

# Major Transformation in CEE TV Markets

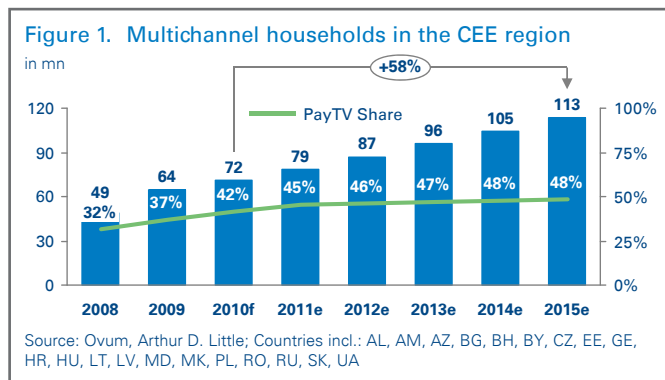
*Shake Up Likely to Continue*



TV markets in Central and Eastern Europe (CEE) are booming, with strong growth in multichannel households, viewing time and revenues. Fuelled by this rapid growth, the rules of the game are changing and competitive pressure is increasing. With digital terrestrial TV (DTT) and over-the-top TV (OTT) on the horizon, who will be the winner of the ongoing platform competition?

Television markets in the CEE region have experienced rapid growth in recent years. The number of multichannel TV households (households that can receive cable or satellite television, as well as terrestrial channels) grew by almost 50 percent and the share of Pay TV increased to over 40 percent between 2008 and 2010. Demand for multichannel TV in the region, however, is far from reaching saturation. Market experts, such as Ovum, project further growth in multichannel households of over 50 percent by 2015, which is striking compared to the mere 10 percent forecast growth in Western Europe.

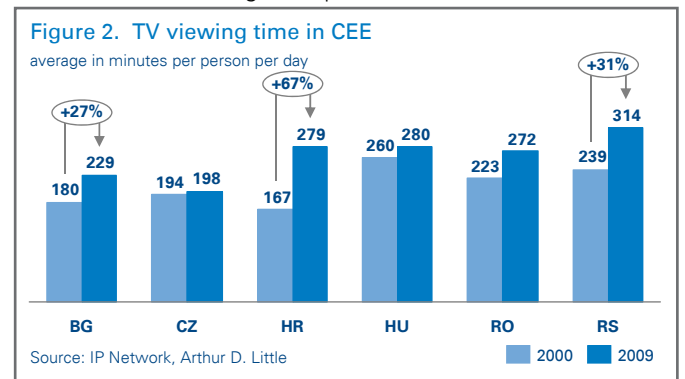
Pay TV providers should benefit the most from this positive trend; they are expected to outperform Free TV competition, to account for almost half of all multichannel households in the CEE region by 2015.



## TV consumption: Viewing time continues to grow, linear TV thrives

TV markets in the CEE region have grown not only in terms of subscribers, but also in terms of TV viewing time per capita. The increase in viewing time has been particularly dramatic in countries with relatively low GDPs such as Bulgaria, Croatia and Serbia, where it has increased by 27 percent, 67 percent and

31 percent, respectively, over the last nine years. The increasing share of multi-set households is also fuelling TV viewing time per person. This trend has not, however, been homogeneous across the region. According to IP Network, multi-set penetration in countries such as Poland (24 percent) or Slovenia (32 percent) is still relatively low, indicating that these markets still have considerable growth potential.



In terms of consumption, traditional linear TV platforms, such as DTH and terrestrial TV, are still the dominant method for watching TV in the CEE region, and Arthur D. Little expects it to remain so at least over the next five years. Even though video-on-demand (VoD), catch-up TV and over-the-top TV (OTT) are increasing in popularity, they are expected to complement linear TV, not replace it.

## HD & 3D – nascent technologies, but first CEE HD success stories

Although HD and 3D are gaining momentum, they currently serve mainly as a complement to popular linear content. An increasing number of broadcasters in the CEE markets are launching High Definition (HD) channels or extending their existing HD bouquets. In Poland, for instance, operators have already launched a total of more than 30 HD channels, thereby significantly surpassing the speed of their Western European peers.

The expansion of HD content, however, has proven controversial among market players, as early efforts have proven to be highly difficult to monetize. The development of HD TV has been hindered by the limited availability of HD-enabled TV sets, bandwidth limitations, and consumers' low willingness to pay a premium for HD content unless there is a significant number of channels available, which makes it difficult to offset the higher cost of producing HD content. This, in addition to the decline in TV advertising in the region, has made some broadcasters cautious about an investment into HD TV.

HD TV has been successfully used in the region mostly as a differentiation and consumer retention tool. Large Pay TV operators in relatively developed markets have implemented HD as a way to upscale their customer base. For example, "n" in Poland has successfully implemented an HD-centric strategy over the last few years, and currently offers more than 25 HD channels. Its more affordable HD packages start at approximately 20 zloty (EUR 5). By the end of 2010, "n" already had over 800,000 HD subscribers out of its total subscriber base of approximately 1.1 million.

Smaller DTH operators aiming to differentiate themselves from large regional competitors can also use HD-centric models as a niche strategy. In order to be successful, however, scale needs to be attained, for example, through white-labeling strategies with larger operators.

3D TV could be another important differentiator and potential growth driver for CEE Pay TV markets. After initial excitement about 3D TV, interest has waned somewhat due to a lack of compatible TV sets, as well as increased caution associated with HD TV. Consumers appear unwilling to pay a premium for 3D unless at least some linear TV channels are available. Therefore, broadcasters and operators have been using 3D TV as a vehicle for image building and marketing. For example, UPC in the Czech Republic has achieved a viewership of only a few hundred consumers in its 3D broadcast trials, but it has still generated a sizeable echo among consumers and in the media.

### Platform competition is fierce – DTH to overtake cable

CEE markets have undergone radical change in terms of TV platforms over the last couple of years and DTH has dominated the platform transformation. DTH's considerable growth has been driven by underdeveloped fixed infrastructure, the high proportion of rural population, competitive prices, and low multichannel penetration. By the end of 2011, its overall market share in the region is expected to surpass that of cable. The outlook for DTH is favorable in a majority of markets, as it is expected to further expand its market share, although at a slower pace. We expect this growth mostly to be driven by established DTH players, as the rate of new DTH start-ups can be expected to decline.

For a DTH provider to maintain strong growth, it will be necessary to embrace new business models and capitalize on differentiation opportunities, such as HD-centric strategies, focusing on niche segments or pre-paid DTH models. Particularly strong growth and investment activity is anticipated in countries with less-developed cable infrastructure, such as the Ukraine and Russia.

Despite the growth of DTH, cable is also well positioned for the future. Although its market share is stagnating or even in modest decline in some markets, the overall number of cable subscribers in the CEE region is still growing, thanks to the implementation of DOCSIS 3.0. In Hungary, the DOCSIS 3.0 subscriber base grew by more than 50 percent over only the last two quarters, and now exceeds 12 percent of total customers.

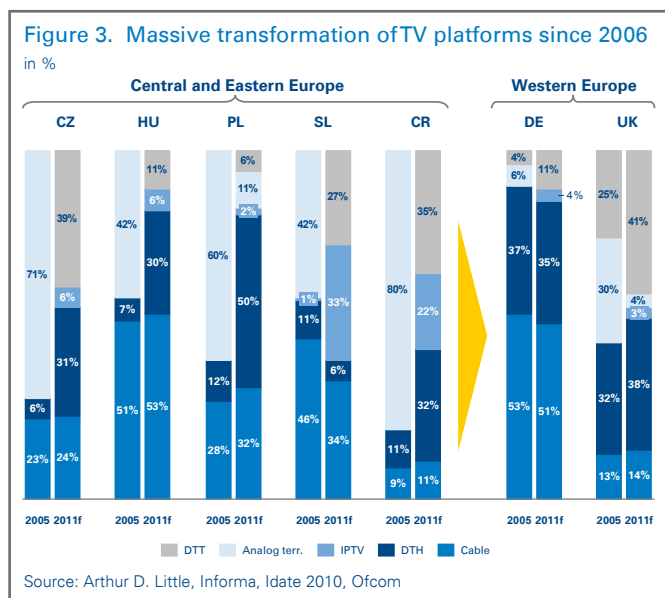
The CEE TV market, however, is far from homogenous. In Hungary, cable remains the dominating platform with a market share of over 50 percent, with DTH also growing. DTH has furthermore exploded in Poland driven by platform switches from households with terrestrial TV, increasing in platform share to 41 percent by the end of 2009 with further growth expected.

The rapid transformation in the CEE region shows no signs of slowing down, especially in markets where analogue terrestrial share is still significant. Arthur D. Little, therefore, expects particularly fierce competition and increased investment activity in these markets, such as in Bulgaria and Croatia.

### IPTV: limited success with exceptions

IPTV has shown impressive growth in certain markets, such as Croatia, where IPTV reached a platform share of over 20 percent in 2010. This development was mainly driven by T-Hrvatski Telekom's MAXtv service, which achieved almost 300,000 subscribers in 2010, or 47 percent of THT's total DSL subscriber base. THT launched the service when multichannel penetration in Croatia was still low and leveraged its existing customer base. Slovenia has been successful as well, and has four IPTV operators in a market of approximately 250,000 subscribers.

In most CEE markets, several barriers still hinder the widespread success of IPTV. First, IPTV is very demanding in terms of fixed broadband infrastructure, particularly when it



comes to HD content. Unfortunately, next-generation access networks required for efficient signal delivery are far from being available on a broad scale. Second, IPTV requires a high level of consumer education as VoD, PVR and other new services add to the complexity of consuming TV. Third, the cost for delivering IPTV is quite high, particularly in comparison to DTT or DTH platforms. Given these factors, Arthur D. Little expects IPTV to grow significantly in only a few markets across the CEE region, with a particular focus on select urban areas.

IPTV will increasingly be used in hybrid solutions in combination with DTH, as it is already the case in countries such as Croatia, Hungary, Poland and Romania. By providing a hybrid solution, operators are not only able to extend coverage significantly, but also to market their product on a national scale without having to worry about IPTV “white spots”

### Bright outlook for hybrid offerings

Most countries in Central and Eastern Europe have already launched or are in the process of launching Digital Terrestrial TV (DTT). So far, DTT has only been really successful in countries where it was launched when the analogue terrestrial share was still high. Examples include the Czech Republic, where DTT's market share exceeds 30 percent already with further growth potential. Arthur D. Little expects DTT to be successful primarily in markets with lower Pay TV penetration. Although available for free in most European markets, with some notable exceptions such as the Netherlands, the most important drawbacks of DTT are related to its technical limitations; it can only carry a limited number of channels and it is a purely linear technology.

With a hybrid DTT-OTT offering, viewers in most markets can consume basic linear channels on their TV sets for free via DTT, enhanced by on-demand content via OTT. In this case, the delivery of OTT content is cheaper than on-demand services via IPTV and a set-top box. Hybrid DTT-OTT offerings will also provide the possibility for multi-screen delivery of the content, such as via mobile phones or tablets. Therefore, hybrid solutions are a trend to watch. This is, of course, not only true for DTT-OTT combinations, but also for DTH-OTT and IPTV-OTT.

Although hybrid solutions may not be available for several years, the first OTT platforms are starting to take off, such as Voyo in the Czech Republic, Nova Play in Bulgaria or Ipla in Poland. Ipla, for example, was launched in 2008 and already boasts approximately 2.4 million viewers who consume about 1 hour of content per month over the Internet. The multi-screen service is available on a range of devices, and can also be available on traditional televisions.

OTT can be very demanding in terms of bandwidth, thus requiring a highly developed fixed broadband infrastructure. Fast broadband is already available in many CEE countries, such as Romania, which is 3rd worldwide in terms of broadband speed, with 43 percent of Internet users connected at speeds greater than 5 Mbps. However, a wide availability of fast broadband is not a given everywhere. Moreover, a content delivery network

(CDN) is required in order to guarantee quality of service to compete with traditional Pay TV platforms. A CDN stores popular content on multiple servers closer to the consumers rather than at a single, central location. Finally, ease of use and a seamless, living room-like user experience on all devices is key and will take some time to be achieved.

Overall, hybrid offerings could become very successful in the long run. In particular, DTT-OTT is expected to put pressure on Pay TV operators, cannibalizing mainly low-end unbundled offerings, with a particular impact on mass-market DTH offerings.

### OTT – friend or enemy to established players?

At first, the entry of OTT offers looks threatening to telecom and cable operators engaged in the TV market. However, Arthur D. Little believes that OTT could also be an opportunity for these players for several reasons.

- New OTT players that lack fixed infrastructure may need to partner with a telecom or cable operator with CDNs, in order to maintain a high quality of service.
- Traditional TV players will frequently act as neutral third parties in larger OTT projects. When large content providers cooperate in an OTT offering, they often face monopoly concerns, as has recently been the case in the UK and Germany. In such cases, a TV player could act as neutral arbiter among competitors in content to ease the regulators' concerns.
- Lastly, telecoms and cable operators are well-positioned to participate in the OTT opportunity. They have large customer bases, enabling them to achieve critical mass through bundling or up scaling. Existing billing relationships and analytical CRM capabilities can also be leveraged. Also, OTT is a means to further push the telecoms' core business, namely broadband, as viewers will require fast or even ultrafast bandwidth services on multiple devices to access the desired OTT content.

Thus OTT does not have to be regarded solely as a threat for network stability and costs, but it can also be seen as a profitable game that telecoms can join.

### Competition driving consolidation in the CEE region

Driven by intensifying competition, consolidation in the telecoms and TV sector is still ongoing in the CEE region. For most players, the main rationale is to strengthen their market position or to support convergent offerings.

Bundling accelerates Pay TV uptake by essentially implying a discount on the TV service. However, this discount dilutes ARPU and reduces Pay TV revenues. Nonetheless, convergent offerings are still a prime motivation for consolidation. In Bulgaria, Telekom Austria Group (TAG)-owned Mobiltel acquired two broadband operators in 2010, Megalan Network and Spectrum Net, to support convergent products. Also in Croatia, TAG took over cable operator b.net. Similar trends can also be seen in Romania, where RCS/RDS, as well as Romtelecom, have entered the mobile market to push convergent products.

Recently, horizontal integration in the value chain has also been occurring; operators have started to acquire content providers or produce content themselves. The main rationale behind such moves is threefold. First, it allows operators to access new revenue streams by selling content to competitors. Second, it converts variable (per subscriber) content fees to fixed channel production/acquisition fees and thus decreases costs as operators grow their subscriber base. Finally, it serves as a differentiator by securing ownership of a key resource – content. Transactions like these have recently taken place in Poland, where Cyfrowy Polsat acquired the second biggest TV channel Telewizja Polsat, and in Romania, where RCS&RDS acquired the music channel U TV.

### Conclusion

TV markets across the CEE region remain very attractive compared to other regions, offering rich opportunities for market players.

*TV in the CEE region is expected to continue to grow rapidly, in contrast to mobile and fixed markets*

Television markets in the Central and Eastern Europe are growing rapidly in terms of Pay TV subscribers, revenue and viewing. DTH has profited most from the boom and will likely continue to do so.

### *OTT is starting to take off*

The first OTT platforms in CEE region, such as Ipla in Poland, are starting to take off. Arthur D. Little expects that they will increasingly cannibalize mostly low-end unbundled offerings, especially in combination with DTT. As such, OTT will put pressure on TV operators following low-end strategies.

For broadcasters and telecoms, however, OTT represents a sizeable opportunity. Broadcasters face new possibilities to monetize their content and telecoms are well-positioned to become their preferred partners, as they can leverage their existing infrastructure, consumer base and CRM capabilities while generating additional revenue through pushing their core business, namely broadband.

### *Players increasingly push quad-play offerings*

Increasing consolidation in the markets is leading to a push in quad-play offerings, putting pressure on mobile-only or fixed-only players. In particular, single-play offerings of cable operators could be at risk as their TV only users could switch to quad-play bundles or OTT offerings. Consequently, cable operators especially need to preempt the emergence of such offers by pushing convergent products themselves and considering the launch of OTT opportunities in their markets.

### *Rapid transformation of TV markets likely to continue*

Ongoing platform competition and the rapid transformation of TV markets in Central and Eastern Europe shows no signs of slowing down and will leave players behind that fail to act upon the new realities of the markets. Whether with OTT or DTT, future winners will need to engage in quad-play.

### Contacts

#### Dr. Karim Taga

Managing Director, TIME practice  
+43 664 230 7189  
taga.karim@adlittle.com



#### Christian Niegel

Principal, TIME Practice  
+49 175 5806 276  
niegel.christian@adlittle.com



#### Clemens Schwaiger

Manager, TIME Practice  
+43 664 6054 138  
schwaiger.clemens@adlittle.com



#### Ansgar Schlautmann

Principal TIME Practice  
+49 175 5806 166  
schlautmann.ansgar@adlittle.com



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### Acronyms

3D	Three-dimensional	DTT	Digital Terrestrial TV
ARPU	Average revenue per user	GDP	Gross Domestic Product
CDN	Content Delivery Network	HD	High Definition
CEE	Central and Eastern Europe	IPTV	Internet Protocol television
CRM	Customer Relationship Management	OTT	Over-the-top TV
DOCSIS	Data Over Cable Service Interface Specification	PVR	Personal Video Recorder
DSL	Digital Subscriber Line	VoD	Video-on-Demand
DTH	Direct to Home		

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