the SIS briefings

A MONTHLY BULLETIN OF THE EBU STRATEGIC INFORMATION SERVICE

October 2002 | Number 52

In this issue...

- Amid the ad downturn most TV networks have maintained their programme budgets but the crisis has accelerated the shift towards “entertainment”, ranging from reality shows to infotainment.
- Entertainment is infiltrating all other genres giving them a range of options for interactivity and marketing that create more profitable shows and opportunities for secondary revenues.
- Repurposing and extending the genre is part of an overall strategy to squeeze assets as broadcasters try to get more air-time from a single original format, to multiply spin-offs, and to seek out new distribution channels.
- If PSBs can make the new successful genres compatible with their remits, they can gain a competitive advantage with a potentially more dynamic model by adapting experience from commercial broadcasters, using stable revenue sources, and optimising their own in-house resources.

- The expansion of western media companies into the East has stalled and in some cases players have withdrawn. Broadcasters and platform operators alike are cutting costs, merging operations, and disposing of unprofitable assets.
- Whether this signals long-term strategy or is merely a short-term retrenchment depends on a number of factors. Opportunities that may yet lure back these players include economic revival, ad market growth; privatisation of public channels; liberalized ownership rules; and availability of new digital licenses.
- Meanwhile local players have emerged in the larger markets like Poland. However, their growth will be highly dependent on national media concentration policies and financing issues.
- Finally, changes in the broadcasting landscape resulting from the enlargement process and alignment with EU audiovisual policy will have an influence on all players in the industry.

Docuwatch

A Merrill Lynch report by Neil Blackley, Global Media Team, London, United Kingdom, September 2002.

Contributors to this issue

F. Barca, A. Zaccone Teodosi and F. Medolago
IsICult
(Istituto italiano per l'Industria Culturale)
Rome, Italy

Alexander Shulzycki
Senior Media Analyst
EBU-SIS
Geneva, Switzerland

Editor
Dr. Paolo Baldi
baldi@ebu.ch

Deputy editor
Alexander Shulzycki
shulzycki@ebu.ch

Production editor
Evelyn Tajetti
tajetti@ebu.ch

EBU-UER

Revenues in times of recession: more entertainment, more profitable entertainment

by Flavia Barca, Angelo Zaccone Teodosi and Francesca Medolago Albani
IsICult (Istituto italiano per l'Industria Culturale), Rome, Italy*

The bursting of the "technology bubble" and the events of 11 September have been at the root of a profound crisis in the TV advertising market, which dropped about 9% in the USA and about 6% in the majority of European countries.

However, the content business - that is, production and distribution - has suffered less than broadcasting per se. Symptomatic of this is the stability of television revenues of the largest European television group RTL Group / Bertelsmann which responded well, despite the crisis, with growth in 2001 of only 0.1% in "broadcasting" but 5.3% in "content". The contrast is also in evidence at Telefónica, whose production unit Endemol saw its sales rise by 63% while its Antena 3 channel recorded an 11% drop in revenues. These examples suffice to show the dynamism of the production sector which is the consequence of intensified competition between the channels.

Nevertheless, the advertising crisis has obliged broadcasters (in their capacity both as producers and as distributors) to adopt policies that reduce costs and maximise profit, and to turn their strategies towards a restructuring of in-house assets: consolidation, both on-air and off-air, on the one hand, and drawing better value from their schedules, on the other hand.

More specifically, our research[1] shows that the recession has accelerated the process - already under way - of a progressive shift in schedules towards "entertainment". Such a shift has the dual benefits of favouring a genre with great public appeal while at the same time offering a vast range of options for interactivity and marketing. It is a genre that allows a new form of profitability for television and the launch of new services bringing in secondary revenues.

Scarce resources go to light entertainment

The advertising recession did not lead to cuts in programming expenditure in 2001. Most networks managed to save money elsewhere. Europe's biggest channel, ITV, slightly increased expenditure despite the toughest advertising recession in memory. RTL in Germany maintained its programme budget at its year 2000 level, although some of the money was re-directed to prime time from other parts of the schedule and advertising revenue for prime time declined less than elsewhere.

Table 1 - RTL and ProSieben entertainment output (as % of total output)

	2000	2001
RTL	20.8	23.2
ProSieben	4	7

Note: Entertainment ("unterhaltung") excludes fiction.
Source: AGF/GfK/Media Perspektiven/SIS analysis

This implies that ever-increasing attention has been given to innovation in the early-evening hours, above all with entertainment productions whose success has been tested and proven. In practice this means an increase of entertainment programming in the schedules in all its forms ranging from reality shows (which, despite warnings of viewer saturation, continue to generate audiences), to factual-reality, to

* *IsICult is an independent research centre specialising in the media economy and cultural policies (www.isicult.it).*

[1] *After making a detailed study of the structure of programmes and schedules of European TV under a commission from the RAI in 1999-2000 (the project "L'erba del vicino è sempre più verde?" - "Is the grass always greener on the other side of the fence?" - some of the results of which were presented during the Prix Italia 2000), IsICult set up a permanent observatory on European TV in the year 2000 on behalf of RTI-Mediaset (the "Entertainment Without Frontiers" project). We thank the Marketing Director of Mediaset for permission to publish here some of the results from an internal research report.*

infotainment. In Italy, for instance, fiction producers say that both public and private channels have cut their expenditure - a sign that entertainment is draining more resources.

- Entertainment is an intermediary that attempts, using a solution that has already been tested, gradually to introduce new spectacular elements that will respond as closely as possible to indications and indeed desires expressed directly by the public. Meanwhile fiction gradually seems to be pulling back, as it were, from the role of interpreter of daily realities, preserving and amplifying a role as a creator of events built around facts and persons chosen for their own potential appeal to the public imagination.
- "Reality" programming, in all its forms, began as almost the only field of experimentation, drawing from other genres that had for a long time been well defined and codified. "Reality" brings together elements that had hitherto been distinct such as programme creation, production, and financing. It has done this by attracting new audiences with new derived revenues and restructuring the star system by recruiting unknown creative talent through competitions (striking examples are the series *My life is a sitcom* and the eighth series of *Periodistas* where Globomedia gets viewers involved in writing the scripts for the episodes via the series' web-site).

PSBs in particular are banking on these aspects of marketing and popular appeal and are looking for ways to make the new successful genres - reality and games shows - compatible with their specific institutional obligations. The BBC is leading the way. It has repositioned BBC1 increasingly closer to ITV1 while BBC2 is increasingly mainstream with entertainment and sport output increased in 2001. In France, France Télévisions has adapted some of its quiz shows to give them an educational aspect. (for example, *Le Juste Prix* has become *Le Juste Euro*).

ARD in Germany was also increasingly fond of light entertainment in the 2001/2002 season, for example with the quiz show *Das Quiz mit Jorg Pilawa*, produced by Grundy Light Entertainment / RTL Group, which competes with primetime quiz show *Wer Wird Millionär* aired by RTL. The dating game show *Herzblatt*, launched in October 2001, is another good example. ZDF in the meantime has been putting into effect a strategy for renewal of its target audience. The network's audience has traditionally been skewed to older viewers. The new President, Markus Schaechter, in place since March 2002, has set objectives for modernisation of the programming with a view to attracting younger audiences and those in the former East Germany. ZDF has put its trust in high-profile sensationalist prime-time documentaries like *Hitler* which in early-evening prime time had an average of 4.5 million viewers and *Storm over Europe* with 14 or 15% market share.

Entertainment series combine other successful genres which are usually "cultural-specific" - i.e. in some way bound to their country of origin. In the United Kingdom, for example, factual-reality is being developed under all possible guises that combine a renewal of core entertainment with the documentary tradition and journalistic research. In this way, as mentioned earlier, the public service continues to fulfil its obligations without abandoning the new potential of entertainment - and reality shows in particular.

Good examples are investigative programmes like *Candid Camera*, which is a distinctive element in the BBC schedules, or the often-criticised *The Weakest Link*. Additional examples are the docu-drama *Conspiracy*, co-produced by HBO and BBC Films, or the "socio-pedagogical" reality show *The Experiment* which was inspired by an experiment conducted in Stanford Prison in 1971 during which 18 volunteer prisoners were formed into "guards" and "thieves" roles and were then forced to live together in a cell to analyse their interactions.

While Germany's ARD is achieving success with chat-show infotainment, the Italian approach is in a way the opposite of what the British are doing, celebrating the age-old combination of reality and Italian-style comedy - the most representative example of which is the *Indovina chi viene a cena?* (Guess who's coming to dinner?) format broadcast by the RAI during the 2001/2002 season.

In general, entertainment - and reality shows in particular - is infiltrating all the other genres, contaminating and swallowing up fiction (a typical example of the new wave is the new American "reality sitcom" *My life is a sitcom* planned for next January) and children's programmes, information programmes (even news is becoming more and more spectacular) as well as sport, documentaries and even the weather forecast.

Table 2 - TF1 programming costs (%)

	2000	2001
Games and variety shows	25.1	28.4
Fiction	26.8	24.8

Source: Company report/SIS analysis

Hybrid products of the major transnational production companies are going around the world collecting success or failure depending on national particularities (*The Weakest Link*, for example, has fared very well in the UK but very badly in Germany and Italy, countries in which aggressiveness and sarcasm do not seem to work best). At the present time, the leader among the various approaches (exemplified by the "tropical" theme of *Survivor* and *Shipwrecked* and the "dating shows" of the UK's *Perfect Match* and the Spanish *Busco Pareja*) is the "musical-reality" format (or "star creation game" or "talent quest"). In fact, the new music formats now winning major success in the schedules of most of the European networks, both private and public, manage to combine the greatest appeal across frontiers and across music generations while maximizing advertising opportunities in all its forms (e.g.: Spain's *Operación Triunfo*).

Squeezing assets

Faced with a recession, broadcasters have done what many other industries have done in similar circumstances: they are exploiting their existing assets to the maximum. They try to get more air-time from a single original format and multiply the spin-offs, seeking out new distribution channels.

Channels are trying to maximise synergies with their sister-services. One particular programme may attract viewers across a whole range of channels. In the UK, Channel 4 premieres popular series like *Friends* on the cable and satellite channel E4. ITV1 has dramatically boosted viewing of ITV2 thanks to extended coverage of *Pop Idol*.

In Germany, RTL builds upon the synergies of the "family of channels" not only as regards acquisition, rights exploitation and advertising planning, but also by cross-scheduling. For example, *Big Brother* is scheduled on RTL1 and RTL2. Elsewhere, the regional PSB (ARD3) is re-running some of the hits from the first channel, ARD1, and managing to obtain fresh benefit from other "premium" productions (or, in any event, high cost productions), in early evening prime time despite having a very

Spain - *Operación Triunfo*

The most striking example, demonstrating the central role that entertainment has assumed on the public channels and showing its successful commercialization, is the Spanish format *Operación Triunfo* (OT). *OT* is aired on TVE1 after having been refused by both Telecinco and Antena 3 for being produced by Gestmusic Endemol - which is nonetheless part of the same group as the latter. RTVE is organising the second edition with the initial participation of 80,000 candidates. The number of hopeful candidates was already 15,000 at the end of February 2002 (conclusion of the first edition of the programme).

Profitability - The programme has brought in about EUR 34 million - set against production costs of EUR 7.2 million. In other words, with *OT* RTVE has recovered the production costs many times over.

Simple, original format - The programme might be classified as a “music-reality show” or “star creation game”: there are 16 competitors, 3 finalists and a single winner - destined to represent Spain in the Eurovision Song Contest.

Hybrid formula - The programme is an original format of Gestmusic although it is clearly similar to the Australian *PopStars* format and the formula shows similarities in certain details with both *Gran Hermano* and *Lluvia de Estrellas*, as well as *Famas* and *Star Academy*. The tendency for hybridisation to produce clones and variants of dubious paternity is confirmed by complaints (leading almost to litigation) by programmes like *Pop Stars* and *Pop Idol*.

Market impact - *OT* with its enormous audience success and the resulting advertising revenues, has been transformed into a sort of “media-social event” with an impact exceeding that of *Gran Hermana*, and it is proclaimed by the Spanish PSB as an enormously successful operation whether in terms of image or in commercial terms, contributing to a repositioning of the first channel of Spanish public-service TV in favour of an audience that is much younger than its consolidated base. Additionally, the dedicated thematic channel carried on Canal Satélite Digital has triggered an increase in audience for the digital platform.

Competitive response - All the other channels have in one way or another tried to “sabotage” the programme’s success, broadcasting clips and causing irritation to RTVE which has warned of its intention to take legal action. The most shameless operation was that of Telecinco’s *Crónicas Marcianas* which, taking advantage of its own late-night slot, laid in wait of those taking part in the final gala as they left the studio.

International marketing of the programme is under way and *OT* now has a Portuguese variant and a series of Latin-American versions (Argentina, Chile, Colombia, Venezuela, etc.) - not to mention the Italian version. The format rights are already being sold also in the USA and China.

Interactivity - The interactive element, in addition to representing one of the keys to the programme’s success, has turned out to be a significant source of revenues. During the last episode of the programme 115 thousand telephone calls were made and 138 thousand SMS messages were sent. Overall, messages and phone calls totalled more than 9 million and generated about EUR 5 million, shared between TVE, Gestmusic, Movilisto Telephone Publishing (Hachette) and the telephone operators. The next edition of the programme forecasts a cost to RTVE of EUR 600 thousand per episode, but also provides for a sharing of revenues that will put 60% in the coffers of Gestmusic Endemol and 40% in those of the public broadcaster.

Merchandising - Finally, a made-to-measure merchandising operation has been developed around the programme: videotapes (distributed by Magna Video), books (Ediciones B - Broadebooks, Grupo Zeta), CDs, t-shirts, etc. CD sales alone have reached 4.5 million units.

restrained budget. It may be noted that ARD believes that one of the reasons for the success of the regional channels, in terms of their audience shares, is the appeal of re-runs.

Light entertainment programmes have been especially fruitful sources of secondary revenues.

Any project should include an analysis of the possible use of the format on as many media as possible and with maximum opportunities for profit. Broadcasters are increasingly on the look-out for products in which each episode opens an interactive window. In the ideal case (e.g. the ever-present benchmark programme *Big Brother*) the format should be able to be exploited on terrestrial channels, mobile phones, thematic channels and the Internet. Such business models generate maximum audience shares and maximum audience fidelity but also - and most importantly - they generate secondary economic benefits coming indirectly from royalties on phone traffic of the users, or directly through merchandising based upon the programme[2].

This phenomenon signals a shift of broadcasting towards business models tuned to the needs of advertisers seeking personalisation and interactivity and, more generally, to increased competition with the new communications platforms ranging from the Internet to mobile telephony. To appreciate the dynamism of PSBs in this sector, we can consider the case of Germany's ZDF which, through ZDF Enterprises (its licensing and merchandising unit), has achieved earnings from merchandising - clothing, discs, books, cassettes etc. - valued at around EUR 150 million per year.

ZDF Enterprises, through its subsidiary ZDF.newmedia, manages various activities that aim to capitalize on online, teletext, and ITV assets. Among others, it has a partnership agreement with the largest European Internet service provider, T-online, to deliver a news portal (heute.t-online.de). Another interesting example is the project for a theme park that ZDF is developing together with the JRA company (Jack Rousse Associates in Cincinnati) and with the Flebbe Group (one of the largest companies in the German cinema business), the project's operational partner. The aim is to create the first entertainment park in the world dedicated exclusively to television programmes - "touchable television" - ranging from news to fiction to entertainment and documentaries. The selected site is in the city of Mainz, close to the public broadcaster's headquarters, and the projected investment is EUR 128 million for a forecast number of visitors of 1 million per year.

Nevertheless, asset squeezing may lash back. Going against the trend, the UK broadcaster ITV made severe cuts in its investment in new programming in 2001, focussing more on re-runs and tried and tested concepts. The effect has been a fall of 2.2 points in prime time audience share with respect to the year 2000 (compared with zero or minimal reductions for the competitors) for a channel that says its makes 75% of its advertising revenues in this time band.

Table 3 - New revenue streams from entertainment programmes

Interactivity	SMS messages Premium rate phone calls
Merchandising	CDs Videos Books, Magazines
Pay-TV	Special feeds available on subscription Advertising on programme site

Source: ISICULT/SIS

[2] *For example, the winning act of M6's Pop Stars sold 2.8 million CDs.*

The PSB's advantages

Paradoxically, at this time, it is the public service broadcasters that have the potentially more dynamic model and a position of advantage. Required by their mandates to engage in experimentation and in the search for innovative forms of communication, public broadcasters find that:

- They are able to draw upon the experience of commercial TV, adapting it to fit in with their own mission and adopting the production and distribution methods. For example, the BBC with BBC Worldwide and BBC Entertainment has promoted internationally successful formats like *The Weakest Link*, *Friends Like These* and *Dog Eat Dog*.
- They have (with a few exceptions) a stable revenue source which is not constantly subject to the whims of audiences and investors.
- They still have room for optimisation of their own in-house resources, whereas this option is almost exhausted in commercial TV.
- They are the repository, in all countries, for assets of inestimable value that can nourish the never-ending game of serving up the "old" as if is were "new", in all possible guises and adaptations permitted in the digital environment.

Nothing is made, nothing is destroyed - everything is transformed.■

Further reading...

ZDF reorients schedule strategy

Responding to a depressed ad market that could drain USD 100 million in its four-year budget period until 2004, ZDF has revised its schedule to put more emphasis on documentaries and programs aimed at younger audiences. The company intends to offer more entertaining shows for younger viewers, given that its average audiences skewed older. In a strategy paper, Markus Schaechter, said that entertainment shows on some primetime slots will be replaced by documentaries on nature, science and contemporary history. In addition, ZDF will seek more cooperation with international partners such as Discovery Channel, Channel Four and History Channel. Schaechter stressed the importance of innovation, and announced the formation of a department bundling development for new formats. "ZDF needs to be the leading talent forge of the industry," he said.

Hollywood Reporter, 14 October 2002

TF1 lineup heavy on reality

Keeping reality TV to the fore in its upcoming schedule, France's leading commercial network, TF1, announced new seasons for two of its established reality shows and the arrival of a fresh format. The new show is "Fear Factor," which will see six contestants whisked off to South Africa, where they will have to face their greatest terrors. The series is produced by Endemol's French subsidiary, with whom TF1 has a first-look deal. The network also plans a third installment of "Koh-Lanta," an adaptation of "Survivor," and a second season of its French version of "Temptation Island," in which couples have their fidelity tested by bronzed beauties.

Variety, 29 August 2002

Western media company strategies in eastern Europe: a tactical withdrawal?

by Alexander Shulzycki, *Senior Media Analyst, EBU-SIS, Geneva, Switzerland*

The goldrush is over. After the transition to market economies, western media groups invested heavily in high-growth areas of eastern Europe, but now expansion into the most lucrative markets in the region has ended and in some cases players have withdrawn. Forced out by economic factors, pressure from parent companies and unscrupulous partners, western investors are exhibiting a strong spirit of financial prudence and selectivity: companies are cutting costs, merging operations, and selling non-performing assets. There is still some activity by a few small new entrants and in the peripheral markets, but for the most part there is a lull –whether this is temporary or not depends on a number of factors will have an influence on how, when and if these players return and under what conditions they operate:

- Economic revival and return of ad market.

Table 1 - Overview of company operations: channels and platforms in eastern Europe

Company	Country	Channel / platform	Type	Launch	% owned	Audience / subscribers 2001
SBS	Hungary	TV2	FTA	1997	49%	30%
	Romania	Prima	FTA	1997	86%	7.7%
RTL	Hungary	RTL Club	FTA	1997	49%	29%
CME	Slovenia	POP TV	FTA	1998	85%	28.6%
	Romania	PRO TV	FTA	1998	66%	19.6%
	Slovakia	Markiza	FTA	1999	70%	50.3%
	Ukraine	Studio 1+1	FTA	1997	60%	21.6%
MTG	Hungary	Viasat3	cable	2000	95%	n/a
	Lithuania	Tango TV	cable	2002	n/a	n/a
	Lithuania	TV3	FTA	n/a	n/a	26%
	Latvia	TV3	FTA	2000	n/a	12.1%
	Estonia	TV3	FTA	n/a	100%	17.5%
	Pan-Baltic	Viasat Baltic	DTH	2000	100%	n/a
News Corp.	Bulgaria	bTV	FTA	2000		34%
HBO	Hungary	HBO local version	Pay	n/a	n/a	352,700
	Czech Republic	HBO local version	Pay	n/a	n/a	286,000
	Slovakia	HBO local version	Pay	n/a	n/a	30,000
	Romania	HBO local version	Pay	n/a	n/a	180,000
	Poland	HBO local version	Pay	1996	n/a	607,000
	Bulgaria	HBO local version	Pay	2002	n/a	0
CANAL+ DTH	Poland	New Cyfra	DTH	2002	75%	700,000
Liberty Media (UPC)	Hungary	UPC Magyarorszag	cable	n/a	100%	668,500
	Czech Republic	UPC Ceska Republika	cable	n/a	100%	305,600
	Slovakia	UPC Slovensko	cable	n/a	100%	299,000
	Romania	AST Romania	cable	n/a	100%	322,200
	Poland	UPC Polska	cable	n/a	100%	998,000
	Hungary	UPC Direct	DTH	2000	100%	n/a
	Slovakia	UPC Direct	DTH	2000	100%	12,000
	Czech Republic	UPC Direct	DTH	2000	100%	n/a
	Poland	New Cyfra	DTH	2002	25%	700,000

Source: The companies.

- Privatisation of public television channels.
- Ownership rules, including cross-media and foreign ownership restrictions.
- Digitalisation: the control of satellite and cable platforms and the roll-out of digital terrestrial TV.
- Uneven country development and differentiation between rich and poor markets.
- Enlargement and alignment with EU audiovisual policy.

At the same time local players have emerged in the larger markets. The growth of strong indigenous players has presented a dilemma for national media policy: how to foster their development while limiting the undesirable effects of concentration.

The commercial broadcasters: SBS, RTL, MTG, CME

SBS: downsized and profitable

Acknowledging that its expansionary period is over SBS Broadcasting[1] is optimising operations and heeding investor expectations to produce margins. To that end it has restructured management, cut costs, sold-off partial interests in TV channels, abandoned new media and focusing on its core advertising business. The results show that this strategy is meeting with success: the company made EUR 18 million in profit in its second quarter this year –its best result ever despite the advertising recession. Cost-cutting was applied over the last year to all levels of the organisation: senior management team was cut by 40%, three station managers were replaced and 10% of the entire workforce was eliminated. Seeing no immediate new revenue streams, the company also abandoned its new media division and has given up on content synergies admitting that its channels have very little connection.

This June SBS agreed to shed its 33% equity stake in Polish commercial channel TVN for USD 150 million in cash to local investor ITI. The deal is consistent with SBS strategy of focusing on channels that it owns and operates. Having closed down Hungarian cable channel TV3 and relinquished its interests in Kanal A in Slovenia, the company's remaining interests in the region are Prima TV in Romania and Hungarian station TV2.

A downsized, recession-proofed SBS may make its shareholders happy in the short-term, but its diminished presence and influence in the region will make it less adept in seizing opportunities in expansion, digitalisation, and privatisation should they arise.

The RTL Group: a tactical retreat

Similarly, cost-cutting and retrenchment have characterized RTL's strategy in Eastern Europe. The company has dropped loss-making operations and is concentrating efforts on its profitable stations. The RTL Group is the most profitable division within Bertelsmann and its EUR 170 million net in the first half of 2002 kept the whole company in the black. RTL's strategy in Eastern Europe as elsewhere, must become consistent with Bertelsmann's goal to achieve a 10% net yield within the next three years.

To that end, late last year the company sold its Polish affiliate, RTL7, together with its formats, film library and satellite transponder contracts to local company ITI. The channel never broke even and one persistent reason for RTL7's lack of success was its low reach which remained under 50%. The company's remaining holding in the region is its 49% share of general interest channel Klub RTL which launched in 1997 and now claims more than half of the

[1] *The company was founded by American Harry Sloan in the early 1990s. Ownership: UPC, 22.15%; Janus Capital, 10.74%; CanWest, 7.5%; EnTrust Capital, 7%; Capital Research, 62%; and State Farm, 5.88%.*

entire TV ad market. Unlike SBS, the company has not given up on programming synergies and given its strong content position (e.g. Freemantle) it may be able to leverage this into more and better programmes.

The company is certainly in a tactical retreat waiting for better opportunities to emerge, for instance, the purchase of shares in leading TV stations or participation in the privatization of public television channels.

MTG: growing ambitions in the Baltics and beyond

Unlike SBS and RTL, MTG's slow steady expansion to the East has not abated. A pioneer in Nordic commercial TV, MTG's Viasat broadcasting business has expanded into Lithuania, Latvia and Estonia. In 2000 the company made its first foray outside of the Scandinavian-Baltic region with the acquisition of a broadcaster in Hungary. Most recently, the company moved into Russia by acquiring 75% of Darial TV and in 2001 a 36.3% share in StoryFirst Communications Inc., a private US corporation that owns CTC, the third largest commercial TV broadcasting network.

MTG is following a two-pronged strategy in the Baltics: roll-out of pan–Baltic free-to-air channel TV3 which is benefiting from the still increasing ad market, and leveraging its Scandinavian digital DTH platform into the region. Through Viasat Broadcasting the company operates Lithuania's largest commercial television channel, TV3, which had a third of the audience share last year. In May 2002 the company launched youth-oriented Tango TV in Lithuania, which is designed to exploit new revenue opportunities, for example, SMS fees generated by interactive programming. Latvia's version of TV3 was granted a national terrestrial licence last year extending its reach to more than 95 % of the households. Early in 2002 MTG consolidated its Estonian holdings and now fully owns all its media businesses there: the digital DTH-platform, pay channel TV1000, the Internet portal Everyday.com, and SDI Media, a media services company. Overall, in the three months ending June 30 2002 TV3 Baltics net sales increased 39% quarter-on-quarter.

MTG has achieved this expansion through leveraging content through the re-versioning of TV3 and keeping transmission costs low by using its existing Nordic distribution network.

Central European Media Enterprises (CME): the 700 million dollar question

Since losing control of its flagship station and main source of revenues, Central European Media Enterprises (CME) has made a profitable business out of successful lawsuits. The company is making money from litigation awards stemming from the illegal seizure of Nova TV in the Czech Republic in August 1999. In the most significant case, a London arbitration court will decide by the end of this year or early 2003 the amount the Czech Republic must pay CME for failing to protect its investments in Nova TV. The Bermuda-based, US-backed company[1] hopes for a USD 700 million cash settlement which includes USD 527 million in lost revenue plus 12% interest. The details of the case are convoluted and involve forged documents, confiscated Monet paintings, naked weather girls, prison terms for top officials, intervention by Vaclav Klaus, and accusations of wrongdoing on the part of the country's Media Council. The result is a major financial burden on the government already suffering from budget woes and from last summer's flooding. The government will try to bargain by offering CME a broadcasting license, however, the company has made no decision: it may do anything from returning the money to stockholders to using it as a fund to expand

[1] *CME's principle shareholder is US billionaire Ronald S. Lauder.*

operations. In any event the amount of the award will be huge and the use to which is put could significantly affect the broadcasting landscape in Czech Republic or whichever market is chosen.

Elsewhere, CME retrenched somewhat, selling its stake in Poland's TVN to SBS in July 2000 and recently reducing its ownership of Slovakia's Markiza to 70% from the 80% it held earlier. CME's stations are stable market leaders, and the company's overall net losses narrowed (see *Table 2*).

Table 2 - CME Stations: ownership and financial performance (six months ended June 30)

Countries	Companies	Ownership (%)	Net revenues (USD 000s)		EBITDA (USD 000s)	
			2002	2001	2002	2001
Romania	PRO TV & Media Vision	66%	15289	15670	1585	-1397
Slovak Republic	Markiza TV	70%	18484	16554	3482	3096
Slovenia *(combined financials)*	POP TV	85.5%	17682	15049	6013	4547
	KANAL A	90%				
Ukraine	Studio 1+1 Group	60%	14354	10543	3930	2428
All Stations			**65809**	**57816**	**15010**	**8674**

Source: the companies.

CME's content strategy remains dependent on foreign imports although most stations have shifted to locally produced shows after the initial glut of US programming fulfilled the company's "catch up with the West" strategy (e.g. 53% US programming in Czech Republic in 1997).

The Pay-TV operators: UPC-Liberty Media, CANAL+, HBO

Apart from MTG's DTH platform the companies discussed above have remained in the commercial free-to-air business. In Pay TV several players have introduced DTH platforms, cable networks, and stand-alone pay channels into the region. Although less prone to the advertising downturn, these companies all have suffered from the economic decline as consumers have less or are willing to pay less for TV. Thus, in broad terms most of these companies have been following similar strategies to the commercial broadcasters: restructuring, cost-cutting, and asset sales.

UPC – Liberty Media

Early next year Liberty Media will effectively gain control of UPC under a restructuring deal that was completed in July in which UPC's parent, UnitedGlobalCom, will cede 65% of itself to Liberty. UPC was built on acquisition and aggressive capital expenditure which peaked at EUR 250 million per month in 2000 and brought it to the brink of financial collapse. Even before the Liberty merger, UPC had been radically scaling back investment in Eastern Europe. New acquisitions were put on hold and last year UPC shut down its flagship cable channel, Wizja TV, in Poland as part of campaign to cut costs and rationalize investment. One effect that is being felt across the region is that more channels are being internationalized for broader audiences.

While reducing content costs UPC is still going after prime distribution assets: it has tendered a bid to buy El-Viv Telecom, the owner of the third largest cable TV network in Poland. The company's core business remains cable distribution and in Hungary, Romania, and Slovakia subscriber growth has been healthy since 2000.

Under Liberty, there may be two effects: funds for further expansion of cable networks and content synergies with Liberty's extensive holdings. However, the company faces regulatory obstacles. For example in Hungary media authority ORTT has ruled that a single cable operator cannot own more than a third of the total market. UPC has already exceeded this limit in most of its markets (see *Table 3*).

Table 3 - UPC Cable and DTH subscribers in Eastern Europe (as of June)

Country	Major subsidiary	Cable 2000	Cable 2002	Growth 2000-02	DTH 2002
Poland	UPC Polska	1'416'473	998'000	-41.93%	*(1)*
Czech Republic	UPC Ceska Republika	356'601	305'600	-16.69%	43'200
Hungary	UPC Magyarorszag	567'065	668'500	15.17%	60'800
Romania	AST Romania	260'307	322'200	19.21%	0
Slovakia	UPC Slovensko	244'343	299'000	18.28%	9'600
Total			**2'593'300**		
Total West			**4'600'700**		

(1) In December 2001, UPC sold controlling interest in its DTH platform to CANAL+ and retained a 25% holding.

Source: The companies, SIS analysis

Vivendi and CANAL+

Like the RTL Group, Canal+ is experiencing the consequences of decisions emanating from its parent company. Under new leadership, sales of assets in Eastern Europe became a first target of Vivendi's company-wide debt reduction plan. Under the restructuring plan[3] CANAL + operations in Poland are to be sold. In telecoms Vivendi is already disposing of its key assets in the region: In Hungary, EUR 450 million is expected from the sale of Vivendi Telecom Hungary. In Poland Vivendi's 51% stake in Elektrim Telekomunikacja is being negotiated with an investment consortium led by Citigroup Investments.

Late last year Canal Plus and UPC finally merged their unprofitable Polish DTH platforms into TKP, a company controlled and operated by CANAL+. UPC was paid EUR 150 million and holds the remaining 25% share. The new platform, New Cyfra, has more than 700,000 subscribers (50,000 analogue subscribers) and was given 12-18 months to breakeven. If Vivendi does go ahead with the sale a key question will be whether the company sells its assets piecemeal or as a package.

HBO: expansion into Bulgaria despite piracy concerns

Backed by Time Warner, Sony and Disney, HBO was one of the first media investors in Eastern Europe launching operations in Poland in 1996 and since then adding Hungary, the Czech Republic, Slovakia, Romania and Moldova. In spring HBO Bulgaria was launched and is expected to be available to 50% of the 900,000 cable homes in the country by the end

[3] *Vivendi will fold Canal Plus Group's core French businesses into Canal Plus SA, keeping 49% of the new entity. Canal Plus SA will also include: a 66% stake in French DTH platform CanalSatellite; a 62% stake in MultiThematiques; Studio Canal; and a 22% stake in Spanish DTH platform Sogecable.*

of the year. HBO waited as the economic and political turmoil of the late 1990's was brought under control. With its main concern now pay TV piracy, the company will role out advanced encryption technology. HBO remains a pay channel and will stick to its tried and proven business model; the company has no ambitions to manage pay platforms or take on additional risks.

The rise of the indigenous players

The withdrawal of foreign media companies has provided opportunities for domestic players. In Poland three local companies have emerged which effectively control the commercial free-to-air industry. Using the largest market in the region as a base, they each have ambitions to expand nationally and regionally.

ITI Holdings - Over the past two years ITI has been buying up TV assets left behind by western companies. The company purchased SBS's share in TVN, a channel originally launched by CME in 1999, and now claiming 20% share of Poland's television ad market. Adding to its portfolio last year ITI bought RTL's struggling channel RTL7. The company also launched a 24 hour news channel and has multiple distribution deals with cable and DTH operators. The three Polish founders own more than 60% of the business and have been planning an offering on the Warsaw Stock Exchange. Domestic and foreign players will be offered 55.9 million shares when market conditions improve.

Zygmunt Solorz's Telewizja Polsat, has been a key player in private commercial television in Poland ever since it launched an unauthorized DTH channel in 1992. Two years later the company was granted a terrestrial license and quickly grew its audience share. In 2000 Polsat launched a DTH platform and at the end of the year the number of the subscribers reached 200,000. The company also has an interest in minor channel TV4. Outside of Poland, Polsat controls Baltic Media Holding which operates a network of commercial channels: Latvia's LNT, Estonia's TV1 and Lithuania's Baltijos TV. The company is seeking an outside investor to fund its expansion plans and will offer between 33% and 49% of the company. Under the Polish law a foreign company cannot hold more than 33% in a media company.

Finally, highly-profitable Agora is the largest media company in the country. It is listed on the Warsaw Stock Exchange and has only a small foreign ownership[4]. With its flagship Gazeta Wyborcza newspaper, the company has extensive publishing interests, 10% of the radio market, and internet properties but has not yet moved into television although it has expressed strong interest in digital terrestrial licenses. With a USD 365 million war chest the company has plans for expansion in Poland and Eastern Europe. A critical obstacle for the company is a proposed cross-media holding rule which would prohibit national daily newspapers and magazines from acquiring national TV or radio networks.

For these companies growth will depend on a number of issues that have general relevance throughout the region. The success of local players depends on the further development of capital markets in Eastern Europe, notorious for their opacity. If development of local players is desirable do national cross-media holding restrictions need to be relaxed to nurture them? To what extent will alignment with EU media policy hinder the ability of national media regulators to foster their own broadcasting industries? And of course, to what extent should foreign capital be used to fund investments and not lose operational control?

[4] *As of July 2002 ownership included Cox Poland Investments with 10.3% of share capital.*

Factors affecting future investment strategies

Economic revival and return of ad market – Although GDP growth in the East remains higher than in the West, the Eastern countries are facing high unemployment and large budget deficits making their economic recovery more challenging. In the Czech Republic and Poland ad spend is expected to be flat through 2004 but one bright spot is Hungary where advertising has remained robust and unemployment remains below EU levels. And taken as a region, the Baltics have the highest growth prospects at the moment (see *Table 4*).

Table 4 - Economic indicators

	Unemployment 2000	Unemployment 2001	GDP growth 2000 to 2001
Bulgaria	16.9%	19.8%	4.5%
Czech Republic	8.9%	8.2%	3.5%
Estonia	13.6%	12.6%	5.4%
Hungary	6.5%	5.8%	3.8%
Latvia	14.5%	n/a	7.0%
Lithuania	15.4%	17.0%	n/a
Poland	16.1%	18.2%	1.0%
Romania	7.1%	6.5%	5.3%
EU	8.1%	7.6%	1% (OECD)

Source: OECD, national statistical agencies.

This uneven development has made Western media groups highly selective in their choice of markets both on the size and wealth aspect (Poland, Czech Republic, Hungary) and also with regard to the openness to foreign investment and ownership rules (The Baltics) (see *Table 5*).

Privatisation

A number of countries, especially those facing budget hardships, are debating the sale of public service channels. The strength of the public broadcasting sectors in the region has largely been a function of the extent to which they have been permitted to advertise. The Czech Republic restricts ad time in public broadcasting to 1%, Hungary to 10%, and Poland to 15%. If sale of second or third PSB channels are opened for tender, foreign investors, if allowed, could reap enormous benefits from the commercialisation of these assets. RTL, for one, has made clear it would return to the region for this purpose under the right conditions.

Table 5 - Television advertising (% change year-on-year)

	2000	2001	2002	2003	2004
Bulgaria	49.3%	7.4%	13.2%	14.3%	6.8%
Czech Republic	16.4%	-1.5%	3.4%	0.5%	0.1%
Estonia	14.3%	80.0%	4.8%	0.0%	-1.9%
Hungary	24.3%	12.7%	17.6%	15.7%	10.4%
Latvia	10.5%	11.2%	8.6%	8.2%	7.2%
Lithuania	-12.5%	2.0%	9.9%	12.4%	25.2%
Poland	-0.2%	28.5%	2.7%	-3.2%	4.4%
Romania	3.2%	-2.5%	5.7%	9.1%	3.5%

Source: Zenith Media

Digitalisation

As digitalisation of television becomes a national priority Eastern countries will require the major capital investment, marketing and technical expertise which foreign companies can provide. However, they risk losing control of how, when, and where digital TV is rolled-out. The smaller, poorer markets will be more at risk. Already MTG has a monopoly on digital television in the Baltics through its satellite platform. UPC is likely to take the lead in the digitalisation of cable in the countries where it operates. A crucial test will come when the legal framework and tender rules for digital terrestrial television are formulated. If DTT markets open themselves to foreign investors we may see another round of foreign incursion not only by the pay TV operators but by the commercial broadcasters as well. On the other hand, if DTT is tightly regulated and overly favours domestic players badly needed capital investment will not be forthcoming.

Finally, the enlargement process will impinge on many of the issues discussed. As the countries of Eastern Europe move closer to EU membership their broadcasting industries will be more scrutinized and broadcasting regulations, many of which had been favourable to foreign investors, will need to be aligned with EU directives. Enlargement is linked to broadcasting policy primarily through the Television Without Frontiers Directive and through Community programmes[5]. By July 2002 all candidate countries except Romania had provisionally closed Chapter 20 on Culture and Audiovisual aspects.■

Further reading…

SBS adopts a more conservative, cost-conscious management style

Europe's second largest station group SBS touted a more conservative, cost-conscious management style and emphasized local programming as the key to greater market share. SBS exec chairman Harry Sloan said the group had performed particularly well over the last quarter, with cost-savings of 8%, and that it was on course for "its best year ever" — record revenues of USD 500 million, record EBITDA and record cash flow. CEO Markus Tellenbach said the company had cleared out under-performing management in several territories and slotted "creative people" into top jobs at each station. Staffs, on average, have been pared by 20% and corporate overheads by 15%. Co-productions and digitalization have also helped trim budgets. Sloan, an American based in London, said SBS' reliance on Hollywood product had lessened considerably. Annual spend on U.S movies and TV series stands at USD 100 million a year, down by 50% over the last several years. "From Hungary to Belgium the audience preference is for local shows," Tellenbach said. SBS had talked of expansion into other markets, but Sloan now says that the focus is on the territories where the company already has a base. Further down the road, greater consolidation in Euro media is bound to overtake the company. A merger with chief rival RTL might make sense, but there would probably have to be station disposals in markets where the two are in competition.

Variety, 10 October 2002

Media Plus means cash for Polish filmmakers

Poland's financially strapped film industry will soon be able to apply for funding from the European Union's Media Plus program. The scheme's Warsaw office, will open later this month in conjunction with the National Radio and Television Council (KRRiTV). But it will ultimately be up to the European Commission to decide who will get the funds. KRRiTV's Braun signed a memorandum of understanding with the EC in June for Poland's participation in Media Plus. The Media Plus program was launched in 2001 and is scheduled to run until 2005. It has a budget of EUR 400 million, which due to EU enlargement plans, will be extended to candidate countries. The funds support projects thematically linked with the EU or its member

[5] *The EU allowed eight candidate countries to join the Media programme which works to develop the film industry through distribution and co-production of material: Bulgaria, Cyprus, the Czech Republic, Estonia, Latvia, Lithuania, Poland and Slovakia will join the program during 2002, or by 2003 at the latest. Slovenia will become a member soon. Only 42 films from central and eastern states were distributed commercially in one or more EU countries between 1996 and 2001, according to a recent study by the European Audiovisual Observatory. One goal is to prevent candidate countries' domestic markets from being dominated by Hollywood majors.*

states, such as film production, film festivals, promotion and TV production. To participate in Media Plus, Poland is required to contribute EUR 1.55 million annually starting this year. The bill will be split between the state budget and the EU's PHARE program, which provides pre-accession funds to EU candidates. As one of eight EU candidate countries of the total 23 countries participating in Media Plus, recipients can expect about EUR 4 million per year. By comparison, Telewizja Polska (TVP) the national broadcaster alone had EUR 6.3 million to spend on feature film production last year.

Warsaw Business Journal, 16 September 2002

"Blueprint for media investment"

A Merrill Lynch report by Neil Blackley, Global Media Team , London, United Kingdom
September 2002, price not available
http://www.mlim.co.uk

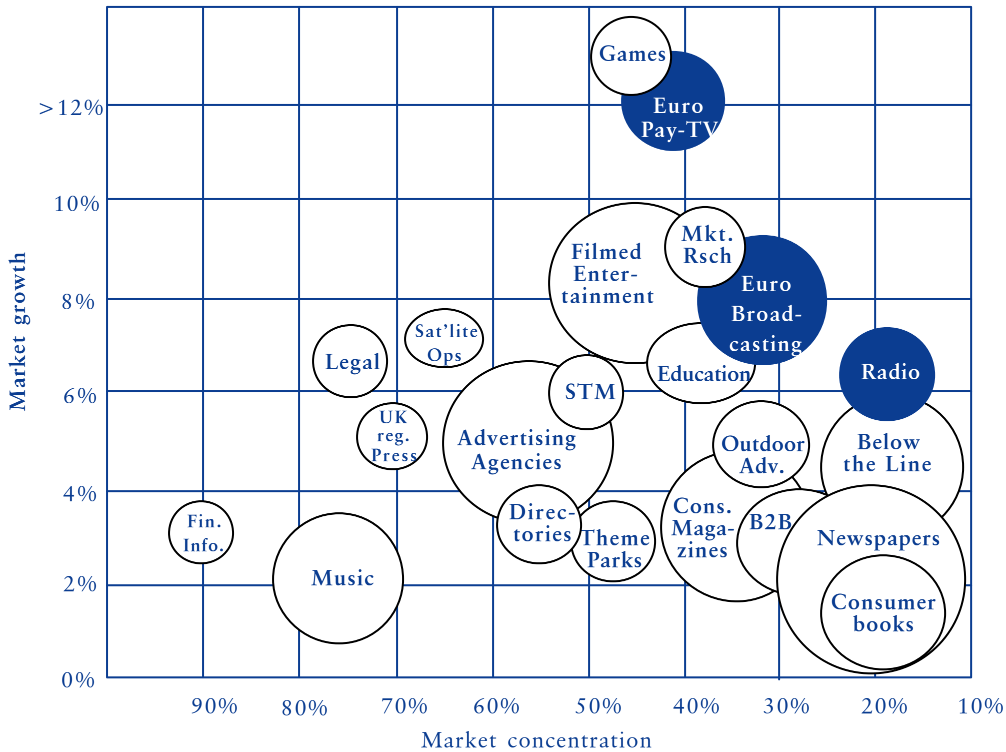
> *"The biggest risk to FTA broadcasters is continued audience fragmentation due to increasing multichannel home penetration (DTT, DTH, and digital cable). In a defensive move the industry is consolidating both horizontally and vertically, although still largely in a domestic context."*

In this comprehensive report aimed primarily at media investors, Merrill Lynch looks at 22 media sub-sectors, makes conclusions about their growth potential and evaluates performance and prospects of the underlying stocks in each sector. The report culminates in valuation tables, buy-sell-hold recommendations together with price objectives for companies covered.

The authors use a traditional strength-and-weaknesses approach in evaluating companies and markets. The country coverage varies by section, but at best includes only the big 5 and Scandinavia.

The following are the main conclusions in the FTA Broadcasting, Radio, and Pay-TV sections:

Chart 1 - Growth vs. fragmentation



Note: Size of the bubble indicates the size of the market. Market concentration = % of market occupied by top 5 operators.

Source: Merrill Lynch

FTA Broadcasting

- European FTA broadcasters have enjoyed above average growth, despite declining audiences, due to the ability to put CPT pricing up well above inflation.
- Leading European broadcasters are a 'must have' mass-market medium for brand advertising.

Table 1 - Operating profit margins

Op margins (%)	2001
Telecinco	c.30.0
Mediaset	25.0
M6	24.4
TF1 Broadcasting	24.0
Antena 3	23.0
SMG	17.6
TF1 Group	16.2
Granada	12.5
ProSiebenSAT1	9.5
Carlton	7.7
RTL Group	6.7

Source: Merrill Lynch estimates

- FTA broadcasters in Continental Europe need to invest more in original drama and have yet to incur the costs of dual illumination.
- Despite recent high-profile failures, DTT can be successful as an extended FTA bouquet avoiding direct competition with cable and DTH operators.

Radio

- Radio has been one of the fastest growing media historically due to growth as a % of advertising in some countries from a low base.
- Growth should continue above average, although the medium is suffering in the recession, and also from having enjoyed the highest proportion of Internet advertising during the tech boom, which has largely disappeared.
- The combination of high margins and high volatility makes the industry quite operationally geared.
- The UK should be one of the most attractive markets going forward due to growth of the medium as a % of total advertising and the significant intra-radio consolidation benefits likely from the relaxation of ownership rules.

European Pay-TV

- The second fastest growth sector historically, and forecast to be the fastest growth sector going forward.
- Growth driven by secular growth of multi-channel home penetration; new services; price increases above inflation due to relatively price inelastic market to value added product and the upgrading and lifting of price restraints within European Cable.
- Share price performances of companies have been some of the worst due to: the costs of transition to digital; free decoder give-aways; rampant piracy; capital intensity of cable build out, and poor cable subscriber management with commensurate high churn.

The authors base their analysis of the future on the assumption that we are at the bottom of the advertising recession and the timing for sustained recovery in not far off.

Merrill Lynch acknowledges that it is providing, or is seeking to provide, investment banking and other services to the companies in the report. ■

Reviewed by Alexander Shulzycki
Senior Media Analyst
Strategic Information Service, EBU, Geneva

Strategic Information Service (SIS)

European Broadcasting Union (EBU)

17A, Ancienne Route CH-1218 Grand-Saconnex
Phone +41 22 717 2111 Fax +41 22 717 2015

www.ebu.ch/sis