TV is dead, long live TV

Janice Hughes, CEO, Spectrum Strategy Consultants

RTS Cambridge Convention, September 2005 always on /

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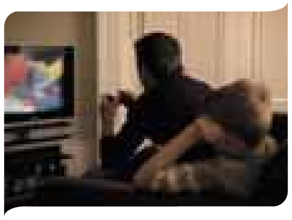
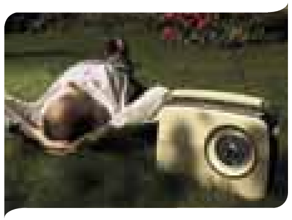
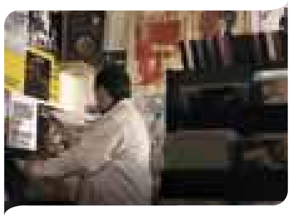


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Background to this research

This report is a summary of findings from research conducted by Spectrum Strategy Consultants during the period August/September 2005, for presentation at the Royal Television Society Cambridge Convention, 15–17 September 2005

Research methodology included desk research and interviews with 20 thought leaders from the UK media and telecoms sectors, including producers, broadcasters, hardware providers, FMCG advertisers, mobile and fixed operators and ISPs. In addition, Spectrum produced a 3,000-line model to forecast the future market size and analyse the impact of potential future scenarios on the market

Spectrum is the UK's leading strategy consultancy focused on the converging industries of telecommunications, information technology and media as well as on the areas where these industries intersect, such as wireless, data communication and interactive TV

This document is divided into three sections, namely:

Changes in viewer behaviour → Spectrum model findings → Implications

Viewers are becoming far more interactive

Consumption

- **Snacking**: Average time spent watching a music TV channel is 4 minutes
- **Multi-tasking**: 50% of all viewing is a background activity
- **Chatting**: More time spent communicating online than consuming content

Access

- **Searching**: 75% of internet users discover content through search engines
- **Sharing**: 60-80% of internet traffic is related to peer-to-peer file-sharing
- **Platform Agnostic**: 33% of DTH subscribers listen to the radio through their TV

Control

- **Organising**: 150m Apple iTunes software packages downloaded worldwide
- **Storing**: By 2007 10% of UK homes will time-shift using a PVR
- **Interacting**: 25% of all households are already using interactive TV services

Source: Spectrum analysis, Daiwa, Jupiter, CacheLogic, Online Publishers Association, BBC

Amongst the young in particular, increased new media consumption is leading to reduced attention to TV

According to The Kaiser Family Foundation survey in the US, children and teens are spending an increasing amount of time using 'new media', without cutting back on the time they spend with 'old' media:

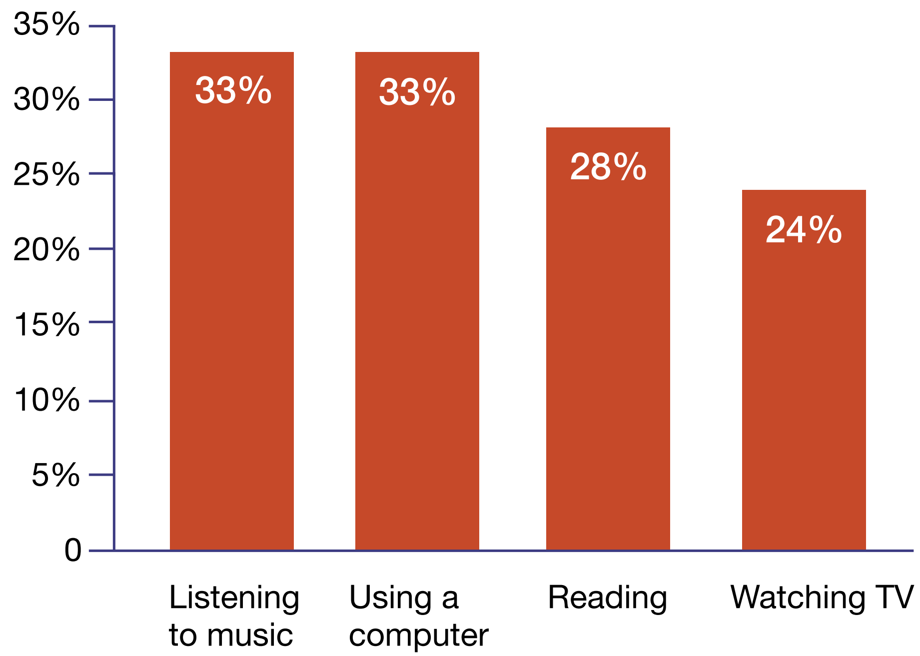
- 24% of US 8 to 18-year-olds use other media "most of the time" that they are watching TV

In the UK, ChildWise research* shows that:

- UK children's TV viewing has remained stable this year, halting the downward trend of the past two years
- 73% of children have home internet access
- 40% already have a broadband connection

With over 7.5m children in the UK, it is likely that here, too, attention on TV is being reduced due to increased time spent with new media

Percentage of US 8 to 18-year-olds who say they are using another medium "most of the time" while:

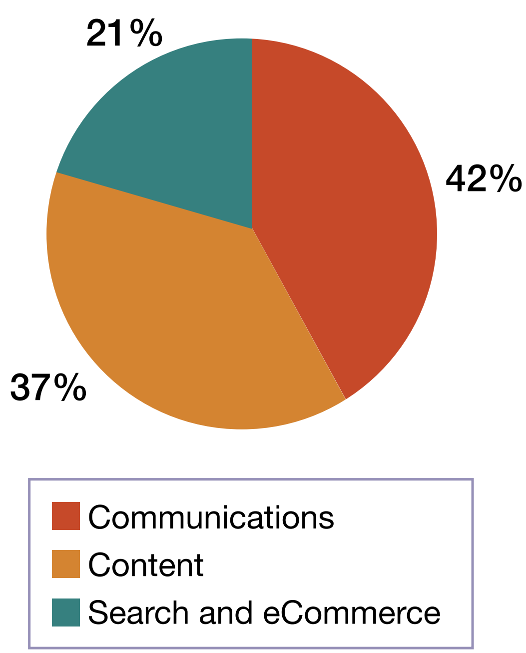


*Note: ChildWise Research, ***Children and Their Media,*** UK, Winter 2004/05, 5 to 16-year-olds

Source: The Kaiser Family Foundation Study, ***Generation M: Media in the lives of 8 to 18-year-olds***, US, March 2005

User-generated content is playing an increasing role in the 'media diet' of consumers, especially online

Breakdown of time spent online, 2004*



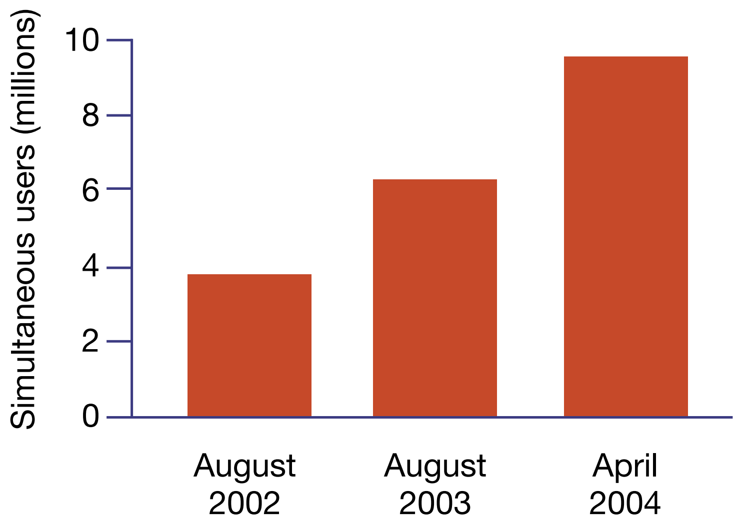
Examples of user-generated content

- **Blogging** – creation of online text, audio and/or video journals
- **Moblogging** – online album of photos taken using a mobile phone
- **Playlists** – track listing and tagging of favourite music to share with others online
- **Profiles** – online profiles, describing an individual's interests
- **Reviews** – user reviews of restaurants, books, entertainment

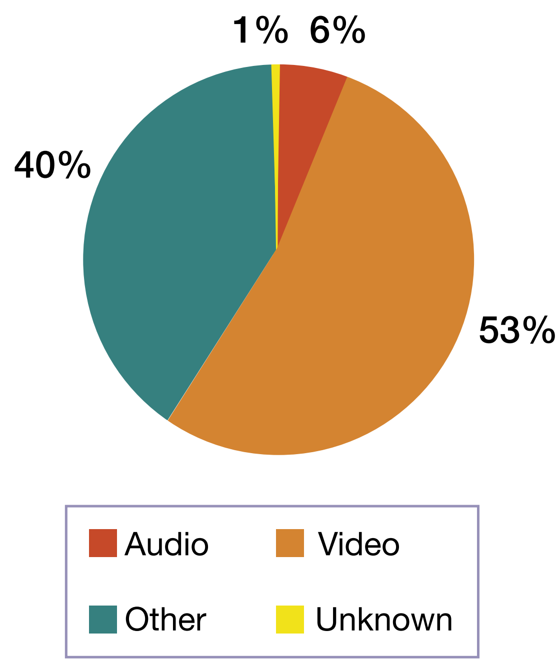
*Note: Breakdown of time spent online is measured for internet users globally
Source: Online Publishers Association, Jupiter, Forrester

Use of peer-to-peer networks is also growing rapidly, with video forming a significant proportion of traffic volume

Global P2P network growth, simultaneous audience, August 2002–April 2004 (millions)



Breakdown of IP traffic volume by content type



Source: Daiwa, OECD, Big Champagne, CacheLogic

The proliferation of effective peer-to-peer networks has led to an increase in illegal downloading of content

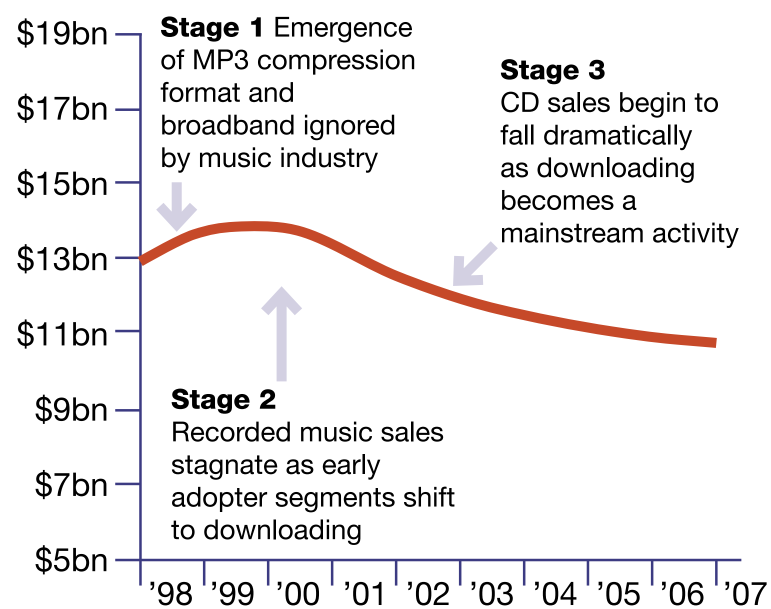
Illegal downloading has significantly impacted CD album sales:

- In the US, CD album sales fell from $14bn in 2000 to $11bn in 2004, primarily due to online piracy

Illegal downloading of movies is already a reality:

- There are 44m broadband households in Western Europe
- 75% of European broadband subscribers use a peer-to-peer network each month
- 15% of European peer-to-peer users download at least one full length (600MB) movie each month, equal to 4.9m movies downloaded in Europe per month

US CD album sales ($ billions)



Source: Jupiter, Media Outlook

Audio-visual content is also increasingly being consumed 'on the move' – anytime, anyplace, anywhere

Better enabled devices mean that the traditional technological barriers to uptake of portable audio-visual handsets, such as limited storage capacity, short battery lifetime and poor user interface are being eroded

Sony's PSP, launched in the UK in September 2005, could bring portable consumption of audio-visual content to the mass market:

- Designed primarily to play games, it also stores digital photos, plays MP3 music files and videos (MPEG-4)

Mobile television is in its infancy but could offer a viable mobile audio-visual service:

- Cellular-based services have been widely launched but uptake and usability are, as yet, uncertain
  – Orange is currently offering an initial line-up of nine channels for £10/month on 'Orange TV'
- Broadcast-based services are also on offer, e.g. the BT Livetime TV (DAB) offer includes live TV news, sport and music videos

Easier transferability of audio-visual content to other devices and storage centres will encourage an even greater proliferation of digital media, e.g. with a wired or wireless connection to the Media Center PC, the Xbox console can now operate alongside the PC

Source: Orange, BT Livetime, BBC

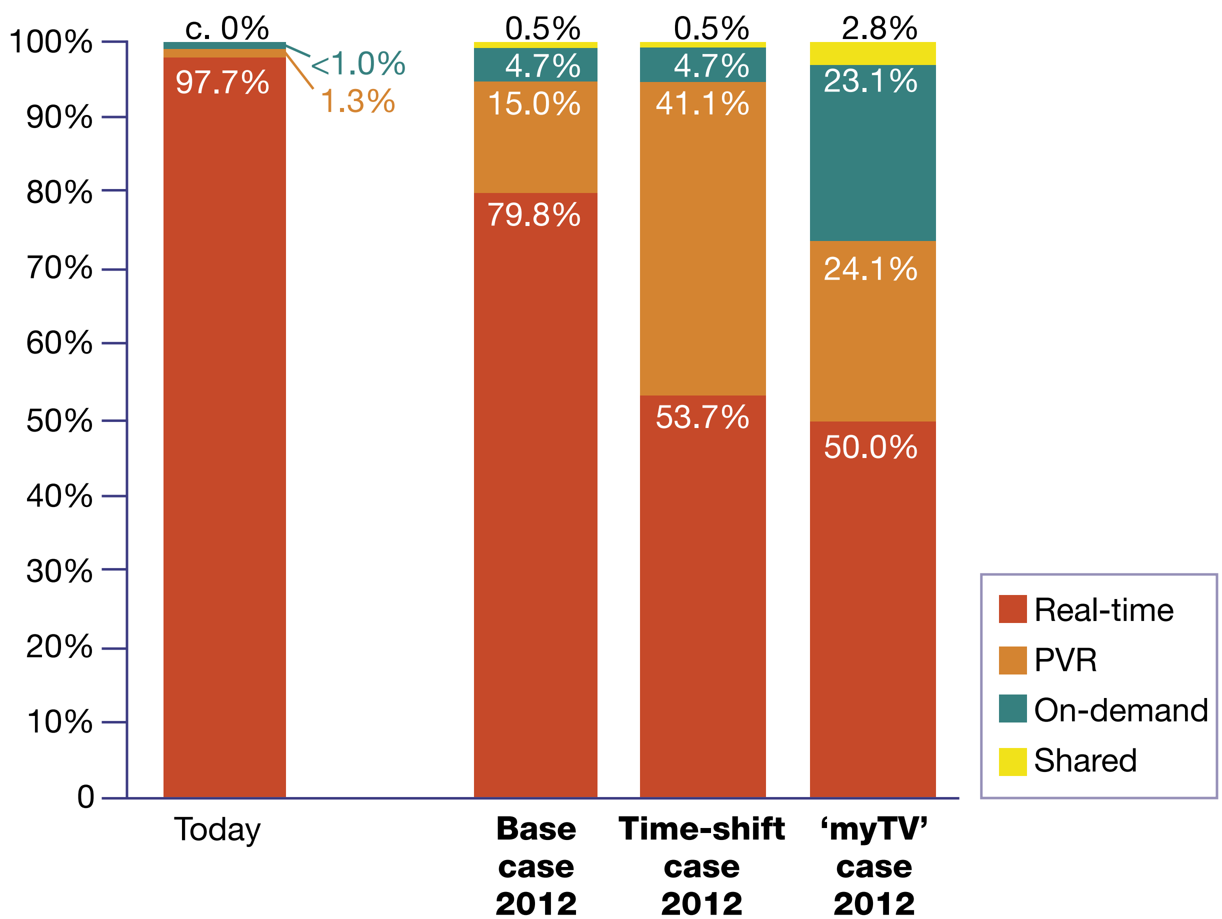
We have modelled three future scenarios of TV consumption

Base case: our base case scenario assumes that a largely scheduled viewing environment remains to 2012

Time-shift case: our time-shift case assumes that PVRs reach 70% penetration by 2012 and, as a result, time-shifted viewing becomes mainstream

'myTV' case: our 'myTV' case assumes that on-demand TV content consumption becomes mainstream, with significant impacts on viewing habits and revenues

Percentage of TV viewing hours



In the base case, Sky reaches its 10m target by 2010, but is overtaken by Freeview in the same year

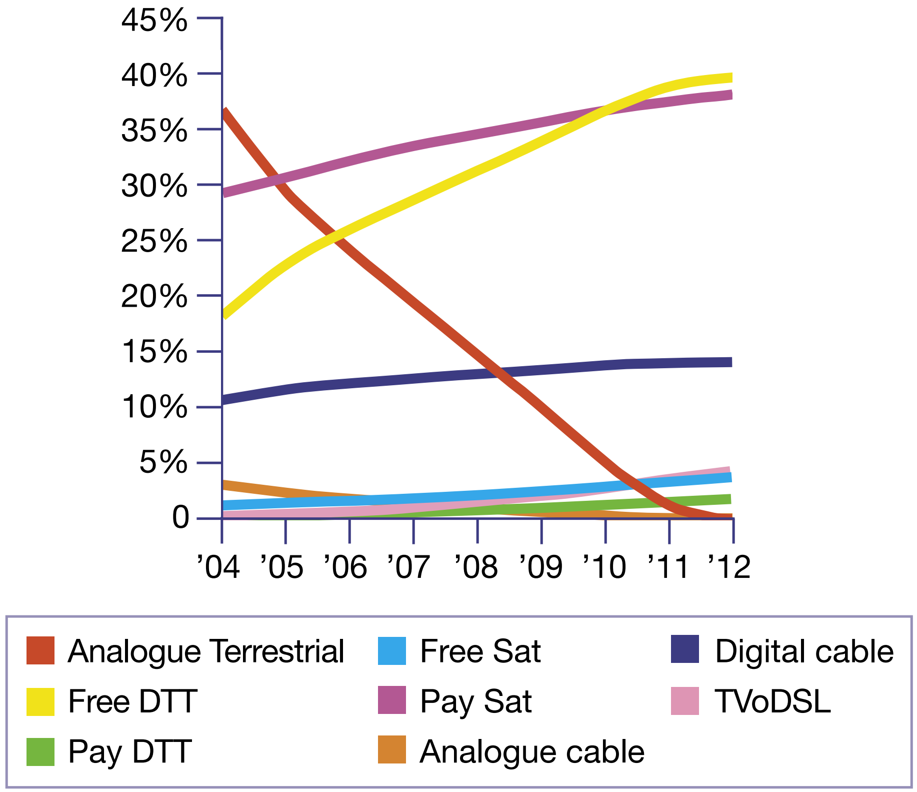
Spectrum model findings

On the basis that 2012 has been set as the final date for digital switchover, we forecast 100% digital penetration by 2012

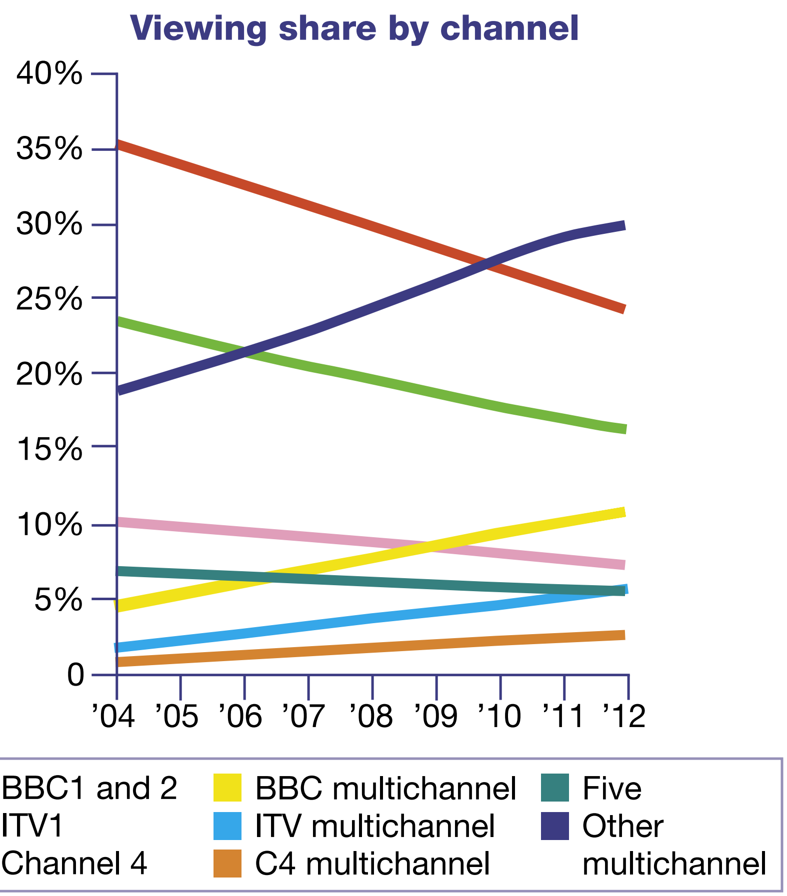
Our analysis suggests that Freeview will be a winning platform:

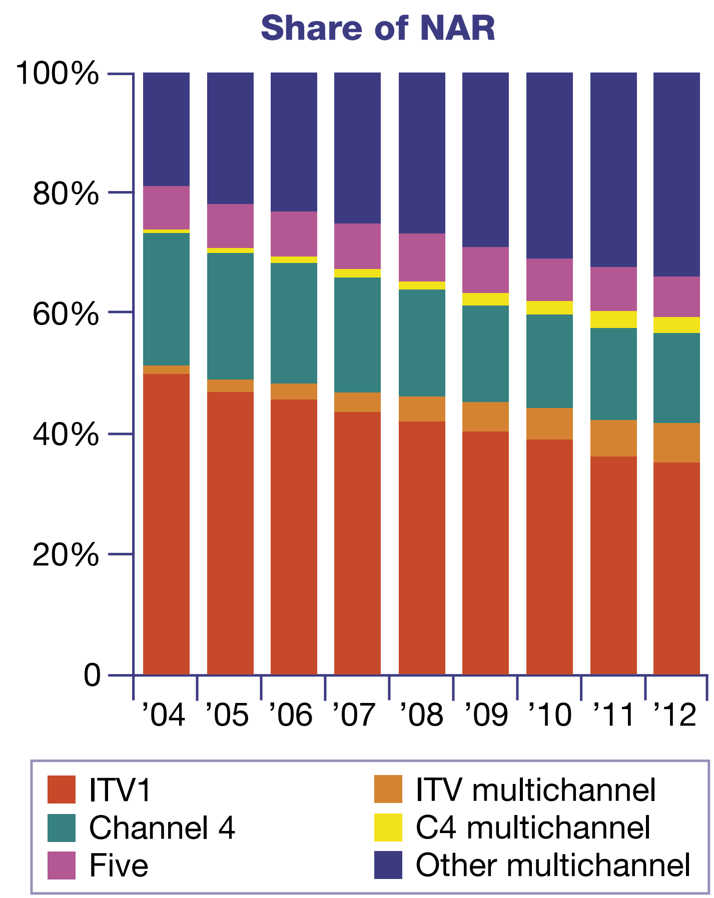
- Freeview overtakes Sky in subscriber numbers in 2010, driven by continued high growth, reaching a penetration rate of 37% by 2010
- Sky will reach its target subscriber numbers of 10m by 2010 and will be the second largest platform in the UK
- Cable growth will be significantly slower and pure TVoDSL will have a low impact on the market

Penetration by platform



In the base case, through their digital extensions, terrestrial channels make up some of the ground lost to multichannel





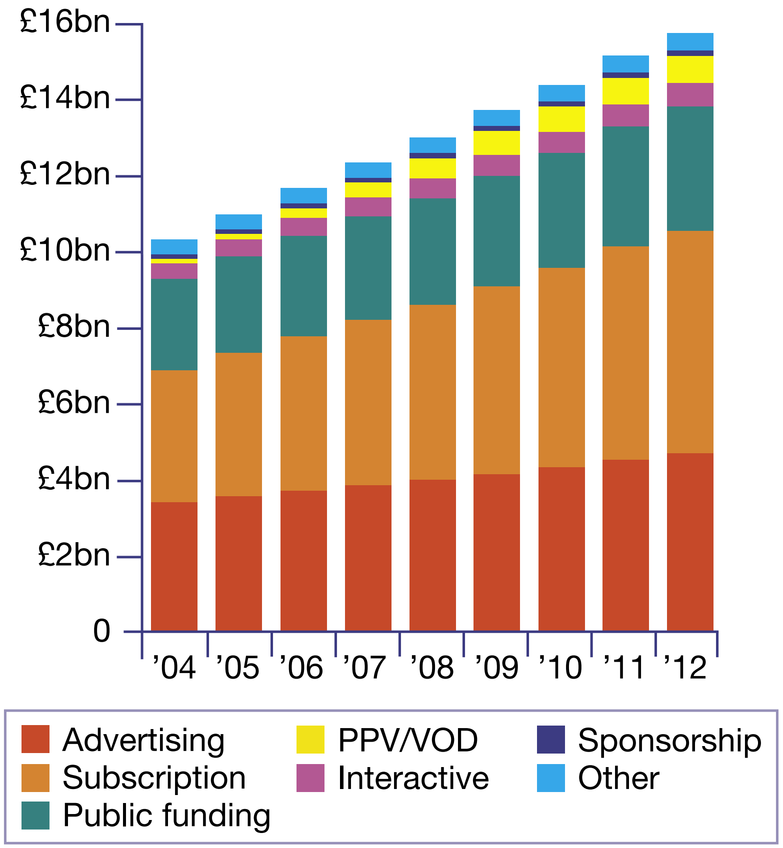
In the base case, revenues grow from over £10bn in 2005 to £15.8bn in 2012, driven by growth in Pay TV revenues

In the base case, total revenues grow from just over £10bn in 2004 to £15.8bn in 2012

Pay TV operators are driving this growth by means of:
- Increased subscriber numbers
- Increased other Pay TV revenues from second set-top boxes, PVRs, betting and gaming

The base case also assumes that:
- The BBC licence fee grows at the rate of inflation, beyond 2006, reaching £3.3bn by 2012
- Advertising spend grows just above inflation to reach £4.7bn by 2012

Revenue split by type



However, advertising revenues could fall as PVRs have the potential to reduce advertising impacts by 12% in 2012

In the base case, we assume PVR penetration of 25% by 2012

Our modelling work suggests that, in 2012, an average of 63% of viewing is time-shifted in PVR households and that an average of 73% of time-shifted advertisements are fast forwarded

On this basis, the impact of time-shifted viewing and ad skipping is a net reduction of 12% in total advertising impacts

If we use the Spectrum 5:1 PVR impact to ad spend ratio, this would imply that £105m of TV advertising spend comes under threat in 2012

PVR impact in 2012, at 25% penetration

Channel	Percentage of viewing hours time-shifted	Percentage of of adverts fast-forwarded
ITV1	45%	50%
ITV multichannel	65%	70%
Channel 4	50%	55%
Channel 4 multichannel	65%	70%
Five	60%	55%
Other multichannel	85%	85%
Total	63%	73%

Source: Spectrum analysis, PHD

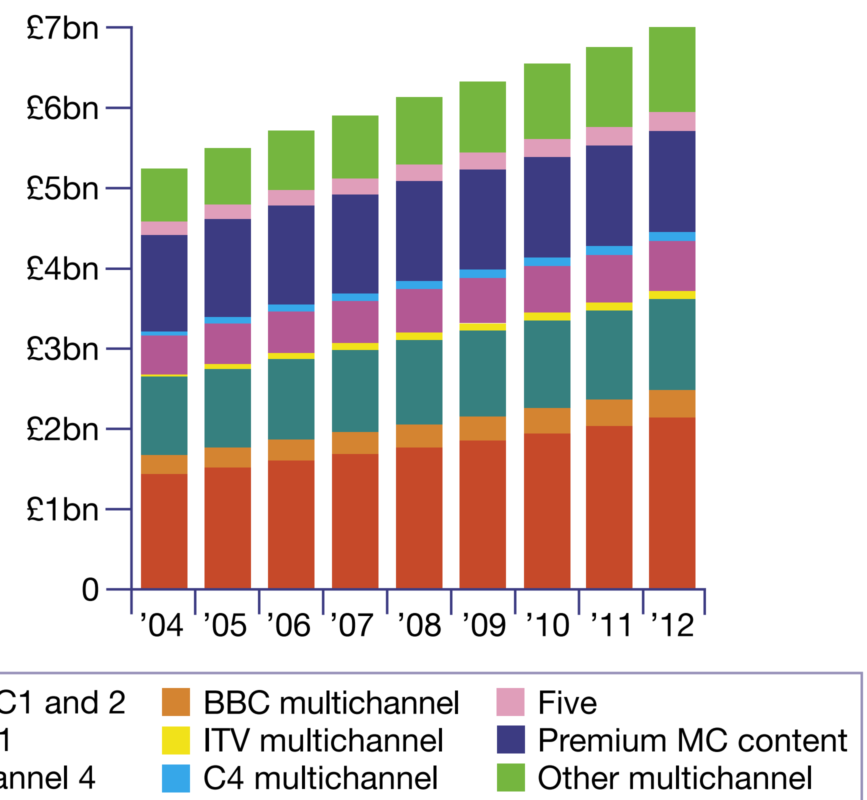
In the base case, we forecast that programming budgets could increase to £7bn by 2012

We forecast that programming budgets could grow to £7bn by 2012, driven by:

- Increase in multichannel numbers and programming spend
- Terrestrial channels producing more compelling dramas, comedies and new reality formats in a bid to increase 'appointment-to-view' programming

Of this, independent producers will account for 25%, resulting in annual independent production spend of approximately £1.7bn by 2012

Programming budget by channel to 2012



Source: Spectrum analysis

In addition, mobile could add annual revenues of £200m to the base case by 2012

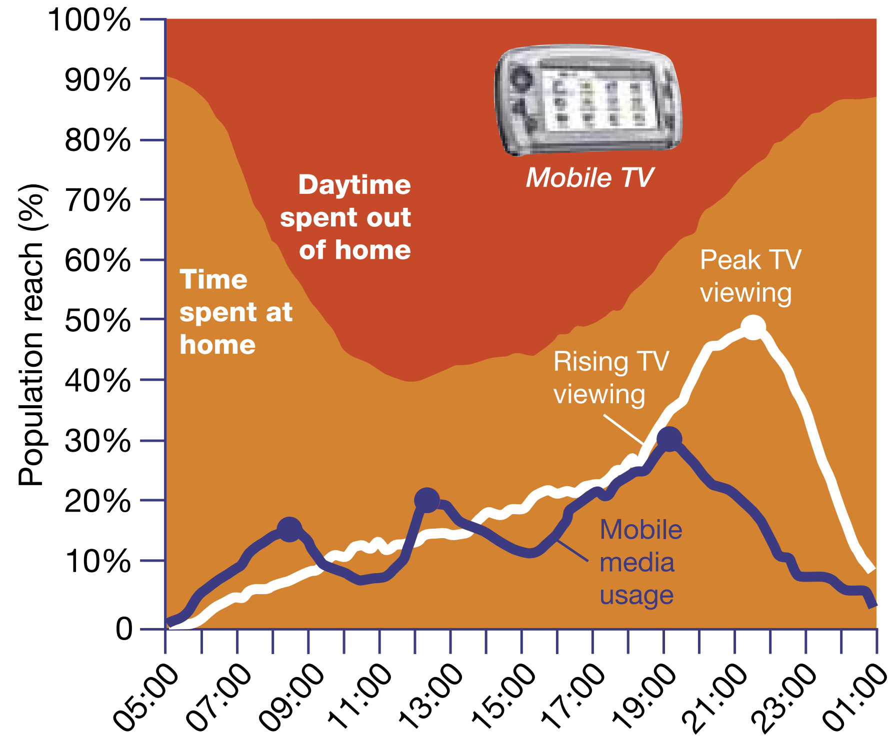
Mobile could also bring incremental revenues to television:

- If we assume 10% uptake of mobile television subscription services and that prices fall to £4.40 per month by 2012, then mobile could bring £200m worth of new annual revenues to television by 2012
- If mobile TV were to really take off and reach 70% penetration by 2012, this could bring £1bn new annual revenues to TV by 2012

The key question is how these revenues will be split between content providers and mobile operators

Mobile also provides a new touch-point with consumers for channel and programme brands

New 'peak' mobile day-parts



In the transitional time-shift scenario, we assume a step change in the amount of time-shifted viewing

The time-shift scenario assumes that PVRs reach mass market penetration of 70% by 2012, leading to a significant increase in time-shifted and on-demand viewing

PVR penetration could reach 70% as:

- Sky has stated that as the cost of PVRs fall they will pass on the saving to consumers
- Freeview recorders are becoming one of the most popular products for those who want to record digital terrestrial television. Current prices vary from £129 to £500, depending on functionality
- The BBC is currently testing a new Freeview set-top-box designed to record all free-to-air TV for a week. Viewers then just pick what they want from the library that automatically grows on its 3.2 terabytes of disk space

In the time-shift scenario, less than 54% of TV viewing is watched in real time by 2012

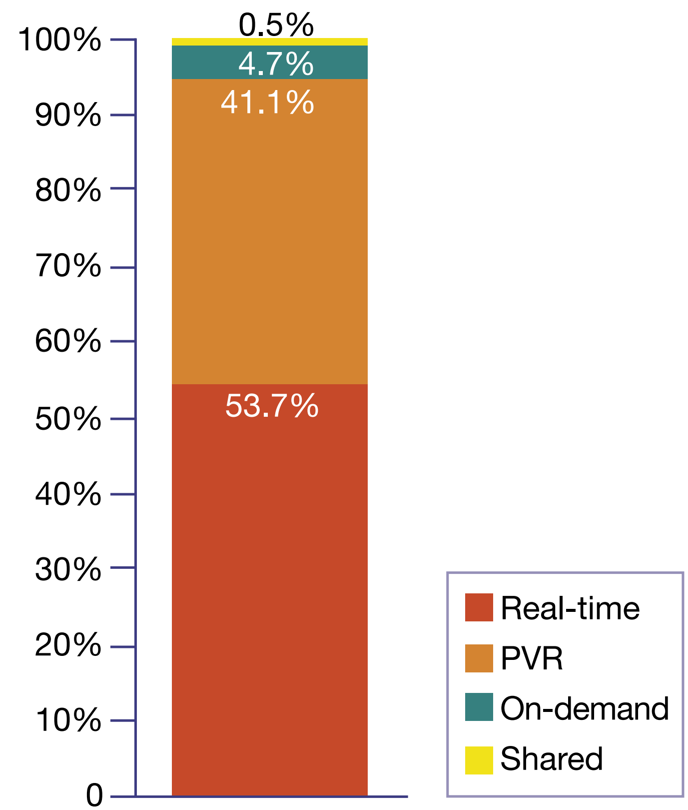
In the time-shift scenario under 54% of TV viewing is watched in real-time, compared with 80% in the base case

Viewing habits change due to the proliferation of PVRs (reaching 70% penetration) and PVR households time-shifting more than half their viewing

Under this scenario there is no change in on-demand viewing from the base case

This amount of time-shifted viewing has the potential to threaten future TV advertising revenues

Percentage of TV watched live in 2012



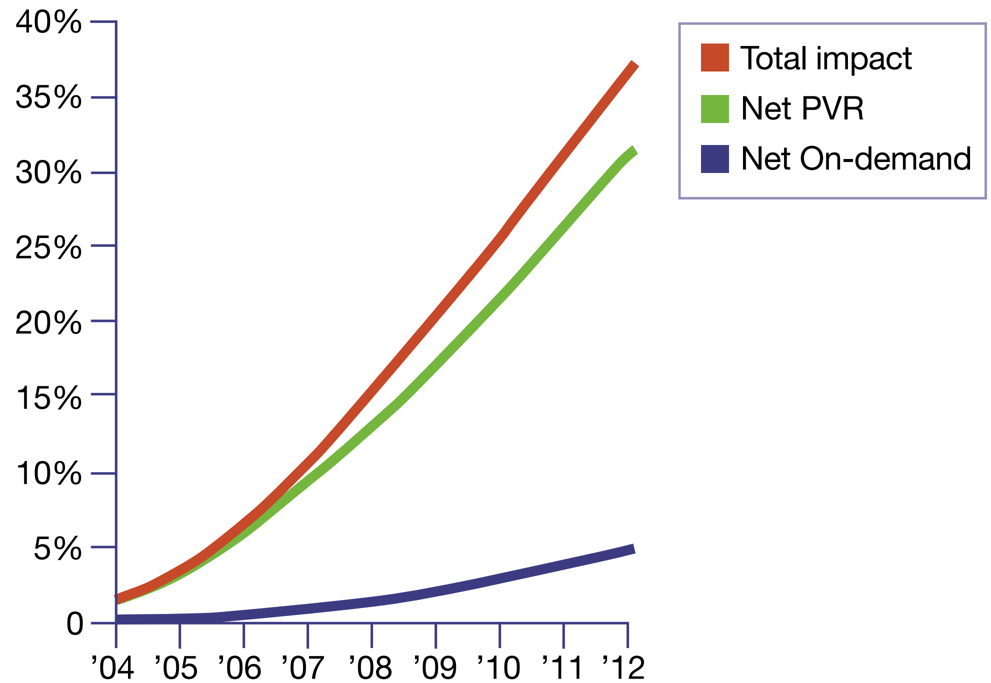
In the time-shift scenario, 37% of advertising impacts could come under threat

Under this time-shift scenario there is a 37% reduction in advertising impacts, driven mainly by PVR time-shifted viewing

If we use the Spectrum 5:1 PVR impact to ad spend ratio, this would imply that £284m of annual TV advertising spend comes under threat by 2012

In addition, advertising revenues could come under further fragmentation pressures (equivalent to £250m), if we assume that there are no advertising revenues associated with on-demand viewing

Reduction in advertising impacts



Under the 'myTV' scenario, 50% of TV viewing is time-shifted or on-demand by 2012

In the 'myTV' scenario, 50% of viewing is time-shifted or on-demand

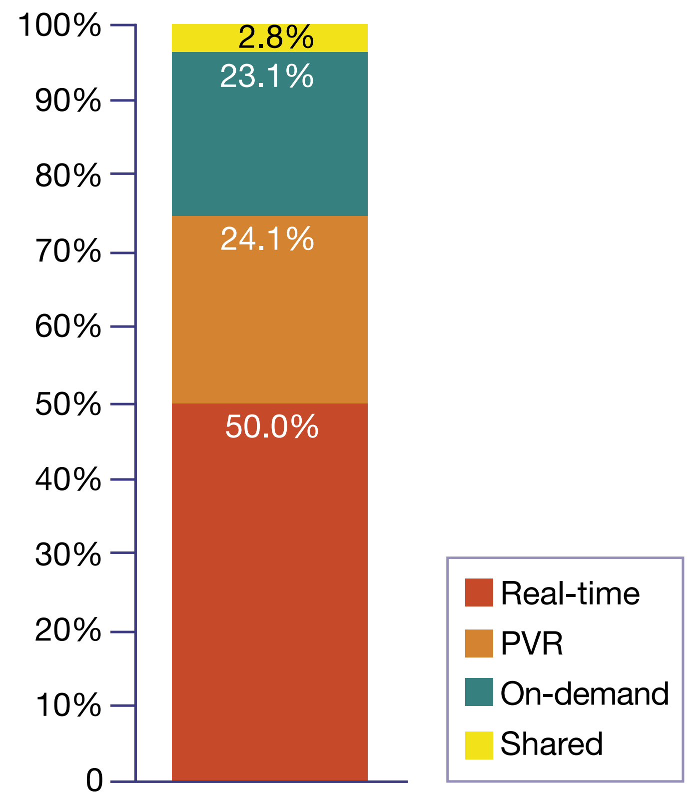
The change in viewing habits is driven by mass market broadband penetration and proliferation of on-demand devices and services

Total revenues increase and more than compensate for the fall in advertising revenue

While on average, 50% of viewing remains real-time in this scenario, this disguises the fact that, in a significant number of households, the majority of viewing will be on-demand; while, conversely, for digital refuseniks, most viewing remains in real-time

However, it is our opinion that it is only a matter of time before the majority of all viewing becomes time-shifted or on-demand

Percentage of TV watched live in 2012



The increase in on-demand viewing in the 'myTV' scenario leads to a significant shift of television revenues by 2012

In the base case, we forecast that total revenues will reach £15.8bn* by 2012, mainly accounted for by subscriptions (£5.9bn), advertising (£4.7bn)* and public funding (£3.3bn)

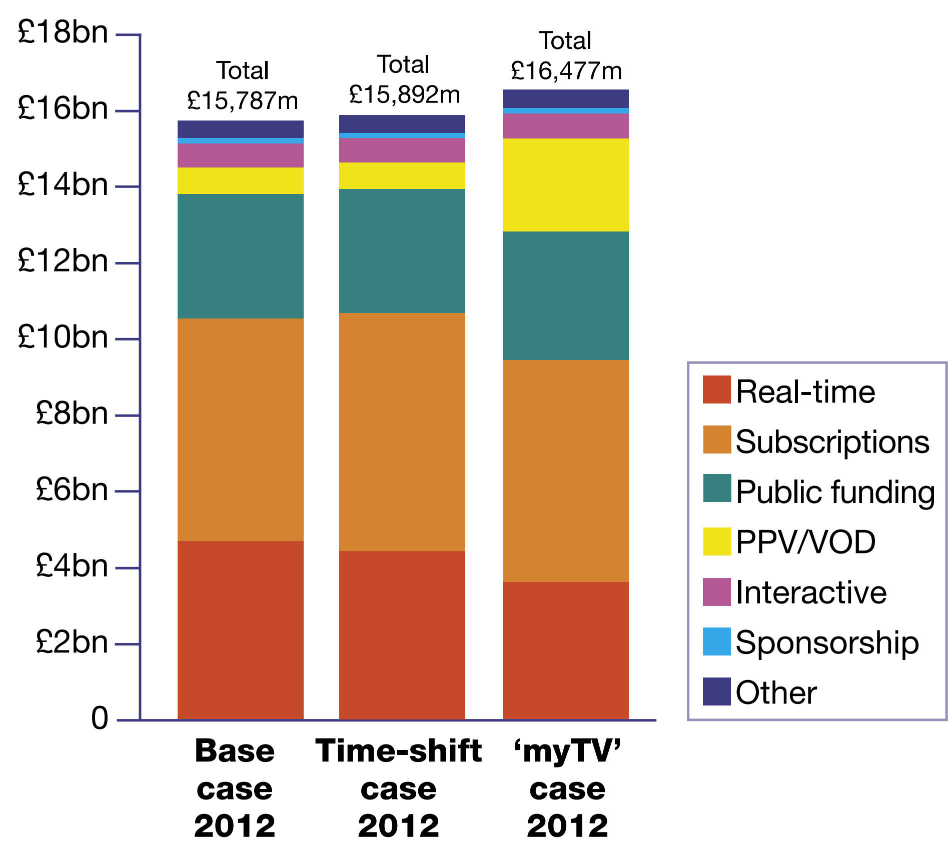
The time-shift scenario assumes a net increase in revenues of £105m on the base case, resulting from:

- An increase of £389m in subscription revenues through incremental PVR rental income
- A reduction of £284m in TV advertising revenues, due to some ad funding being diverted out of TV

In the on-demand scenario, revenues increase by £690m on the base case. This is driven by:

- A £1.7bn increase in on-demand revenues
- A rise of £209m in PVR rental revenue
- A reduction of £1.2bn in advertising revenues, driven mainly by on-demand viewing

TV revenues by scenario



*Note: In the base case, the £105m advertising revenues at risk from PVR time-shifted viewing are still included

The likelihood of this scenario is increased by BT's 21st Century Network rollout plans

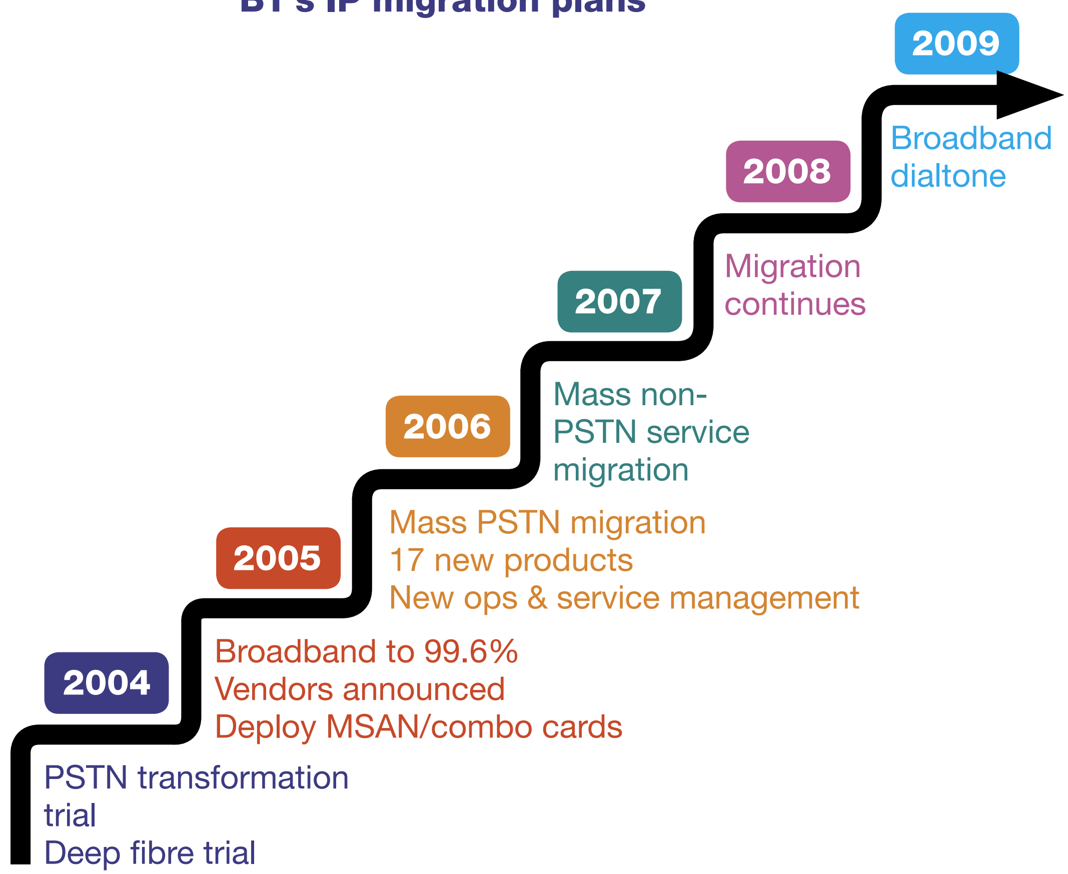
BT is pioneering one of the most aggressive IP migration plans:

- Mass migration from PSTN to IP from 2006
- Full migration expected by 2009
- Capex investment of £3bn, with expected annual opex savings of £1bn

Already BT has indicated that it is making moves in the pay television landscape:

- BT plans to trial TV over broadband services powered by Microsoft TV IPTV Edition in early 2006, with delivery of a commercial service expected to begin in the summer of 2006

BT's IP migration plans



Source: BT Wholesale

Whichever scenario plays out, there are implications for all players along the value chain

	Rights holders	Producers	Channels	Platforms	Device manufacturers
Opportunities	• New markets for libraries (new channels) • New products for new markets (mobile)	• More funds for programmes (direct from subscribers/ advertisers) • New markets for content (mobile) • Bypass channels	• New markets for existing content • Aggregating and reformatting new content for new markets (mobile) • Branded entertainment • Product placement	• Increased ARPU from new revenue sources (interactive/PVRs/ betting etc.)	• Increased sales opportunities through growth of STBs, PVRs, HDTV, flat screens etc.
Threats	• DRM • Rights ownership • Piracy	• Reduction in traditional sources of programming budgets (channels)	• Disintermediation • Piracy	• Loss of control of content distribution	• Risk of backing wrong technology e.g. DVB-H vs. DAB
Recommendations	• Retain rights • Protect rights • Exploit rights	• Develop in-programme advertising solutions • Explore new sources of funding from advertisers/ subscribers	• Become DRM experts • Build sophisticated EPGs and search engines • Be the consumers' trusted navigator in the on-demand environment	• Develop cross-platform distribution strategy	• Maintain flexibility • Invest in multiple technologies • Develop converged devices

Channels must work to protect advertising revenues or risk losing NAR share

Despite falling impacts, many advertisers remain convinced of the unique value of television, assuming the quality of programming and mass market reach will remain

- ***"I choose TV for a combination of reach, environment and speed and, so long as it continues to give me that combination, I will stay with TV"*** Leading UK FMCG advertiser

However, should that ecology change, advertisers are willing to switch money out of television

- ***"TV advertising has become more vulnerable because of increasing concerns as to whether it is communicating as well as it used to"*** Leading UK FMCG advertiser
- ***"Fifteen years ago we used to spend 95% of our advertising budget on TV, that is now 80% to 85%. TV remains a very effective medium for many of our brands, but unquestionably, going forward there will be more challenges for us to justify continued investment in TV at the current rate"*** Leading UK FMCG advertiser

The challenge for advertisers is to:

- Protect programming budgets to ensure quality
- Develop alternative advertising solutions to work alongside the 30" advertisement in an on-demand world e.g. sponsorship, in-programme advertising, non-fast-forward adverts

Source: Spectrum interviews

Channels and platforms must learn to exploit their assets in new ways in an on-demand world

Assets of value in an on-demand world are threefold:

- Content
- Brand
- Distribution network

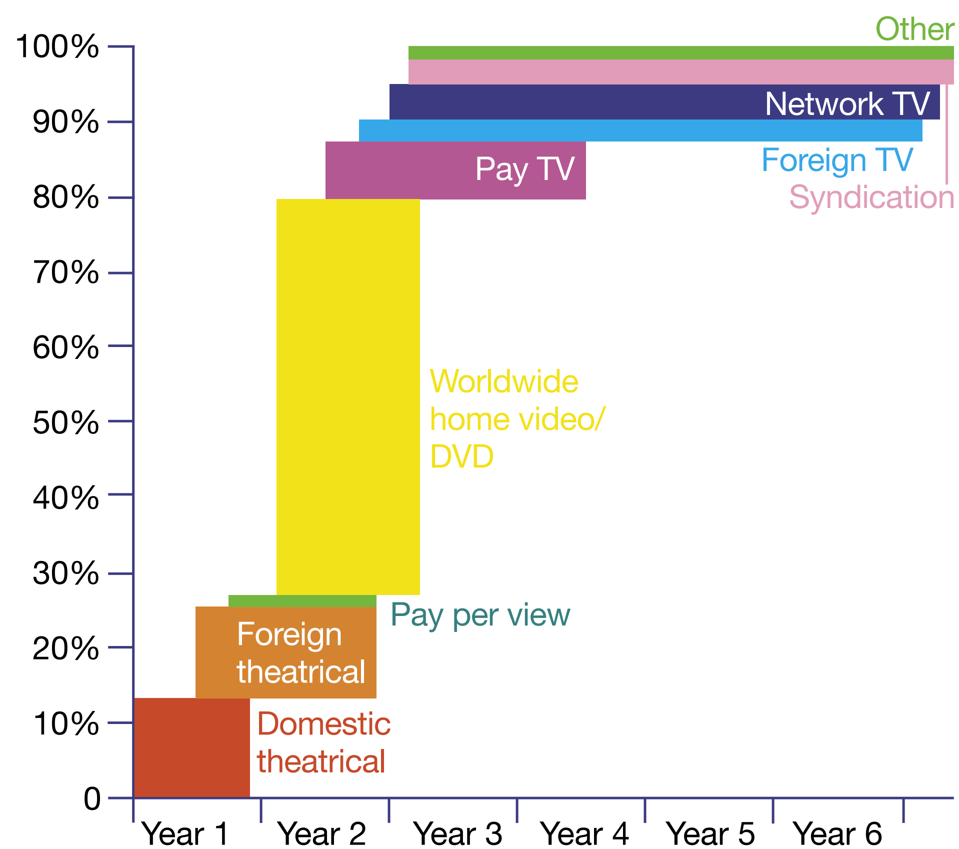
Content owners must work to develop new windows to exploit content over a longer period of time:

- *"In the new world, windows won't matter any more, it will simply be a time and price equation"* On-demand content provider

Channel brands must become trusted advisors, directing viewers towards quality content and recommending appropriate content

Network owners should become household gatekeepers

Typical revenues for a movie



Source: Spectrum interviews

New players will also seek to maximise returns from these new opportunities

Google

In June this year Google unveiled a video-viewing channel on its search engine

'Google Video' also lets users search an index of televised content and video material

Google had annual revenues of $1.9bn last year and has a market capitalisation of $90bn

Will Google become one of the new global TV and entertainment leaders?

Yahoo!

Yahoo! video search was released in December 2004 and now includes video clips from CBS News, Discovery Communications, MTV, Reuters and Buena Vista Entertainment

By allowing direct access to videos, Yahoo! is a step ahead of Google, which is indexing information on video content but does not allow viewers to play videos

Yahoo! had annual revenues of $2.4bn last year and has a market capitalisation of $55bn

What will you Yahoo! in 2012?

Source: Adweek, eWeek, Yahoo!, Google, AOL

there aren't too many bankers with whom you could discuss the origins of hip-hop

we have a team of them

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