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Brave New TV World

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Introduction

Welcome to this report which looks at the changing nature of the UK television landscape.

The UK television industry continues to thrive; UK produced content is showcased around the globe and TV remains the most heavily consumed media. At the same time, the ways in which consumers interact with TV content and the structure of the industry itself is changing. We believe the long term impacts for the sector will be substantial and action needs to be taken today to be best positioned for these changes, many of which are already underway.

In this report we have identified some of the key shifting sector dynamics affecting the industry and look at some of the implications for companies operating in the industry.

We have done a lot of work within this ever-changing TV market, including:

- Reviewing overseas TV and OTT market trends to understand the implications for the UK
- Supporting investors in diligencing TV channel and TV production acquisitions
- Helping TV businesses prepare for sale
- Supporting TV channels in how they manage their content digitally
- Carrying out TV market reviews to support investment decisions for major pay TV transactions

We would love to debate some of these issues with you, and are happy to discuss how your business can best adapt to this changing environment, so don't hesitate to get in touch with us.

Mark Maitland, Media Strategy Partner, PwC UK

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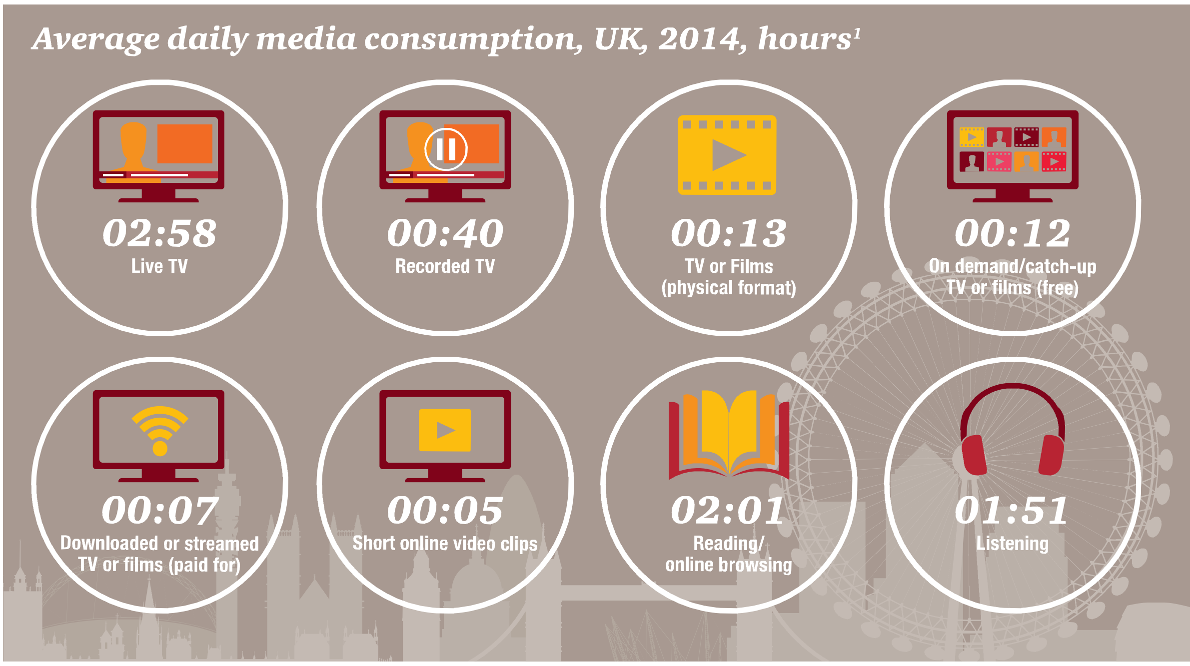
Traditional broadcast TV remains robust and live; linear TV is the main way that people consume programmes.



te growing online usage, TV (licence fees, subscriptions and advertising) still accounts for around one fifth of total media spend in the UK (22%) and in Western Europe (c.21%)[2], both unchanged from 2010. In our recently launched Entertainment & Media Outlook 2015-19, we estimate UK television revenues were c.£13bn in 2014, a c.12% increase since 2010.

The UK creates brilliant TV content

The UK TV sector is highly advanced, with companies having invested significantly in innovation in both services and business models. UK produced television is in high demand, with 2013/14 exports of £1.3bn (up 5% from 2012/13)[3].

Particular growth has been seen in high end drama, helped in part by tax credits. There have been large successes in the form of UK dramas that have gone on to global acclaim such as Sherlock, Call the Midwife and Mr Self ll as inward invested projects such as Game of Thrones; £344.3m was spent on high-end drama production in 2014, considerably up from £181.2m in 2013[4].

1 Ofcom, Digital Day 2014, Overview of findings published in the Communications Market Report 2014

2 PwC E&M Outlook 2015-19

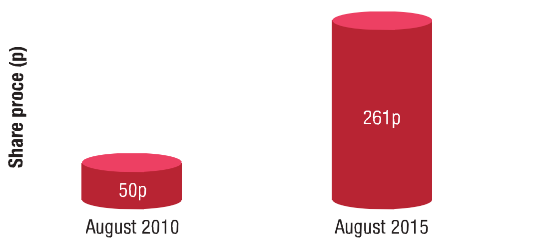
3 PACT UK Television Export Report

4 BFI Statistical Yearbook

Most UK broadcasters are performing well

UK commercial broadcasters have performed strongly in recent years. ITV has grown through diversification; rapidly expanding its production arm and re-entering the pay TV market with ITV Encore. ITV's share price has more than quadrupled since 2010 (despite losing viewing share). Channel 4 has seen more recent performance improvements, with a £30m increase in revenues in 2014 returning the broadcaster to operating surplus after two years of heavy investment in content and technology as part of their 'Investing in Innovation' strategy[5]. Since Channel 5 was acquired by Viacom it too has performed strongly, growing its share of viewing amongst 16-34s and ABC1s[6]; further investment is expected in programming and a rebrand has been announced for later this year. UKTV has grown initially through rebranding its channels and more recently through strengthening content acquisitions and original commissions[7].

ITV plc share price, Aug 2010-Aug 2015[8]



TV a hot area for M&A activity

TV transactions accounted for four of the top 10 UK Entertainment & Media deals in 2014, demonstrating continued, significant M&A activity in the sector. Across Europe as a whole, the top five Entertainment and Media deals were all in the Cable & Satellite space, with players such as Vodafone and Liberty Global looking to expand their TV distribution networks. We believe that deal activity will continue in this space.

Top 10 UK Entertainment & Media deals in 2014[9]

Date	Target	Acquirer	Sector	Deal value (£m)
Mar 2014	Trader Media Group Holdings Ltd	Apax Partners LLP	Online	1,433
Dec 2014	Endemol, CORE Media, Shine Group	Twenty-First Century Fox, Apollo Global Management	Television	786
Aug 2014	All3Media Ltd	Liberty Global, Discovery Holding	Television	671
Sep 2014	Channel 5 Broadcasting Ltd	Viacom Inc	Television	548
Dec 2014	Perform Group PLC	AI PG LLC	Marketing Services	498
Feb 2014	Mergermarket Ltd	BC Partners Ltd	B2B Media	459
Oct 2014	Gorkana Group Limited	Cision AB	Marketing Services	253
Jul 2014	CSC Media Group Ltd	Sony Corp	Television	134
Aug 2014	Engine Group Ltd	Lake Capital Partners Inc	Marketing Services	126
May 2014	Jobsite UK (Worldwide) Ltd	Axel Springer SE	Online	110

5 Channel 4 Annual Report 2014
6 BARB
7 UKTV Annual Results
8 Share price as of 13 Aug 2010 and 14 Aug 2015, www.itvplc.com
9 PwC, "Reshaping Europe's media landscape: Pinpointing the drivers of media M&A"

The changing TV landscape

Whilst the UK TV industry has performed well, it is being impacted by a number of changes which will affect how it operates in the future.

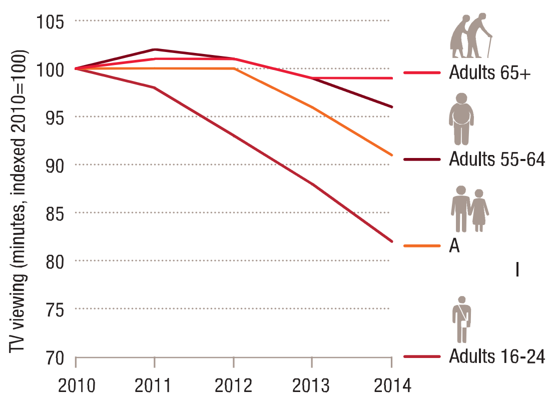
Broadcast TV viewing declining

The first and, potentially, most significant change to consumption is the decline in broadcast TV viewing. In 2014, average broadcast TV viewing was 3 hours 40 minutes per person per day, falling from 4 hours 2 minutes in 2010[10].

While TV viewing levels may fluctuate due to factors such as the quality of TV content, unemployment levels (higher unemployment can help viewing levels), major events (e.g. The World Cup) and the weather (warm weather can mean less TV viewing) the declines appear to be a longer term trend, particularly amongst younger age groups. For example, broadcast TV viewing amongst 16-24 year olds declined by c.20% from 2010 to 2014[10]. However the near term impact of this is tempered by the fact that viewing in the 55+ demographic, which accounted for a 48.5% share of total adult 16+ viewing in 2014[11], has remained broadly stable.

The decline in viewing also varies by channel genre; whilst US data shows that US kids and music channel viewing has declined by c.20% since 2011, sports entertainment and drama have been fairly stable[13].

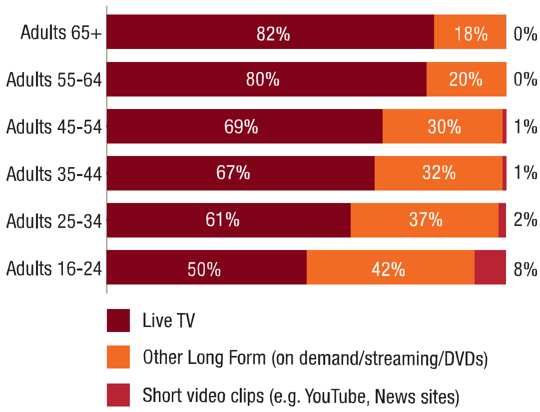
Average broadcast TV viewing, 2010-2014[12]



Customers exploring new ways of consuming content

Much of this decline reflects changing viewing habits; consumers aren't watching less content, but different content through new mediums – and these mediums are currently not as readily measurable as broadcast TV (although this will be partially addressed by BARB's data on broadcaster VOD & live streams which will first be released in September 2015).

How viewers split their time between content, 2014[14]

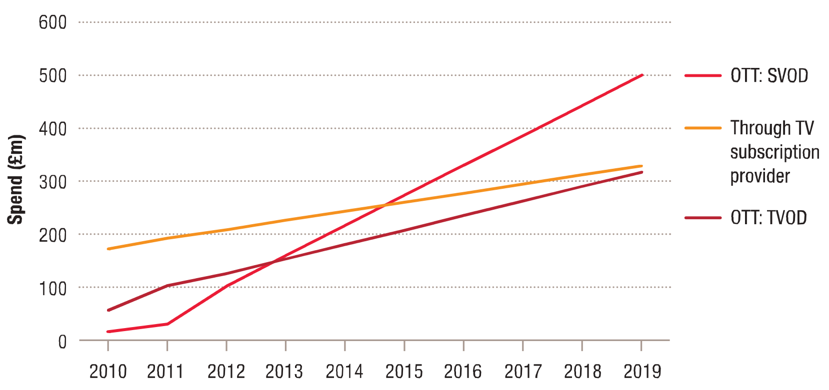


10 Ofcom Communications Market Report 2015
11 Enders Analysis
12 Ofcom Communications Market Report 2015
13 Nielsen, PwC analysis
14 Ofcom, Digital Day 7-day diary, 2014

As we know, consumers increasingly demand high quality, (often original) content available on demand which has resulted in the rapid growth in online models such as OTT (Netflix already has 4.4m subscribers in the UK[15]), catch up (there are over c.8m BBC iPlayer TV requests per day[16]) and short form services. Whilst much of this OTT viewing has been complimentary to traditional TV viewing, it is clear that some of it is now seen as an alternative to broadcast TV, particularly for 16-24 year olds. Short form is particularly prevalent amongst young adults – recent PwC research found that 15-18 year olds in the US spend on average 7.3 hours a week watching short form video.

We expect 2015 to represent a tipping point for "subscription based VOD", with these revenues out-stripping "VOD through a TV provider" (e.g. buying a movie through Virgin Media on demand) for the first time.

UK spend on OTT, 2010-2019[17]



15 Digital TV Research

16 see http://www.broadcastnow.co.uk/news/top-gear-f ls-record-daily-iplayer-views/5086043.article, February 2015

17 PwC, E&M Outlook 2015-19

The US TV market

The move away from linear TV viewing is currently having a greater impact in the US, which has a much larger proportion of cable subscribers than the UK.

Based on a PwC US survey[18], cable subscriptions in the US dropped 6% between 2013 and 2014 amongst viewers under the age of 35. At the same time, alternati

tflix subscriptions grew by c.25% amongst existing pay TV subscribers, suggesting it has reached an overall 65% penetration of all pay TV subscribers. Amazon Prime subscriptions also jumped from 18% to 32% of Pay TV subscribers over the same period. Going forward, it appears this trend will continue as only 61% of existing Pay TV viewers said they expect to be subscribers in five years' time, dropping to 42% of viewers, 10 years from now.

Earlier this month the stock market's nervousness about this cord cutting/trimming became evident; America's largest media companies (Disney, Time Warner, 21st Century Fox and Discovery) all suffered falls in stocks following Disney revising subscriber estimates for its ESPN cable subscriber network downwards. This had a more moderated knock on effect to European FTA broadcasters (including ITV), however analysts note they are less exposed than US equivalents as they are much less reliant on retransmission fees and expect a recovery on the back of strong September advertising results.

18 [Note: *Based on a study (Feeling the Effects of the Videoquake) carried out with BAV Consulting; a global leader in research and insights that's home to the largest and leading quantitative, empirical study of brands and consumers. We sampled 1,024 consumers via an online survey in 2014 and compared to a similar 1,008 person study conducted in 2013].

Some growth in broadcast TV advertising, but strong growth in online

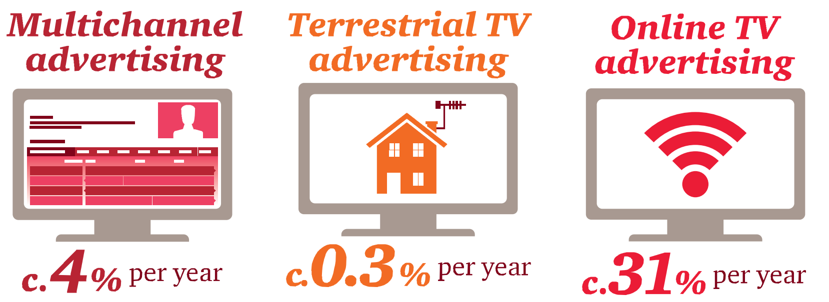
In the short term, slight declines in audiences combined with improving demand for advertising slots will help drive inflationary growth in broadcast TV advertising; we expect broadcast TV advertising to grow at c.2% p.a. to 2019.

Advertisers are, however, changing their allocation of spend to reflect shifts in consumer viewing trends.

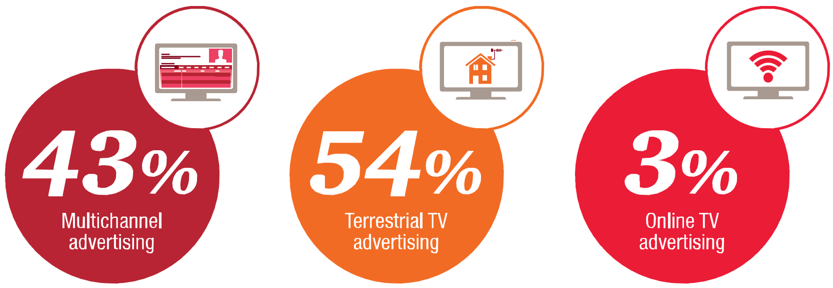
Agencies such as Omnicom have encouraged this move from TV to online video advertising. In October 2014, Omnicom CEO Daryl Simm stated that the agency was advising clients to move 10% to 25% of their TV budgets to online video[19]. Food giant Mondelez International also announced it was committed to allocating 10% of its global advertising budget to online video in 2014[20]. Linear TV, however, remains the best way to reach mass market audiences for brand building campaigns.

This shift to online video advertising, however, means that broadcasters face competition for advertising spend from online specialists such as YouTube and Facebook (Facebook received 4 billion video ad views a day globally in April 2015, up from 3 billion in January 2015[21]). In 2014, c.£127m of the UK's c.£442m spend on online video advertising was with broadcasters[22]. Whilst this is still small relative to total TV advertising, we expect it to continue to grow as VOD and catch up TV via OTT increase in popularity.

Growth in UK TV advertising revenue, 2014-19[23]



UK TV advertising revenue split, 2014[23]



19 see http://blogs.wsj.com/cmo/2014/10/06/omnicom-advises-marketers-to-move-10-to-25-of-tv-ad-dollars-to-online-video/, Wall Street Journal, 16th October 2014,

20 Mondelez International press release, 1st October 2014

21 Facebook In lations

22 IAB Adspend Study and PwC E&M Outlook 2015

23 PwC E&M Outlook 2015-19

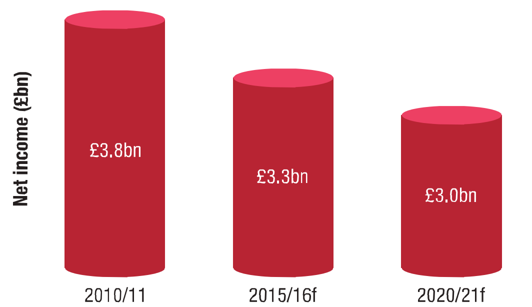
The role of the BBC is being debated; this creates potential opportunities for other players

DCMS has been clear and put BBC funding under pressure. In addition to having to pick up the cost of the over 75s licence fee subsidy by 2021, the upcoming charter review may lead to further budgetary pressures which would have a knock on impact on the wider TV industry, as the BBC might have to reduce the amount spent on producing original content.

The proposal to set up 'BBC Studios' as a commercial subsidiary, however, presents opportunities for other production houses to compete more extensively than now for BBC commissions. While the exact shape of BBC Studios is not yet clear, it is possible that in the future the likes of ITV could compete against BBC Studios to produce Eastenders or Strictly Come Dancing.

We also expect BBC Worldwide (BBCW) to continue to be a large contributor to the sector. BBCW acts as a showcase of UK content globally, with large international sales of titles including 'Doctor Who' and 'Sherlock'.

Forecast BBC total net income for PSB services (const. 2010 prices), Enders Analysis[24]



Pay TV subscriptions growing

Despite declining broadcast TV viewing and the emergence of OTT, UK pay TV subscriber levels are growing, and at their highest level - in part due to rapid growth from (often lower cost) pay TV options with TalkTalk and BT Vision.

Pay TV platforms have continued to innovate to keep up with consumer demands, with catch up TV and video on demand, evolving into TV anywhere (and via any device) propositions and tie-ups with Netflix too. Whilst there have been some signs of cord cutting /trimming in some countries, we believe that these innovations should help sustain TV subscriber volumes, alongside the stickiness created by the bundled nature of most of these services (triple pla). Our Entertainment & Media Outlook 2015-19 forecasts 3% p.a. revenue growth to 2019 from UK pay TV subscriptions.

Changes will take time but action must be taken now

While we have identified these significant changes, we do not expect the industry to transform overnight. Instead, these transformations are likely to take place over a number of years, with the pace of change/impact uncertain.

However, now is not the time to be complacent. Companies must act now to ensure that they can reap the rewards of potential opportunities and mitigate emerging challenges.

24 Enders Analysis - BBC Green Paper: red alert on funding

How should the industry react?

Content remains king

Ownership of, or access to, original content remains critical, and therefore we expect to see TV channels continuing to increase investment in this area, especially following Ofcom's recent ruling that there is no case to reform the terms of trade. This may be through in-house development or strategic acquisitions of content producers to capture the 'next big thing'. However, given the recent explosion in scripted content and consumers being increasingly overwhelmed by the breadth of high-quality content on offer, this investment will need to be selective. The winners will be those able to develop or acquire 'best in class' creatives – and retain them!

Partnerships with emerging distributors becoming more important

For content producers, even those who are part of public broadcasters, emerging distributors (such as OTT providers) may represent a longer term revenue opportunity through content partnerships.

Wider partnerships may become increasingly common to offer the opportunity to do something new and innovative, with different funding models and fewer advertiser-driven constraints. With OTT players increasingly demanding exclusive worldwide rights content, producers will have to decide which distribution model best suits their property, and look to either build partnerships with the likes of Netflix, or enhance their own online offerings.

Broadcasters must enhance online content and VOD capabilities

Consumers are increasingly getting used to, and demanding, the ability to consume content on demand. In order for broadcasters to compete with OTT platforms they must continue to develop their catch-up offerings. A strong VOD platform is essential; one that allows consumers to access content when they want through devices of their choice. Broadcasters should also explore different revenue models such as offering paid access to view 'premieres' of programmes before they're broadcast on the main channel, or freemium models where users can subscribe for ad-free or downloadable content.

Short form strategy must be defined

Broadcasters must define a short-form strategy; either focussing on short form clipping and additional content f ting stand-alone short-form content/brands. If creating stand-alone short form brands they must also think about how to transition these audiences to their linear channels.

There has already been investment in this space by broadcasters (A&E's investment in Vice Media, and ITV's investment in Channel Mum and Believe), production companies (All3Media's investment in Little Dot Studios) and large media companies (Fremantle's investment in Divimove and their partnership with Vice). Short form is still nascent, with various players experimenting and monetization often low, but interest and deal activity in this area is expected to increase as short form evolves.

Clearer ROI for linear TV and VOD advertising

Given TV's continued position as the most heavily viewed medium, we do not expect TV advertising spend to decline in the near future. However, in the medium to long term, the industry will f lenge from online specialists (e.g. YouTube) increasingly targeting brand budgets for online video advertising.

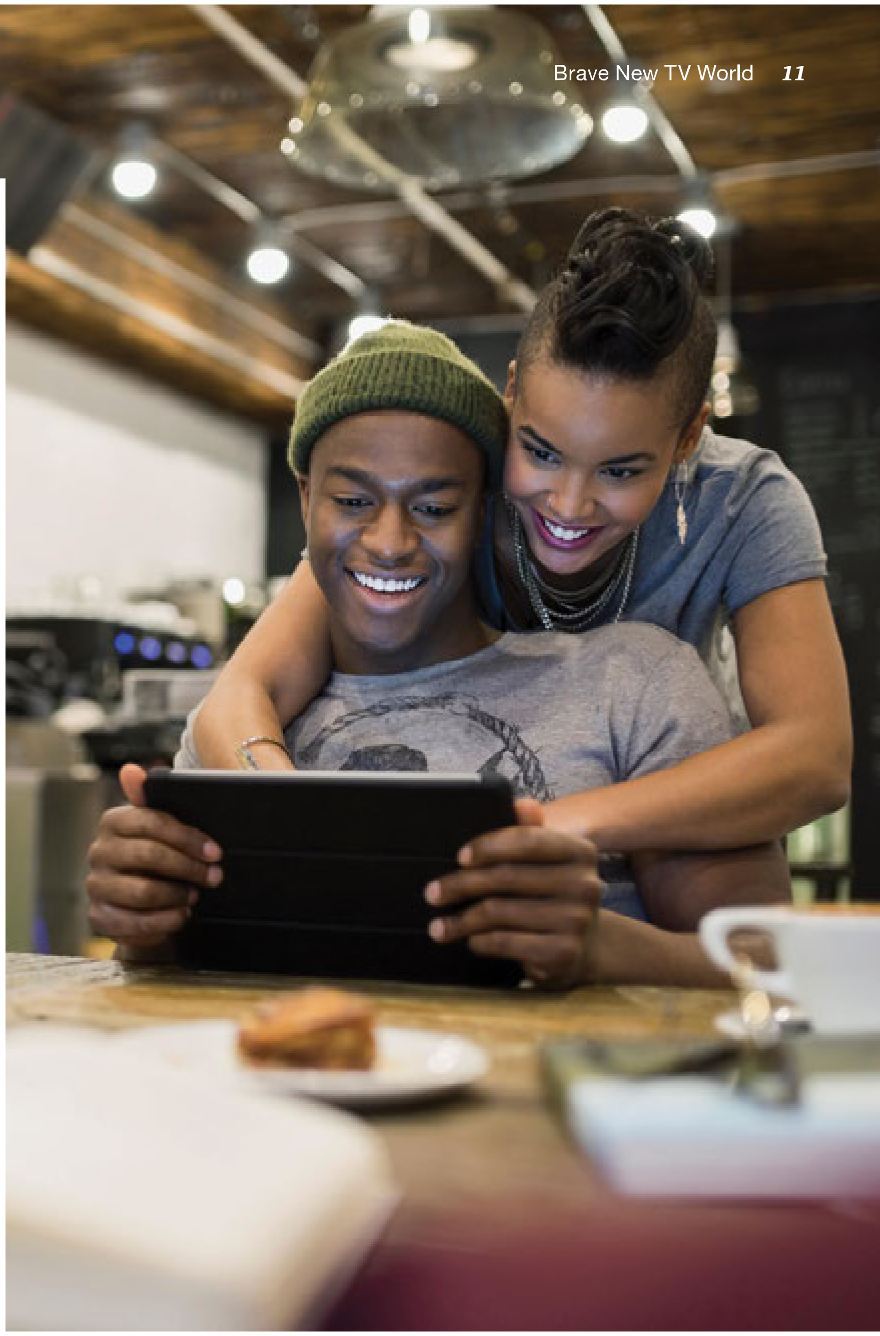
To combat this threat, TV broadcasters will need to clearly articulate their value proposition, potentially through greater use of ever more detailed viewing data.

Broadcasters will also have to continue to develop their VOD advertising proposition, allowing more detailed measurement and targeting of online viewers (potentially through implementing 'registration-walls'), in order to 'recapture' some of this spend. The increasing volume of data which can (and must) be analysed to gain greater insights into viewer activity will require different skillsets to be developed in-house.

Using data to inform content creation

Rich data is increasingly available on audience engagement, albeit not necessarily being used as much as it could be. VOD platforms and pay TV operators are able to measure viewing figures and demographics of viewers for programmes as well as capturing additional data. Programme creators and channels could use this data to adapt existing formats, gain insight on future programming, and enable advertisers to better gauge how different demographics react to advertising content to improve future campaigns.

Whilst we recognise that it will not be easy to achieve, we believe that industry players should try to work together so that data can be analysed and insights fed back to channels and content creators (recognising privacy restrictions on some data). Whilst players are currently protective of their own data, wary of losing competitive advantage by 'giving it away', sharing this data between pay TV operators, broadcasters, advertisers and programme makers could benefit all parties – by driving better content, more TV viewing, stickier pay TV subscribers and improved TV advertising revenues.



Closing remarks

It is clear that the TV industry is under-going significant changes and we expect this to continue and potentially accelerate. However, the sector is still in relatively good health, given continued consumer demand for good content and television (even if via alternative platforms), and with advertisers still looking to pay for the scale and experience of broadcast TV and increasingly online TV advertising. That said, broadcasters must adapt to these changes to ensure they are as relevant in 5-10 years time as they are today - to both consumers and advertisers.

Please do get in touch if you would like to discuss any of this, or other TV related matters with us.

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