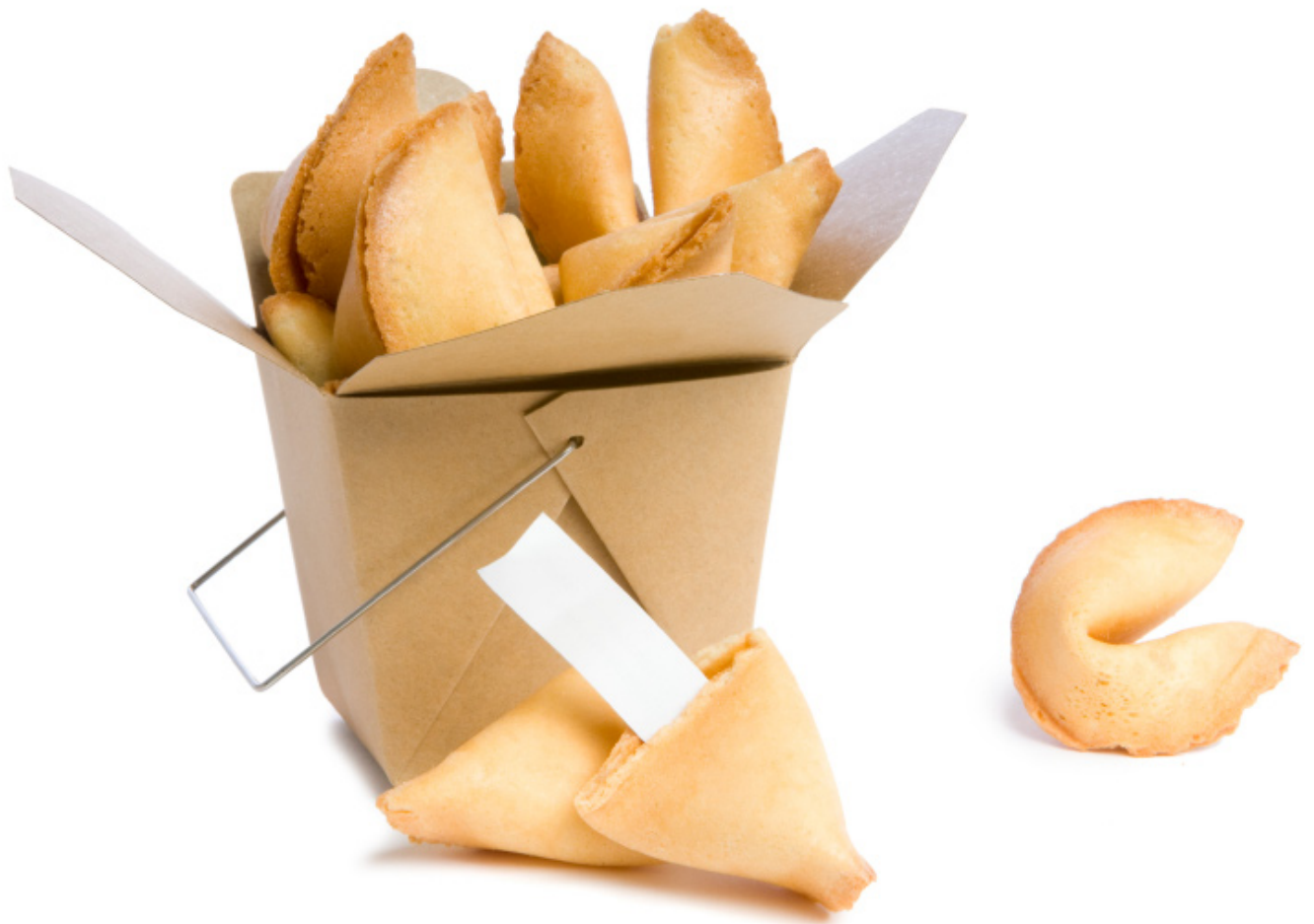


2009 Industry Outlook:
Media & Entertainment
Challenging Times,
Emerging Opportunities



Media & Entertainment



U.S. Media & Entertainment

In a sector already marked by significant change in recent years, the combination of new digital distribution modalities and evolving audience consumption habits and demands will continue to challenge traditional Media & Entertainment (M&E) business models during 2009. It also could mark the beginning of a radical transformation that reshapes the entire M&E ecosystem.

The Media & Entertainment sector consists of the creation, aggregation and distribution of content – products and services, news and information, advertising, and entertainment – through a variety of channels and platforms. M&E is one of the largest sectors in the U.S. economy: about \$950 billion was spent on products and services provided by M&E companies in 2006. This spend had been expected to grow by 38 percent over five years to \$1.3 trillion, a 6.6 percent nominal compound

annual growth rate (CAGR).² While the current economic downturn will have a negative impact on this forecast, the sector's historical resistance to down cycles in the economy suggests that it will be impacted less than almost all other sectors.

Impacts of Digitization

Digitization has created a number of industry-wide challenges that will continue into 2009 and beyond. Among these are protecting intellectual property, sustaining historical revenue streams, and finding ways to utilize and monetize emerging new platforms for traditional content – including print, filmed entertainment, and recorded music – as well as user-generated content and other new services, applications and formats that compete for consumer mindshare and time.

To date, the digital revolution has impacted M&E sub-sectors in different ways. Accordingly, the outlook for each varies:

- The Interactive Gaming sub-sector has enjoyed substantial growth because of favorable demographics (increasingly, gamers are older and skewing more toward the female population); new growth segments like mobile and online gaming; successful titles, and the phenomenon of in-game advertising, that even political candidates have embraced as a new medium. While we anticipate continued growth in this segment, the state of the economy will dampen the significant growth this sector has recently enjoyed.
- Advertising, which is a critical revenue source, is both under threat and faced with incredible opportunities. The traditional advertising segment has been struggling for some time and will continue to struggle into 2009 with the conclusion of the US Presidential election and the turmoil in the automotive and financial sectors which are among the top advertising spenders. Online advertising is growing fast, as evidenced by 26 percent growth in 2007.³ Yet with some advertising budgets locked into longer term contracts, the ability to shift more advertising spend online could be limited. Mobile

¹ The US Media & Entertainment sector is comprised of nine sub-sectors: Advertising, Printing & Publishing, Cable & Broadcast, Filmed Entertainment, Consumer Internet, Interactive Gaming, Live Entertainment, Recorded Music, and Business Information Services.

² Sources: Company filings, Deloitte intelligence estimates, *AdAge*
³ IAB Internet Advertising Revenue Report, May 2008

advertising, which to date has failed to gain traction, could offer the much-needed growth opportunity in 2009.

- Filmed Entertainment companies have been forced into the digital distribution business. As content owners (or, at least, rights holders), they are struggling to understand and exploit new distribution windows, metrics and economics. These more traditional M&E organizations are not well-structured to take advantage of the industry's digital transformation. Many company departments still operate within silos, which creates obstacles for exploiting digital opportunities that cut across the organization. Scale limits the ability to be nimble and a long and profitable history of embracing the status quo creates inertia. However, as long as the demand for professionally-produced content remains high, which is expected into the long foreseeable future, the filmed entertainment industry will continue to evolve, albeit slowly, and find new ways to monetize their content. The good news for content owners in 2009 is that the small screen fares well during economic downturns, when more and more consumers choose to entertain themselves at home.
- Broadcasters — both traditional networks and broad-based cable networks — are struggling and that struggle will continue into 2009. Because they own very little of their content and their advertising-based business is centered on attracting eyeballs and reselling attention, they are greatly impacted by audience fragmentation. Conversely, most themed cable networks have targeted subject matter and audiences and, therefore, have an opportunity to extend their brands into products, events, etc. Their traditionally slim production budgets and operating margins, combined with their proximity to the customer, gives them an advantage in the digital world.
- Print Media is in the most peril. Reduced cash flows caused by the migration of readers and advertising dollars to the Internet, compounded by 2008's weakening economy and an overburden of debt, are threatening newspapers' very existence. Major consolidations in 2009 may be their only avenue to survival.

- The Music sub-sector is being forced to transform. The process is not yet complete, however, and the sub-sector will likely continue to see decreased revenues for years to come. What we know for certain is that tomorrow's music industry will be very different from what it is today.
- Live Entertainment, including sports, is less affected by the digital revolution. It is, however, impacted by falling consumer incomes and reduced marketing budgets. The segment will likely see a drop in spending on the big ticket events as sponsors pull back and consumers tighten their spending. Looking even further down the road, if broadcast network revenues continue to shrink, they will have trouble paying the big price tags for broadcast rights.

The Digital Supply Chain

The increase in digital content and number of new distribution channels — a result of rising Internet penetration, shifting demographics, and changing consumption habits (more Internet usage, a continuing decline in TV viewership, the extraordinary growth of interactive games) — is having a dramatic impact on the M&E supply chain. Combine that reality with the growing consumer demand for content that is available at any time on any platform, and the current M&E supply chain structure appears inadequate.

Consider this finding from our second *State of the Media Democracy Survey*⁴: Millennial and Generation X consumers have an increasingly strong desire for a seamless, synergetic, digital media experience across any type of device or platform. Sixty-seven percent of Millennials and 61 percent of Xers want the ability to move their music, television shows, podcasts, movies, etc., to any device and platform that they own without any problems. Boomers are not far behind, at 41 percent.⁵

Millennials and Xers are not only demanding device and platform-independent content, they also want technology enhancements that will enable them to interact with and manipulate their digital media in new, creative ways. For example, 69 percent of Millennials, 62 percent of Xers and

⁴ State of the Media Democracy Survey, 2nd edition, 2008. www.deloitte.com/us/realitycheck

⁵ Ibid
⁶ Ibid

45 percent of Boomers say they are increasingly making their own entertainment by editing their photos videos and/or music.⁶

The technical scale and complexity of the transactions required to maintain digital business models (e.g., rights, licenses, security, and usage tracking) supporting these growing consumer demands – (which will continue to increase as technology responds with improved capabilities) cannot be served by the industry’s current structure and capabilities. Rather, a new ecosystem will need to evolve, one that features content creators focused on manufacturing original content; massive digital content repositories and processors for aggregating and distributing content; and digital portals specializing in packaging and retailing content and services to consumers.

While this new ecosystem will take years to develop, 2009 will mark the beginning of its evolution.⁷ To prepare, companies should begin to assess the capabilities they have – or must develop – to remain relevant, maximize and implement new business models and supporting infrastructures, and facilitate alignment with key supply chain partners.

Other Key Issues

In addition to digitization’s impacts on the supply chain and asset management, the M&E sector faces other key issues in 2009 related to the digital revolution:

1. **Convergence of media, telephony and technology**

— Driven by increased digitization and technological advancements, the long-predicted convergence phenomenon is now a robust reality. As telecom networks provide close to full coverage, both wireline and wireless companies are looking for ways to better exploit their assets. Thus, they are entering into content aggregation and distribution as well as (occasional) creation and other areas related to M&E. Similarly, technology companies are launching innovative products and services that are shaping the way content is distributed and consumed. Cable companies, in turn, are pursuing opportunities that have traditionally been served by telecom service providers.

This convergence of media, telephony and technology is

producing both opportunities and threats for traditional participants. On a positive note, it has led to the creation of new product/service categories and markets, potential and actual new distribution platforms, changes in the structure of existing industries, the emergence of new distribution channels and business models, an explosion of personal and user-generated content, and more effective advertising models. Conversely, convergence is posing some significant threats to traditional media companies, such as competition from typically unrelated industries (e.g., telecom operators and new media players), pricing pressures, content glut, changing consumption habits, and the spread of piracy. Historically, the M&E industry has exhibited a reluctance to embrace new technologies, which has resulted in its slow adoption of technology trends and its frequent organizational marginalization of technology resources. Going forward, M&E companies will need to identify, procure and retain the creative and technical talent they require to thrive in a digitized, converging marketplace and to create environments where this important talent can prosper.

2. **Changing business models** — The media industry is continuously evolving as a consequence of many factors, including increased digital content management challenges, convergence, globalization, and shifting consumer behaviors. In response, M&E companies are being forced to transform their business models, distribution strategies, and sales force management practices to sustain market share and create new revenue sources. The spread of the Internet and interactive advertising not only offers new revenue sources for existing content creators and aggregators, it also allows new entrants to obtain a foothold in M&E by utilizing new business models. These changes produce operational challenges such as incompatible or outdated business processes, inadequate supporting metrics, and overstretched support functions and capabilities. Industry players, therefore, are adjusting existing processes, embracing acquisition strategies, adopting cost reduction initiatives, and introducing new business models to remain competitive.

⁷ Deloitte Digital Media Framework. www.deloitte.com/us/ddmf

3. **Content security concerns** — An increase in digital content management, driven in part by broad-based, virtually instantaneous Internet distribution, is cause for security concerns. Piracy of copyrighted material – particularly software, music and video – has become increasingly problematic with the proliferation of the Internet and technological upgrades. As evidence of the threat, more than a third of worldwide Internet traffic in 2007 was expected to be illegal, peer-to-peer video. The U.S. economy loses \$58 billion in total output, 373,375 jobs, and \$2.6 billion in tax revenue annually due to piracy.⁸ To combat the problem, M&E companies have adjusted distribution and pricing models and instituted new security procedures. The growth of Internet and phone distribution will only further complicate these challenges and provide an impetus for the continuing evolution of business models and processes to manage digital distribution and intellectual property (IP), including contract/deal structuring, asset protection and inventory management.
4. **Next-generation advertising and advertising effectiveness** — The rise of digital advertising poses opportunities for advertisers and challenges for agencies. Increasing broadband and mobile penetration and the growing interactive games market are broadening the advertising landscape – M&E companies have entered into strategic alliances with major mobile operators and game publishers to capitalize on new revenue opportunities. However, some content providers are struggling to adjust their revenue models to the shift in advertising dollars to digital formats. On the agency side, competition has increased due to the emergence of boutique digital ad firms and the entry of non-traditional companies into this space, as well as the constant innovation of traditional competitors in response to the challenge and opportunity. As noted earlier, the appropriate metrics and infrastructure to measure, communicate and audit advertising effectiveness will be a linchpin for expanding this Internet monetization opportunity so critical to the M&E sector.
5. **Global expansion** — Strategic partnerships, acquisitions and the efficient distribution of digital content are enabling U.S. media companies to expand into regions with both developed and emerging economies, contributing to the globalization of the industry. Growth into other countries enables these companies to leverage more favorable media consumption habits, in particular where consumers are more open to technologically advanced products. Expect to see M&E companies increasingly making acquisitions and entering into strategic alliances in 2009 to build scale, capabilities, and presence in international markets. Yet, while revenue opportunities abound, global expansion can create challenges. For example, content development companies must strike a balance between appropriate recognition of local customs/mores and broader global appeal. Also, piracy continues to be a significant challenge, especially in emerging markets.
6. **Privacy** — Data privacy is a primary concern of most customers who share sensitive information electronically. Privacy can be breached in several ways, including attacks by hackers and by data being released to unauthorized parties. Also, downloading digital media, conducting online financial transactions, and participating in social networking sites are often accompanied by an expanding array of threats to users' personal information. In response, large companies are spending billions of dollars to develop security suites to more effectively maintain data privacy. Those organizations that effectively manage their digital assets will ultimately benefit from a robust privacy solution. Conversely, consumers presented with an almost overwhelming array of choices may – perhaps counter-intuitively – surrender some aspects of their privacy and private data in order to enable better guidance and a more manageable set of pre-screened choices.

⁸ "The True Cost of Copyright Industry Piracy to the U.S. Economy", The Institute for Policy Innovation (Oct 2007).

Stay Tuned

2009 is anticipated to be a difficult economic year for all industries: Consumer confidence is down and there is less money for discretionary spending. While Media & Entertainment likely will fare better than other sectors if history is a guide, the growing number of opportunities for free entertainment available on the Internet may rewrite history and leave a permanent mark on the M&E landscape.

The M&E sector has tended to be resistant to (although not immune from) traditional economic downturns because its products and services are among the few affordable pleasures left to consumers in a tight economy. In fact, the last two times the economy experienced a downturn, movie ticket and DVD sales went up. It is likely that people will continue to indulge themselves in the small pleasures of DVD consumption, interactive game-playing, online entertainment, books, social networking and television while eschewing big-ticket items such as cars, refrigerators and computers. Advertising budgets will go down, but guerilla marketing and other innovative platforms for reaching consumers may thrive. Fewer movies will be released, but this is as much a result of actors' continuing failure to have a contract and the desire (and now the opportunity) of studios to smooth earnings by stretching their best movies over a longer period. Ironically, the filmed entertainment business may actually contract and become more profitable.

The game business will continue to prosper, albeit perhaps at a slower pace, as will many Internet-related businesses. Newspaper readership will continue to decline, but books and DVDs will be sold in perhaps greater numbers. There is, however, a worry for the M&E sector associated with the continuing evolution of the Internet as an entertainment source: While a great deal of what is currently watched by large audiences on the Internet is professionally-produced content, more and more people may be motivated by increased free time and decreased resources to find other forms of free entertainment, including participating in and consuming user-generated

content, social networking and Web-based fantasy pursuits. If this alternative occurs, will consumers return to traditional media when the economic cycle turns, or will traditional M&E companies have figured out a way to use this shift to their economic advantage? Will new revenue opportunities emerging from the digital revolution and global expansion help to offset these developments? As always, the future is difficult to predict, particularly in this swirl of economic, technical, demographic, practical and historical forces.

The next year or two could see more M&E industry realignment, consolidation, ownership changes, failures of marginal companies, and emergence of new power players than the sector has experienced in a long time. Those companies with strong balance sheets and access to capital could benefit by purchasing distressed assets at fire sale prices – in fact, we wouldn't be surprised if a major movie studio was sold in 2009. Conversely, the tightening of credit markets could exert increasing downward pressure on above-the-line talent costs and motivate other cost reduction approaches heretofore not acceptable in the sector. Finally, 2009 is expected to be a year of contrasts: Although more mature media outlets such as publishing and traditional advertising may struggle for survival, Internet upstarts and game companies likely will be riding a wave of digital success, either absolute or comparative. Stay tuned for exciting times.

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