Arthur D Little

Global Report Launch

Telecoms & Media executive breakfast event

Launch of the 14th anual joint Arthur D. Little/Exane BNP Paribas Study in London

On May 19, 2015, Arthur D. Little held the launch of the latest edition of our Arthur D. Little / Exane BNP Paribas 14th annual Telecoms & Media Report with an unprecedented attendance of global senior industry executives and key investors, including more than ten leading UK operators, multiple web-majors and OTTs, infrastructure companies, several private equity firms and representatives of the vendor community and UK government advisory bodies.

This year's edition of the report focuses the evolution of audio and video content delivery, and the relationships between major players in this ecosystem. This was the most important shift in the strategic landscape during 2014, cited by more than half of the study respondents, and supported by our quantitative analysis.

The event commenced with a welcome by Richard Swinford, Head of the Telecoms & Media team of Arthur D. Little UK, on behalf of the global firm. Subsequently, Bertrand Grau, lead author of the study, made an executive presentation of the key learnings from the report, on behalf of both companies. This was followed by a supporting comparison of the UK market situation, and then a lively Q&A session with questions from the audience and attending journalists covering the launch, responded to by the presenters and Karim Taga, the Global TIME practice leader.

Key conclusions from the report:

The megatrend towards online nonlinear video usage will only accelerate in the coming years.

- New internet-based players compete with traditional ones in all segments of the value chain and are far too big to ignore.
- Content remains king. We expect the rise in OTT to drive further content cost inflation.
- Traditional media, both pay-TV and free-to-air, TV and radio, are threatened by pure OTT players.

We explore three market scenarios with varying impacts on the different types of players, and we propose responses, including surfing the OTT wave, by launching their own OTT services.

For telecom operators, we see the OTT wave as a growth driver for superfast broadband usage – with monetization opportunities in access, but also value added services to traditional media players and medium-size pure OTT providers.

We believe that a return to growth in European telcos' revenues is finally in sight

Significant shifts in media consumption – the beginning

The way we consume media – in particular, audiovisual content – is changing dramatically, with two concomitant trends: a strong increase in the number of digital devices such as smartphones and tablets, which are used more and more to watch videos and listen to music, and the rapid development in nonlinear usage.

Beyond the fall in physical sales, the impact of the "digital revolution" on traditional TV is not evident – yet. A number of smaller channels have started to disappear and the profitability of large TV channels has suffered, but so far they seem to have been impacted more from audience fragmentation and economic recessions than from the rise of pure online players. In addition, pay-TV penetration and revenues are still growing, with no evident slowdown recently. Conversely, telcos' connectivity revenues have continued declining due to continued pressure on ARPU.

However, the generational gap between traditional TV viewers and digital natives is huge. We believe that in the coming years, these secular trends are likely to accelerate rather than slow, creating massive opportunities and threats for all types of players in the value chain – the traditional ones as well as the emerging ones.

New players and new business models: too big to ignore

In all parts of the media delivery value chain – from content rights to distribution – a number of new actors have been emerging, leveraging new digital and online technologies to compete with traditional players. These new players include Internet giants such as Google, as well as YouTube, Amazon, Apple and Netflix.

Their scale is already an order of magnitude bigger than that of traditional players in the value chain, even compared to large pay-TV or telecom operators. This is true both in terms of operational metrics (e.g. geographic footprint and audience) and in financial terms (market capitalization, ability to finance themselves).

In each European country, many players have emerged and are competing in the online content distribution markets, with several business models (such as free-to-air, freemium, subscription based and transaction based). The largest and most successful players so far are global Internet leaders: Netflix, which is growing quickly on a global scale and accompanying its rise with large content investment; YouTube, owned by Google, looking beyond its free model; Apple, with further ambitions in streaming; and Amazon, which recently launched its Prime Instant Video service proposing S-VoD services.

Is content still king?

The evolutions of the ecosystem in the past few years have led to content producers capturing a growing share of value in the value chain. Will this trend continue with the rise of online services in the coming years?

Not all content is alike: we show the huge range of value attached to different types of video content, the real king remaining the global sporting events or national football championships. However, beyond premium sports and live news, exclusive series have an increasingly important role. This format is perfectly suited for OTT S-VoD providers, so we expect more along these lines.

Our analysis shows that unless one assumes Netflix's customer bases in European countries will rapidly triple – reaching penetration of c.50% – which seems unlikely, even the leader in the OTT space will not have the scale to compete with the pay-TV leaders (such as BSkyB) for the whole range of their content line-ups.

Still, our industry experts anticipate that overall content costs will continue rising in the coming years – and we agree. From a qualitative point of view, we expect the key words to be "exclusivity", "series" and "attractive". Finally, international content should continue to grow, even though the global-versus-local content battle remains undecided in Europe, with preferences varying by country.

Serious threats to traditional TV

The rise of pure OTT players is a challenge for traditional TV players, both pay-TV and free-to-air – but not all are equally placed to face these challengers. We believe that the largest and most innovative pay-TV groups will be able to adjust, but with rising costs, and leading free-to-air TV channels will also keep high advertising revenues. The most challenged players are small TV channels and low-end pay-TV.

Traditional pay-TV is facing competition from pure OTT players on multiple content segments, mainly on price. Also, with the rise of on-demand programs, there is less value in aggregating a large number of channels. The long tail of channels is therefore losing interest from users. As a result, we believe that the long tail of large pay-TV bouquets will be under growing pressure. Pure OTT players also compete with premium series production – hence, pay-TV players will be able to maintain their leadership in content, but they will face pressures on both prices and costs.

Some Industry experts believe that there is a serious risk that pure OTT services may cannibalize traditional TV in the long-term – i.e. that pure online video players have the scale and potential to move up the ladder and become the new pay-TV.

Leading pay-TV groups should be able to adapt, fending off pure OTT competition by launching their own OTT services and leveraging their key assets, such as brand, relationships with content providers, technical skills, and last but not least, intimate and long-established relationships with their customer bases. However, this will require more costs (in content but also in new services) and probably some price adjustments.

Finally, on the advertising revenue side, the move to online consumption is a threat to broadcasters' advertising revenues. We believe that fee-to-air leaders should remain attractive to advertisers, and that innovative players will be able to capitalize on digital innovations, which can also enrich the advertising market. However, the new world will be a challenging one for smaller TV channels, which will not be able to amortize the growing cost of exclusive and attractive content for a sufficiently large viewer base.

Three possible market scenarios

A strong parameter influencing the market's evolution will be the strength of the local content in terms of its availability and users' appetency for it in each country. We therefore see three scenarios for the evolution of the competitive landscape:

- Scenario 1: local and premium content continues to "win", enabling a leading pay-TV operator to keep its leadership versus pure OTTs, limiting Internet players to a long tail of content with relatively lower value;
- Scenario 2: a few global pure OTTs manage to reach the scale necessary to compete with pay-TV on premium content;
- Scenario 3: global pure OTTs take over not only pay-TV, but the whole TV market, attractive massive audience and advertising revenues.

Network growing strains

A much-talked-about consequence of the growth in online video is the massive increase in data traffic carried over the Internet, and hence over telcos' networks. Ensuring that the quality of the viewing experience remains up to standards requires players to continuously upgrade their equipment.

Opportunities for telcos: not a one-size-fits-all

The balance between risks and opportunities associated with the rise of online video appears much more favorable for telecom operators than for traditional TV players. Indeed, telcos have much smaller vested interests than traditional TV operators, and their network assets and advanced positions in the digital revolution are key assets that they can – and should – monetize:

- All telcos can create value through an "enabler" role, monetizing their network assets.
- The revolution in the TV market can also be an opportunity for some telcos to generate revenues, not only as enablers, but also as direct players in online video and/or pay-TV.

Overall, opportunities for Telcos to actually create value by investing in content and/or their own pay-TV platforms will be the exception rather than the rule. Only the largest operators in specific market contexts can actually create value in such moves. For the majority, the preferred route should, in our view, be to partner with OTTs and local media players such as Pay-TV and FTA channels – sharing the risk and the upside with players that will have greater scale, both locally and globally.

Telco revenues: a return to growth finally in sight

As we anticipated, the sector revenue trend remained negative in 2014 (-3%), but this was a milder decline than in 2013 (-5%), thanks to improvements in both mobile and broadband.

We have left our estimates for 2015–2016 virtually unchanged, with -1.5% in 2015e and stabilization in 2016e. Optimism has returned to executives across Europe, and we expect the sector to return to growth from 2017e, with 1% growth per year in the longer term and a +0.6% CAGR over the 2016e-2020e period.

Conclusion

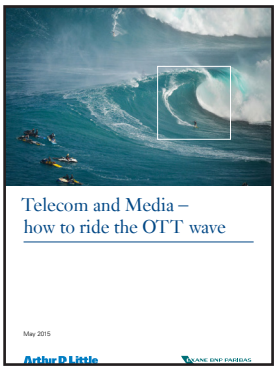
The Q&A session following the presentation of the study results reflected both the major messages of the report and the breadth of audience, representing key stakeholders from across the industry.

- Representatives of some of the biggest telecoms and media groups questioned the strategies of the major studio producers, including the apparent inconsistencies between their current business models, the licensing of content to new OTT video providers and their own longer term transformations.
- Several participants sought views on the extent to which web-majors might seek to utilize the capitalization (and cash piles) to acquire telecoms / infrastructure assets, which was seen as less likely, or at least geographically selective.
- The potential for cross industry M&A between the telcos and the content producers / rights owners was debated, with the key constraint being the ability of new owners to extract rights value across a wide enough footprint to make a deal work.
- Audience members questioned whether the ability to transcend to from traditional print/advertising to digital business models was evenly distributed within the media industry, noting the achievements of the British education sector.
- The issue of new regulation – addressed in the report though not in the presentation – was also of keen interest, in particular whether recent 'Network Neutrality' moves in the US, Europe and India would accelerate or imperil the return to growth of the sector through data monetization.

About the Arthur D. Little – Exane BNP Paribas annual report

In 2015, we are honored to globally release the 14th Arthur D. Little Exane study. Every year since 2002, Arthur D. Little and Exane BNP Paribas have conducted an in-depth examination of the telecoms and media market with a focus on European operators.

To conduct these studies, Arthur D. Little's international consultants meet with a variety of stakeholders within the sector, including operators, hardware manufacturers, media companies, web-majors and regulators. The 2015 report is the result of more than 110 interviews with telecom operators, telecom and device vendors, regulators, utilities and local authorities across many countries in Europe.



The PDF version of the presentation is available to our select clients upon request, from swinford.richard@adlittle.com

Arthur D. Little

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Arthur D. Little has offices in the most important business cities around the world. We are proud to serve many of the Fortune 500 companies globally, in addition to other leading firms and public sector organizations.

For further information, please visit **www.adlittle.com**

About Exane BNP Paribas

Under the Exane BNP Paribas brand created in 2004 following the partnership signed with BNP Paribas, the Exane Group offers research, sales and execution on European equities to institutional investors. With more than 630 European stocks covered, 115 analysts and 90 sales and sales-traders, Exane BNP Paribas has the critical size and reknown expertise in cash equities and intends to continue to invest in this business. Exane BNP Paribas currently serves more than 1200 institutional clients around the world through 9 offices (Paris, London, Geneva, Frankfurt, Milan, New-York, Madrid, Stockholm and Singapore). Its teams and research are praised for their expertise and are regularly awarded (in the 2013 Extel survey, Exane BNP Paribas ranked N°4 on European sector research).

Founded in 1990, Exane is an investment firm focused on European equities. The Group has three core businesses: Cash Equities, Equity Derivatives and Asset Management.

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