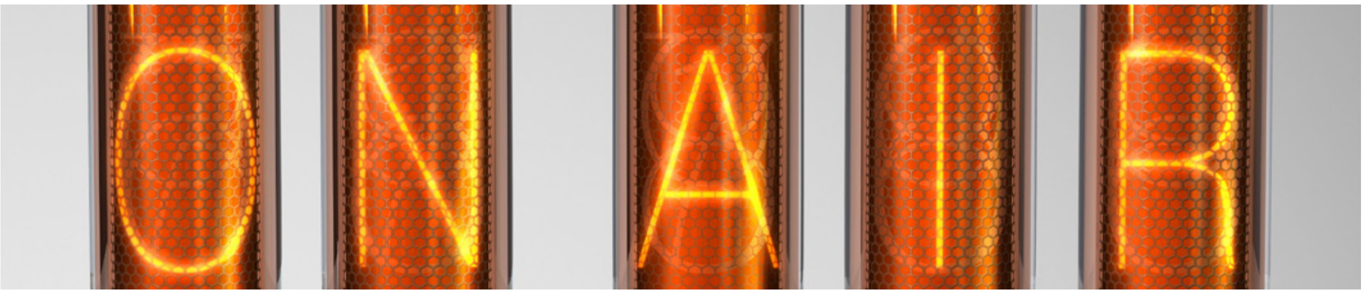
Media & Telecom Executive Breakfast Event

Presentation in Paris of the Arthur D. Little report on "Trends in the Media Industry"



On June 22, 2017, Arthur D. Little presented the results of its international report on flow of funds in the media industry. The event took place in the prestigious Four Seasons Hotel on George V Avenue in Paris, and gathered about 40 leaders from the media and telecom sector in France.
The event began with a welcome and introduction by Vincent Bamberger, Managing Partner and Didier Levy, Director in charge of the Telecommunication, Information, Media & Electronics (TIME) practice in the Paris office. Then Clemens Schwaiger, Head of Arthur D. Little's global Media competence center, presented the main findings and conclusions of the report. This was followed by a Q&A session, during which the participants engaged in a lively discussion about the trends and challenges of the media sector.

The study, entitled "Media Flow of Funds," addresses, among others, the following key questions:

- What are the new trends and the models for media companies in the context of digitalization?
- Which player in the ecosystem will capture the value created in the next years?
- Will the media industry find success through consolidation or diversification?

Main conclusions

As a synthesis, Arthur D. Little extracted the following conclusions from the study:

1. Steady growth of the media industry

Media activities have been constantly growing in the last few years at a global level, and represent more than $1 trillion today. At a global level, the media industry will generate a 4% CAGR between 2011 and 2020. The biggest geographies of the media industry remain North America, Asia-Pacific and Europe, which has fallen to third place in the ranking, overtaken by the strong Asian media industry.

However, dynamics differ largely by segment and geography, and not all activities are affected by this growth.

Global media market, by source 2011–20

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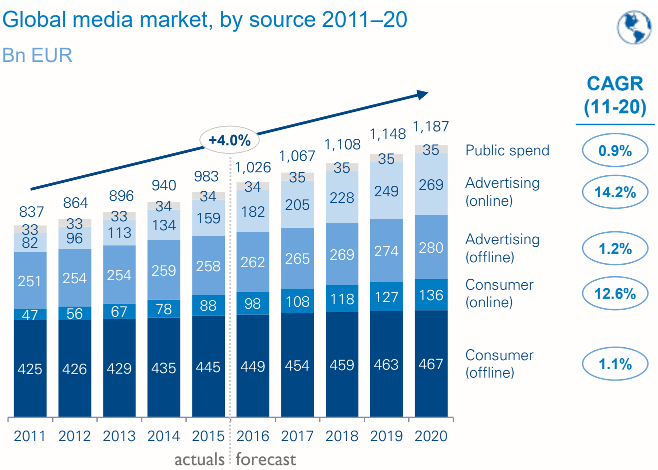

Source: Arthur D. Little Media Flow of Funds database

2. Strong value shifts in the media industry

Traditional activities such as offline consumer spend (newspapers, games, CDs, DVDs, pay-TV subscriptions, etc.) and offline advertising spend (radio, TV, print) present a flat dynamic – respectively, 1.1 and 1.2 percent of CAGR between 2011 and 2020 – and even relative decline in some areas of the world. Indeed, in North America and Europe, those traditional revenues will stagnate in the next years, with 2011–20 CAGR of 3.2 and 2.1 percent, respectively. Other regions, such as Latin America and Asia, keep taking advantage of the development of the traditional content industry, with 2011–20 forecast CAGR of 7.3 and 6.3 percent, respectively.

Global media market, by geography, 2011–20

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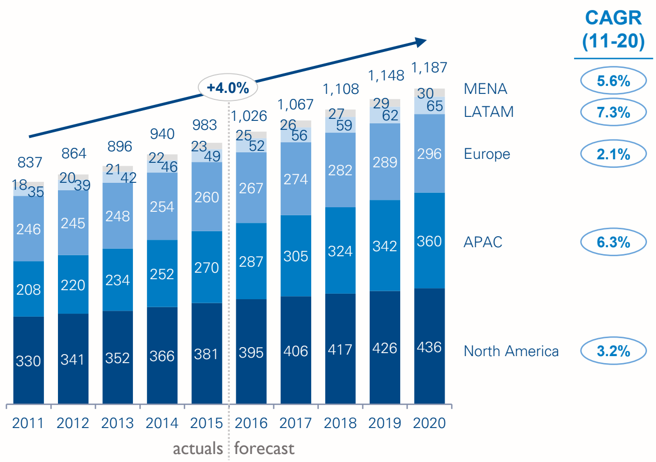

Source: Arthur D. Little Media Flow of Funds database

Hence, the migration of the media sector is following a path towards online, which today represents 30 and 29 percent in Asia-Pacific and North America, respectively. Asia-Pacific, in particular, has experienced impressive growth of online share and spend: in countries such as South Korea, more and more customers are buying or making online subscriptions to online newspapers and various content. Europe is a bit behind, with a share of online revenues of 26 percent, compared to the world average of 27 percent. South Korea, the UK and Canada are the most advanced countries in terms of the online shares of their media industries.

Looking at the various media segments, we can see that only news and print is in decline, with a CAGR of -1.2 percent between 2011 and 2020. TV and video remains the largest segment, but the online advertising segment is progressing at the fastest pace, with a 2011–20 CAGR of 14.2 percent.

Global media market, by segment 2011–20

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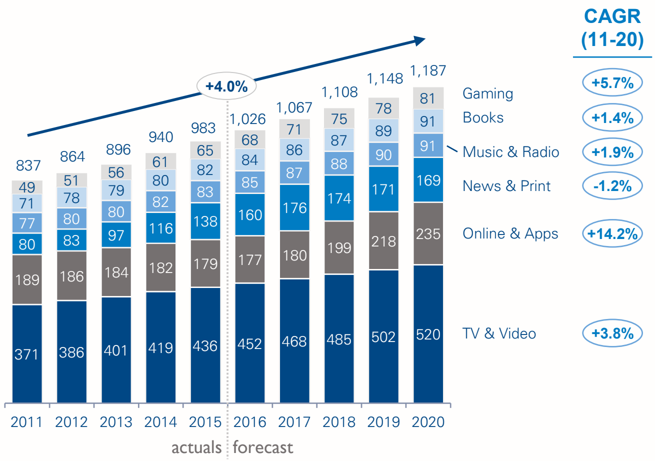


Note: Includes spending from consumers, advertisers and public subsidies
Source: Arthur D. Little Media Flow of Funds database

3. Need for traditional aggregators to diversify

Traditional aggregators will continue to shed value to online players and content producers. Most major media groups are showing revenue and profitability growth, but US-based groups are performing far better than their European peers. There are many attractive diversification opportunities for traditional media players in live events, e-commerce and marketplaces.

Diversification is often achieved through mergers and acquisitions: today, the total value of media-related M&A transactions is growing, driven by increasing deal sizes. For instance, Tencent acquired game studio Supercell for €7.8 billion, Dalian Wanda bought Legend Pictures for €3.2 billion and Virgin Media Ireland acquired two commercial TV channels for €97 million. This form of digital integration creates the need for traditional aggregators to diversify.

Growth initiatives of media companies can typically be classified into core, near-core and non-core areas:

- Core business is related to the consolidation of profits within segments and across the value chain, leveraging content across media segments and content marketing.
- Near-core business is related to local online aggregation, targeted advertising, globalization of digital products and brand licensing.
- Non-core areas are related to e-commerce, live events, e-learning, decision-support tools and e-health.

Key players in the industry have started to diversify in near-core and even beyond-core activities. Some companies have understood this well and begun to rethink their business models to create more value and differentiate from competitors. For example, the German BEEF! Magazine has started selling kitchen tools and even dry-aged steaks to create additional revenue from its highly engaged audience. TV broadcaster ProsiebenSat1 has built an ecosystem of digital properties along the travel vertical and steers its audience towards these.

4. Crowded investment space

Consolidation has begun, but many players remain strongly active, at strategic and financial levels, requiring portfolio synergies to win in acquisition battles.

Entertainment content investment is rising as linear pay-TV platform operators announce ambitious original programming plans. Furthermore, more and more telecom operators are moving into the content space. For instance:

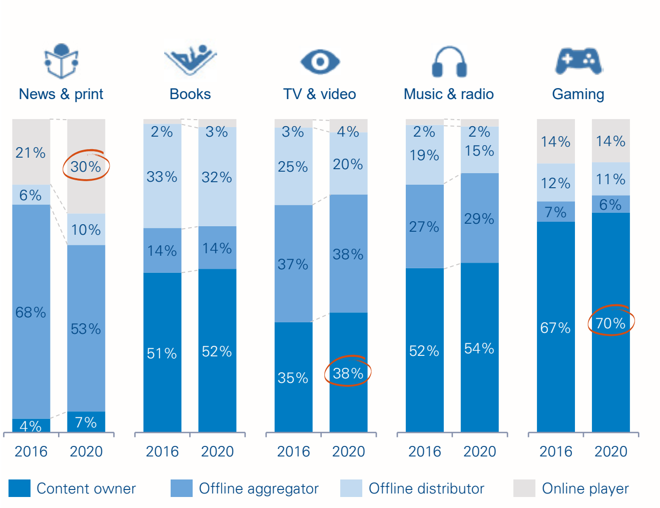
- Telefonica aspires to become the leader in Spanish-language TV content, and will invest €70 million to produce four drama series in 2017, as well as 10 in 2018.
- Sky has announced its willingness to invest €600 million in high-quality local TV shows and series with international relevance in order to attract distribution revenues.
- Liberty Global, one of the largest international cable companies, has commissioned four multi-territory original drama series through all3media, a leading creator of TV content (subsidiary).
- SK Broadband announced its investment of approximately €100 million in the coming years in a wide range of local TV series and virtual-reality content (anime, documentaries, drama, comedy).

5. Case of France: big bets and reconfiguration

As in most developed countries, the online segment has seen strong growth in the last years, with France ranked seventh in terms of online share of the media industry. However, this revenue share remains limited (27 percent of total revenues), which raises the question of the monetization models of the strong volume growth in online content and usage.

The biggest value shift will happen in the news and print segment, with significant growth of online players (from 21 percent of the total value capture in 2016 to 30 percent in 2020). TV and video will also see significant value shifting from distributors to content owners, as shown on the graph below. Globally, in terms of value capture, online pure players and content owners are taking advantage of the market.

France, value capture, by segment, 2016 vs. 2020



Source: Arthur D. Little Media Flow OF Funds database

Several major players are currently investing in the media market, which will raise some opportunities and dynamics. In particular, the recent moves by Altice/SFR may trigger aggressive counter-moves, driving up costs and investments overall:

- The recent move by the company to secure exclusive Champions League and Europa League rights, on top of existing exclusive English Premier League rights, challenges the status quo in the pay-TV market.
- In addition, SFR has concluded an exclusive output deal with Universal for entertainment content.
- Other initiatives include the acquisition of the NextRadioTV Group (BFM, RTL, 01net), of a DTT channel (Numero 23), and the launch of the innovative SFR Press service.

Focus areas during the Q&A discussion

The Q&A session following the presentation focused on some of the key issues raised during the conference.

It was mentioned that the online value chain was starting to fragment, especially in the press and music segment. If, in the past, the same players handled content aggregation and distribution, now the two functions are separating in some cases. For instance, Spotify plays the role of a marketplace more and more through association with various start-ups, one of which creates playlists for retailers to encourage customers to make purchases.

The conference also raised questions about the future situation of the media industry in France. How will French media players evolve in terms of size? Will there be stronger consolidation between media pure players and telecom operators? Will this happen at national level, or at regional or world level? Many scenarios were discussed, and French media clearly stands out as a test bed for industry reconfiguration.

Finally, the theme of Big Data and its implications in the media sector was brought up. Companies such as Facebook and Google have much data and technical skills that they can exploit. This directly implies the subject of multi-sectorial and vertical alliances to compete with these sprawling players.

Conclusion and actions

The digitalization of the media industry, already at work at a global level, will clearly continue in the following years. To seize the new opportunities, the actors of the sector will need to catalyze their own transformation through investments and diversification by developing new business models and activities – all to adapt to a changing environment.

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Arthur D. Little

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