THE UK TV ADVERTISING MARKET; BATTERED, BRUISED...BROKEN?

The TV advertising industry was worth over £5bn in 2016. However a combination of economic, legislative and audience factors are likely to significantly reduce revenues over the upcoming twelve to twenty four months.

- **Brexit:** Economic headwinds
- **Legislative factors:** Increased legislation around gambling advertising
- **The Marketing Mix:** Digital spend will take a greater share of marketing budgets
- **Declining audience quality**: An ageing and less affluent viewership
- **ITV's sports programming**: A lack of high quality, revenue driving sports programming

EXECUTIVE SUMMARY

- To date, TV ad revenues have resisted the momentum of digital media
- The structure of the advertising pie and economic headwinds have now reached a tipping point
- Capturing growth in online video will be the battleground, sitting at the intersection of all media
- Linear TV advertisers will increasingly mirror TV's audience profile & spot revenues for all broadcasters will start to erode - slowly
- However there is hope - digital ad spend is now under the microscope and is due a recalibration

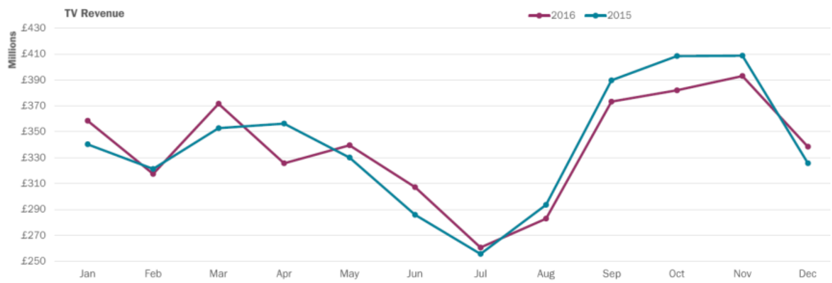
BREXIT: ECONOMIC HEADWINDS

The second half of 2016 produced significant declines in TV advertising expenditure and marketing confidence following Brexit. The early signs for 2017 are highly negative.

TV advertising revenues showed clear signs of suffering in the wake of the Brexit vote. Advertising revenues from Jan-June 2016 had been resilient, up by around 2% YoY however they fell away significantly in the second half of the year.

September to November showed combined year-on-year revenue declines upwards of £60 million (fig. 1.). In the first two months of 2017 declines have been even more precipitous with estimates suggesting 5%

Fig. 1. The direct impact of Brexit on TV revenue



declines in January & February. March (which is admittedly impacted by the early Easter in 2016) is expected to show double digit declines.

However, our analysis is based on more than market revenues. The TV advertising market is often referred to as a leading economic indicator & as we look elsewhere various economic signals suggest a challenging time ahead for the UK economy.

These include signs of instability in the UK housing market (a bedrock of consumer confidence) and increasing consumer inflation. The latter is likely to dampen retail spending as wages are stretched. It also risks creating a vicious cycle of instability as businesses, in the face of falling profits may look to reduce overheads elsewhere (e.g. headcount), particularly as UK productivity is already significantly lower than many other leading economies. When viewed holistically this suggests a significantly weakened outlook for UK TV revenues.

LEGISLATIVE FACTORS: INCREASED LEGISLATION AROUND GAMBLING ADVERTISING

The UK Government is pushing for increased regulations around (and a reduction of) gambling advertising on television. These advertisers currently account for an estimated 4% of all TV advertising revenues. Any subsequent reduction in spend will damage media owner profitability.

In the TV advertising market one of the most highly demanded and profitable genres is sports programming, as evidenced by media owners' willingness to spend large sums of money to win major sporting broadcast rights. It delivers a hard to reach and upmarket male audience, it is also typically viewed live meaning advertising breaks aren't skipped. Gambling advertisers currently purchase expensive pre-planned packages within this programming.

If gambling advertisers were prevented from airing commercials pre-watershed (9pm) as is being proposed this would dramatically reduce their spend. This loss of revenue will have significant knock on effects for the wider marketplace. By reducing the total amount of cash in the market, it would lower the cost of all TV advertising significantly. This is likely to have a significant and lasting impact on the profitability of media owners.

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THE MARKETING MIX: DIGITAL SPEND WILL TAKE A GREATER SHARE OF MARKETING BUDGETS

Advertisers have finite budgets that are subject to significant internal and external pressures. Print revenue has already shrunk by over 50% since 2010. Further online growth will come from television budgets.

The UK is a major international advertising market however total expenditure has reached a saturation point, advertising spend per head is almost double that of France, a similarly sized and mature market. When Brexit is taken into account the size of the overall marketing pie is likely to shrink over coming years. At the same time advertisers are pressing relentlessly ahead with plans to increase their digital advertising investments.

It is our opinion that further digital growth will require a reduction in the overall spend on television. Print has already shrunk to historically low levels, cinema and radio account for approximately 5% of the total marketplace. TV is the only platform which has the size and scale to absorb significant declines that can fund future digital growth. As media agency profits & revenues are increasingly driven by online investment and their offline margins continue to shrink holding companies are in our opinion likely to support this shift.

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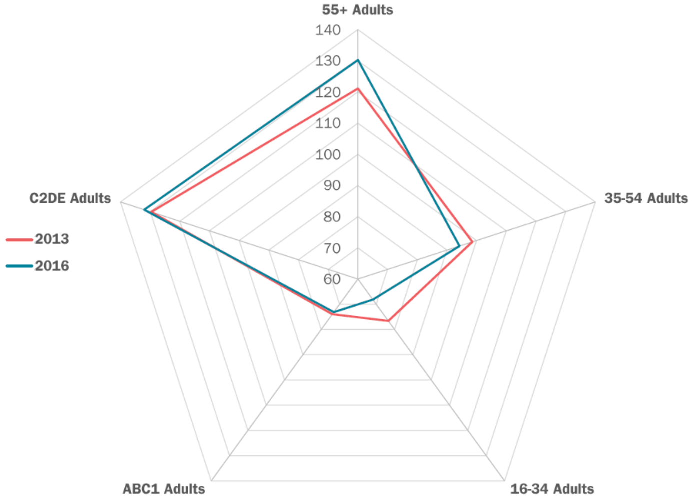
DECLINING AUDIENCE QUALITY: AN AGEING AND LESS AFFLUENT VIEWERSHIP

TV's total audience is not falling significantly (a decline of 3% between 2012-2016 according to BARB). However evidence suggests advertisers are likely to see decreasing ROI as TV's viewership are becoming significantly older.

In few instances do advertisers explicitly target older audiences (55+). During 2013-2016 the likelihood of a commercial being viewed by someone over the age of 55 increased by around 8%, and the likelihood of a viewer being under the age of 35 fell by over 10% (fig. 2.). A continued decline in audience quality is likely to place pressure on media owners. Their ability to deliver broad upmarket audiences and rapid mass reach for advertisers is being squeezed.

Fig. 2. Viewer demographics by social and age classification, 2013 v 2016



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The next 24 months may mark a turning point as younger, more affluent audiences spend an increasing proportion of their time with other media. Reduced viewing time means advertisers would have to spend significantly greater sums to ensure target audiences are reached, in future they may choose to use other platforms instead.

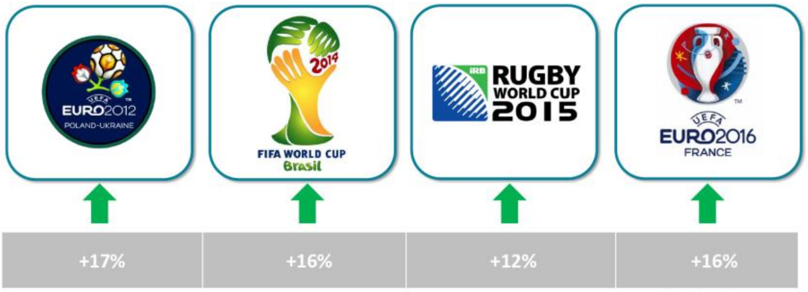
> Historically each event (Euro Championships, Rugby World Cup, Football World Cup) is worth approximately 2% in direct additional spot revenue to ITV.

ITV'S SPORTS PROGRAMMING: A LACK OF HIGH QUALITY, REVENUE DRIVING SPORTS PROGRAMMING

ITV lacks the rights to a global sporting event until the summer of 2018. Traditionally these have been used to drive advertising revenue across the rest of the year, subsequently in 2017 ITV has reduced negotiating power with media agencies.

ITV lacks a major sporting tournament in 2017 that would allow it to deliver hard to reach, light-viewing male audiences. Historically each event (Euro Championships, Rugby World Cup, Football World Cup (fig. 3.)) is worth approximately 2% in direct additional spot revenue to ITV. They also contribute to spend across the year; as consistently 'supportive advertisers' who invest with ITV across the year you are given preferential access.

Fig. 3. ITV year-on-year revenue increase during sporting events



Our analysis also shows that ITV's price premium compared to the rest of the marketplace has historically seen an improvement in years where they broadcast major sporting events. Without this programming to build audiences and support advertiser investment, ITV appears to be facing a potentially turbulent 2017. The decision to cut 120 jobs in the last quarter of 2016 could be read as an indirect recognition of this.

SUMMARY

There can be no doubt that TV media owners face gloomy prospects. When the factors above are viewed holistically they have the potential to significantly weaken the market. If audiences remain stable any significant decrease in revenue may spark a vicious cycle of deflation as CPT's (cost per thousand impressions) decline and their inventory falls in price. In conclusion TV advertising faces its first significant challenge since the 'Great Recession' of 2007/8 & there appear to be no easy solutions.

The only short term saviour may come from advertisers moving money away from the "murky at best and fraudulent at worst" world of digital marketing (at least according to P&G). However with Google opening itself up to third party verification and the opportunities for innovation in the online space this would appear optimistic at best and delusional at worst.

ABOUT

MediaSense advises marketers on how to take more control of their media, across owned, earned and paid channels.

Our services fulfil a growing need among clients for impartial support, evaluation and oversight of their media infrastructure.

Greater control allows brands to be agile, flexible and autonomous in their media decision-making. It gives brands greater certainty that strategies developed and investments decisions made on their behalf are aligned to their best interests and are held accountable.

ANDY PEARCH
DIRECTOR, CO-FOUNDER

Andy co-founded MediaSense in 2009, having built his reputation as a leading figure advising brands on media value management, performance analysis and agency oversight. He has over 30 years of experience in UK and international media.

JAMES GLENDENNAN
ANALYST

James joined MediaSense in 2015, having previously worked in the commercial management team for the UK's largest TV media owner ITV. As Media Analyst his role encompasses a cross-section of projects from qualitative market research to media pitch management.

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