

TRENDS REPORT

2014 MID-YEAR UPDATE

PREAMBLE: let's not lose sight of the big picture

This mid-year report presents six recent market developments that are notable in their potential to accelerate trends documented in the January Report. While the Keytrends report has a strategic focus, here we aim to provide supplementary insight on the topics that should remain on the CMF's radar. Once again, we consider challenges and opportunities related to the market developments that may affect the Canadian TV and digital media industries.

Technology continues to shift towards robust content delivery systems, higher quality screens and an ever increasing number of internet-enabled devices available in households. All of these facilitate the spread of content that's available worldwide and accessible primarily through streaming distribution complemented by pay-per-view and downloading strategies.

In this essentially on-demand world, user behaviours remain mainly characterized by a will for more control, choice and mobility. Audience viewing habits will be increasingly guided by tools for recommendation (such as social media or algorithms), curated content and self-aggregation services.

In such a context, one should not be surprised to read the most recent documents (April, 2014) released by the CRTC in regards to their policy of the television framework ("Let's Talk TV") and their review of the industry practices and regulatory measures that govern packaging of programming services (Order in Council P.C 2013-1167) which raise the possibility of requiring that BDUs and programming services provide Canadians with more flexible, build-your-own package offerings while, at the same time, acknowledging that "pick and pay" approaches could lead to a decrease in revenue predictability for BDUs, an increase in subscription fees on a per service basis, and the likely demise of some discretionary services. **In the next few months: unbundling will be the most important challenge for the North American cable, satellite and broadcasting industries.**

In Europe, things are not any easier for policy makers and governments. After several months of negotiations over "Cultural exception" regulations - a set of rules designed to protect the French TV and film industry from foreign competition, including the obligation to hand over part of the revenues to contribute towards the system - Netflix executives and the French government were unable to reach an agreement. Yet, this will not impede Netflix to launch their streaming services into the French market by the end of this year by operating out from Luxembourg.

These ongoing changes reinforce the scenario of an audiovisual market that will be entirely online. One in which "legacy players" from the broadcasting industry (everywhere in the world) are losing **a) curatorial control over the TV-viewing experience and b) distribution exclusivity for local audiences.** What remains to be seen is whether the Canadian broadcasting industry will be able to position itself in such an open competitive environment or will remain a relatively small player in an open, global, online-only audiovisual world.

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1 ALWAYS ON: Virtual Flirting with Reality

UPDATE: The “always on” era continues to gain momentum. The trend toward personalization and optimization of connected objects continues to develop. Moreover – as hyper-connectivity and interactivity become our new normal – we see an opportunity for a major vertical to emerge in parallel: Virtual Reality.

USA 2013 > \$1 BILLION
in venture capital
was invested in > THE INTERNET
OF THINGS

Google recently held an initial conference for developers working on Project Ara, a line of totally modular smartphones currently in advanced development. The first Ara phones should be launched sometime in 2015.

Smart TVs continue to gain ground. Google Chromecast is now available in Canada. This peripheral, which resembles a USB memory stick in appearance, turns basic television sets into “smart” systems. In Canada, Chromecast retails for \$39. Amazon has also released its first Smart TV box, called Fire TV, which includes a special voice-control feature.

This always-on connectivity is taking a new direction: the real and the virtual are overlapping more than ever. Google Glass systems are intended to make the virtual world ubiquitous in users’ everyday lives. Several other projects recently launched also propose to bridge the real and the virtual. One of these, JIM, a platform developed by the Canadian production company Version 10, facilitates the development of interactive experiences in physical spaces (e.g. treasure hunts) linked to TV shows. In Europe, Cinemacity has attracted a great deal of attention. Initiated by ARTE, this application makes available hundreds of film clips that have been geolocated on the map of Paris and can be viewed from the same location where the scene was shot. Versions of this app for Berlin, New York and Montreal are under development.

**Virtual reality is the physical perception
of a non-physical world.**

Virtual reality has been much discussed in recent months thanks to one venture: Oculus VR, the maker of the Oculus Rift, a virtual reality headset. What distinguishes this headset from its predecessors is that it succeeds in fundamentally altering perceptions: within seconds, the user is totally immersed in a virtual environment.

VIRTUAL REALITY WORKS BY:



1) Tracking your
movements.



2) Using this information to
immediately redraw a scene.



3) Then passing the
re-created perceptions to
the eyes and the ears.

The first Oculus Rift prototype was launched on Kickstarter in the summer of 2012. The crowdfunding campaign succeeded in raising a total of \$2.5 million (the initial objective was \$200,000). In March 2014, Facebook surprised everyone by purchasing Oculus VR for a total of \$2 billion.

The Oculus Rift headset should be marketed by the end of 2014. The retail unit price is expected to be \$350.

"We want to start focusing on building the next major computing platform that will come after mobile."

- Mark Zuckerberg
founding president and CEO of Facebook,
commenting on the acquisition of Oculus VR



CHALLENGES

- ◆ New technologies enabling upgrades will accelerate consumers' adoption of an even higher number of connected devices.
- ◆ The likelihood of increased market concentration and control in the hands of already big players: Google developing Project Ara, Facebook buying Oculus. (This was mentioned in the previous Keytrends report in January 2014, about upgradeable and customisable devices.)
- ◆ Increasing competition for audience's attention as the array of viewing experiences continues to expand.

OPPORTUNITIES

- ◆ Huge amounts of VR content await creation. This is practically virgin territory. VR content creation could well be the next "hot new market."
- ◆ Facebook's \$2 billion gamble suggests that there could be massive investment (and not necessarily by the players who first come to mind) in virtual reality – on the tech side as well as content.

UPDATE: Our January 2014 report identified users' desire for unrestricted access to content – a desire thwarted by the existence of copyright barriers and legislative challenges such as net neutrality rulings. The report also highlighted some of the risks for the industry (bypassing access via VPNs or pirating) if it does not respond adequately. This report examines the issue of access to content from another angle: that of limitations of infrastructure.

The launch of the second season of *House of Cards* on Netflix and the fourth season of *Game of Thrones* on HBO have confirmed the importance of a solid bandwidth service-delivery as a major competitive advantage in an environment in which mass adoption of video-on-demand services continues.

A FEW STATISTICS ON HOUSE of CARDS

FIRST SEASON
(2013)

 **2%**

of Netflix subscribers watched
at least one episode **over the
entire weekend.**

SECOND SEASON
(2014)

16% 

of Netflix subscribers watched
at least one episode **the day
the new season was released.**

BANDWIDTH CONSUMPTION

The entire second season of *House of Cards*

Watching on a **1080p HD TV**



amounts to **27 GB**

Watching on a **4K TV**



consumes **UP TO 5 TO 6 TIMES MORE** than 1080p HD TV

Although Netflix succeeded in meeting the challenge of maintaining available service at peak demand, HBO failed to do so and had to interrupt its service for several hours, causing major frustration among subscribers. Worse yet, while subscribers were spinning their wheels, waiting for service to resume, the first *Game of Thrones* episode was propagating on peer-to-peer (P2P) networks, which gain efficiency as the number of users sharing the content increases.

Questions arise: is there a way of using these P2P networks as a solution to make content accessible in a legal manner? For example, could a system be developed for unlocking content on “torrent style” systems, using prepaid key codes, which would ensure monetization and fair compensation to the network holding the rights? Has the necessity to maintain robust and reliable streaming services paved the way for new partnerships like the one between HBO and Amazon Prime? Are we about to see more and more of these alliances between premium content programmers -no longer being limited to cable and satellite distribution- and online video service providers?

The reality is that cable and satellite distribution services are merging more and more with over-the-top (OTT) streaming services to allow an increased access to content everywhere. The good news is that these mergers work to the benefit of both sides: Netflix has recently announced its first cable-TV deal in the US with Atlantic Broadband, RCN Telecom Services and Grande Communications which will allow Pay-TV subscribers to access Netflix from their cable-tv without the need to switch to a different set-top box (with online access) or remote control.

TV EVERYWHERE
viewing rose
— 246% —
over the last year (US)

CHALLENGES

- ◆ Reliability of broadband infrastructure is becoming a major competitive advantage and pressure to lift bandwidth caps or review net neutrality regulations may increase.
- ◆ OTT service providers may move to the cable distribution space through agreements with cable and satellite distributors, creating greater competition to traditional TV broadcasters' offerings.
- ◆ Making premium content libraries available on online video distribution platforms could encourage some cord-shaving and cord-cutting from cable and satellite subscribers.

OPPORTUNITIES

- ◆ Increased choice and accessibility to content for consumers.
- ◆ Expanding cable and satellite content offering by embedding OTT's libraries could counter the cord-shaving and cord-cutting effect.
- ◆ Competition between OTT services and cable and satellite distributors may turn into "coopetition": more partnerships with shared benefits for both.

3 TRANSMEDIA: Originals from Everywhere

UPDATE: Web and OTT players have moved to compete against Premium TV. They've ordered original series to attract and retain the attention of over-solicited media consumers on their internet platforms. Players like Netflix and Amazon have gained more credibility as commissioners of Premium TV content, and new players like Microsoft and Sony are entering the field. The recent Digital Content NewFronts (presented in parallel to the traditional broadcasters Upfronts) featured the productions slates of YouTube, Vice, Yahoo, AOL and even The New York Times and National Geographic, thereby confirming that online video is fiercely competing for advertisers' attention and money.

As part of an ongoing deal between the streaming service and DreamWorks Animation, **Netflix** has ordered three new kids' series from the studio. It also ordered its first original series for Latin American markets. And it has promised original content for France and Germany, where it is expected to launch in 2014.



Amazon just announced full-series orders of six new shows (two comedies, two dramas, two for kids). This is the second slate of original shows they've picked up.

The makers of gaming consoles have also turned to TV production. **Sony** ventured into original programming for PlayStation 4 as a way to make it a true multimedia box. The recently ordered supernatural detective show *Powers* will be available exclusively for US PlayStation Network customers – a reach of approximately 30 million homes.

For its part, **Xbox** Entertainment Studios is teaming with UK broadcaster Channel 4 in the coproduction of *Humans*, a remake of the Swedish hit series *Real Humans*. The science-fiction drama will share its first broadcast window on both the Xbox network for North America and Channel 4 in the UK. Xbox is working on other premium offerings, including a *Halo* series to be produced by Steven Spielberg.

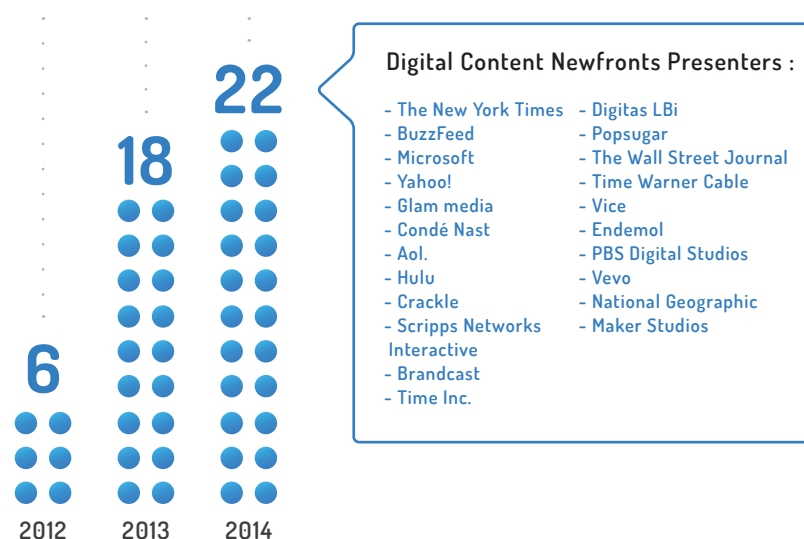
Netflix continues to innovate, developing a hybrid model around its investments in exclusive content. Besides commissioning series as new intellectual property (as described above), the streaming service, for a second time, will revive a TV series that was not renewed by its original broadcaster. Having brought back the situation comedy *Arrested Development* in 2013, Netflix will offer subscribers exclusive access to the final season of *The Killing*, a police drama that was dropped by the original

network, AMC. This approach reveals a restoration strategy for back catalogues, stimulating consumption of previous series during additional seasons. Netflix is banking on the fact that current fans as well as latecomers to these series will have no choice but to subscribe to the platform if they want to access final episodes of a given series.

Netflix is playing on Canadian turf, too. It sealed a distribution deal with eOne for the hit comedy *Trailer Park Boys* in commissioning its first exclusive order for Canadian content. The show's eighth season is to be produced exclusively for Netflix and will be available in every market where the service is present. This move is aligned to the company's revival strategy described above.

Among Netflix Canada's other significant moves, it outbid local broadcasters for rights to *The 100*, a new CW series. The episodes will be available for Canadian subscribers within 24 hours of the US broadcast. This is the first time Netflix has locked down exclusive rights in Canada for a series.

MORE AND MORE ONLINE CONTENT PLATFORMS FEATURING THEIR PROGRAMMING SLATE AT THE NEWFRONTS



CHALLENGES

- ◆ Increased competition for broadcast rights. Netflix can now be considered a fully active player in the Canadian content industry, and other major online content commissioners may be attracted to our market as well. Potential effect: bidding war for rights in the market, for both foreign and Canadian titles.
- ◆ The Canadian regulatory and funding systems do not currently facilitate coproduction opportunities such as the one between Xbox and Channel 4.

OPPORTUNITIES

- ◆ Canadian producers may have new clients with the option to be commissioned or sell originals to Netflix or other OTT providers.
- ◆ New coproduction arrangements are emerging (e.g. Xbox and Channel 4).

THE POWER OF MANY: When Audiences Become Makers, Investors and Marketers

UPDATE: As users gain power – especially by mobilizing large communities – “traditional” players and brands are more willing to dive into open collaboration with both users and makers. What they see is a new pool of ambassadors that might reinvent crowdsourcing and crowdfunding to their own benefit in the so-called “Like Economy”.

The maker movement presented in previous reports has grown stronger through experiments on audiovisual projects co-created with users. Dutch director Paul Verhoeven (*Total Recall*, *Robocop*) was among the first established directors to experiment with crowdsourcing while writing the script of *Tricked* (2012). Hollywood's *enfant prodige*, Joseph Gordon-Levitt, is a principal of HitRecords, a self-described “open collaborative production company.” Having tested their techniques with music and books, the company now produces a variety show co-created with users. It also has several film initiatives underway. It's worth noting that HitRecords – which hopes to share any earnings with creators and contributors that have participated in a project – is backed by Sony and book publisher Harper Collins.

At the latest MIP TV (April 2014), Australia's national public broadcaster (ABC) received an International Emmy for its comedy series *#7dayslater*. Promoted as TV “made by you” and the “TV series created with online

audiences,” it had audiences “build the brief” for the show's creative team – that is, come up with plots, themes and dialogue. The team then had 7 days (hence the show's name) to deliver the episode for ABC2.

On the marketing side, the term “Like Economy” was coined to define a new reality in the way any product - including artists and content - is increasingly being marketed, i.e. by leveraging social media and the power of users' sharing and curating. In other words: social currency has a value that can be leveraged into industry dollars. Among its characteristics:

- The consumer is also the marketer.
- Younger generations are more likely to accept mashups of culture and commerce (i.e. product placement, brand sponsorship, etc.)
- There is a strong element of self-branding and self-empowerment in consumer-driven promotional strategies.

CHALLENGES

- ◆ Loss of control on brand messaging, program buzz and audience-building strategies.
- ◆ Crowdsourcing is disrupting creation and production pipelines, creating a need to develop strategies for continuous conversation with participants and rapid-production turnarounds.

OPPORTUNITIES

- ◆ Involving audiences at very early stages of project development increases adoption rates and marketing opportunities.
- ◆ Innovation in storytelling and creation processes.
- ◆ Development of projects that are more aligned with viewers' tastes and preferences.

UPDATE: Subscription and packaging models have multiplied, becoming more sophisticated and personalized. Only now is the audiovisual industry acquainting itself with “pick and pay.” In the music sector, there are signs of a more streamlined approach, one which could be effectively converted to the audiovisual sector down the road.

Social currency continues to attract a lot of industry attention, even if recent developments seem to minimize the value of social TV (that is, social media that draws television audiences). This tends to debunk efforts by Facebook and especially Twitter to monetize this activity. Initiatives such as *See It* (Comcast's deal with Twitter to embed buttons in Twitter feeds that link to a TV program), *Amplify* (running TV ads on Twitter) and Promoted Tweets, show that the social media experiment has so far failed to deliver meaningful TV audiences.

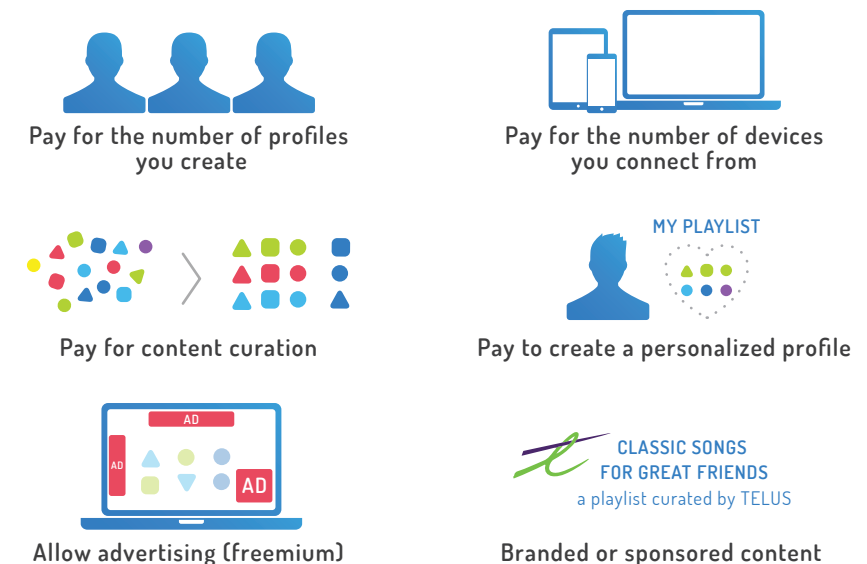
The preferred option for monetizing digital rights in the audiovisual industry currently seems to be through subscriptions. This is also a way to compete with increasingly popular OTT and soaring subscription video-on-demand (S-VOD). However, the audiovisual industry largely associates “subscriptions” with “unlimited viewing on all platforms.” The digital music sector offers an alternative view. For the past two years, it has attempted to monetize “personalization” through streamlined subscription models. Trends in streaming music, then, may inform us on the next-generation of S-VOD services.

The music industry has raised accessibility, discovery and personalization to the status of essential services, as evidenced by popular services like Pandora, Spotify or Rdio. What these digital music services have in common is that (a) they offer an alternative to the iTunes monopoly in the world of digital music distribution and (b) they offer users access to an almost limitless library of musical content by paying “publishing royalties” in the same way as radio stations. They are an illustration of what could become a highly enriched environment where content is fed from all

possible sources, without necessarily negotiating distribution licences ahead of actual use, in order to satisfy users' appetite for on-demand service.

This model has numerous critics, and its profitability for many of these players (as well as the real earnings for copyright holders – artists in particular) has yet to be proven. However, a few aspects which the audiovisual industry might consider should be noted here:

THE MANY POSSIBILITIES OF A SUBSCRIPTION BASED MONETIZATION MODEL



CHALLENGES

- ◆ Diminished brand awareness: labels fade to the background. Users only remember the name of the service through which they access their preferred content.
- ◆ More middlemen are being added to the supply chain, fragmenting the already small margins of digital revenues for each player in the chain and, especially, weakening revenues paid to content creators.

OPPORTUNITIES

- ◆ New sources of potential revenue.
- ◆ There is still room to streamline and innovate in terms of models for monetization through subscriptions.
- ◆ The impressive number of subscribers to music services like Pandora, Spotify and Rdio, clearly shows that a market opportunity exists for multi-content distribution services. This opportunity could generate substantial added value for companies with multiplatform ecosystems and extended content libraries (e.g. vertically integrated companies like Rogers and Quebecor).

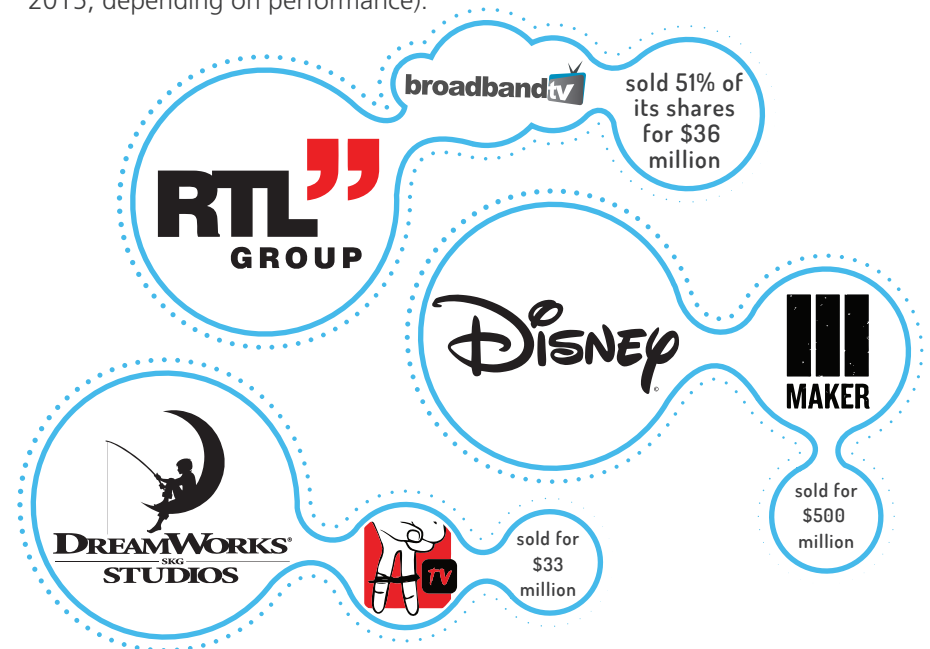
UPDATE: A startling wave of acquisitions and partnerships shows that even the “Big” need to ensure their competitive edge via alliances. There’s also a pressing need for them to innovate if they want to maintain leadership in content production and distribution. Five stand out: Google, Apple, Facebook, Microsoft and Amazon – all American companies rooted in the web and new technologies – whose diversification has led to domination not only in the media industry, but in other sectors as well.

Efforts to secure valuable user data have underscored the acquisition of promising start-ups, a trend observed in our January 2014 report, and confirmed by the Google and Facebook takeovers of Nest and WhatsApp respectively for record amounts: \$3 billion and \$19 billion (USD).

These transactions reflect an inflationary curve in the current race for data. Though it apparently spent lavishly, Facebook might earn returns quickly: WhatsApp has some 450 million users, each valued moderately at about \$40 (USD). The \$19 billion price tag indicates, though, that such acquisitions may be reserved for a limited club of “super rich” companies (Google, Amazon, Facebook, Apple, Microsoft and a few others) to the detriment of all other players.

A multi-channel network is an organization that works with YouTube channels, to offer assistance in areas such as “product, programming, funding, cross-promotion, partner management, digital rights management, monetization/sales, and/or audience development” in exchange for a percentage of the ad revenue from the channel. The name Multi-Channel Network has only recently begun to be standard.

YouTube’s Multi-Channel Networks (MCN) system highlights another notable phenomenon: acquisitions proving that “small” self-distributed players can become huge by tapping into global audiences via open video platforms. In the last 12 months, the Canadian-founded Broadband TV sold 51% of its shares to the European RTL group for \$36 million; Disney took over Maker Studios for \$500 million (with potential extra \$450 million by 2016, depending on performance) and Dreamworks bought AwesomenessTV for \$33 million (with potential extra \$117 million by 2015, depending on performance).



The situation raises questions about big local players. Can they ensure leadership on their territory when competing against web channels that aggregate viewership across global audiences? Maker Studios, for instance, represents 55,000 YouTube channels, a total of 380 million subscribers and 5.5 billion views per month. The only serious Canadian MCN, Broadband TV, consists of 15,000 channel partners, 120 million subscribers and 1.5 billion views per month.

One can argue these players do not provide the premium content and production values typical of major TV networks. Clearly, though, they are competing for audiences' time and attention on a global scale. Their impressive viewership attracts advertising dollars to a degree not easily matched by other online content – especially individual, local S-VOD services related to traditional broadcasters.

CHALLENGES

- ◆ Less control in local markets: Canadian audiences are now targeted by an array of YouTube channels.
- ◆ A race to acquire audiences attracted to new start-ups or MCNs could require massive investment and competition against richer, bigger networks.
- ◆ Faced with global competition for content production and distribution, established national leaders may need to reassess their strategies.
- ◆ An industry-wide system for measuring and analysing users' data still needs to be developed and adopted. However, given that "big data" is the main competitive advantage in the online world, there is little chance that data-driven companies will open and share their treasured measurement systems to allow the industry as a whole to progress.

OPPORTUNITIES

- ◆ A chance to tap into massive online audiences.
- ◆ New entrants and creators who attract industry dollars (brands, advertisers or buyers).