



Fundamental Shifts in the U.S. Media and Advertising Industries

New Politics Institute

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NEW POLITICS INSTITUTE
A Think Tank for Politics

THE U.S. MEDIA AND ENTERTAINMENT INDUSTRY IS EXPERIENCING UNPRECEDENTED CHANGES

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- Extensive audience migration across and within media formats is driving major shifts in advertising spending, benefiting formats with targeting ability
- Advertisers are shifting ad dollars to digital media slower than they should given the cost and effectiveness of digital media
- The most innovative advertisers will utilize sophisticated direct marketing techniques (e.g., segmentation, targeting, etc.) and will adjust the digital marketing vehicle mix for each customer category
- Effectively creating “at scale” digital campaigns and integrating them into traditional marketing requires direct marketing skills that traditional marketers, particularly brand marketers, often lack
- Commercial advertisers are rapidly shifting dollars to internet advertising, in particular internet video, and are aggressively experimenting with new formats such as wireless and videogame advertising

BRAND MARKETERS ARE NOW BEGINNING TO UNLOCK THE VALUE OF INTERACTIVE TARGETED MEDIUMS OVER MASS REACH VEHICLES

"I hate to sound like such a marketing geek, but we like to fish where the fish are." (GM's online ad budget growing from 10% share in 2004 to over 20% in 2006)
-- Julie Roehm Dir. Comm. Chrysler

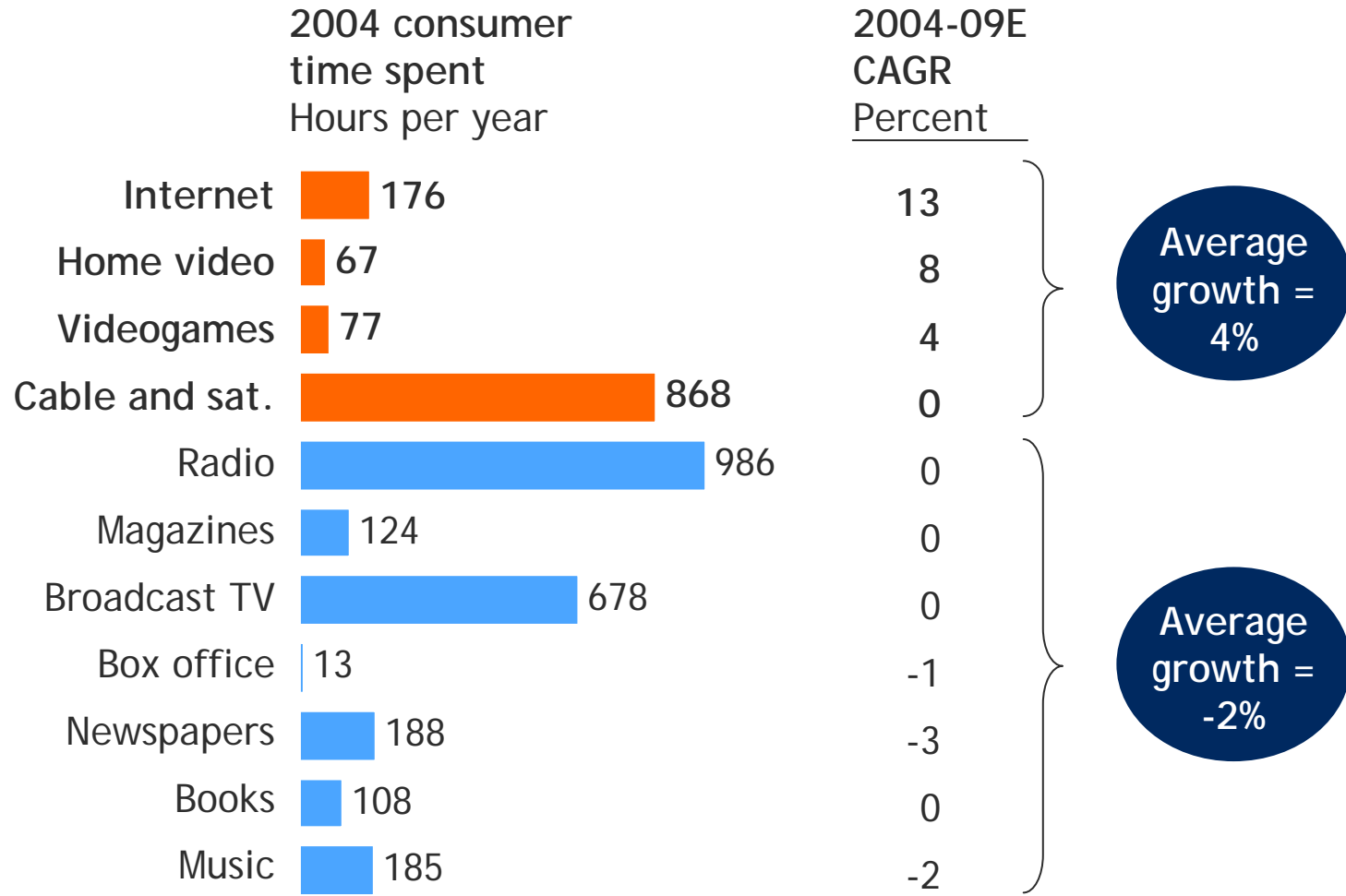
"Nearly 85% of 99 major advertisers and 20 ad agencies are planning to expand their online ad budgets this year. There is a radical shift from the belief that brand building and the internet don't mix."
-- Forrester Research, May 2005

"Our business is probably coming more from television, especially broadcast television, than from any other medium"
-- Wenda Millard, CSO Yahoo

"Certainly the upfronts are less meaningful today because network TV isn't watched by as many consumers as it used to be. The couch potato has been replaced by the Web surfer."
-- John Hayes, CMO American Express

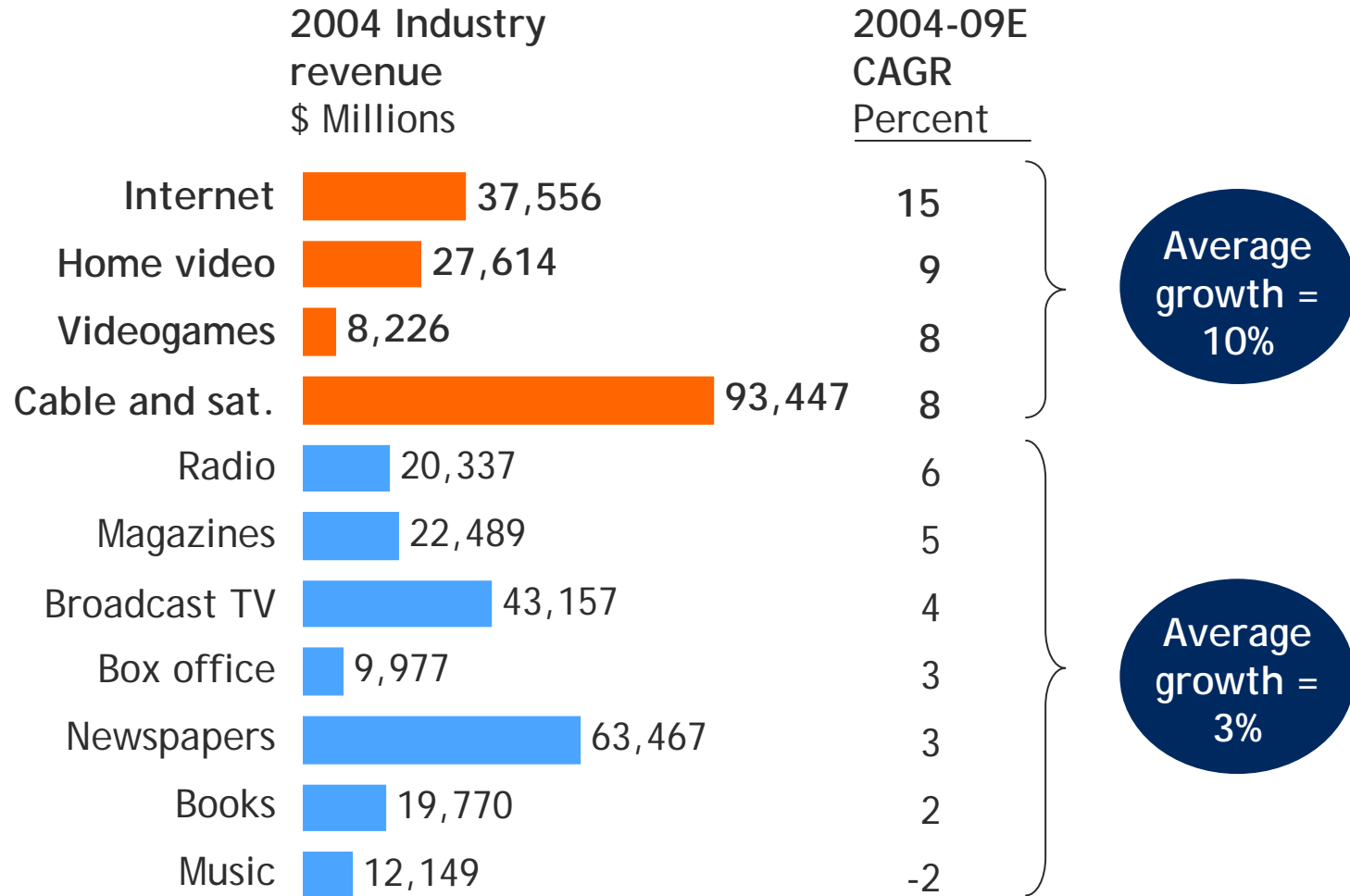
"Years ago, we looked at [the Internet] as more of a niche audience. Now it's part of everybody's life."
-- Jeffrey Godsick, EVP Marketing Fox

CONSUMER USAGE ACROSS MEDIA IS SHIFTING FROM TRADITIONAL OUTLETS TO NEW, MORE TARGETED CHANNELS



Source: *Communications Industry Forecast* Veronis Suhler, 8/05

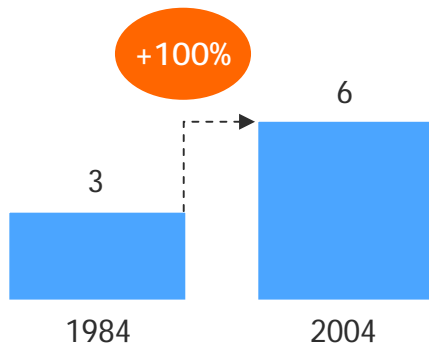
ADVERTISING DOLLARS ARE FOLLOWING AUDIENCES TO THESE MORE TARGETED OUTLETS



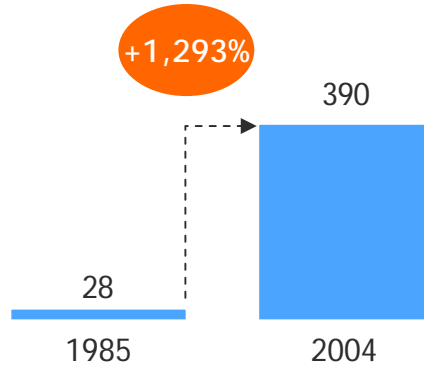
Source: *Communications Industry Forecast* Veronis Suhler, 8/05

EVEN THAT GROWTH DATA UNDERSTATES THE CHANGES FELT BY ANY SPECIFIC MEDIA PROPERTY

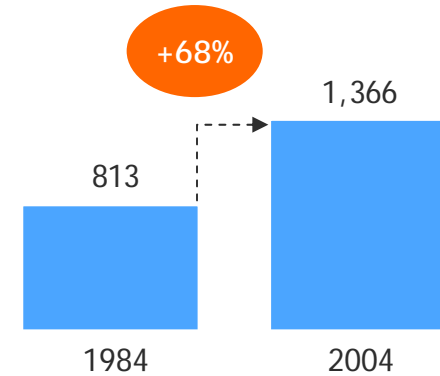
Number of broadcast networks



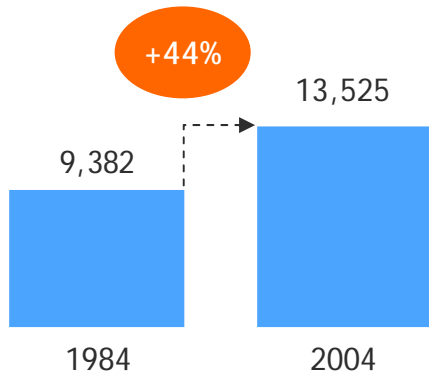
Number of cable networks



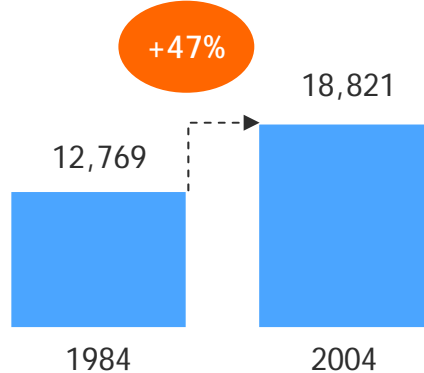
Number of TV stations



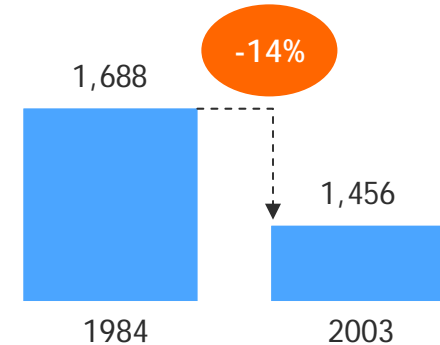
Number of radio stations



Number of magazine titles



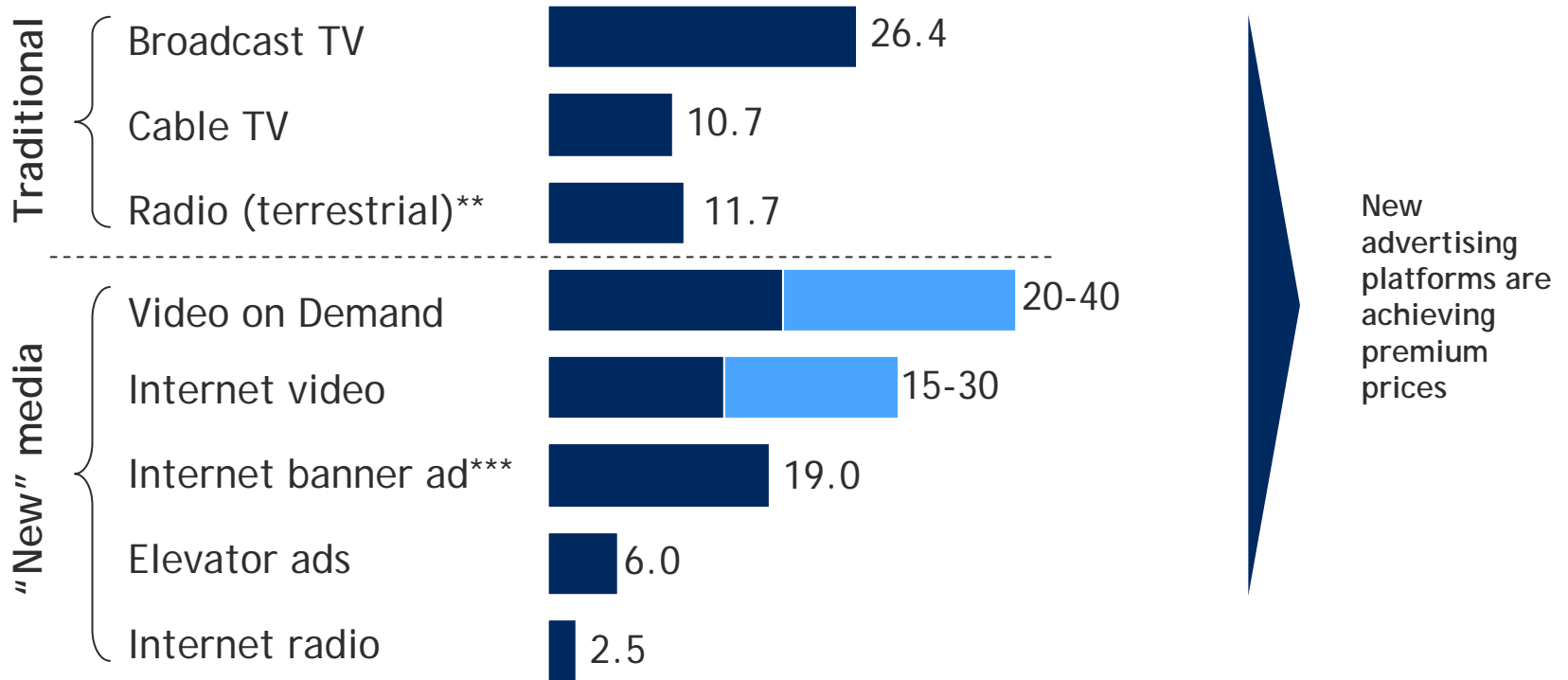
Number of daily newspapers



Source: Industry trade associations; FCC

COMPLETELY NEW MEDIUMS ARE ALSO CAPTURING SUBSTANTIAL ADVERTISER INTEREST

Primetime* CPM, 2004
Dollars



* Primetime refers to traditional media only; "New" media pricing represented is unrelated to daypart

** Spot

*** 2002-03

Source: Media Dynamics; Radio & Internet newsletter; industry publications; U.S. Census; Kagan 2004; Niensens; Accustream; Veronis Suhler *Communications Industry Forecast*

KEY INDUSTRY TRENDS: TELEVISION NETWORKS

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Industry trend

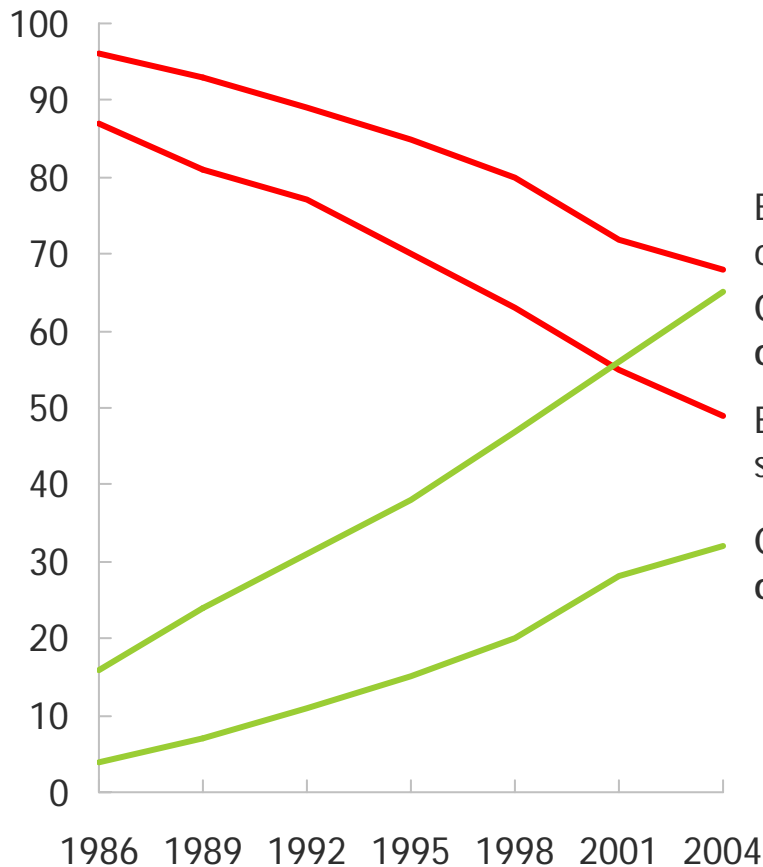
- Overall television viewership growth driven largely by shift in viewing from broadcast to targeted cable, which now exceeds broadcast in aggregate viewership
- Advertisers increasingly seeking more targeted opportunities to reach television viewers
- Consumer choice for video entertainment content and device delivery is growing at a rapid pace, fueling audience fragmentation
- Market for mainstream channels is saturated and networks need to innovate to generate growth
- Programming costs (especially from sports) continue to rise and networks are increasing investments in original programming

Industry response

- Cable networks trying to achieve “fair share” of ad dollars and, within the segment, leading networks capture disproportionate share of ad revenue
- Cable operators are interconnecting local cable systems to create scale and leveraging new ad technologies to capture share from other local media players
- Networks are pursuing new platforms for content distribution (e.g., wireless, internet video, gaming) to maintain consumer touch points
- Networks are increasing investments in original programming and acquiring or launching smaller, more targeted networks
- Networks looking to new distribution entrants to displace some cost increases as largest distributors continue to leverage their scale to contain license fee growth

BROADCAST NETWORKS HAVE ALREADY FALLEN BEHIND CABLE IN OVERALL AUDIENCE AND ARE LOSING SPEND

Percent Share of total*



Point change In share '85-'04

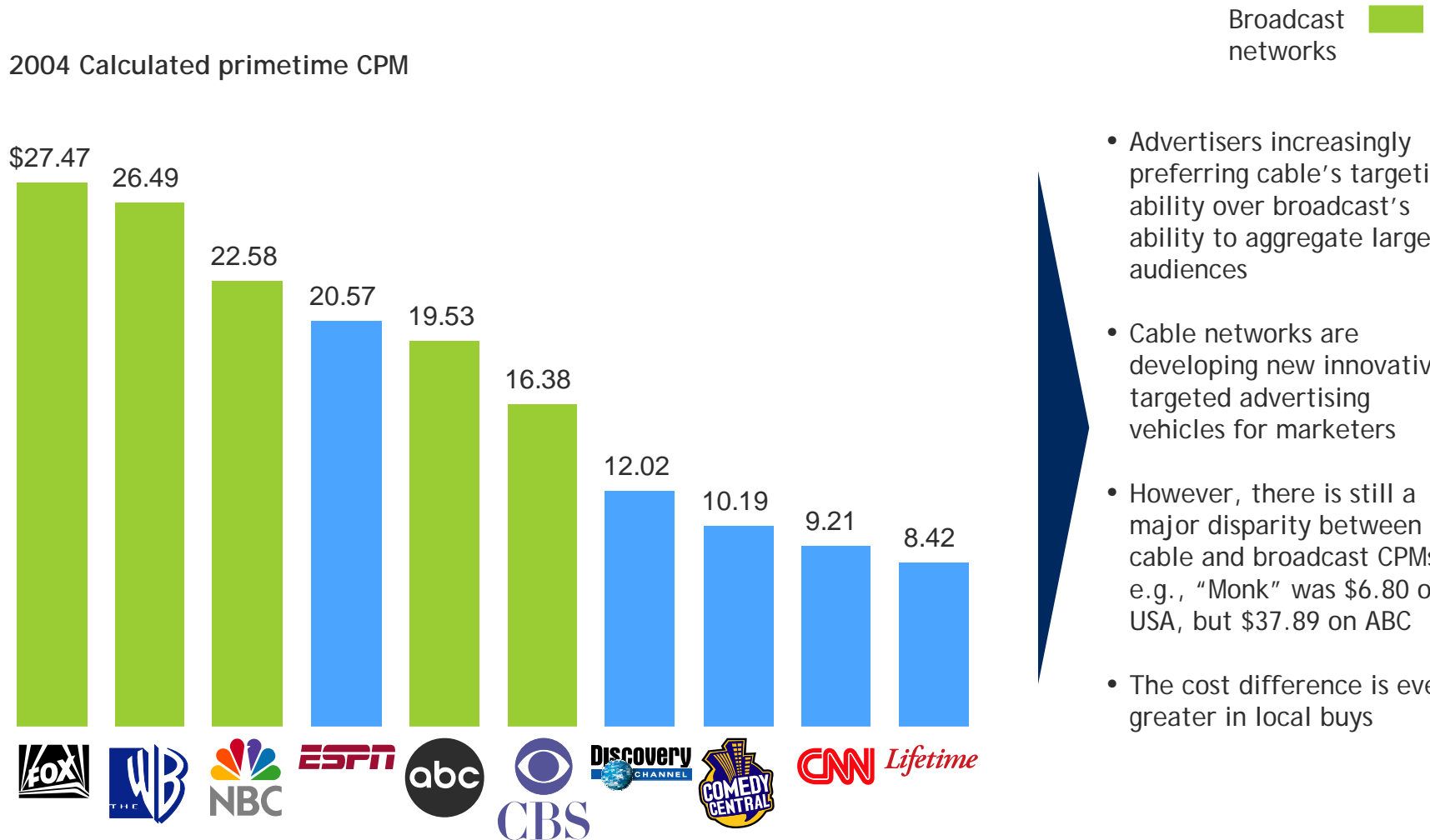
Broadcast share of TV ad revenue	-38
Cable TV share of audience	+28
Broadcast TV share of audience	-28
Cable TV share of ad revenue	+48

Key findings

- Cable viewership exceeded the broadcast networks in 2001, but broadcast networks still garner 70% of all television advertising revenues
- As broadcast viewership continues to decline, the networks are positioning themselves to advertisers as a “mass reach” audience, enabling annual CPM increases

FURTHER, IT IS MORE EFFICIENT TO TARGET SPECIFIC DEMOGRAPHIC SEGMENTS ON CABLE

2004 Calculated primetime CPM



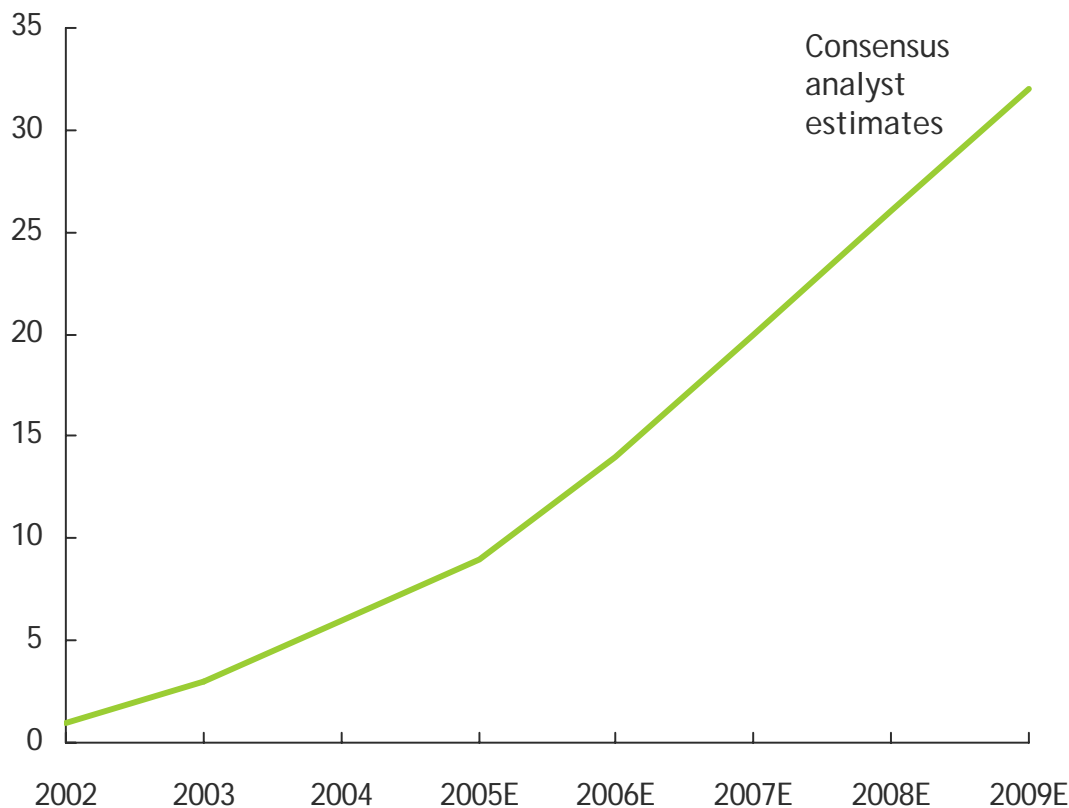
- Advertisers increasingly preferring cable's targeting ability over broadcast's ability to aggregate large audiences
- Cable networks are developing new innovative targeted advertising vehicles for marketers
- However, there is still a major disparity between cable and broadcast CPMs, e.g., "Monk" was \$6.80 on USA, but \$37.89 on ABC
- The cost difference is even greater in local buys

Source: Kagan; CSFB; industry publications

TRADITIONAL TV ADS ON BOTH BROADCAST AND CABLE WILL BE CHALLENGED BY THE GROWING PENETRATION OF DVRs (E.G., TIVO)

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DVR HH penetration
Percent



- Satellite and cable operators are rolling out DVRs to help them in the increasingly competitive marketplace, and by 2009 nearly a third of all TV households will have DVRs
- A 2004 CBS study found that 64% of DVR users skip all commercials, however, 21% of ad skippers recall at least one spot, and the average DVR has recall comparable to those of the average live TV viewer
- Ad agencies are employing a number of strategies to compensate
 - Branded entertainment (e.g., product placement, sponsorship)
 - New commercial formats (e.g., long-form advertising)
 - New advertising technologies (e.g., interstitials)

Source: VS 7/05; PWC 7/05; MS 7/05; CSB 12/04

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KEY INDUSTRY TRENDS: NEWSPAPER PUBLISHING

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Industry trend

- Audiences, particularly younger ones, continue to shift news consumption away from newspapers
- Declining share of audience have made newspapers an expensive advertising buy
- Newsstand sales continue to decline
- Major advertisers reducing national newspaper advertising spend in favor of more targeted media
- Online advertising has stolen share from newspapers

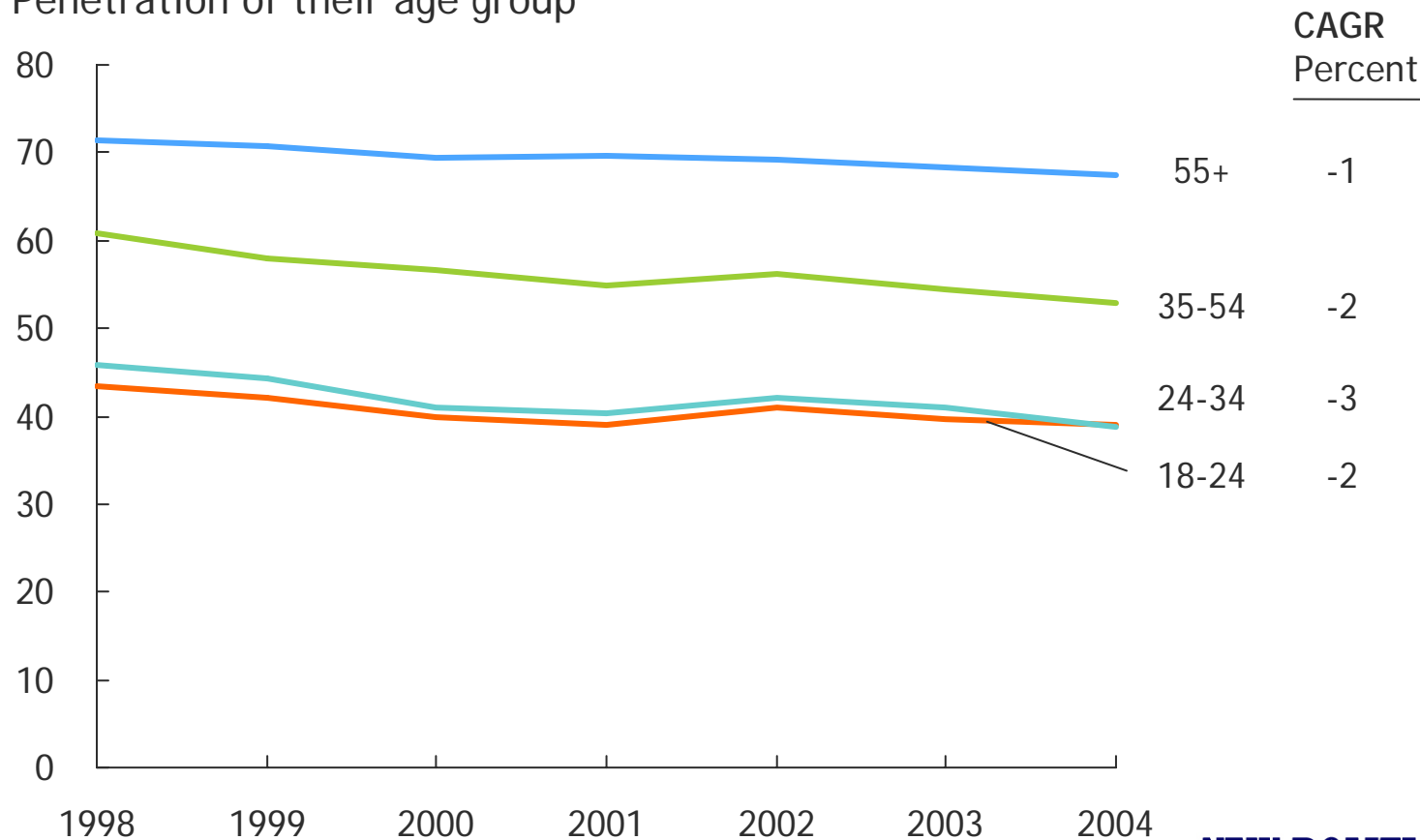
Strategic response

- Industry offering customized products (e.g., free commuter dailies, podcasts), zoned editorial, and improved design in effort to reach non-endemic readers
- Newspapers are working to realign sales forces and develop new products to invigorate growth
- Publishers have cut cover prices and considered switching to the more easily read tabloid format
- Weekly and local newspapers meeting advertiser needs with more targeted products and services
- Major publishers have increased their efforts in the space through better sales force alignment and key search engine marketing acquisitions

OVERALL NEWSPAPER READERSHIP IS DOWN, ESPECIALLY AMONG YOUNGER READERS

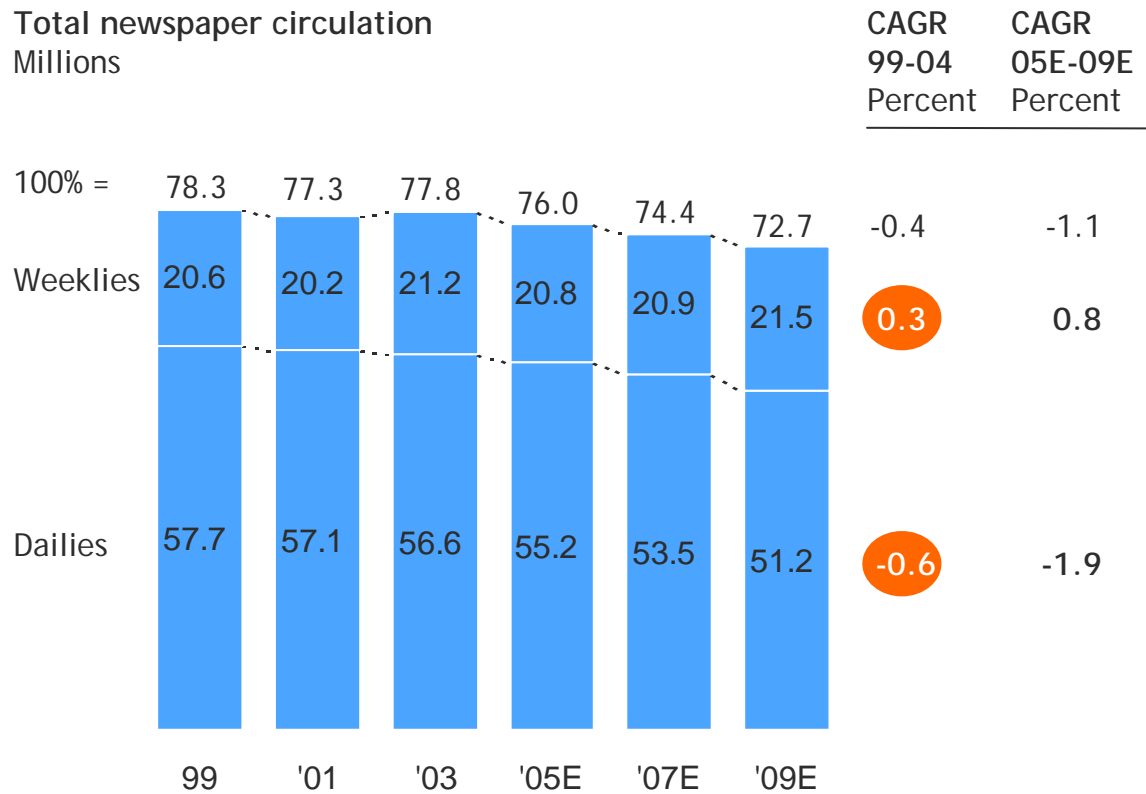
Even older demographics aren't reading as much

Newspaper readership
Penetration of their age group



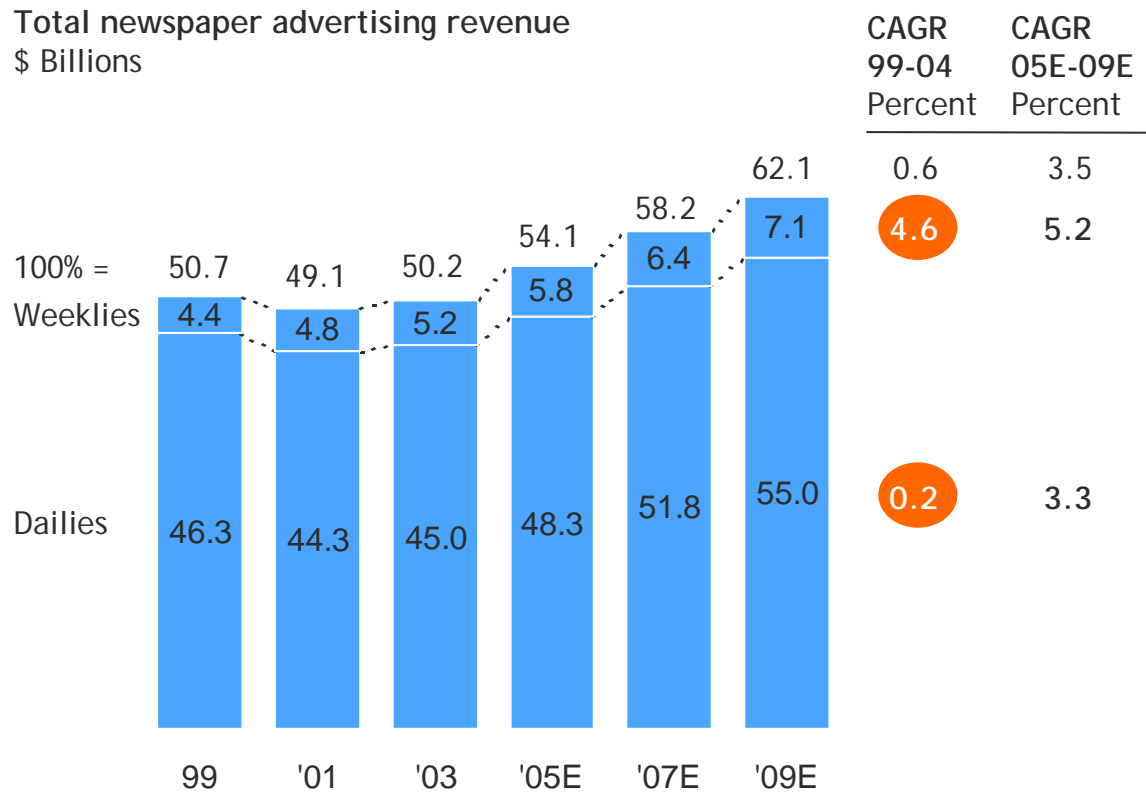
Source: NAA

COMMUNITY NEWSPAPERS ARE DRIVING WHAT CIRCULATION GROWTH THERE IS IN THE INDUSTRY



Source: Veronis Suhler, 8/05

NOT SURPRISINGLY, ADVERTISERS ARE FOLLOWING WITH THEIR DOLLARS



Source: Veronis Suhler, 8/05

KEY INDUSTRY TRENDS: RADIO BROADCASTING

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Industry trend

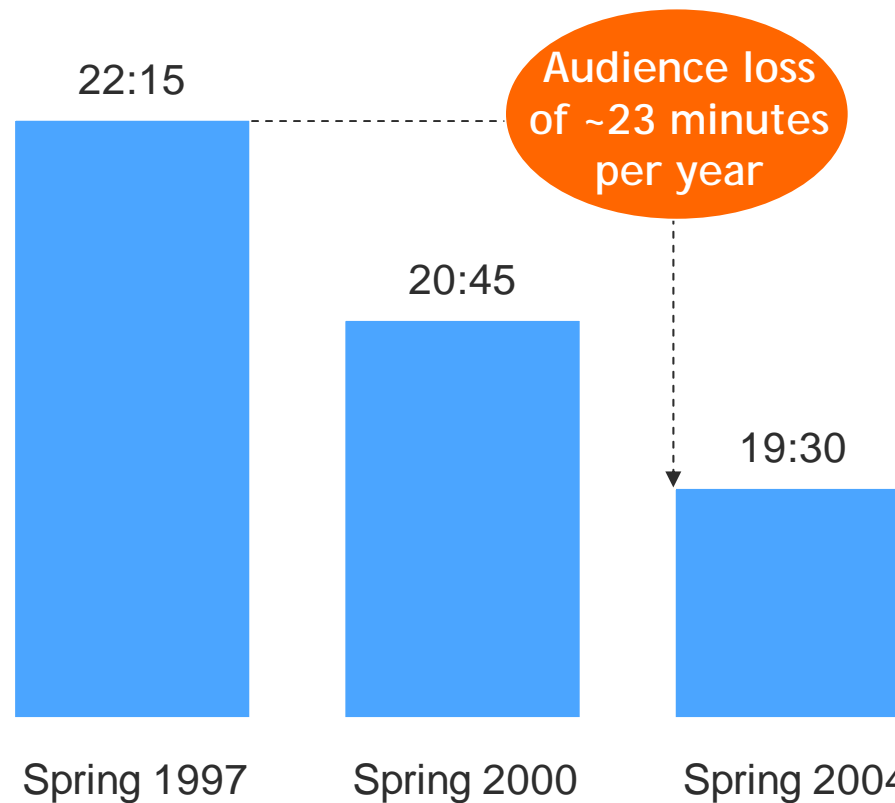
- New players compete for radio listening audiences in car (e.g., satellite) and at home/work (e.g., Internet radio, podcasting)
- Market remains fragmented despite consolidation by leading players (e.g., Clear Channel, Infinity)
- Consumers are increasingly frustrated by high levels of advertising
- Local programming is becoming key selling point for broadcasters
- Key talent (Howard Stern, Opie and Anthony) joining satellite radio to avoid FCC indecency regulations

Industry responses

- Broadcasters invest in new technologies and devices to offset competitive disadvantages
- Acquisition opportunities for smaller players remain considerable as larger players have reached regulatory limits in top markets
- Broadcasters experiment with reduced advertising time and shorter spots (Clear Channel) to reduce clutter
- Broadcasters lobby to prevent entrance of satellite into local market
- Appear to shift programming to less controversial content

PEOPLE ARE SPENDING LESS TIME LISTENING TO BROADCAST RADIO

Time spent listening to radio per year (persons 12+)
Hours



THREE TECHNOLOGIES ARE DRIVING CONTINUED AUDIENCE PRESSURE ON TERRESTRIAL RADIO IN THE NEAR TERM

- Primary threats
- Secondary threats

MP3 players (e.g., iPod)

Offering

- Also known as MP3 players
- Currently available in portable, home and auto formats
- Portable player offerings include flash (e.g., Rio) and jukebox formats (e.g., iPod)

Impact on terrestrial radio

- Primary threat is from portable devices (i.e., growth of iPod, podcasting)
- Devices increasingly offer more storage, battery capacity and ease of use
- Functionality is essentially “make your own radio” based on databases of 2000+ songs and ease of playlist customization
- ~4.6M iPods shipped in fiscal Q1 2005. iPod has ~65% share of digital audio players.

Satellite radio

- Subscription based service
 - Sirius, \$12.95/mo equipment costs \$75-\$300
 - XM, \$9.99/mo, equipment costs \$99-\$300
- Unique, plentiful content
 - Sirius offers 120 (i.e., 65 commercial free music, 55 news, sports and other)
 - XM offers, 130 channels plus additional premium channels (e.g., Playboy radio)
- Growing importance of ad support to business model (i.e., Karmazin seeking 5% of future radio ad revenues)
- Offers “plug and play” devices that can be attached to existing stereo system or offer portable palm-sized functionality (e.g., XM’s wearable MyFi)

- Subscriber growth currently ahead of expectations
- Major talent has been “poached” from terrestrial radio (e.g., Howard Stern on Sirius, Bob Edwards on XM)
- Premium/proprietary content vs. terrestrial (e.g., NFL, OutQ network on Sirius, MLB on XM)
- Largest impact on terrestrial radio will be on time spent listening in car
 - Satellite subs tend to listen more in car vs average
 - Offered as option in over 40% of new cars sold domestically by year end 2007

Internet radio

- Streaming music offered on-line
- Major providers include Yahoo Launch, iTunes radio, MSN

- Consumer research indicates that terrestrial radio use is the same among “streamies” and non-streamies
 - Both allocate ~31% of weekly media usage to terrestrial radio

KEY INDUSTRY TRENDS: INTERNET

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Industry trend

- Broadband penetration rates increasing rapidly
- Contextual search connecting consumers with advertisers in a more targeted fashion
- Online media consumption is increasing as consumers habits transition from analog to digital
- Evolution of pricing models
- Major shift in classified revenues from offline to online



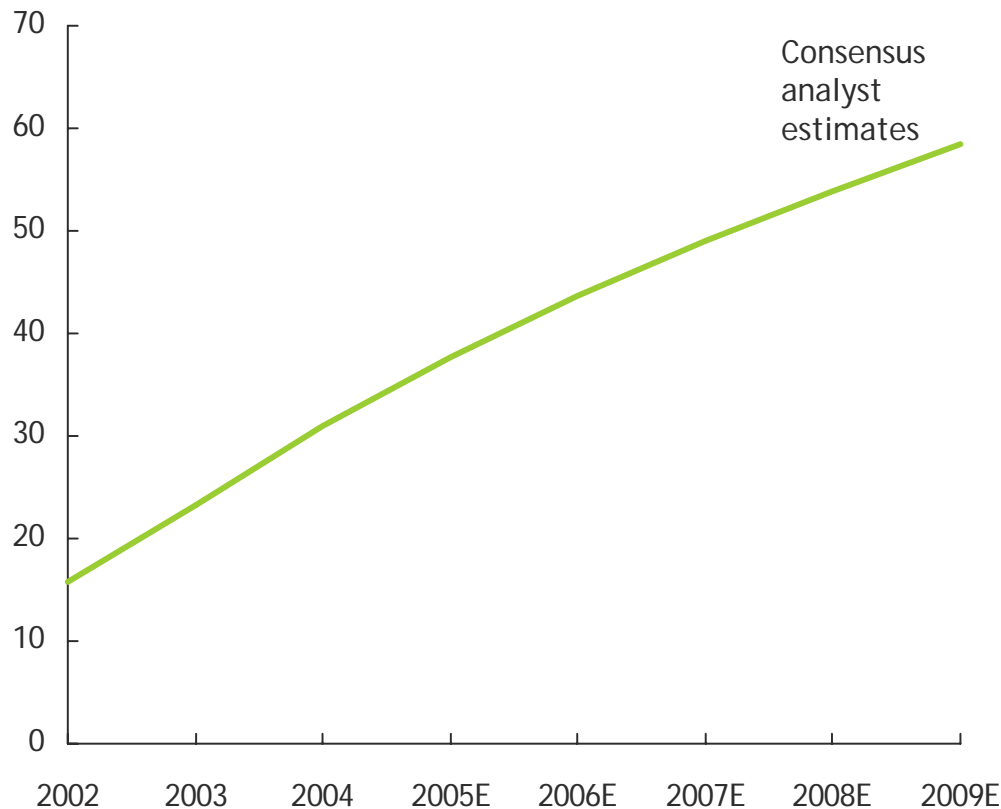
Industry responses

- Portals and content providers are offering videos to attract attractive broadband demographics and getting CPMs comparable to broadcast television
- Portals are currently capturing the bulk of search-related revenues but traditional media players are looking to capture value
- Linear programmers are launching internet channels to shore up their offline brands and eventually generate revenues
- Internet advertising models are evolving along with consumer usage from CPM to Cost-per-click and now CPM again
- Online players stealing share from incumbent analog players as the internet is a more efficient and accessible channel

NUMEROUS FORCES ARE DRIVING TO AN EXPECTED 60% BROADBAND PENETRATION RATE OVER THE NEXT FEW YEARS

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Broadband penetration
Percent

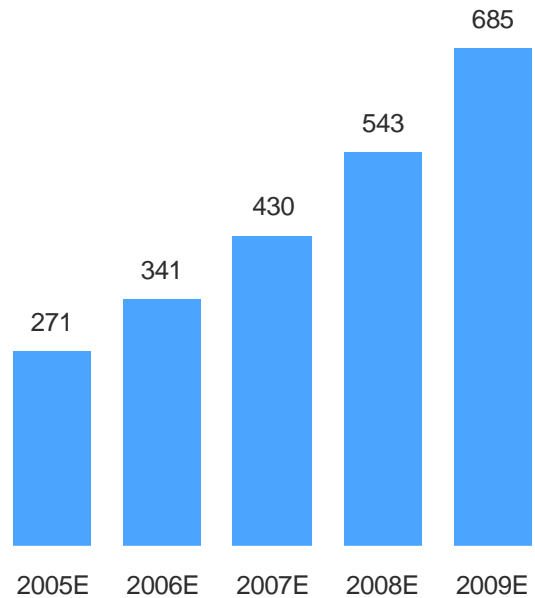


- Cable companies have been offering data as the second piece of their services bundle for almost a decade
- Telcos are rolling out fiber optic infrastructure to compete with the cable companies
- Telcos and satellite providers are pursuing technology solutions and partnerships to compete with cable
- Players from along the value chain are partnering in order to expand their customer relationships, e.g., Yahoo SBC
- New distribution technologies like wireless and Wi-Max can disintermediate incumbent solutions

INCREASING BROADBAND PENETRATION IS DRIVING MEDIA COMPANIES TO ESTABLISH ROBUST ONLINE OFFERINGS WITH AD-SUPPORTED VIDEO

Ad dollars will follow the increasing amounts of broadband video consumers

Internet video advertising revenue
\$ Millions



Internet video users
Millions



Media companies are looking to leverage new and existing video content to attract viewers and ad dollars



- Viacom's MTV launched its "Overdrive" online video service in April 2005 with repurposed and original programming
- Upcoming launches will include channels on videogame culture and style
- Corporate sibling Nickelodeon is also working on a similar product for late 2005



- Time Warner's CNN.com is switching strategies to increase traffic and ad revenues by making most of its video content free
- CNN.com's subscription model had limited success, but is planning a premium service in Fall 2005.
- Rival news channels News Corp.'s Fox News and NBC Universal & Microsoft's MSNBC already offer video for free



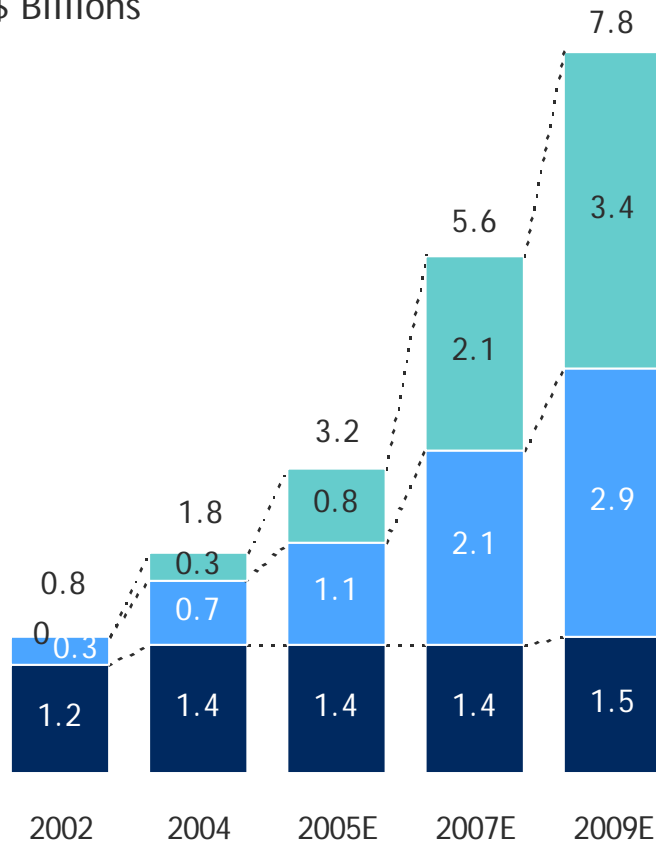
THE E.W. SCRIPPS COMPANY



- E.W. Scripps's Scripps Networks is taking its on-demand efforts in-house and launching websites with online video in late 2005
- The new websites will offer both repurposed and original programming targeting specific lifestyle niches: kitchen design, hobbies and its popular "Food Network."
- Company was unable to realize any revenues with free on-demand cable offerings

INTERNET CONTENT USAGE WILL CONTINUE TO INCREASE RAPIDLY AS CONSUMER BROADBAND USAGE DRIVES USERS FROM TRADITIONAL MEDIUMS

Internet content revenues
\$ Billions



Online music

- Significant upside given the enormous popularity of the Apple iPod and iTunes service
- Still a significant number of music users consuming analog products
- Some question as to how online music will fare as the nascent wireless entertainment market evolves

Online games

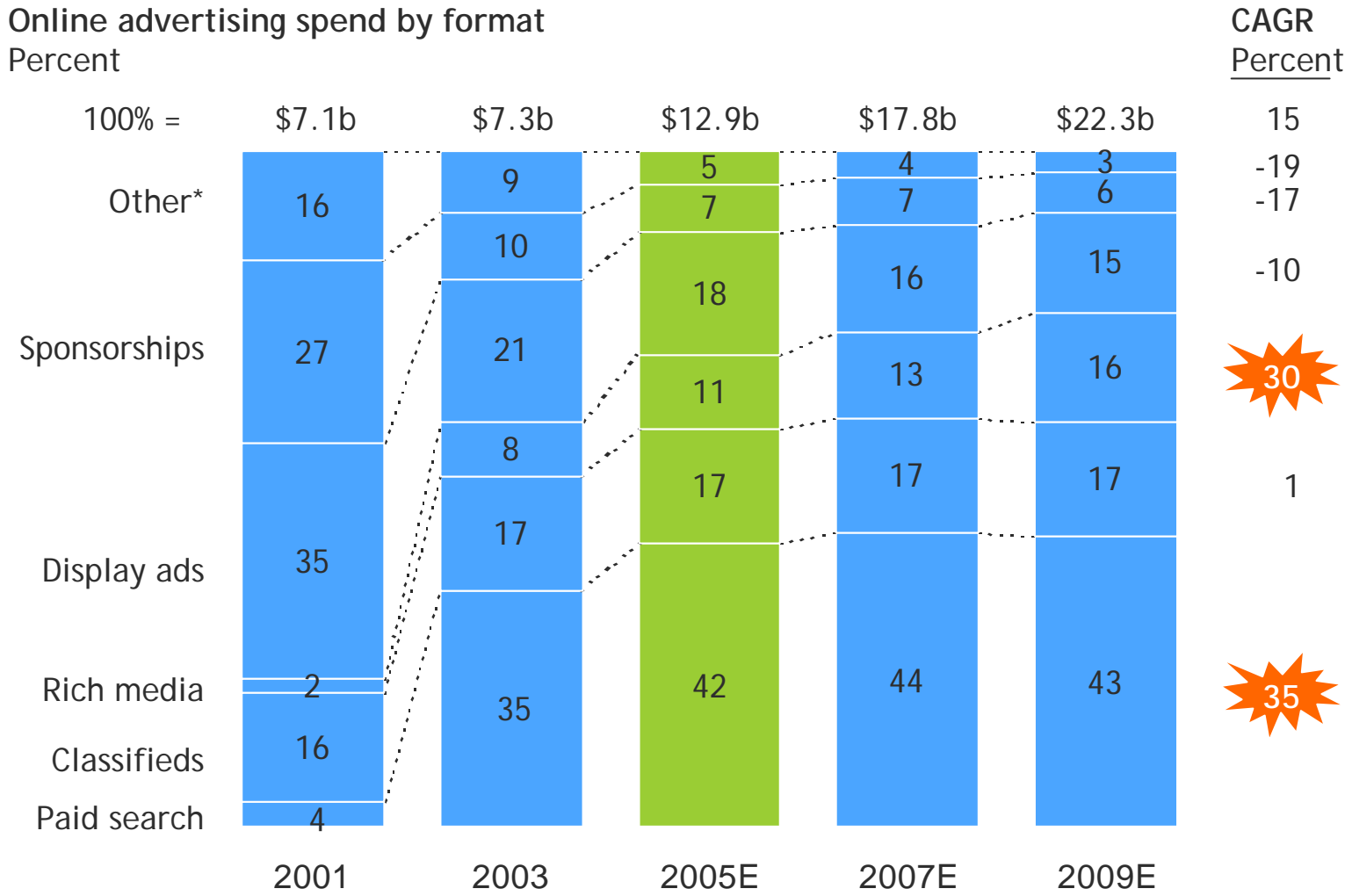
- Still in its infancy as publishers work to develop more robust mainstream offerings
- Driven primarily due to strong community model including chats, forums other communications
- Other offline trends like poker and gambling have stimulated interest in online gaming

General content

- Driven primarily by personals/dating and finance-related sites, but personals expected to slow as the crowded and competitive category matures
- Category faces several barriers to growth, including convincing consumers that the medium is a superior experience worth paying for given the alternatives

INTERNET ADVERTISING REVENUES ARE SHIFTING TO FORMATS WITH SUPERIOR TARGETING ABILITY

Online advertising spend by format
Percent

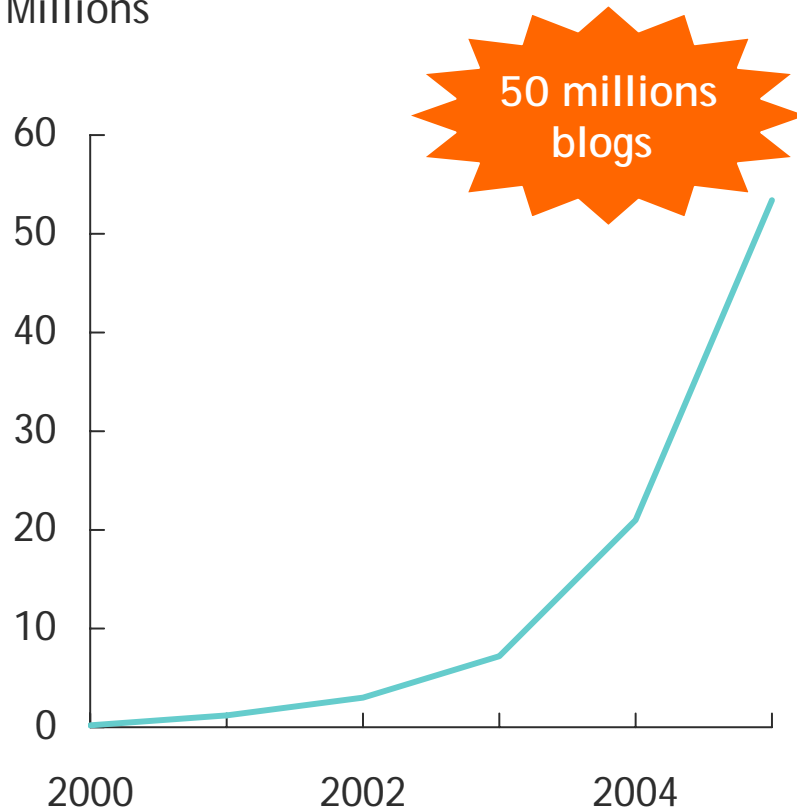


* Includes email, interstitials, slotting fees, referrals

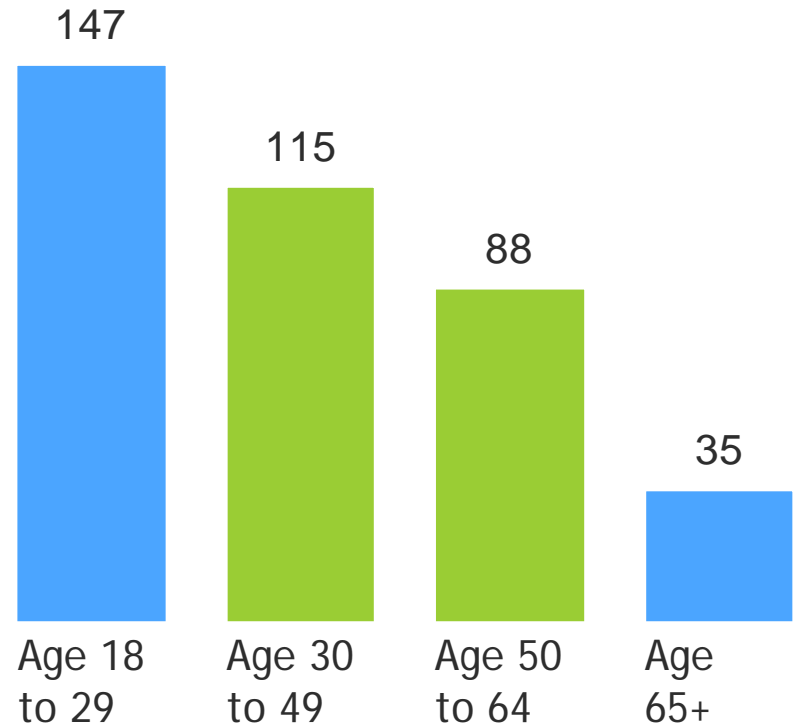
Source: eMarketer, 7/04

SELF-PUBLISHED CONTENT IS GROWING, WITH EVEN "MATURE" 30-49 YEAR OLD USERS BLOGGING

Hosted blogs
Millions



Index of total blog usage vs.
share of population



Source: Citibank Smith Barney, 12/04

KEY INDUSTRY TRENDS: WIRELESS

Industry trend

- Consumers increasingly looking for “anytime, anywhere” content
- Nascent wireless advertising market still developing
- Younger demographics developing away from traditional media and online- and digital device-focused
- Robust wireless entertainment market currently limited by MNO “walled garden” strategy
- Consumer wireless entertainment usage gaining momentum around music and games



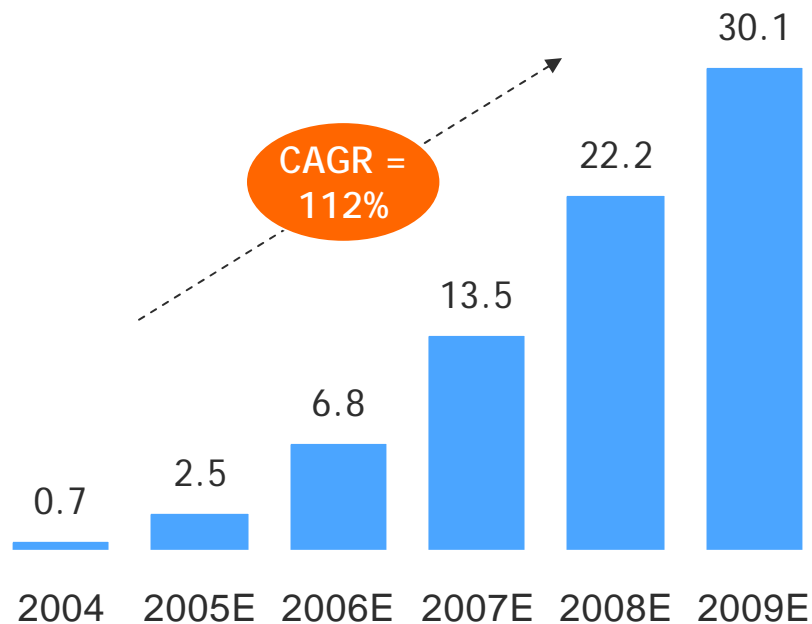
Industry responses

- Cellphone evolving from communications device to entertainment platform
- Currently limited to simple opt-in SMS-based communication but open wireless market holds promise of deeper and highly targeted consumer relationships
- Wireless players and content owners looking to grow brands and capture behavior with targeted content and services
- Operators slowly acknowledging need open networks in order to stimulate nascent market
- Wireless publishers and content aggregators moving quickly to secure offline content licenses and launch products

WIRELESS IS EVOLVING INTO A SIGNIFICANT CONTENT DISTRIBUTION CHANNEL

25

U.S. wireless video users
Millions



Share of U.S. wireless subscribers
Percent

0 1 3 6 10 13

The key drivers of wireless video gaining traction are

- Digital consumer trend of moving away from traditional analog media to new devices and platforms, especially younger generations
- “Anytime, anywhere” mentality of people consuming content wherever and whenever they want
- Media companies’ incumbent distribution channels are maturing and they are seeking new ways to connect with consumers

THE MIGRATION TO WIRELESS MEDIA IS ACCELERATING WITH A SLEW OF NEW TECHNOLOGIES

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Networking devices



Market overview

- Current 60% penetration of mobile phones growing to 80% over next few years, with most internet-enabled
- Portable computing devices are increasingly being sold with integrated wireless capabilities

Potential market disruption

- Telecom carriers, device manufacturers, and aggregators taking away share of the value chain from traditional media companies
- Specialized wireless content providers currently dominating content generation
- Rapid acceleration of development and adoption of wireless broadband potentially in combination with advertisers migrating meaningful portion of ad spend to wireless

Portable media players



- Popularity of digital music devices, e.g., iPod (<50% penetration by 2010)
- Microsoft Media Center (20 million units installed base by 2008)

- Portable media players (primarily audio) will become ubiquitous in the next 5 years
- Disintermediation of traditional distribution channels (brick & mortar retailers)
- Potentially stimulate video consumption behavior

Handheld gaming



- Portable game consoles (10% of HHs by 2006, of which 60% use Game Boys, ~40% Playstation Portables)

- Anytime, anywhere content consumption resulting in new content distribution channel
- Opportunity for brands to connect with hard-to-reach demographics

Satellite radio

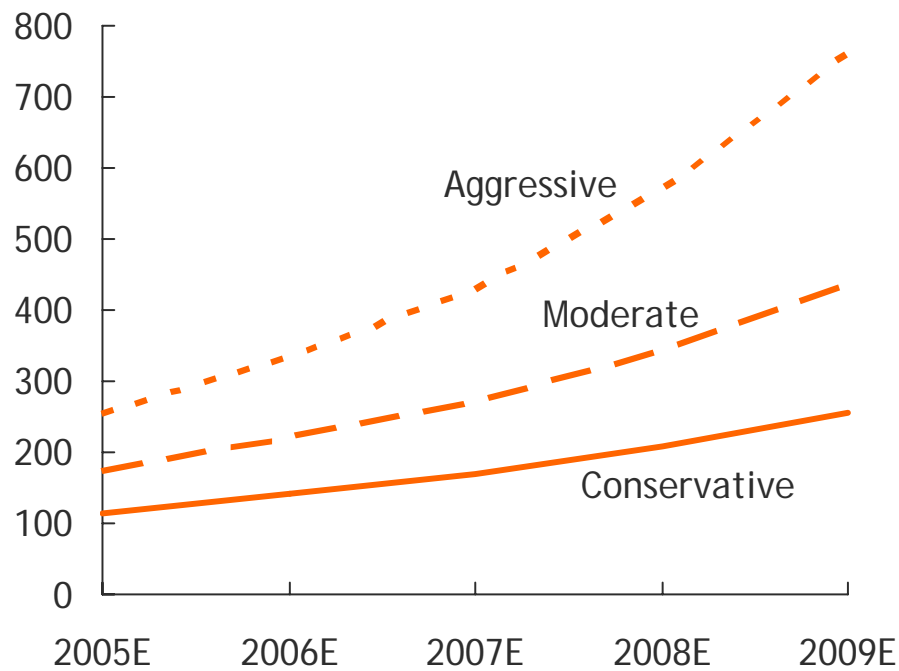


- Growth in satellite radio (29 million subscribers by 2010 or roughly 2 of every 5 long distance commuters by 2010)

- Satellite radio adoption accelerates rapidly
- Auto-manufacturers install satellite radio in a much higher percentage of new cars
- Key personalities move to satellite
- Local content offered on satellite expands beyond traffic and weather

WIRELESS MEDIA SUCH AS MOBILE TV, MUSIC, AND GAMES WILL DRAW ADVERTISING REVENUE

U.S. Wireless advertising and marketing spend
\$ Millions



Year	Wireless as percent of overall
2005E	0.2
2006E	0.2
2007E	0.3
2008E	0.3
2009E	n/a

Mobile platforms are extremely well suited to consumer profiling, targeting and interactive models as well

- Users registered with the network can be tracked for demographics
- The device can be present at the point of research or purchase
- The mobile back-channel allows for interactive advertising, click-through pricing, and some tracking of direct ROI for marketing dollars spent

Source: Morgan Stanley, 4/05; eMarketer, 2/05

Industry trend

- Hit-driven industry results in established offline brands dominating sales with marketing benefits from built-in audiences
- Continued growth of broadband-enabled consoles and wireless handsets will grow gaming market
- Videogames are drawing male demographics from traditional media creating new opportunities
- Each generation of consoles results in increasing game development costs (\$8-10m for next generation)

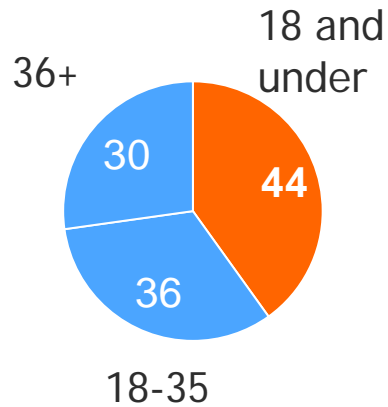
Industry responses

- Publishers acquiring key licenses and developing portfolios of hit franchises
- Publishers allocating development resources toward multiplayer features and wireless games
- Publishers and third parties are develop in-game advertising solutions for marketers
- Players implementing improved business planning processes and operational controls to help mitigate risk

VIDEOGAME DEMOGRAPHICS ARE SHIFTING FROM TRADITIONALLY YOUNG MALES TO A BROADER AND OLDER GROUP

Console gamers

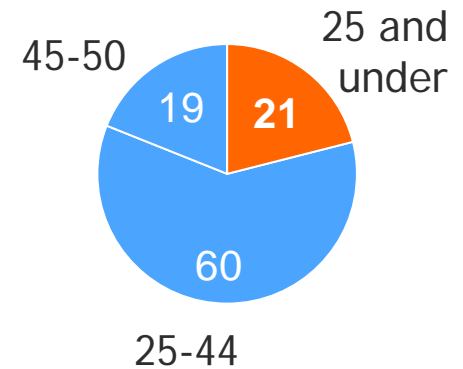
Age



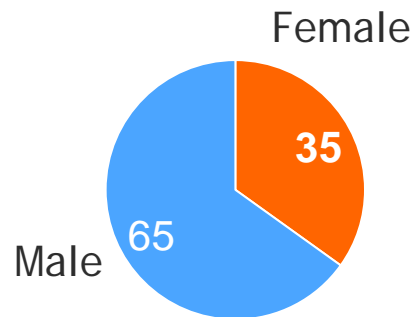
The interactive gaming population is growing older as it moves online. . .

PC online gamers

Age

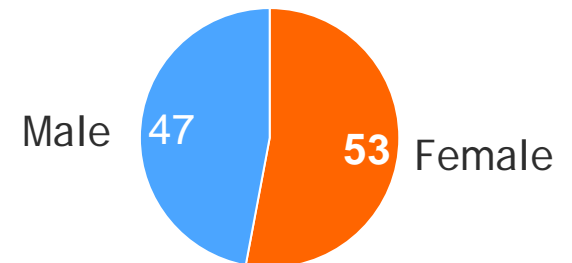


Gender



. . . and women are equally enthusiastic interactive consumers

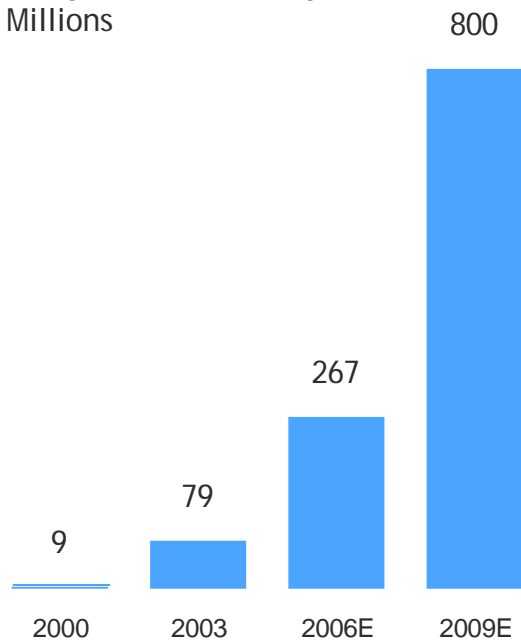
Gender



TARGETED VIDEOGAME ADVERTISING ENABLES MARKETERS TO REACH KEY AUDIENCES LEAVING MASS-REACH MEDIA

Ad dollars following male demographics from mass media to videogames

Videogame advertising revenue
\$ Millions



Videogame HH penetration
Percent



Players along the value chain are looking to capture incremental in-game advertising revenues



- Videogame publisher has long worked with advertisers who pay sponsorship dollars to have their ads featured in games
- Experimenting with third part ad servers like Massive Inc.



- Media conglomerate is launching on-demand game service to broaden demographic reach from core audiences and recapture young male demographic



- One of several third party ad servers that host ad network and integrate technology into games to dynamically server ads
- Partner with Nielsen to launch game measurement service
- Already working with several major publishers and blue chip advertisers
- Some question about gamer response due to intrusion of non-contextual ads in paid product

- Traditional media vehicles are becoming a more expensive option to reach a shrinking mass audience
- As a result, commercial advertisers are beginning to shift the emphasis of their advertising efforts from traditional to targeted media such as cable networks, the internet and local newspapers
- Further, they are actively experimenting with emerging advertising platforms such as wireless devices and videogames