoo!	**GOOGLE LAUNCHES** MSN			**CLASSIFIED PRESS ADVERTISING ENTERS DECLINE**			**66 LOCAL PAPERS CLOSED*; CLASSIFED SPEND DOWN 56% ON 2004**		TV search?	
E-commerce	**AMAZON LAUNCHES**	E-Bay	Monster	Betfair				GroupOr	**BORDERS / WATERSTONES IN CRISIS**			
Media streaming / downloading			**NAPSTER LAUNCHES**	**RECORDED MUSIC SALES START TO FALL**	iTunes		YouTube	BBC iPlayer Spotify	**RECORDED MUSIC SALES DOWN c40% ON 1999**	Sky Anytime+ / YouView		
Social media				Friends reunited		MySpace	Twitter **FACEBOOK LAUNCHES**				Video Sharing?	**TV ADS IN DECLINE?**
Smartphones							Apple iPhone	Google Android			4G?	

Note: The term Web 2.0 came to prominence after the O'Reilly Media Web 2.0 conference in late 2004
*from January 2008 to July 2009

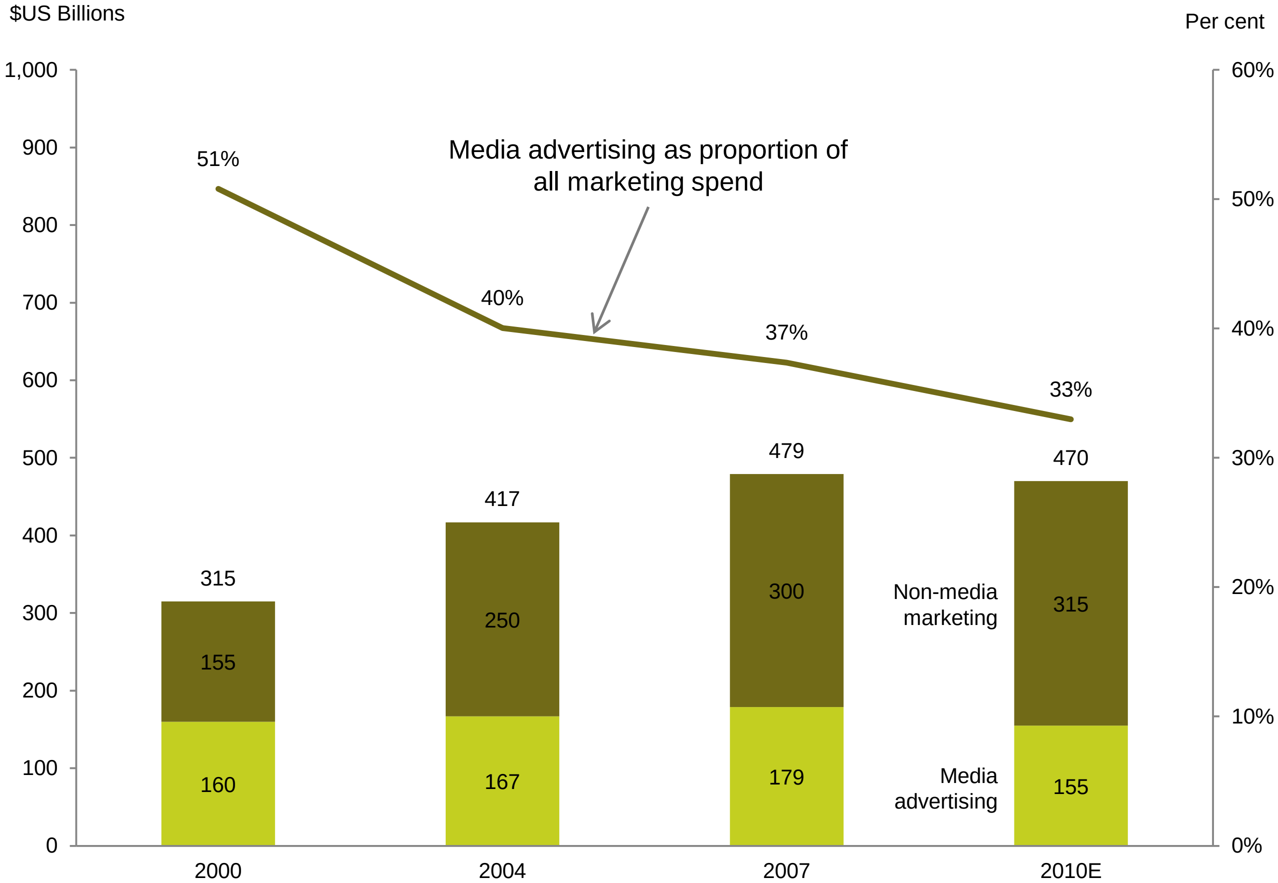
Source: Oliver & Ohlbaum Analysis

Forces for change – shifting advertiser behaviour

Shift of marketing spend away from media

Total spend on "traditional" media advertising has been squeezed as marketing departments have been shifting budget into other area, principally online infrastructure and other forms communications such as PR and viral marketing

Total US marketing spend, 2000 to 2010E



This trend has been seen in the UK and all major developed markets:

- The main driver of the shift in spend away from media advertising has been the growth of the Internet
- Website spending usually sits within global marketing budgets
- Investment in website infrastructure and on-going development has been squeezing other marketing spend
- Old media is has been hit by a double whammy – the shift to online response advertising within media and a squeeze on all media advertising spend
- This is why the engine of advertising growth and the link to GDP growth appears to have broken since 2000
- However, online spending is likely to separate from marketing spend in the future

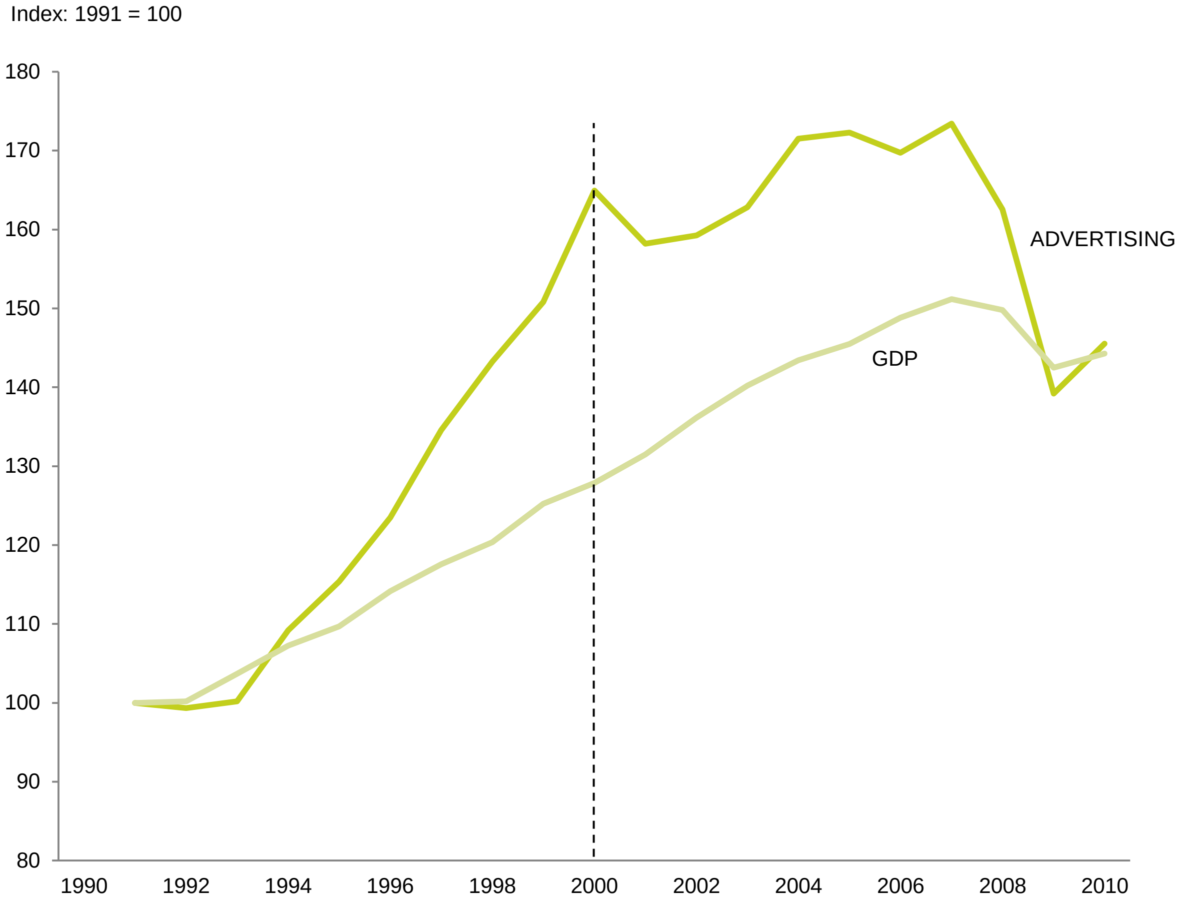
Source: UBS Research (April 2010), Oliver & Ohlbaum Analysis

Forces for change – shifting advertiser behaviour

Shifting ad spend patterns

As a result, the traditional link between GDP growth rates and overall media advertising expenditure growth rates is broken

UK advertising expenditure and GDP (real terms), 1991-2010



Advertising expenditure grew at a higher rate than GDP as it recovered following the economic downturn

- Whilst GDP may return to long term growth, advertising expenditure is unlikely to see the same growth rate as advertisers seek cheaper ad models
- Growth in different forms of advertising, often cheaper than traditional advertising – such as online and non-media marketing – have had an impact
- The proportion of overall growth which this substitution effect has impacted is not clear

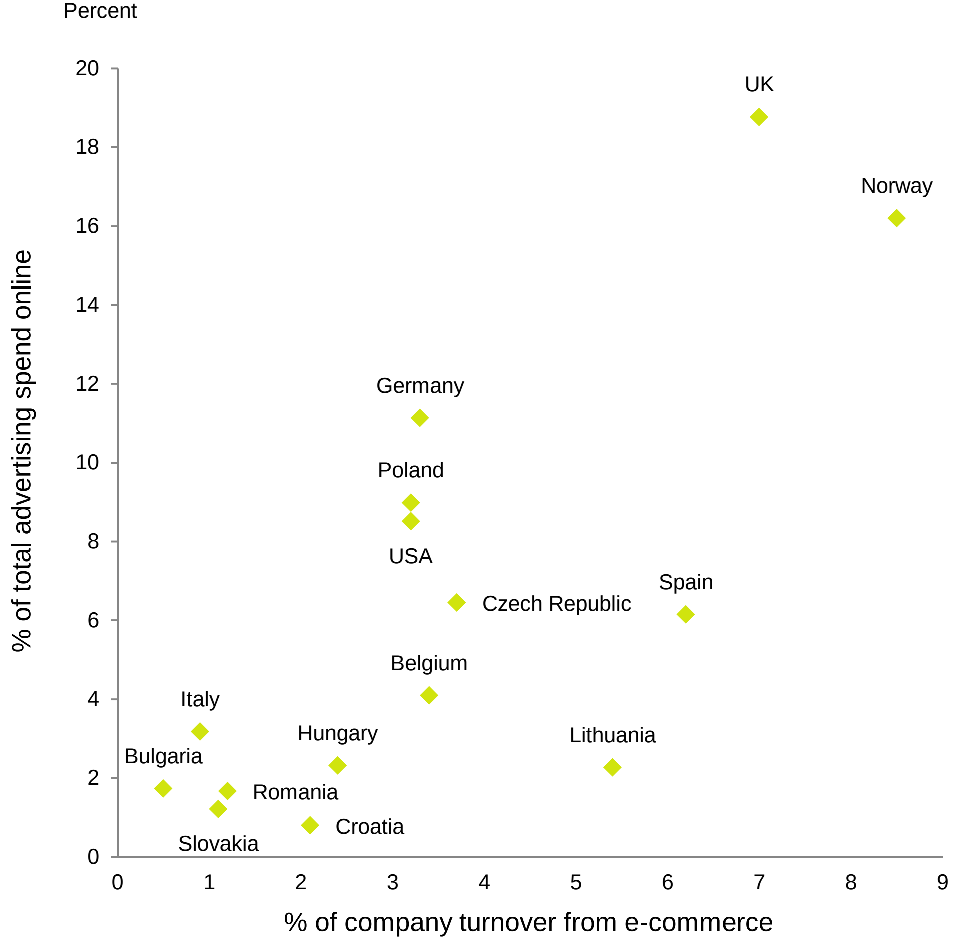
Source: Advertising Association, ONS, Oliver & Ohlbaum Analysis

Forces for change – shifting advertiser behaviour

Shifting ad spend patterns

Within traditional media advertising categories, advertising expenditure is shifting online, largely driven by the rapid growth of e-commerce

Average proportion of company turnover from e-commerce versus proportion of total advertising spend online, 2007



The UK has high levels of online advertising spend and e-commerce relative to the US and other European markets

- High broadband penetration and consumer time spent online has made the UK one of the leading e-commerce markets

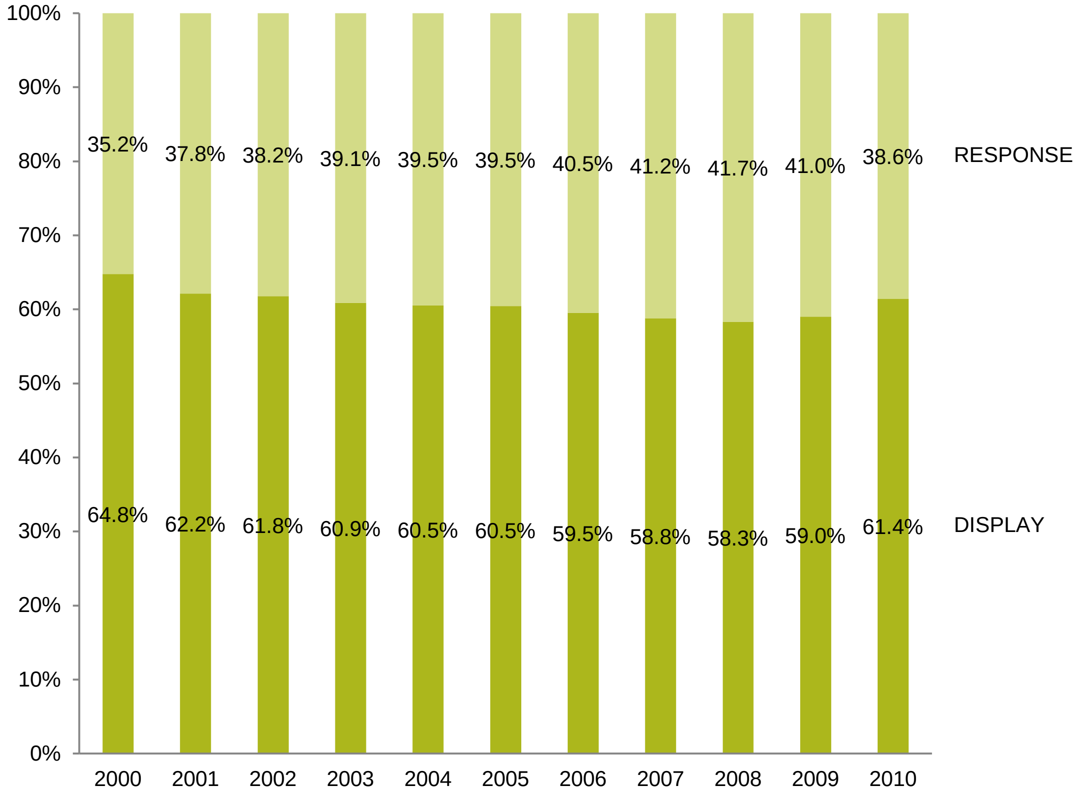
Source: Enders Analysis, Google, Eurostat, Zenith Optimedia, US Department of Commerce, Morgan Stanley, Oliver & Ohlbaum Analysis

Forces for change – shifting advertiser behaviour

Shifting ad spend patterns

The result of the shift of spend online has been a macro shift of advertising expenditure from display to response media, mostly driven by the rise of search advertising – display budgets, including television, have come under sever pressure

UK display and response expenditure as a proportion of all media advertising expenditure, 2000 to 2010



There has been a gradual shift towards response-based advertising over the last ten years

- There was a transfer back to display advertising in 2010, as it was able to recover quicker than response media advertising following the recession. The trend of shift towards response media is expected to continue

Note: Display advertising gained share in 2009 and 2010 because display media have bounced back fro recession quicker than response media – this trend is expected to reverse in the next 3-5 years

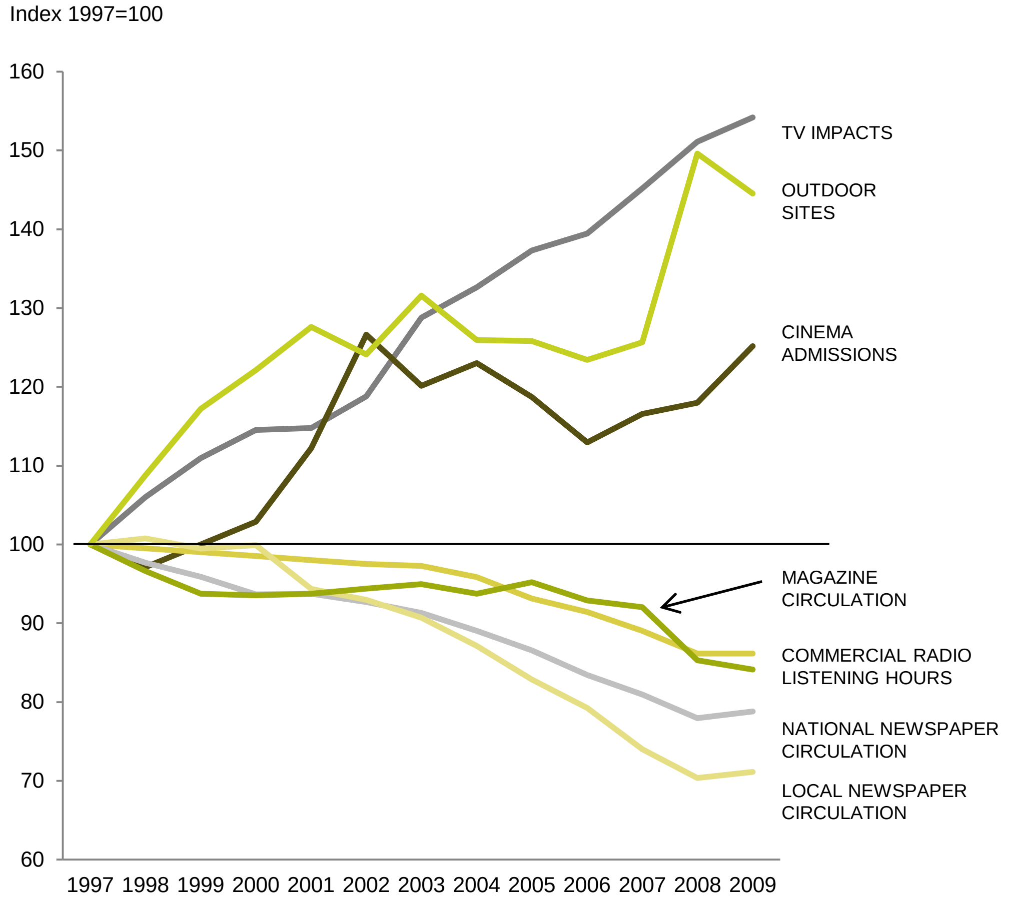
Source: Advertising Association / WARC (June 2011), Oliver & Ohlbaum Analysis

Forces for change – shifting advertiser behaviour

Display media inventory

However, within display, the media which have seen increased levels of consumption / inventory seem to have performed relatively well and remained robust to date

Commercial inventory by media index, 1997 to 2009



Consumers are buying fewer magazines and newspapers, listening to the radio less and are instead watching more television and films

- Television impacts saw continued growth through the economic downturn, whilst cinemas also saw an increase in admissions
    - TV impacts have grown due to growth in average TV viewing levels and also the shift of viewing fro PSB to non-PSB channels which carry more advertising inventory
    - Cinema admissions continue to rise as the audience experience continues to improve with bigger and better multiplex complexes with more screens, longer film runs and special events (such as 3D blockbuster releases)

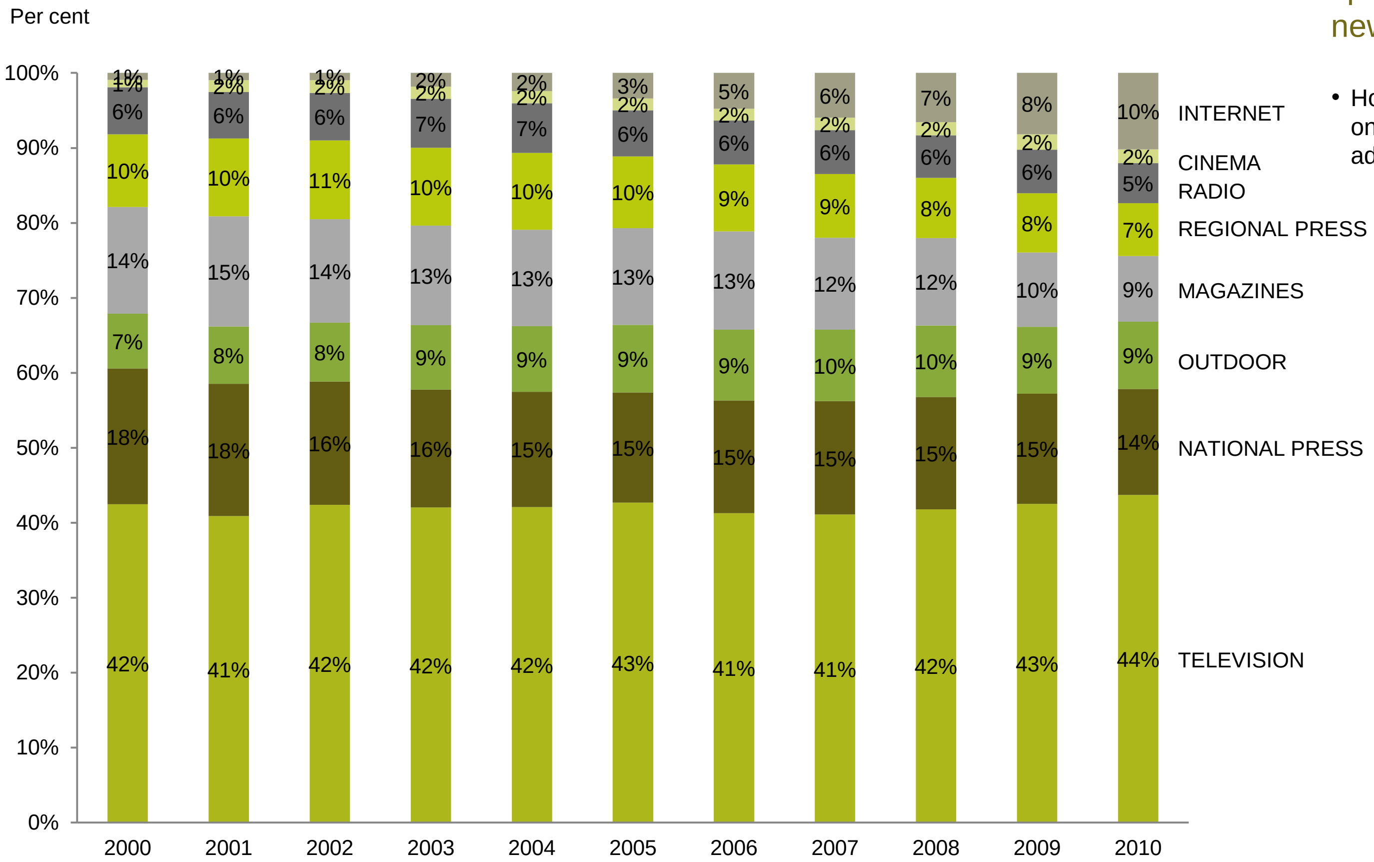
Source: Advertising Association, Nielsen, RAJAR, Oliver & Ohlbaum Analysis

Forces for change – shifting advertiser behaviour

Share of display by media spend

However, online properties have rapidly increased their share of all UK display advertising expenditure – television is unlikely to remain immune to this squeeze as online display takes and ever greater share of all display advertising

UK display advertising: share of total gross expenditure by media, 2000 to 2010



Online has seen an increase in advertising spend at the expense mainly of regional newspapers and magazines

- However as increased video consumption moves online, linear television is likely to lose display advertising share to the internet

Source: Advertising Association / WARC (June 2011), Oliver & Ohlbaum Analysis

Forces for change – shifting advertiser behaviour

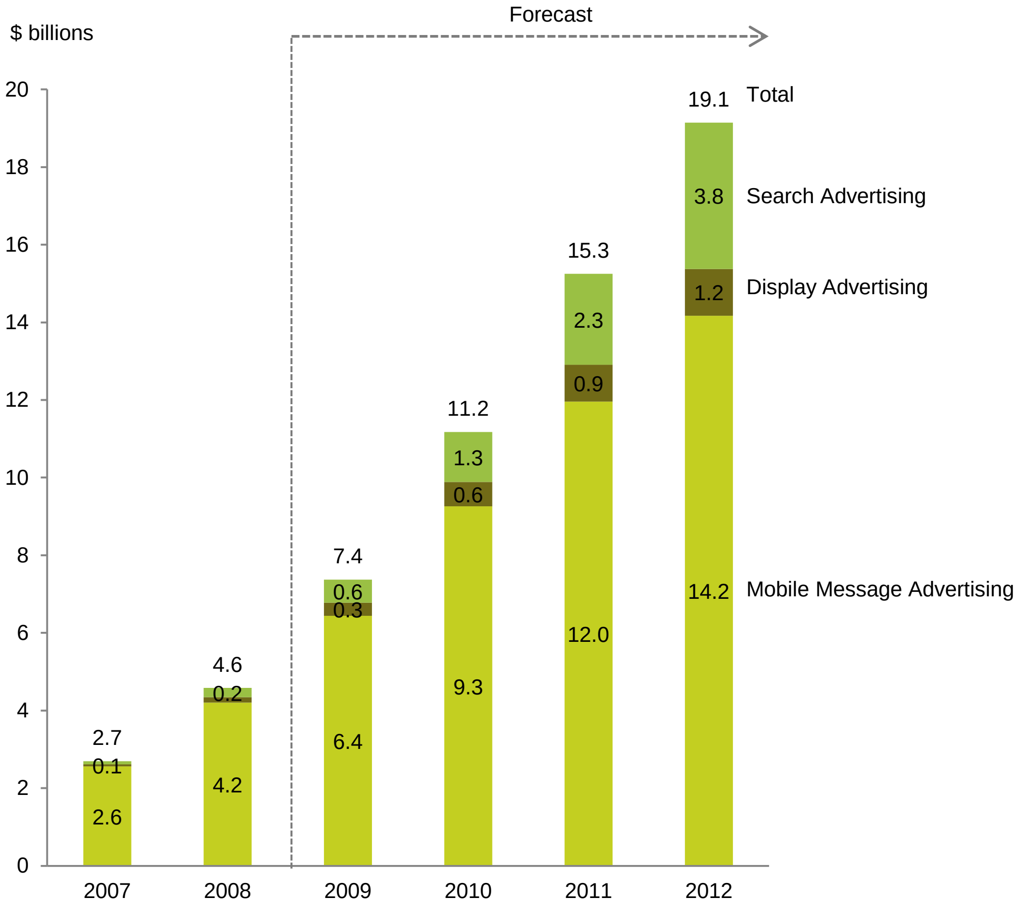
Mobile advertising

The rapid adoption of smartphones has also kick-started rapid growth in mobile advertising expenditure, which is likely to accelerate the level of pressure on traditional media budgets in the next few years

UK mobile advertising spend by category, 2009 to 2010

UK mobile advertising spend (£ millions)	2009	2010	Growth %
Search	**20.2**	**54.9**	**172%**
Display	**17.4**	**28.1**	**61%**
Banners and Text Links	14.6	23.7	62%
Tenancies	1.4	1.7	21%
Pre and Post-roll advertising	0.2	1.1	450%
Other display formats	1.2	1.6	33%
Total	**37.6**	**83**	**121%**

Global mobile advertising spend by category, 2007 to 2012



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Emerging macro trends

Summary

The result of major forces for change is the emergence of a number of key macro trends which are starting to radically alter the media value chain

Demand for traditional media and entertainment services is likely to continue to fragment, while delivery across types of media and entertainment content re-aggregates around delivery, device and access providers, enabling the emergence of powerful new global market leaders

Advertisers will benefit from a wider range of ways of accessing consumers involving both direct association with content and through platform/device based location and behavioral targeting

Leading players will seek to manage the consequent shifts in value and control by increasing levels of horizontal and vertical integration/cross ownership, potentially benefiting new global market leaders

Demand will fragment, re-aggregate and polarise:

- Demand for traditional nationally based media and entertainment packagers – TV channels, radio stations, newspapers, magazines etc. – will continue to fragment
- But demand will re-aggregate around more global cross media device and delivery providers who bundle content and access
- Demand for individual pieces of content will polarise with even bigger global hits, and a long tail of also-rans

Consumer market segmentation and discrimination will move from release windows and format to delivery and device access, while advertiser segmentation in display advertising will move from broad demographics and specific media to behavioral and location targeting

- Release window and format based segmentation (such as exists in films) will decline to be replaced by bundled device/delivery and content access – a subscription to a cable film service allows consumer to consume film on any other device, or purchasing a Blu-Ray disc allows consumer to access film through any authorised device
- Advertisers will be able to access audiences by direct funding of content or through targeted ad insertion by devices and delivery networks. This will move display ad buying to more niche tribes and groups and further towards direct purchase driving

Content provision is likely to become more globalised:

- Lower hit rates but higher rewards for hits is likely to push content creation towards a more global supply chain (although this will sit alongside local adaptation and significant pan regional plays – e.g. English, Chinese and Indian content hubs)

There could be seismic shifts in value and control which will provoke certain types of strategic response:

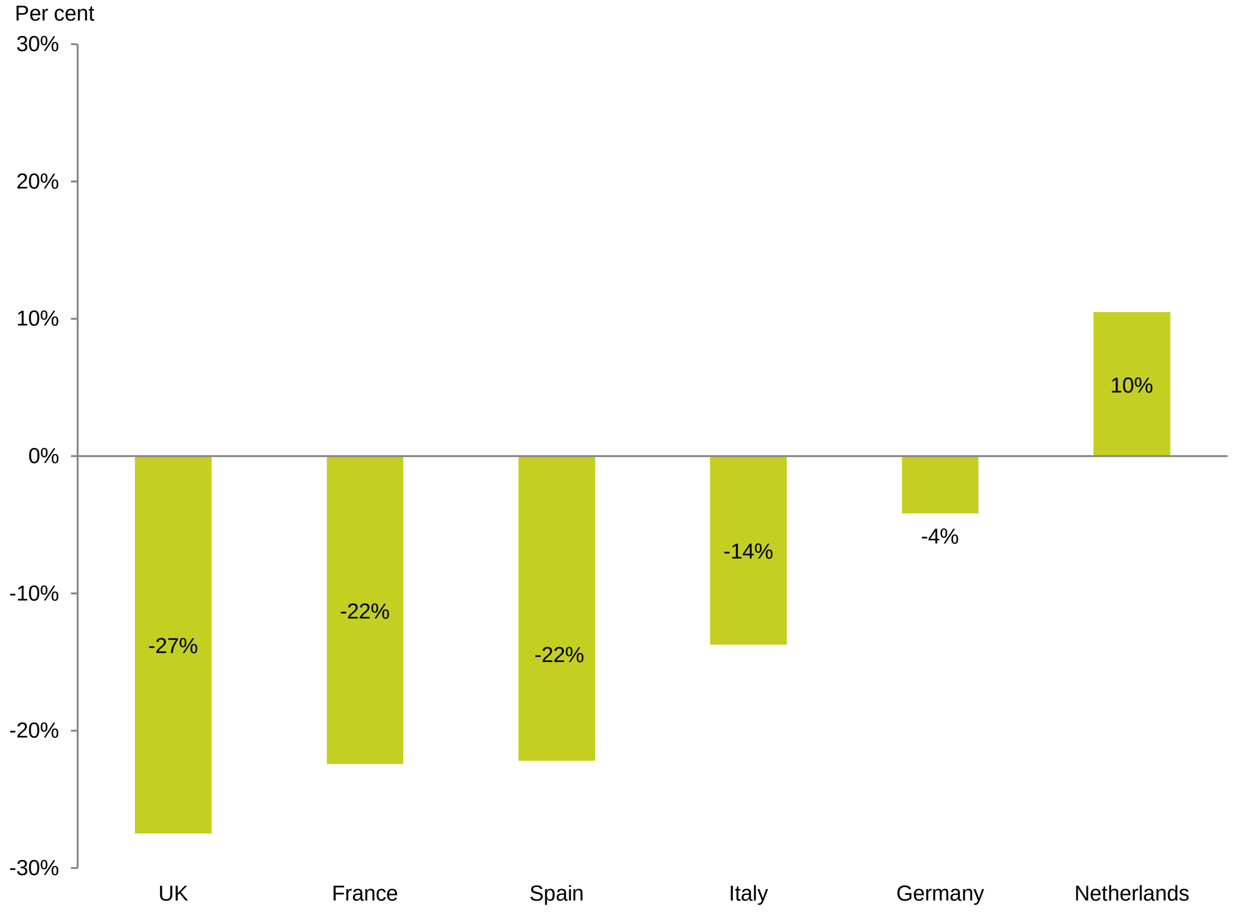
- There is likely to be a value and control shift away from traditional media packagers and middlemen towards delivery/device networks and access providers at one end, and key content owners at the other end of the supply chain
- There is also likely to be a value and control shift away from national players to global and pan regional players
- Major players will seek to manage these shifts through both horizontal and vertical integration and cross ownership -.e.g. platform and device companies owning key content assets and bypassing traditional middlemen

Emerging macro trends – fragmentation

Major channels losing audience

Major network broadcasters have lost a considerable proportion of their audience in most major markets as multichannel television penetration has grown – new on-demand and mobile services are likely to lead to continued viewing share loss

Proportionate loss / gain of audience share for combined major free-to-air networks by country, 2003 to 2010



Broadcasters in markets with a legacy of basic cable relay networks to homes have seen less of a switch as a large channel choice has long been established

- Other markets, such as the UK, France, Spain and Italy, where traditionally there were only a maximum of 5 or 6 analogue channels have seen a greater level of audience fragmentation through the switch to digital and roll-out of broadband internet

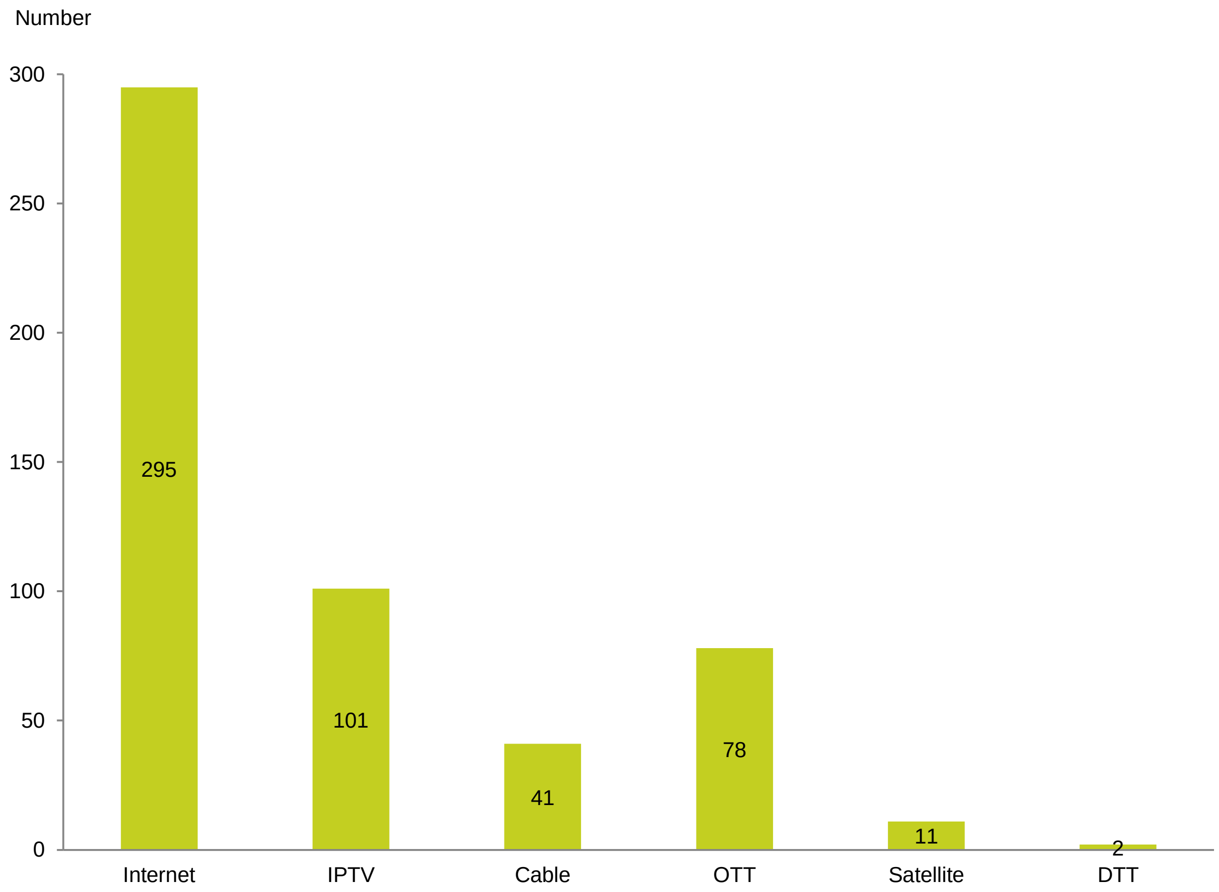
Source: OBS, Mediametrie, TNS, AGF / GfK, SKO, Auditel

Emerging macro trends – fragmentation

New competition

There are a large and growing number of web-based and on-demand television services – this rapid explosion in consumer choice is driving rapid fragmentation of viewing away from traditional broadcasters

European VOD catalogue providers by platform, 2011



Broadcasters, producers, platform owners and aggregators have established portals to exploit their content

- Content owners and aggregators are able to generate incremental advertising and subscription revenues from programmes in catch-up windows and back catalogue content

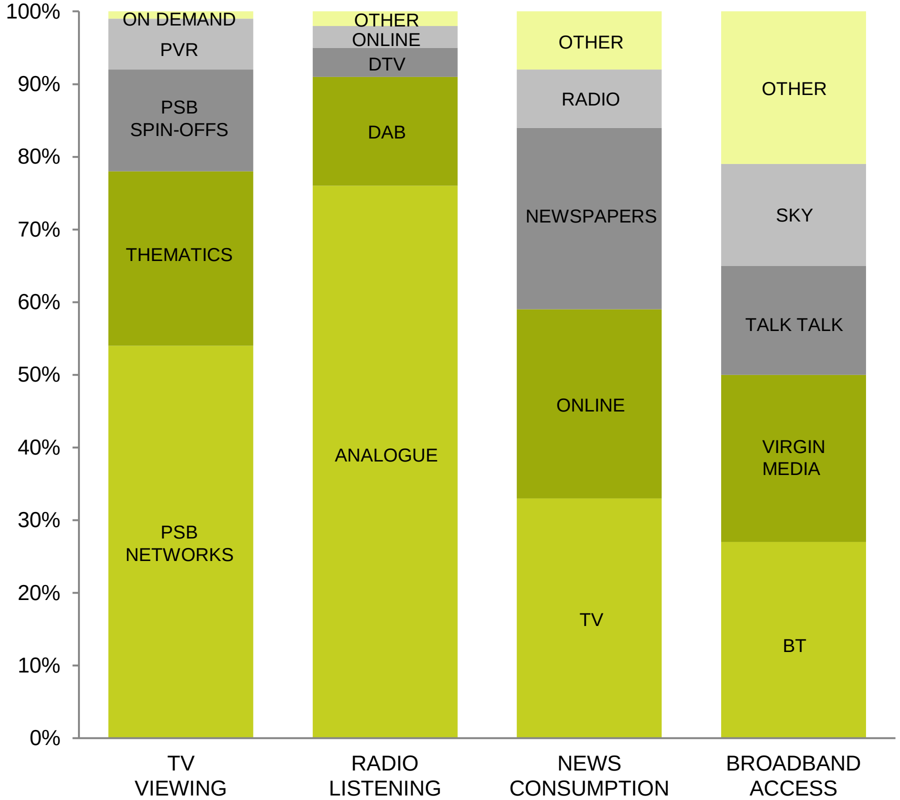
Note: European countries included: AT, BE, BG, CH, CY, CZ, DE, DK, EE, ES, FI, FR, GB, GR, HU, IE, IS, IT, LU, LV, NL, PL .PT, SE, SI, SK
Source: January 2011 Interviews, European Commission AVMS,

Emerging macro trends – fragmentation

Fragmentation across media

Consumption is also fragmenting across media services and platforms in different verticals

Fragmentation of consumption by delivery channel in key media vertical segments in the UK, 2009



The switch to digital in television and radio has fragmented consumption across established and thematic channels, whilst online is now seen as a major news source

- The PSB networks and established analogue radio networks are still the most frequented channels, due to continued investment in new programming and brand loyalty
- However, consumers are increasingly using the internet as a source of news, as much as television and newspapers
- The main broadband providers BT, Virgin Media, Talk Talk and Sky have similar numbers of subscribers

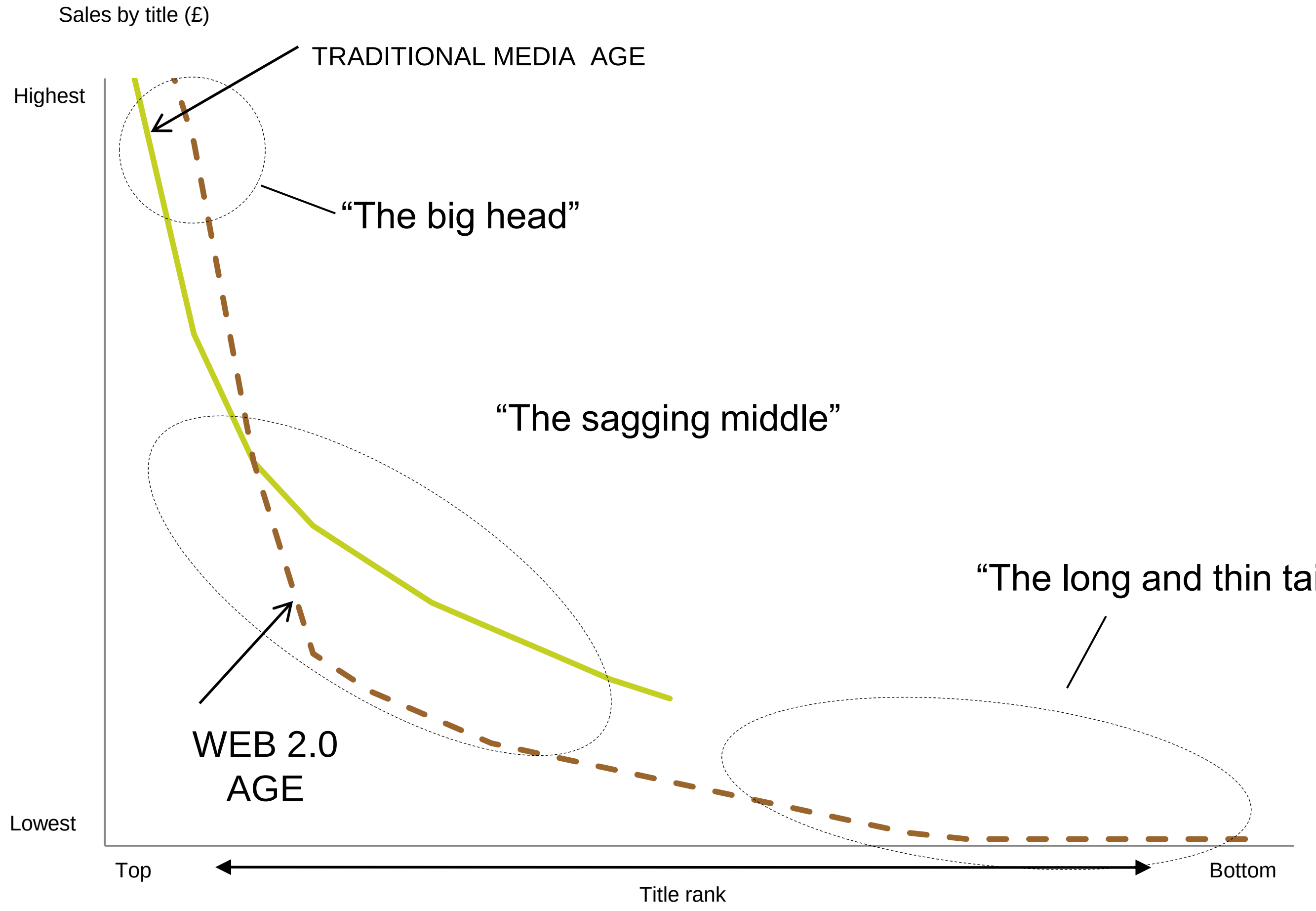
Source: BARB, RAJAR, Company Reports, OFCOM, Efficient Frontier, PWC survey, Entertainment Retailers Association, Oliver & Ohlbaum Analysis

Emerging macro trends – polarisation

Polarisation of consumption

The polarisation of consumption favours big players and creates winner takes all markets – a smaller number of major successful hits will increasingly account for a greater and greater proportion of all content market revenues

Distribution of revenues by title – traditional media age versus Web 2.0 age



The web can give obscure titles a new lease of life:

- But it also tends to enhance the global market for top performing titles and it tends to punish mediocrity hard
- PRS analysis of downloads on Rhapsody in 2009 suggested that of 13m tracks available, 0.4% accounted for 80% of downloads

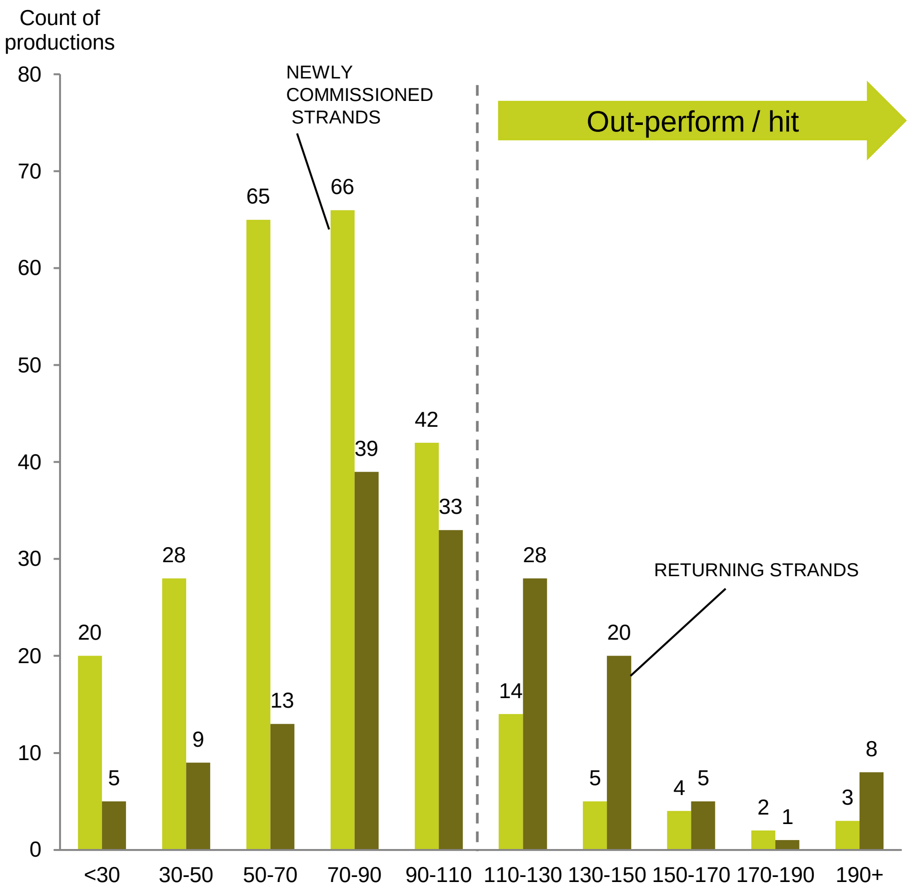
Source: Oliver & Ohlbaum

Emerging macro trends – polarisation

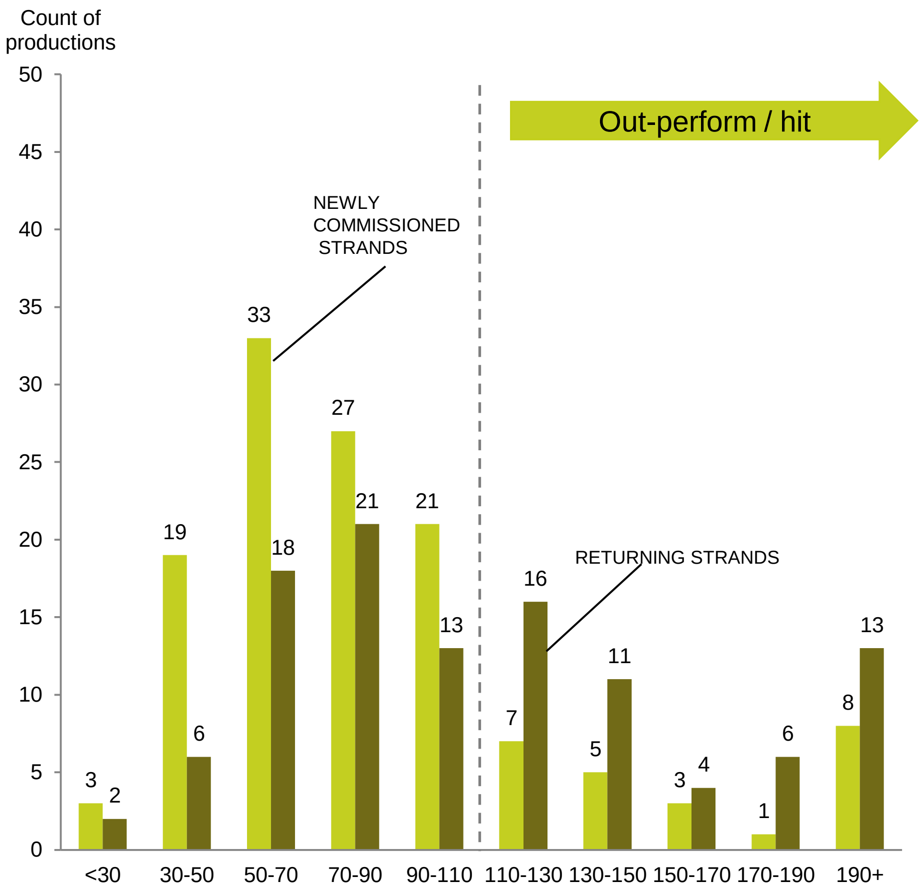
Polarisation of consumption

The difference between successes and failures is ever more stark, increasing the risks of investment over time – in UK television, only around 1 in 9 new drama strands and 1 in 6 new UK comedy strands are hits

UK Drama: Audience variance analysis versus channel average audience, 2008*



UK comedy: Audience variance analysis versus channel average audience, 2008*



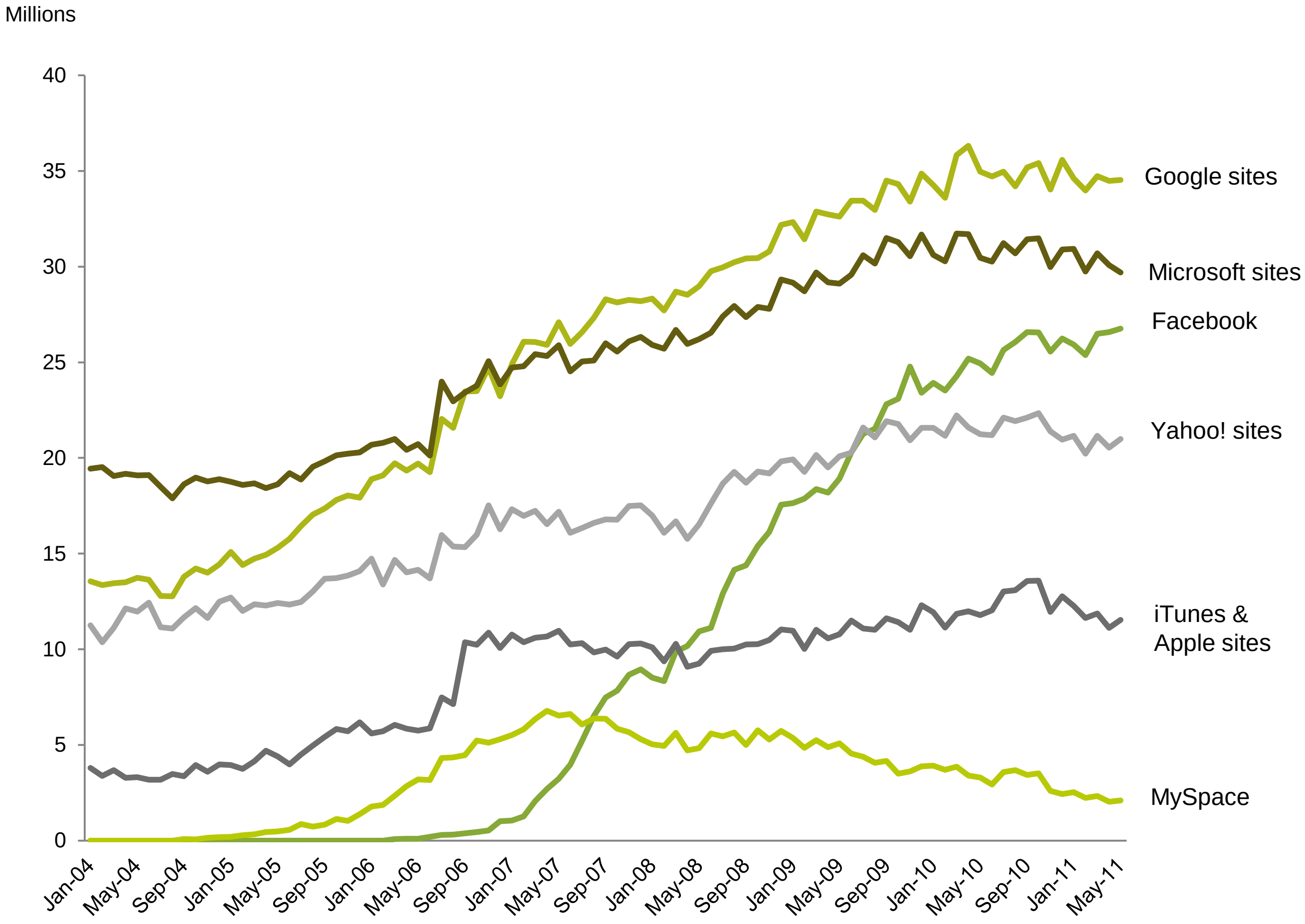
Note: *only main five terrestrial networks included in analysis
Source: BARB (Attentional), Oliver & Ohlbaum Analysis

Emerging macro trends – globalisation

New global players

New major global players have emerged – they compete directly with nationally focused incumbent media organisations

UK monthly unique users of major online properties, Jan 2004 to May 2011



The majority of these new players have grown significantly but steadily since their launches in the first dot.com boom

- Google continues to challenge traditional media organisations with aggressive plans for YouTube, and greater opportunities for and adoption of internet advertising than previously
- Facebook has emerged as a bigger threat than the first wave of dot.coms, with greater global reach having grown more rapidly than any other start-up
- In the now socially networked era, Facebook, Twitter and Linked In, for example, present different competitive challenges to traditional businesses

Source: Neilsen

Emerging macro trends – globalisation

Asymmetric competition

Asymmetric competition is occurring where global players can out-punch national media / content based organisations

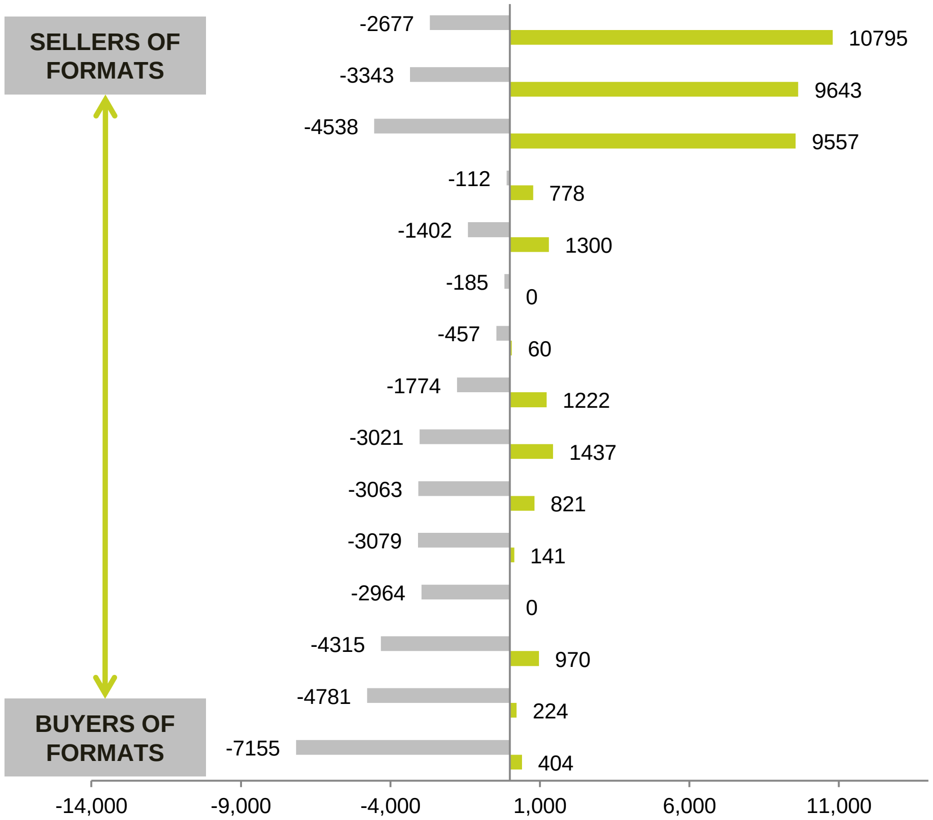
	COMPETITIVE ADVANTAGE	DETAIL
1	Economies of scale and scope	• Global online players can leverage investment / innovation in one country on a global scale • Broadcasters ability to leverage investment internationally is limited – programme sales overseas account for only a small proportion of revenues
2	Ability to arbitrage internationally	• Major global players have the ability to structure their business in a financially efficient manner using different international regulatory and tax regimes • Broadcasters are tied to home market regimes
3	Structurally lower cost bases	• Global online players have optimised cost bases to maximise returns on a global basis • Broadcasters, have inefficient cost bases by comparison and have to invest in costly programmes which they can monetise in a single market only • New global players are starting to invest in content which can be leveraged across many markets

Emerging macro trends – globalisation

Globalisation of content markets

An emerging global market for television content favours "global" brands that can leverage assets globally

Total imports and exports of TV format hours by market, 2006 to 2008



	NET TRADE
United Kingdom	8,118
Netherlands	6,300
USA	5,019
Japan	666
Argentina	-102
Czech Republic	-185
India	-397
Scandinavia	-552
Australia	-1,584
France	-2,242
Poland	-2,938
Russia	-2,964
Germany	-3,345
Italy	-4,557
Spain	-6,751

Other major content sectors have always exported to the rest of the world:

- Games have been global from the start
- Films are still dominated by US to rest of world trade flow, but other trade flows are developing
- UK betting sector is increasingly moving offshore
- Online retailers (and price comparison sites) are breaking down national / regional rights windowing and pricing structures across books, music, film and TV

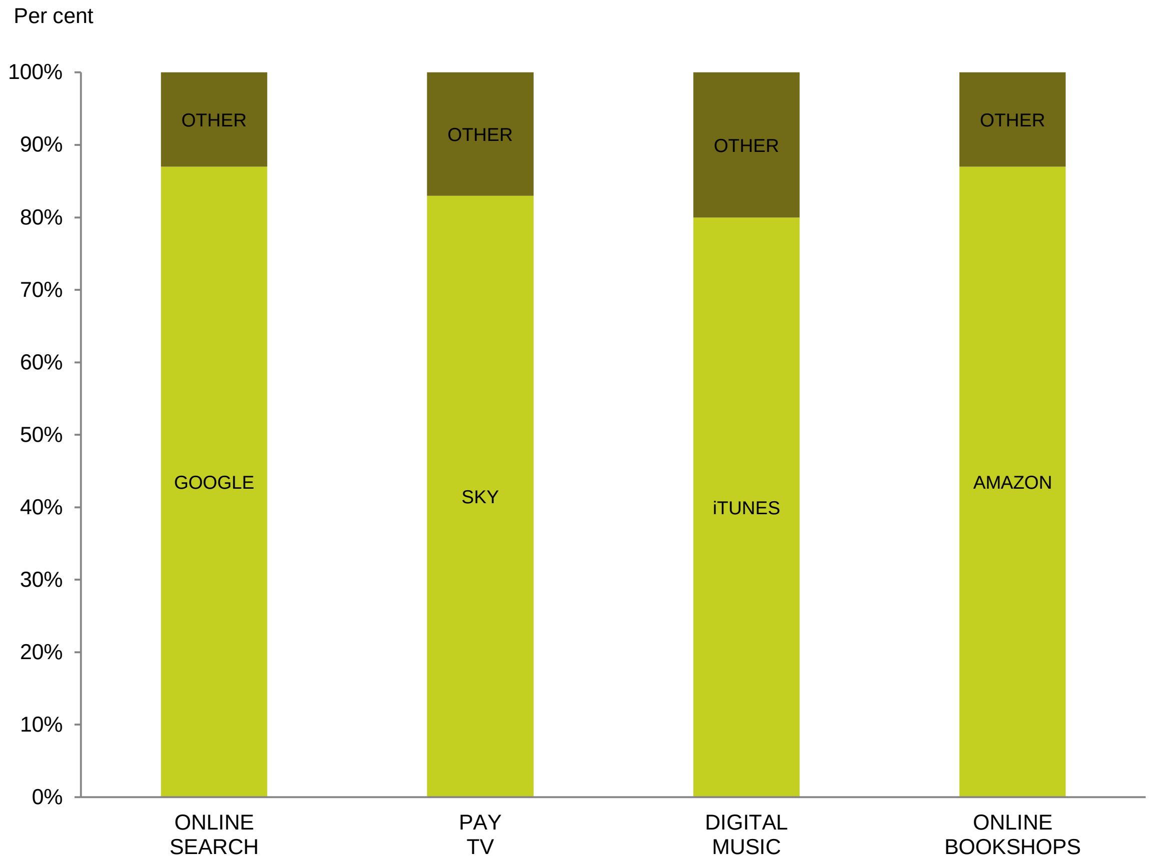
Source: Oliver & Ohlbaum Analysis

Emerging macro trends – reaggregation

New market leaders

While consumption is fragmenting across media services and platforms, certain brands have managed to re-aggregate demand and establish a leading position across multiple national markets

UK market share of lead players in key new media entertainment sectors, 2009



Across new media, pay TV and e-commerce portals, there are a select number of brands who have established themselves as market leaders nationally and globally

- These brands are now able to look at alternative areas of growth and are increasingly overlapping in their consumer proposition

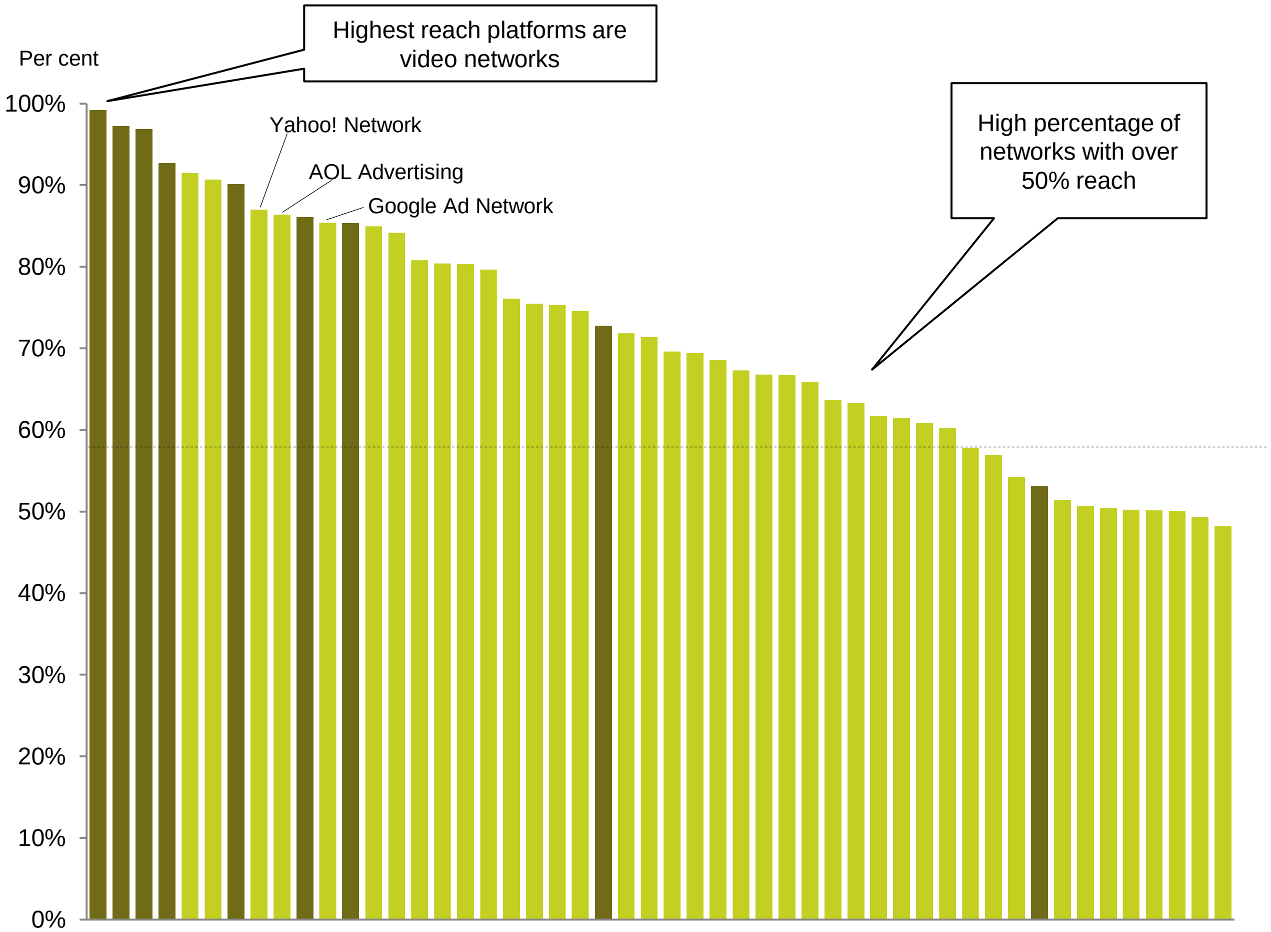
Note: Market share data shown is in terms of market revenues
Source: Company reports, Oliver & Ohlbaum Analysis

Emerging macro trends – reaggregation

Online display: Networks and Google

Since 2008, the highest reach ad networks have continued to innovate their targeting and charging mechanisms, with video networks now amongst the highest reach aggregators online

US reach of unique visitors amongst the top 50 ad carrying online properties, Sept 2010



Over the last few years, the reach of online ad networks has increased and the prevalence of the video network has grown substantially:

- Google has recently announced two initiatives that will use its existing ad networks to get closer to consumer purchases:
  - Product listing ads
  - Comparison ads
- Both of these are being trialled on a cost-per-lead or cost-per-acquisition basis

Source: ComScore Ad Focus report

Contents

How great is the threat to advertising funded broadcasters?

Summary

To date, television has proved relatively robust as a display advertising medium. The growth in online search and classified expenditure has mainly affected response media and online display expenditure has accounted for only a small proportion of overall display expenditure

However, there is strong evidence to suggest that Facebook and Google are now proving to be effective display media and their display revenues are starting to grow accordingly

The result is likely to be a squeeze on the revenues of traditional display media over the coming years and commercially funded broadcasters are unlikely to remain immune to this pressure, given the likely projected rate and magnitude of change

However, the TV ad market is most likely to remain robust for the next 3-5 years, albeit with the challenges we are identifying here

How great is the threat to advertising funded broadcasters to 2020?

- There is now a growing body of evidence to suggest that advertising funded broadcasters will no longer be immune to the macro shifts of advertising expenditure to new online players
- Facebook and Google are now proven to successfully drive traffic to leading brand websites and these leading global properties control a significant proportion of all online display advertising inventory
- This emerging strong position in online display advertising is now driving rapid growth in the display advertising revenue of Facebook and Google

What is the impact on broadcasters likely to be?

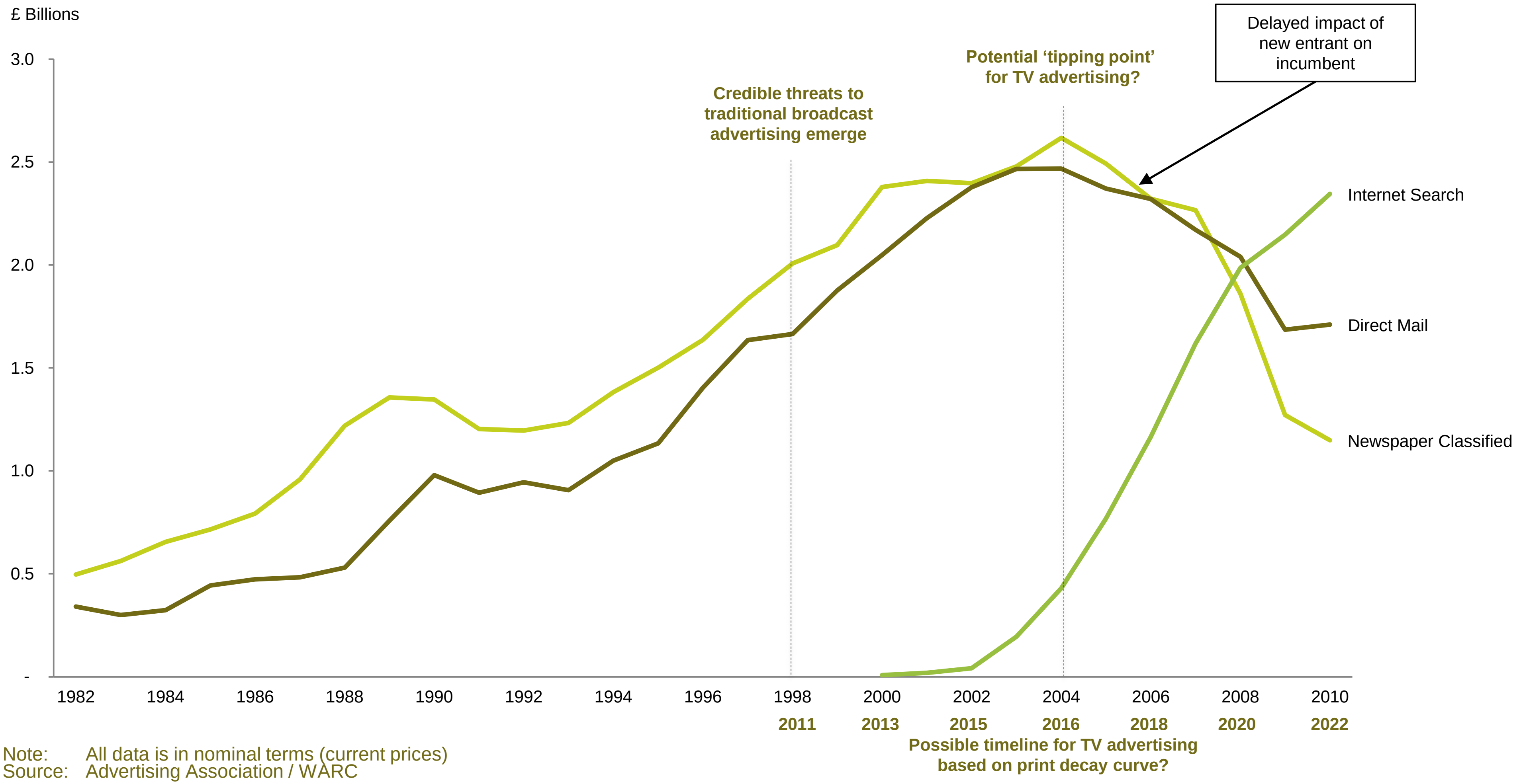
- The result of this new competition is likely to be a squeeze on display advertising expenditure with traditional display media – television is unlikely to prove immune to this pressure
- If current display advertising expenditure trends are extrapolated, let alone intensify, UK television advertising revenue is likely to decline in real terms to 2020
- The impact of this revenue decline will almost certainly be the inevitable reduction of original UK content budgets as broadcasters look to maintain profitability

Forces for change – shifting advertiser behaviour

Delayed effects of competition

The TV advertising industry may have only reached the point that the print advertising industry approached in 1998, when Google launched. If we apply a relative decay curve, the impact in TV may not be felt for 5 years - until 2016 and beyond

UK direct mail and newspaper classified advertising expenditure (nominal terms), 1982 to 2010



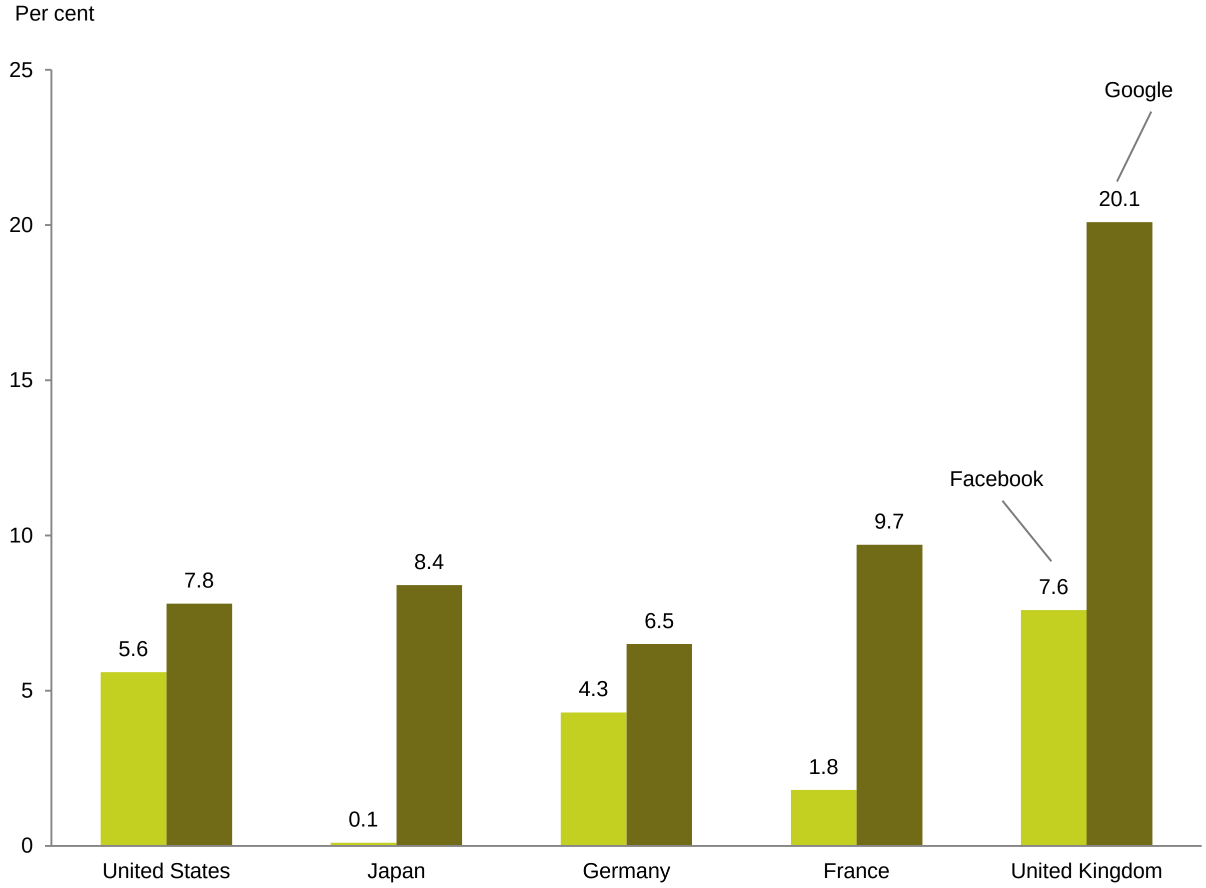
Note: All data is in nominal terms (current prices)
Source: Advertising Association / WARC

How great is the threat to advertising funded broadcasters?

Major new competitors proving effective

Both Facebook and Google have proved effective at driving traffic to major brand websites

Proportion of total entries to the number one retail website in each country that are via Facebook or Google, March 2011



Online consumers in the UK are especially likely to use third party search functions to guide them to retail websites

- This leads advertisers to increase spend on search terms and key words

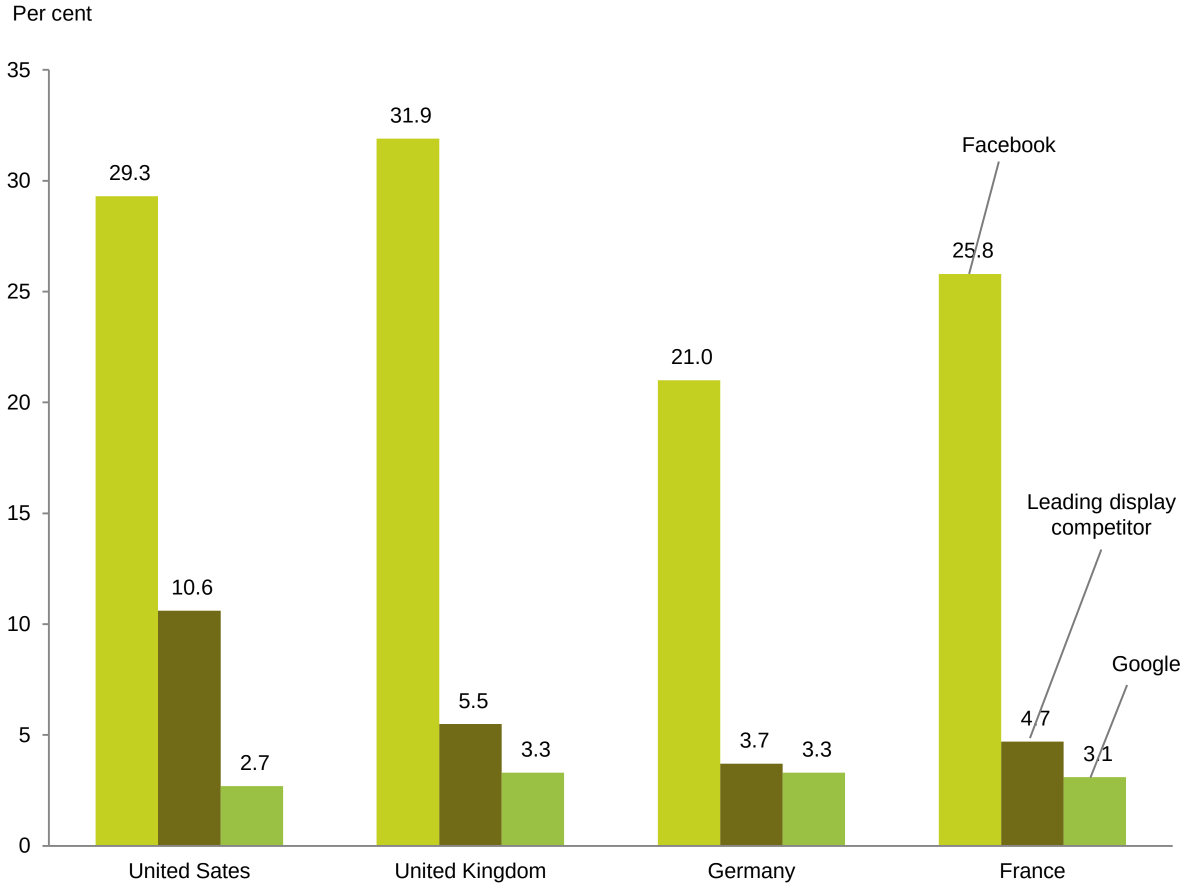
Source: Enders Analysis "Facebook's threat to Google" (May 2011), ComScore

How great is the threat to advertising funded broadcasters?

Control of online display inventory

Facebook already has a significant share of online display inventory in major developed markets, directly threatening traditional display media

Market share of all online display advertising impressions by country, March 2011



With Google the dominant player in search advertising, Facebook is increasing its share of the online display advertising market

- With almost a third of the UK market, Facebook is also the leading display advertiser in the US, Germany and France

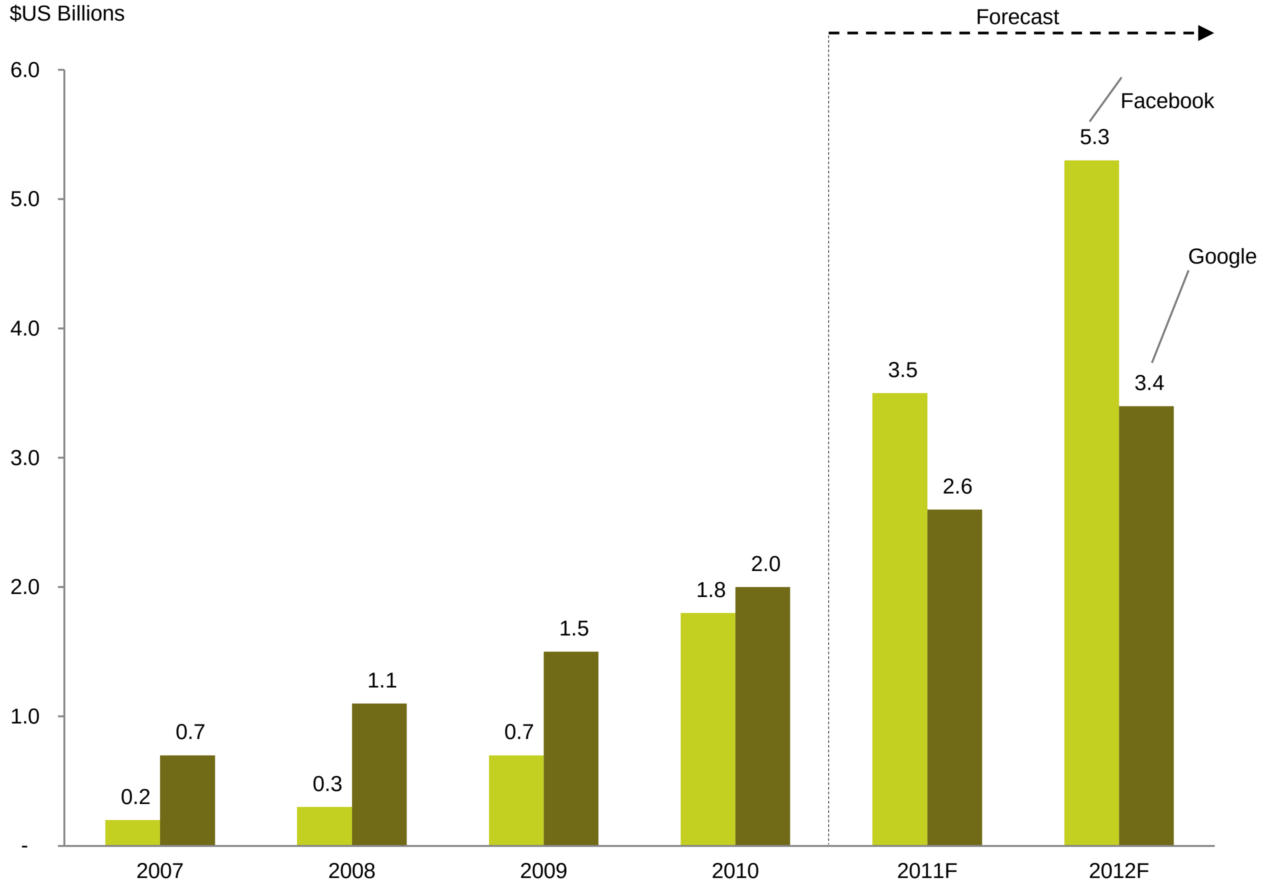
Source: Enders Analysis "Facebook's threat to Google" (May 2011), ComScore

How great is the threat to advertising funded broadcasters?

New players grow display revenues fast

The combination of effectiveness at driving traffic to brands' websites combined with control of a large proportion of total global online display inventory has led to both Google and Facebook rapidly growing display revenue

Google and Facebook: global online display advertising revenue, 2007 to 2012



In 2011, Facebook outgrew Google as the leading online display advertiser

- Facebook has seen rapid growth as its subscriber base has escalated and is forecast to generate over US$5 billion in advertising revenue in 2012

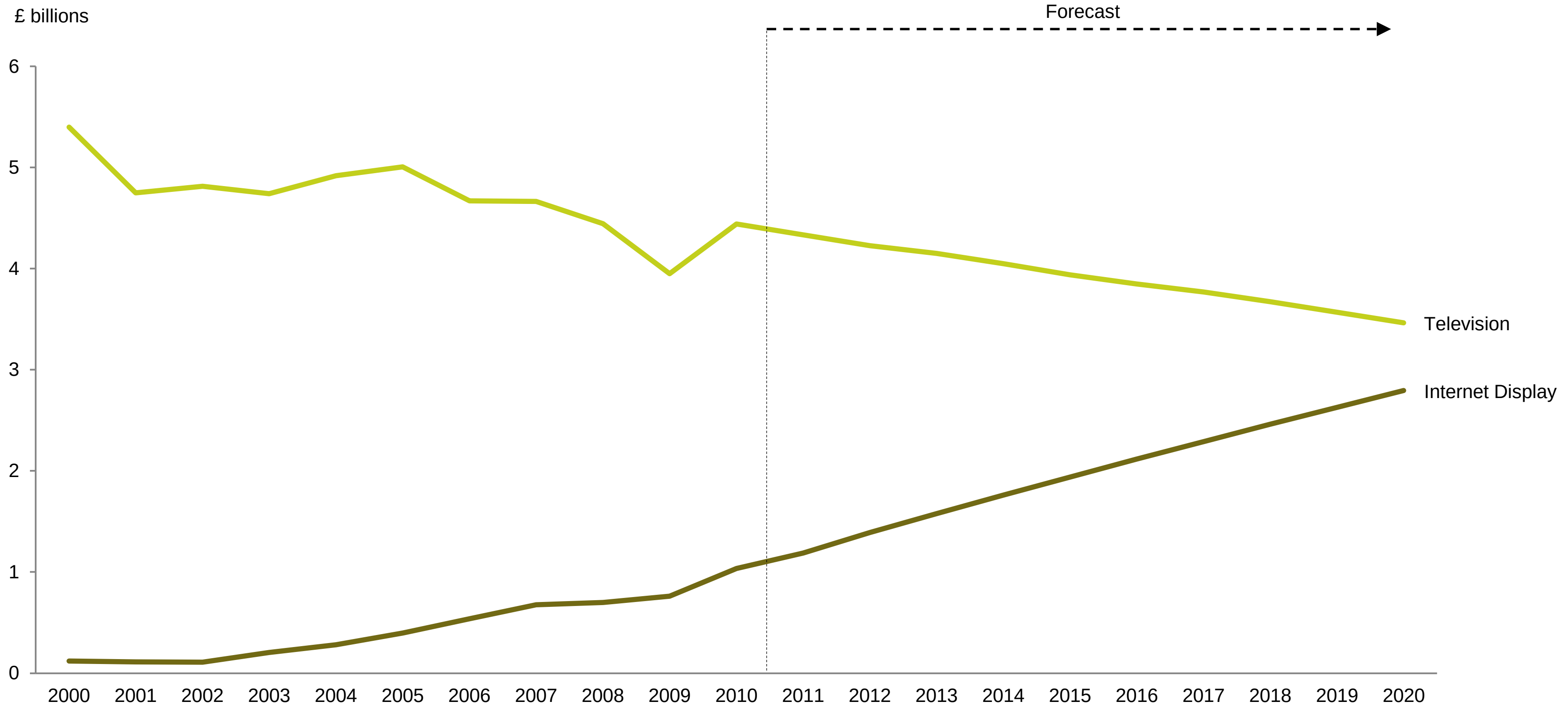
Source: Enders Analysis "Facebook's threat to Google" (May 2011), ComScore

How great is the threat to advertising funded broadcasters?

Share of display by media

Traditional display media are starting to be squeezed by Internet display expenditure growth – the result for television is likely to be a real terms decline in television gross advertising expenditure to 2020

UK television and Internet display: gross advertising expenditure (in real terms at 2011 prices), 2000 to 2020



Note: Forecast assumes that total advertising expenditure grows at 3% per year in nominal terms to 2020
Forecast assumes that the proportionate switch from display to response continues at the same compound annual rate as from 2000 to 2008
OECD GDP deflators / inflators used to convert data to 2011 prices (2000 to 2010 actual and 2011 and 2012 OECD forecasts)
Average of OECD deflators 2000 to 2012 used to convert 2013 to 2020 forecast data to 2011 prices (2.5%)

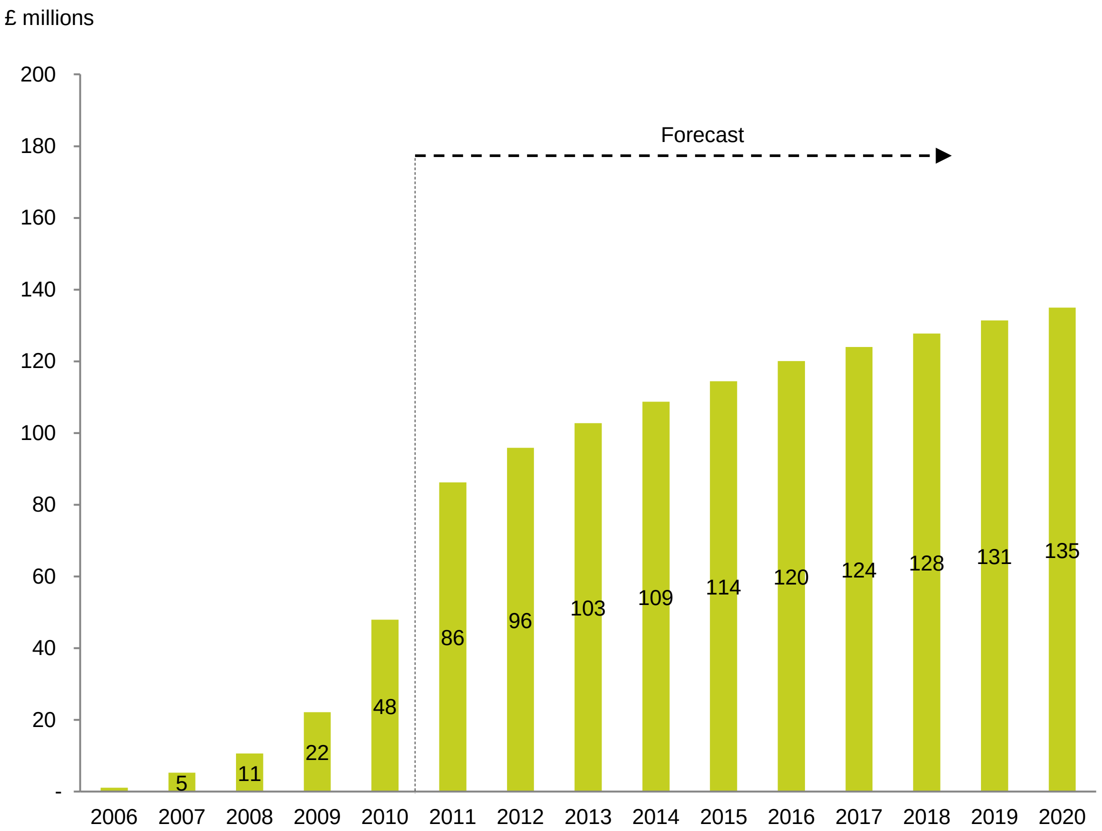
Source: Advertising Association / WARC (June 2011), Oliver & Ohlbaum Analysis

How great is the threat to advertising funded broadcasters?

New revenue streams

While commercial PSB on-demand revenues (and other new media revenue streams) are growing rapidly, it is unlikely that they will make up for lost net advertising revenues

Estimated UK commercial public service broadcaster on-demand revenues* (in real terms at 2011 prices), 2006 to 2016



On-demand revenues of around £135m in 2020 will nowhere near make up for linear gross advertising revenues declines of around £1bn versus 2010 levels

- Advertisers see online video as another form of television and so expenditure is proving substitutional of rather than additive to linear

Note: *gross revenues to broadcasters after agency commission and revenue share payments to platforms and third-party syndicated websites
OECD GDP deflators / inflators used to convert data to 2011 prices (2000 to 2010 actual and 2011 and 2012 OECD forecasts)
Average of OECD deflators 2000 to 2012 used to convert 2013 to 2020 forecast data to 2011 prices (2.5%)

Source: OECD, Company Reports, Oliver & Ohlbaum Analysis

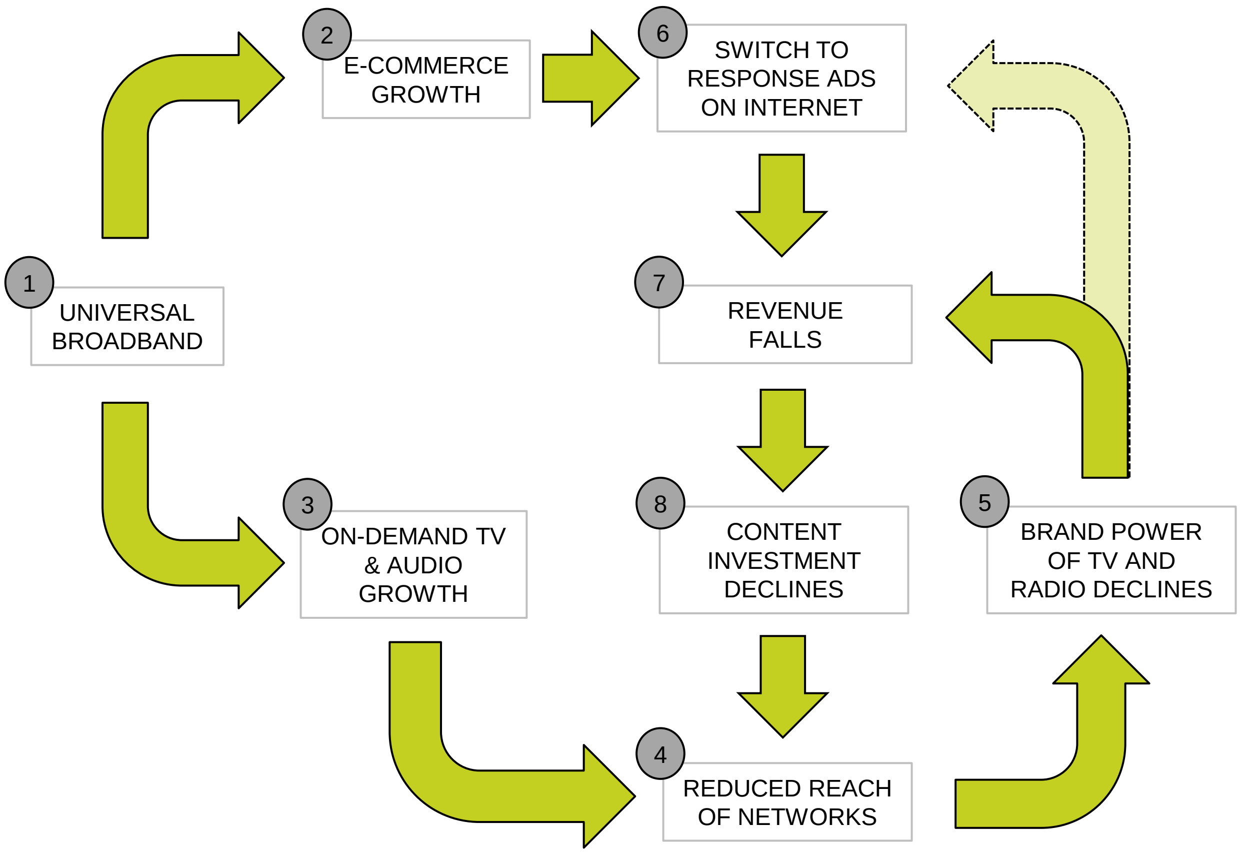
Contents

What are the implications for UK TV commercial broadcasters?

The vicious circle of decline

As net advertising revenue declines, a vicious circle is developing where commercially funded broadcasters are seeing margins squeezed which may lead to slower growth in programme investment over time, if not cuts to budgets

Potential negative feedback loop arising from the radical fragmentation of viewing

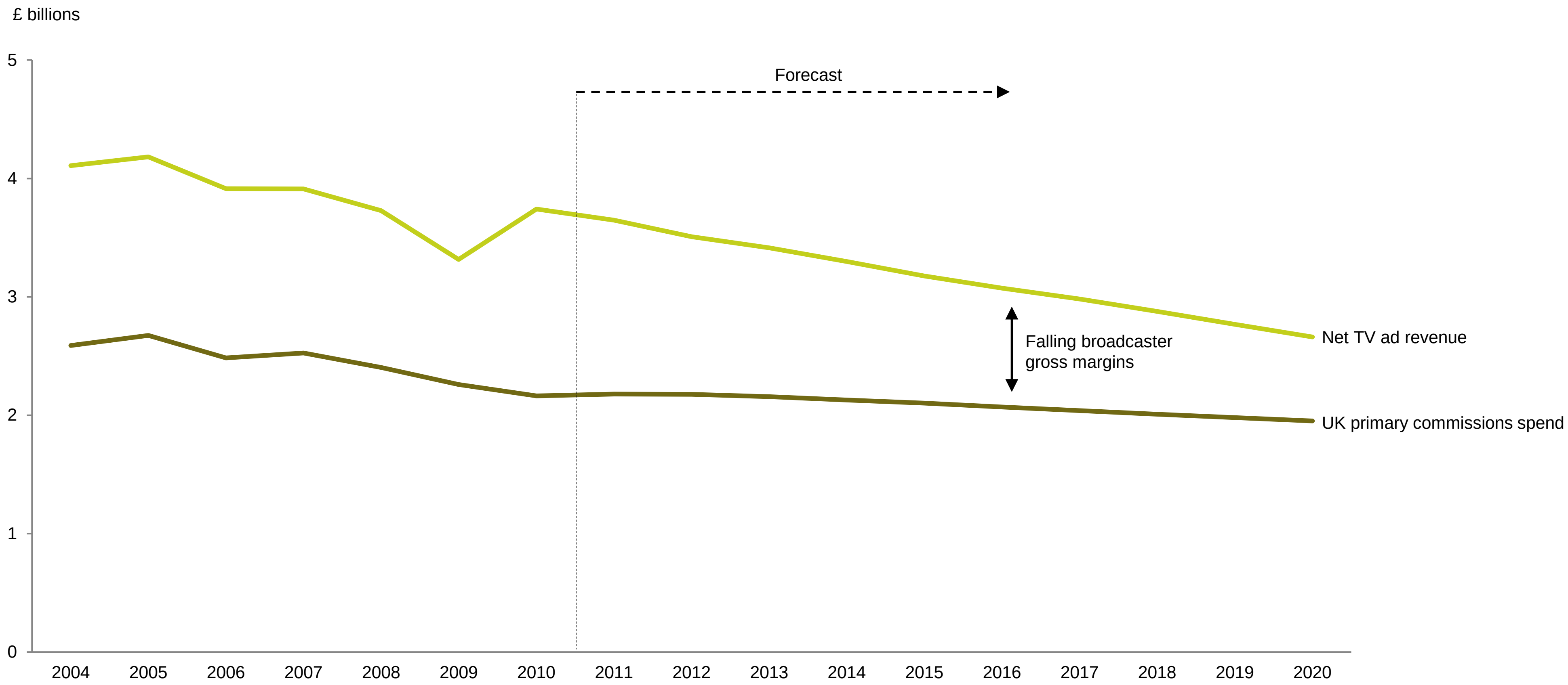


What are the implications for UK TV commercial broadcasters?

Outlook for content investment

The result of this vicious circle is likely to be continued pressure on content investment budgets over time

UK television gross advertising expenditure and total expenditure on UK original television programmes (in real terms at 2011 prices), 2000 to 2020



Note: ONS deflators used to calculate historical data at 2011 prices and average of deflators 2000 to 2007 used to convert forecast data

Source: Advertising Association / WARC (June 2011), ONS, Ofcom Communications Reports, Company Reports, BARB, Oliver & Ohlbaum Analysis