



The calm before the storm

Arthur D. Little Latin America media Flow of Funds

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Arthur D Little

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Authors:



Clemens Schwaiger

Principal, Telecommunication, Information, Media & Electronics, Vienna
schwaiger.clemens@adlittle.com



Guillem Casahuga

Partner, Telecommunication, Information, Media & Electronics, Houston
casahuga.guillem@adlittle.com

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Executive summary

During the last six years, we have seen a general recovery of the world's economy from the last big economic crisis in 2008, with some specific and interesting contrast between the advanced and emerging economies. In the first half of this decade (2010–2015), Latin America and the Caribbean (LATAM) enjoyed a steady economic growth of 6.2 percent, while the European Union, the US, Canada and Japan were struggling to reach 2.7 percent annual growth. This tendency is the same in the media and entertainment industry, in which LATAM experienced healthy 8.9 percent yearly growth, versus a 4.1 percent in the most advanced economies for the same observation period.

Even though the economic-growth tendency in LATAM changed during the last two years, driven by a decrease in oil prices and other commodities in the region, we still expect a healthy yearly growth of 5.6 percent, versus 2.4 percent in Europe and 3.5 percent in North America, until 2020.

However, not everything is good news for the traditional media and entertainment players in LATAM, which have enjoyed this growth. Shifting from an 8.9 percent to 5.6 percent yearly industry growth rate, traditional players will start to notice erosion in their income, driven by a surge of new digital trends and players that will become more relevant in the coming years – just like the advanced economies are experiencing right now.

Our analysis describes how the different revenues will shift from traditional to online players in each industry segment from the media and entertainment ecosystem, and how each main component of the value chain will be advantaged or disadvantaged in this transformation. Our main conclusions for the next three years are:

- The news and print industry will experience the biggest pressure in its revenue structure. Traditional players will struggle to protect their income and decrease their share of advertising revenues. In addition, consumer spend will migrate to new online business models with lower rates and higher reach.
- The “books” industry will also be disrupted, as distributors will have to compete against new business models in which consumers can get their desired content directly from authors.

- The TV and video industry will experience growth that will compensate for the value shift to new online players, at least until 2020. This scenario might look different in countries where the population's connectivity and availability of electronic payments evolve fast.
- The music and radio industry will be the least affected in the coming years, given the population's low connectivity and lack of access to electronic payment options, which limits the reach of new online music services.
- The gaming industry, which traditionally has held the highest online share of all media segments, will continue to experience growth based on digital distribution and massively multiplayer online games.

In general, the impact of new online players and business models will not be as critical in LATAM as in other regions in the next three years, thanks to the low connectivity and banking levels of the Latin American markets. However, this situation will not last forever, and traditional players should learn from what is happening in the most advanced markets and prepare to compete with the new entrants disrupting the entire industry via other markets.

1. Key figures

€4.37 billion	LATAM Media Industry	5.7% CAGR
Incremental online revenue growth of the global media industry between 2016-2020		Average growth of the global media industry from 2016 to 2020
16.3%	LATAM Media Industry	€13 billion
Share of online revenues in the media industry revenues by 2020		Incremental total revenue growth of the media industry between 2016-2020
11%	LATAM Online Consumer Spend	+12.1 CAGR
Share of online consumer spend in total consumer spend in 2020		Average growth of the global online consumer spend from 2016-2020
24%	LATAM Online Advertising	+15.4 CAGR
Share of online advertising revenues in total advertising revenues in 2020		Average growth of the online advertising revenues from 2016-2020

2. Introduction

The media industry is experiencing a massive digital transformation, with some disruption speeds specific to market attributes. New online competitors and business models are challenging traditional media companies. At the same time, through the digitization of the industry, consumers are gaining access to myriad new opportunities to consume media.

This creates a complex and volatile environment for media companies, and it becomes ever more important to understand how this transformation affects value flows. With this report, Arthur D. Little provides insight into the speed and main beneficiaries of this transformation of the media industry for Latin America, given its market specific conditions.

The objectives of this report are to enable:

- Media corporations to identify opportunities for vertical or horizontal integration, as well as guide portfolio optimization and go-to-market strategies
- Financial investors to identify the most attractive market segments and acquisition targets
- Policy-makers to identify areas where excessive value capture is leading to economic imbalances during the transformation
- Academia to build on a strong base of data and a framework that can be used to deepen research into the transformation of individual segments of the media industry.

“Flow of Funds” methodology

Arthur D. Little employs a comprehensive methodology to study the evolution of the media industry. In our global report (see “Consolidate, diversify or perish,” published February 2017, www.adl.com/MediaIndustry), the analysis focused on North America, APAC, Europe, LATAM and MENA and studied the period between 2011-2020, as well as offering a forecast until 2020.

For this LATAM edition, we focused on the main Latin American markets (Mexico, Colombia, Peru, Brazil, Argentina and Chile), summarizing key trends and value shifts of more than 70 individual media segments. This report’s analysis centers on the period of 2016–2020; for presentation reasons, we summarized this extensive quantitative data in six major media segments

(TV & video, news & print, books, music & radio, gaming, online advertising).

Our quantitative analysis identifies the sources of funds (advertising spend, consumer spend, public spend) and whether the spending is for online or traditional (“offline”) consumption. Most industry forecasts only provide revenue developments by media segment, while our analysis tracks specifically how this revenue flows through the rest of the value chain – i.e., from distribution to aggregation to production. This sheds light on the impact of the online transformation throughout the value chain, and helps to identify value-chain positions that will claim a growing or declining share of the industry’s value.

Our analysis was based on historical and forecast values of third-party data providers for the revenue inflows. We then conducted significant cross-checks and improvements to these original data sources per segment and geography. For the flow between the individual value-chain steps and the respective media segments, we conducted a comprehensive analysis of gross margin trends per value chain step, as well as individual cost item trends (content cost in pay-TV, traffic acquisition cost in online advertising, etc.). We used 2016 average exchange rates for historical and forecast revenue data.

We define traditional distributors as all entities holding the direct consumer relationship in each media segment (e.g., pay-TV platform, news stand, physical media retailer), and traditional aggregators as all entities aggregating individual units of content into consumable media (e.g., newspaper/magazine publishers, TV channels, games publishers, music labels and publishers).

Content producers can be either individuals (e.g., authors, independent journalists, composers, artists, TV/film producers) or corporations (e.g., Hollywood studios, press and photo agencies).

3. Latin America as a different market

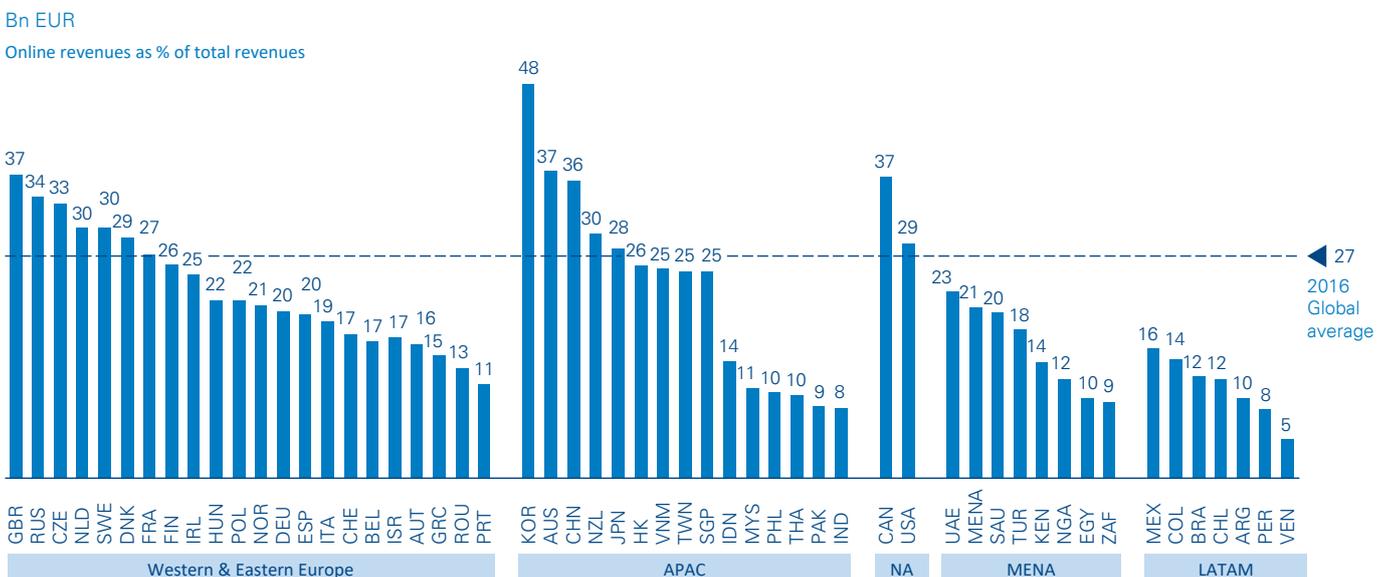
Composed mainly of developing economies, Latin America has very different digitization maturity compared to the developed economies of the world (North America, Canada, Western Europe and Japan).

For example, millennials, which are considered the driving force of digitization needs, have a less pronounced impact on the media industry than elsewhere. Although they represent 41 percent of the population in Latin America versus 31 percent in developed countries, millennials in Latin America are restricted by less access to digital electronics. This is because digital electronics are considered a luxury product and more exposed to robbery, and there is less trust in digital transactions and lower internet penetration. Low digital trust affects the development of the digital economy, which is heavily changing the rules of the game for the media and entertainment industry in advanced countries (for example, with sharing economies, online consumer advocacy groups and price comparison platforms).

In terms of the mobile industry as the driver for service anywhere and anytime, specific gaps between Latin America and developed countries have to be considered, too. Mobile subscription penetration is similar in Latin America versus developed economies, with 110–113 subscriptions per 100 habitants, but typologies differ heavily. Voice is still the value

driver for Latin American mobile users, representing 60 percent of their subscription costs and leaving the remaining 40 percent for data packages. Comparing this data share versus the 55 percent average spend per subscription in developed countries, we can assume that there is a major difference between mobile phone users in these markets. This situation becomes even more evident when we consider that Latin America has an average revenue per user (ARPU) of US\$11.2 per month, versus US\$29.4 ARPU in developed markets. This triggers lower affordability of mobile services in Latin America, given that the GDP per capita is less than one-fifth compared to developed regions. In terms of internet-usage penetration, Latin America ranks far lower than developed countries. According to the World Bank, only 54.5 percent of Latin American citizens use the internet on a regular basis, compared to an 84 percent in developed economies. Furthermore, this gap is more dramatic if we take into account the segment of 60+-year-old population for which Internet adoption is only 11 percent in Latin America and 25 percent in developed countries. Additionally, the quality of connectivity differs from one market to another. Despite the mass-market deployment of 4G mobile technologies and fixed broadband as the main option to ensure high-quality and unrestricted traffic, connectivity has different levels of penetration. As an example, there are 39 connections per habitant in developed economies, as opposed to only 10.5 for

Figure 1: Online share, by region 2016



Source: Arthur D. Little Media Flow of Funds database

Latin America. This is forcing a major share of the Latin American population to connect via mobile broadband with coverage, spectrum saturation and traffic restrictions.

Banking coverage and electronic-payment accessibility are another major difference between the regions. In Latin America, the banking product coverage (ages 15+) reaches 51.4 percent, versus 96.9 percent in developed countries, and credit card usage is 21 percent and 52.2 percent, respectively, for the same markets.

These differences have helped the media and entertainment industry in Latin America to maintain their traditional core revenues so far, unlike in the developed markets, where major disruptions are already happening. The limited connectivity and digitization among the Latin American population is delaying the

revenue-share growth of online businesses in the media and entertainment industry compared to in other regions.

In a high-level overview of the online revenue share of the global media and entertainment industry in 2016 by region, Latin America is the least-developed region, showing a 12 percent online share compared to a weighted global average of 27 percent.

We expect that this “digitization-lag effect” will give traditional media and entertainment players in Latin America some time to pursue their transformation goals with a profitable core business. However, this “advantage” will not last more than a couple of years, and slow movers will face major challenges in the future.

4. The media & entertainment industry – The calm before the storm

As discussed in the previous section, Latin America is lagging behind Europe and North America in the connectivity and digitization of its population and markets. This effect is also evident in our quantitative analysis, which indicates 5.7 percent CAGR industry growth between 2016 and 2020. Traditional offline advertising and consumer spend still has some considerable growth ahead, despite an evident migration to the online players, which will be facing connectivity challenges.

Analyzing the expected trends in the media market by source in Figure 2, we can see a two-digit growth rate in online advertising and consumer spend, but still this aggressive behavior is not enough to decimate offline-generated revenues.

As an aggregate for the total media industry, we estimate a three-year window of opportunity for traditional players to react and transform their businesses while there is still reliable revenue coming from their core offline activities. Indeed, the main challenge for media companies will be to get ready to capture online market-share growth.

As a general perspective, offline revenue streams are experiencing single-digit growth due to incipient migration of users to online business models and lower economic growth

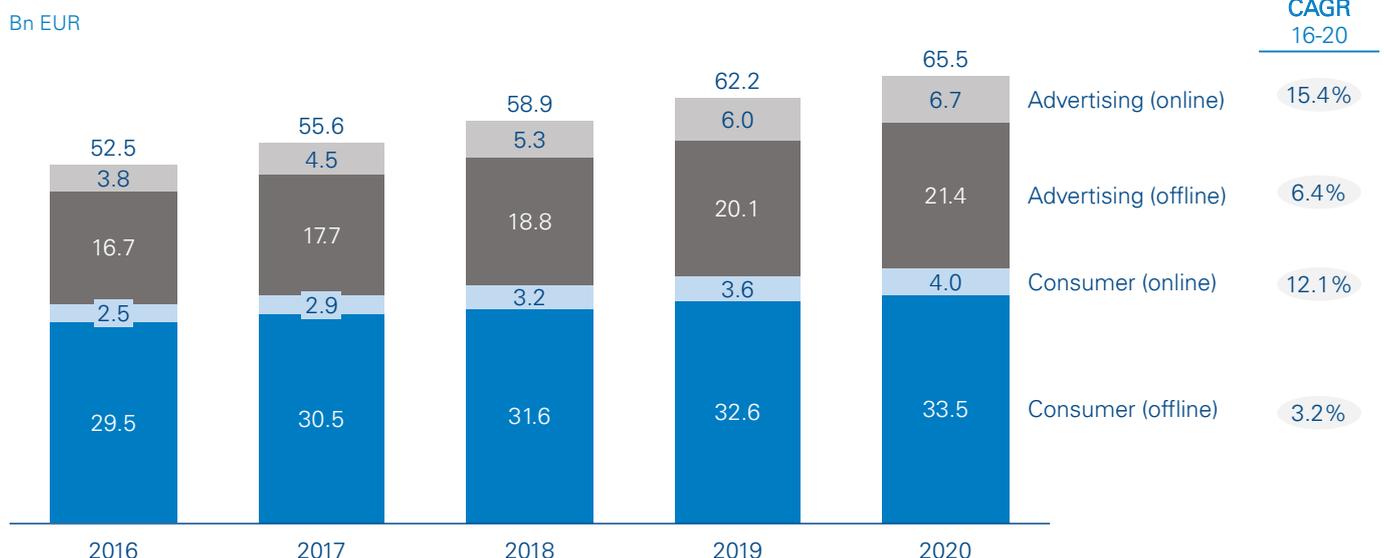
in the region. Offline consumer spend, mainly driven by subscriptions (i.e., pay TV) and retail transactions (i.e., magazines and newspapers), will be the revenue stream with lower growth thanks to new business models that seek more direct interaction between final customers and publishers or content owners. The two-digit growth of online customer spend will be boosted by the increase of e-commerce, OTT and on-demand content players, which are starting to consolidate in the region.

From the advertising-spend perspective, offline channels will remain important for advertisers in order to reach the non-connected population, which still accounts for the majority of the market. The new digital platforms and increasing connectivity will drive double-digit growth in online advertising spending.

Strong revenue growth in LATAM, but dynamics differ by segment and geography:

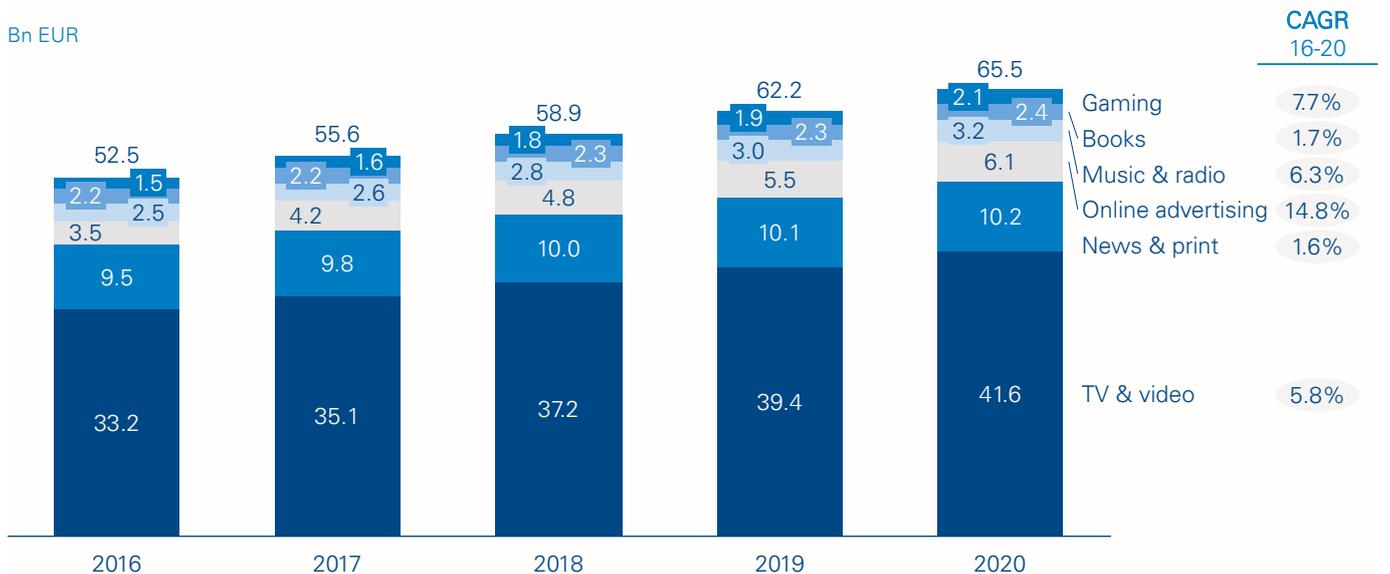
In our quantitative analysis of the LATAM media Industry, we collected data for more than 70 individual segments. However, in our report, this data can be summarized in six major segments:

Figure 2: Latin America media market, by source in bn EUR, 2016–2020



Source: Arthur D. Little Media Flow of Funds database

Figure 3: Latin America media market, by segment in bn EUR, 2016–2020



■ **News & print** represents all B2C circulation and advertising revenue for newspapers and magazines, as well as related online subscription and advertising revenue for e-magazines, e-newspapers and comparable portals. The internet has enabled an explosion of online distribution of breaking news, with online portals eliminating the time delay of traditional editorial activities.

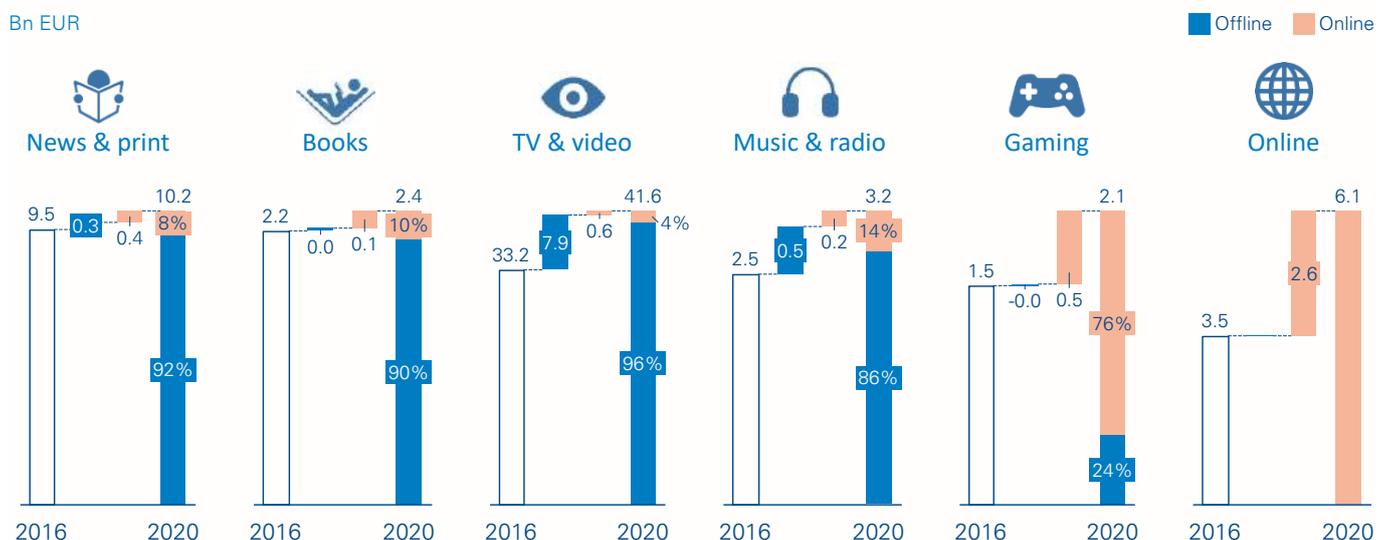
Offline print revenue is expected to grow by a mere EUR 0.3bn across the LATAM region, while online revenue will grow by just EUR 0.4bn. Traditional news & print companies are being challenged by social networks as a new information channel for online users, and also experiencing a strong impact in print circulation and share of online traffic.

This offline revenue growth suggest that traditional news & print companies in Latin America have a unique chance to take advantage of the slower erosion of their core offline businesses compared to in other regions. It is imperative to invest in driving a fast and effective transformation in order to adapt to the new online business models already seen in the advanced economies.

■ The **books** segment is comprised of all B2C revenue for physical books, audio books and e-books.

In our analysis we categorized the sale of printed books as offline (including printed books sold by e-commerce) and the e-versions (or e-books) as online. Offline revenues are

Figure 4: Offline decline & online growth, by segment 2016-2020



expected to be resilient (no growth from 2016–2020) to the digital transformation, and online growth will compensate (EUR 0.15bn), leading to an online share of 10 percent in 2020. Online revenue growth will come from the emerging e-books segment, which is preferred mainly by young and digitalized audiences, but with a lower unitary price that will limit the growth potential of the industry’s revenue.

- **TV & video** is by far the largest segment, and contains cinema (box office and advertising), home-video entertainment (retail and rental), online video (TVOD, SVOD, AVOD), pay TV (subscription, advertising), free-to-air TV (advertising), and public-service broadcasting fees where applicable.

Traditional TV & video companies in the region will be less challenged by the digital disruption discussed in this report. The TV & video segment will account for 91 percent of total offline growth in the media and entertainment industry in LATAM from 2016 to 2020. This large share of offline growth strongly contrasts with the online share of TV & video of only 14 percent during the same observation period.

This segment is showing healthy growth (almost 6 percent over 2016–2020), adding a total of EUR 8.4bn through 2020 to segment revenue. However, the online share will be quite low (4 percent in 2020).

Offline revenue growth will be driven by both consumer and advertising spend. The first is boosted by income growth of the still-non-digitalized households that want to get access to better content by pay-TV subscriptions, cinema box office and home video. Advertising spend will also increase in this segment, driven by advertisers’ need to reach the income-growing middle class who are not digitalized yet.

SVOD will drive most of the online growth in TV & video, but will remain constrained by low connectivity levels, lack of online payment options, and limited access to the local content that catches the attention of most of the population during prime time.

Traditional TV & video companies need to start preparing for an imminent connectivity surge in the general population while their core businesses are still growing.

- Revenue for **music & radio** comes from sales of recorded music (physical media, downloaded, streamed) and advertising (online radio), as well as from sponsoring and ticket sales for live-music events. Most of the growth will come from offline revenue in both advertising and consumer spend, accounting for a total of EUR 0.5 bn (out of 0.7). Online revenues will represent 14 percent of total revenues by 2020, and be the largest online share across all segments (except the gaming segment).

- Besides connectivity, online growth has two other challenges in the music & radio segments in Latin America:
 - Little access to digital payment methods such as credit cards, which prevents users from accessing online OTT premium content such as Spotify and Deezer.
 - High level of music piracy that grants easy access to desired content for the general population, through sale of low-cost, custom-made CDs in the streets and even in some malls. This highly accepted piracy activity still erodes the interest of individuals in paying a monthly fee for an online music platform.
- Given the specific market dynamics for this segment, traditional music & radio companies should be prepared for the digital disruption in the media industry, just like TV & video. But again, this situation will change as soon as the general connectivity levels of the population reach a more advanced stage.

- **Gaming** traditionally has the highest online share of all media segments, as the share of physical gaming revenue rapidly declined at the expense of digital distribution (i.e., downloads, streaming) and massively multiplayer online games (MMOG).

Just like other regions, Latin America has a fast-moving video-gaming industry that has gone through exciting changes over the past five years. Video-gaming experiences are constantly improving as video quality rapidly increases and new devices are launched. Gaming companies are changing their business models in response to strong competition, such as moving to free-to-play games, monetizing in-app advertisement and in-app purchases, and shifting their focus from physical to digital games to attract more players.

It is important to note that the gaming niche is more technology focused than the general population, even in a low digitization region such as Latin America.

Latin America already has a large share of online participation in its gaming segment. One of the main causes of this situation is high levels of broadly accepted piracy in all of the main gaming consoles. This piracy effect has existed since the 1990s, and historically limited video-game producers’ income to hardware revenues (i.e., console sales) and a few non-pirated games.

This lack of consumer spend has shifted the segment income to online business models during the last decade. Therefore, at least for the Latin American region, the concentration of growth in the online business of the gaming segment is not a surprise or disruption, and we do not expect major challenges for existing companies.

General country analysis

The dynamics in the six most important economies in LATAM differ significantly.

- **Brazil** is the largest Latin America media market, and online media revenues have reached a 12 percent share of total media revenue. Over the next three years, this share could grow by four percentage points (adding EUR 1.7bn) to reach 16 percent in 2020, representing half of offline growth (+EUR 3.1bn). However, online share is still below that of most other Latin American markets and suggests considerable upside potential.
- **Mexico**, as the second-biggest economy in Latin America, will be a key contributor to Latin America's online market growth and individually. This country will have the highest online share in its media and entertainment industry (21%), with online growth (EUR 1.3bn) identical to its offline growth (+EUR 1.3bn).
- **Argentina** will be the fastest-growing media and entertainment market, with overall revenue CAGR of +8.4 percent versus the +5.7 percent Latin American average. Online share of revenue is 10 percent, as opposed to the 12.3 percent Latin American average. However, the online double-digit growth rate (+15.5 percent in three years) won't be a threat for traditional offline players during the observation period. Offline media revenue will grow by four times (+EUR 2.2bn) the rate of online growth (+EUR 0.5bn).
- **Colombia's** media industry will grow significantly (second-highest revenue CAGR). Share of online media (14% in 2016) will grow up to 19 percent in 2020, making it the second-

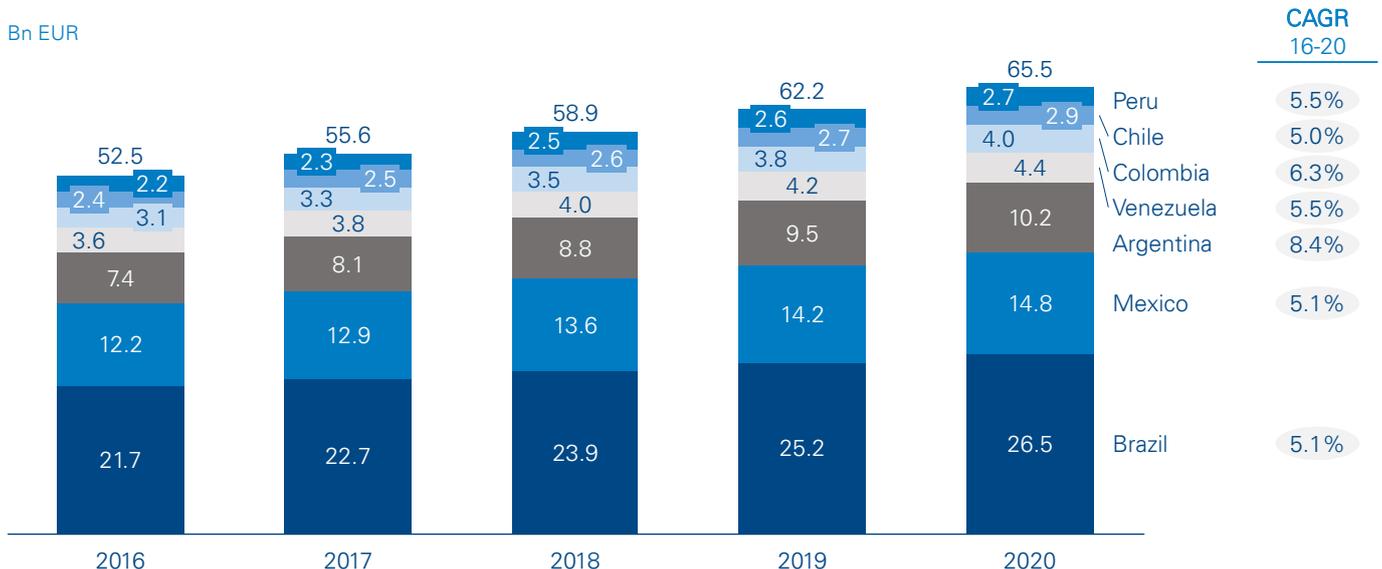
most advanced country after Mexico, thanks to several efforts from the government, such as the national broadband development plans ("Vive Digital"), which doubled fixed- and mobile-broadband penetration.

- **Chile**, as the most advanced economy of the region (highest per capita income), will exhibit an overall media revenue CAGR of +5% over the next three years. It is expected to see offline growth of nearly twice the rate (+EUR 0.3bn) of online growth (+EUR 0.17bn).
- **Peru** has the smallest economy of all reviewed countries in this report, and this is reflected in its media & entertainment industry with a total value of EUR 2.2 bn, accounting for 4.2 percent of the total regional market. The Peruvian media & entertainment industry will exhibit an average CAGR of +5.5 percent, similar to the Latin American average, but it will have the highest expected online ramp-up, with a +16 percent rate, reaching a 12 percent share of total media revenue.

Media flow of funds: How value flows in the media industry

The digitization of the media industry has led to significant challenges for its major players. Over the period of 2010-2016, the US-based media groups (e.g., Viacom, The Walt Disney Company, Time Warner) and LATAM groups (Televisa, Grupo Clarín and El Comercio) showed stronger fundamentals than their European peers, i.e., higher revenue and profitability growth. This was mainly due to a stronger domestic market, which rebounded faster from the economic downturn in 2008-2010, and a higher share

Figure 5: Latin America media market, by country in bn EUR, 2016–2020



Source: Arthur D. Little Media Flow of Funds database

Figure 6: Online / Offline share of revenues 2016

Bn EUR



Source: Arthur D. Little Media Flow of Funds database

Note: Figures in charts represent online revenues as % of total revenues, figures below charts are incremental values until 2020

of audiovisual revenue. Furthermore, the data suggest a link between scale and performance, with European companies recording substantially lower revenue than

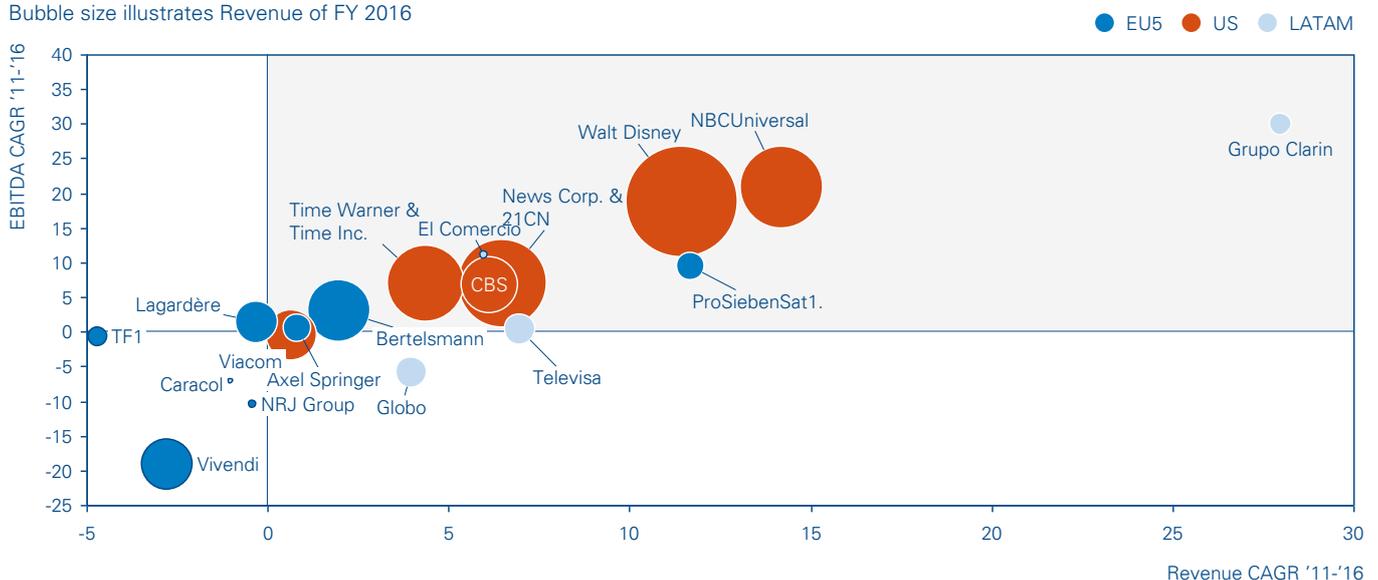
their US and LATAM peers. Most European media groups have sizeable legacy businesses in News & Print, which are undergoing a structural decline, which thus impacted headline revenue growth negatively. However, as a consequence, the European companies (e.g., Schibsted, Hubert Burda Media,

Axel Springer) were forced to diversify aggressively into online segments, with the online revenue of some of these companies now accounting for up to 50% (or more, in some cases) of their total. Going forward, we thus expect stronger revenue growth rates for most European players.

The revenue perspective only gives us a high-level idea of how the media industry will be changing in the coming years. In order to improve this perspective, Arthur D. Little has carried

Figure 7: Revenue & EBITDA CAGR, 2011–2016

Bubble size illustrates Revenue of FY 2016



Source: Arthur D. Little analysis

out a structured study of the recent evolution of the media & entertainment sector in the LATAM region.

With this analysis, we are able to distinguish the sources of funds and their destinations, and separate online and offline consumption based on the projected income of the different players among the different sectors in the media and entertainment industry. Applying our methodology to deep dive into the six main markets in LATAM (Brazil, Mexico, Argentina, Chile, Colombia and Peru), we developed the flow of funds for the region's media & entertainment industry (Figure 8).

Our analysis of the flow of funds reveals three main conclusions:

1. The traditional players still have some time to adapt

No country, industry-segment or value-chain actor is suffering an important drop in their traditional offline income during our analyzed period.

This is an important regional advantage in the media & entertainment industry that needs to be exploited. Traditional companies should invest in understanding the main challenges of their peers in more advanced economies and transform themselves, so that they are prepared for the disruption coming in the middle term, now that they have the cash flow to do so.

If traditional players decide to stay put in their current offline business models, they will face the same challenges produced by the general disruption we see today in Europe and North America.

2. Content owners are the big winners

Thanks to the new business models in which digitization allows a better end customer/content-owner interaction, the last ones will be able to capture a larger share of the value chain, providing their content with less or entirely without intermediaries.

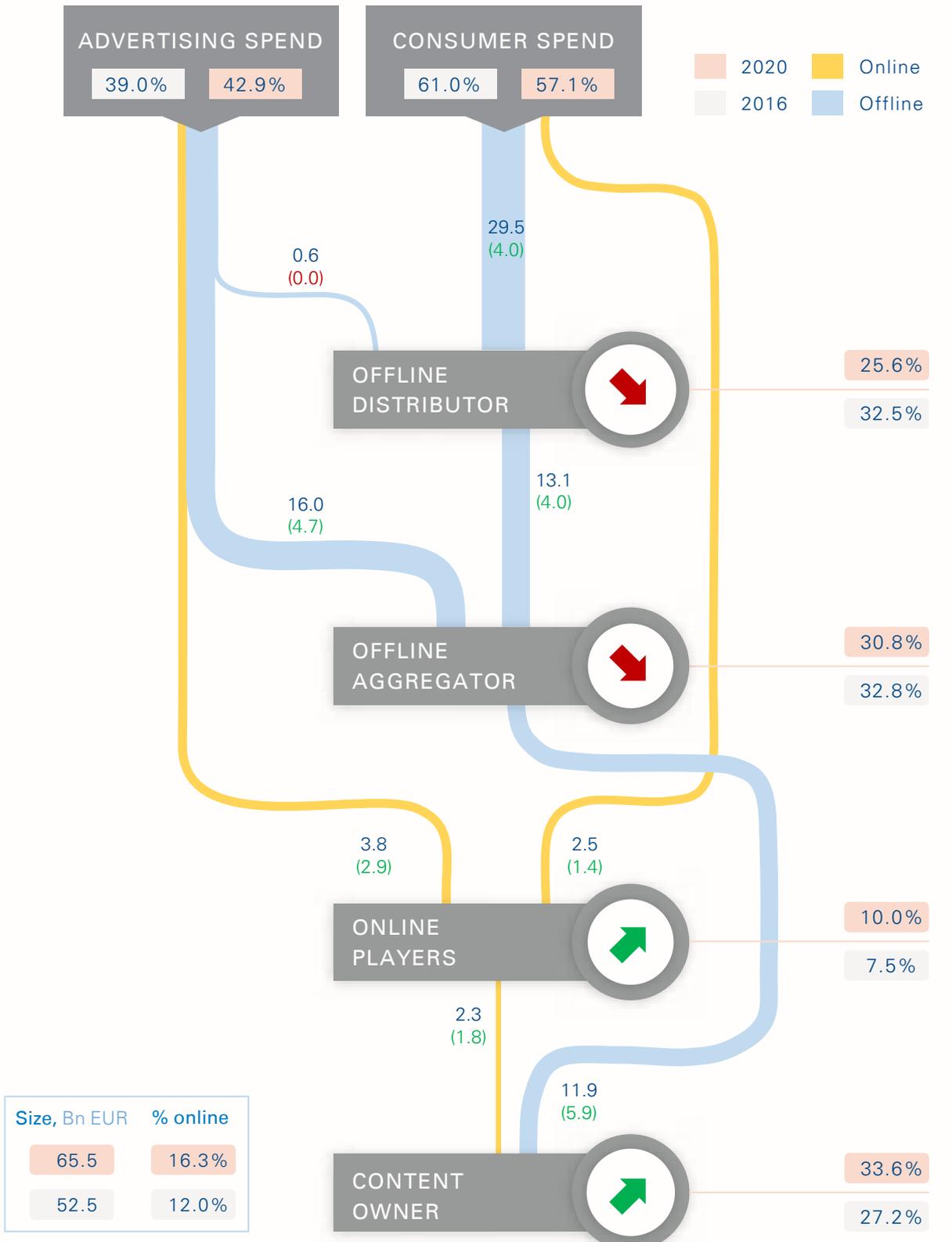
Specifically, content owners will increase their value share from 27.1 percent in 2016 to 33.1 percent in 2020, while offline distributors and aggregators will be affected the most by the eroding their value shares by six and two percentage points, respectively.

3. Offline intermediaries need to transform

As stated in the previous conclusion, offline distributors and aggregators will experience an important erosion in their value chain share. However, it is also important to note that offline distributors and aggregators will still experience some revenue growth, even with their relative share shirking.

As they are already facing the challenge of less market power because of erosion in their value-chain share, offline aggregators and distributors need to prioritize their investments in transforming or consolidating their businesses in order to survive.

Figure 8: Latin America Flow of Funds, all segments in bn EUR, 2016 vs. 2020



Source: Arthur D. Little Media Flow of Funds database

5. Highlights by country

The key trends in the media sector over the next years will not affect LATAM in the same way. In this section, we will provide an analysis of each market individually, assessing the trends in sources of funds and growth per media segment.

Brazil

In terms of online revenue growth, Brazil is adding 1.7 of the total EUR 4.3 bn regional growth, accounting for a 39.5 percent share that is very similar to its regional industry share. This means that besides being the biggest player, Brazil is driving average behavior in terms of regional offline-to-online industry revenue migration.

As with all Latin American countries, Brazil's media & entertainment industry's most important sector is TV & video with a more than 60 percent share.

It is also important to note that Brazil's two main media & entertainment segments, news & print and TV & video, will have a very mild online revenue share by 2020. This means that the other small segments, such as gaming and music & radio, will have a significant role in pushing the general online revenue growth of the country.

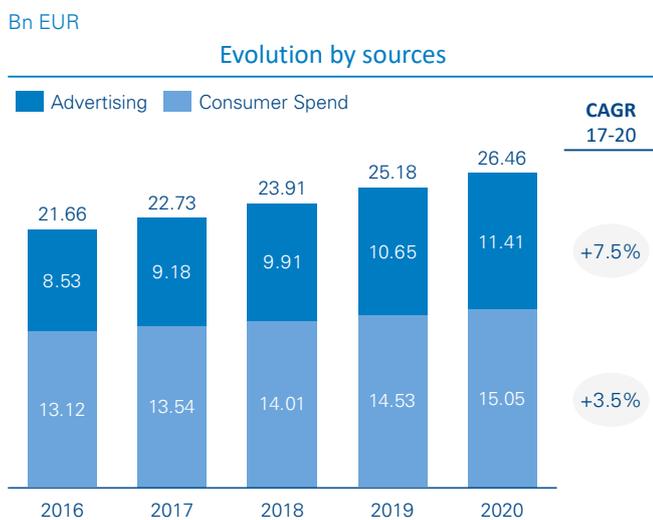
Brazil's flow of funds shows a consistent revenue increase for all online and offline players in the media-industry value chain, with the only exception of offline distributors' advertising spend (i.e., cinema advertising).

Even though offline distributors and aggregators will enjoy a mild revenue increase, it is important to note that their relative value share will erode during the observation period. Offline distributors' share will experience a strong erosion of 6.5 percentage points (20 percent relative), mainly driven by a lower increase in consumer spend due to the new competition by online players attracting consumers directly, without distribution needs. Offline aggregators will also experience a mild erosion of their share, mainly caused by an increasing preference of advertisers for online players.

Last but not least, besides online players, content owners are the big winners during the observation period, with a EUR 2.9 bn revenue increase and a six percentage-point share ramp up.

This effect is the result of new online players and business models with less intermediation being willing to share a larger piece of the value captured from the final consumers, as well as higher content cost in the traditional media value chain (e.g., price increases in premium-sports rights in TV).

Figure 9: Brazil- Evolution of sources of funds



Source: Arthur D. Little Media Flow of Funds database

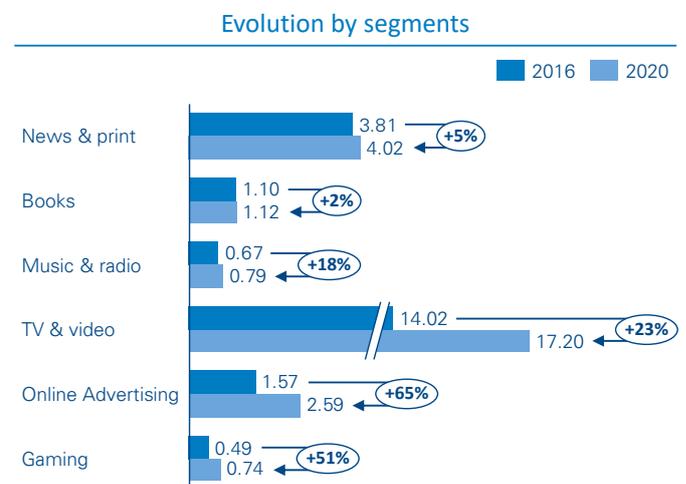
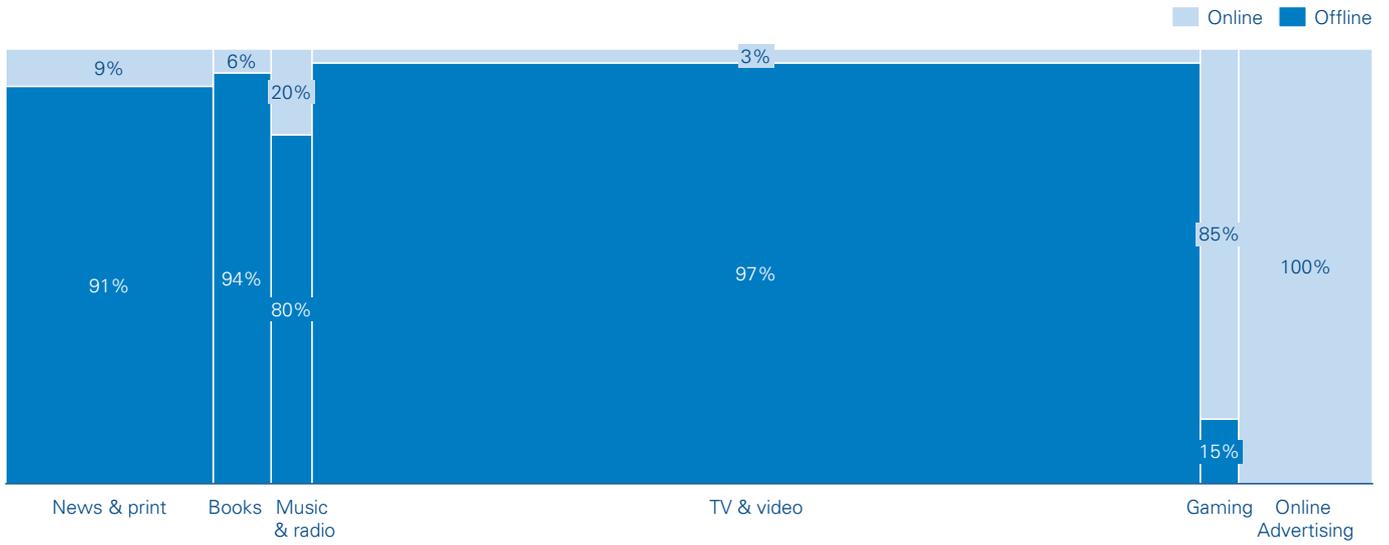
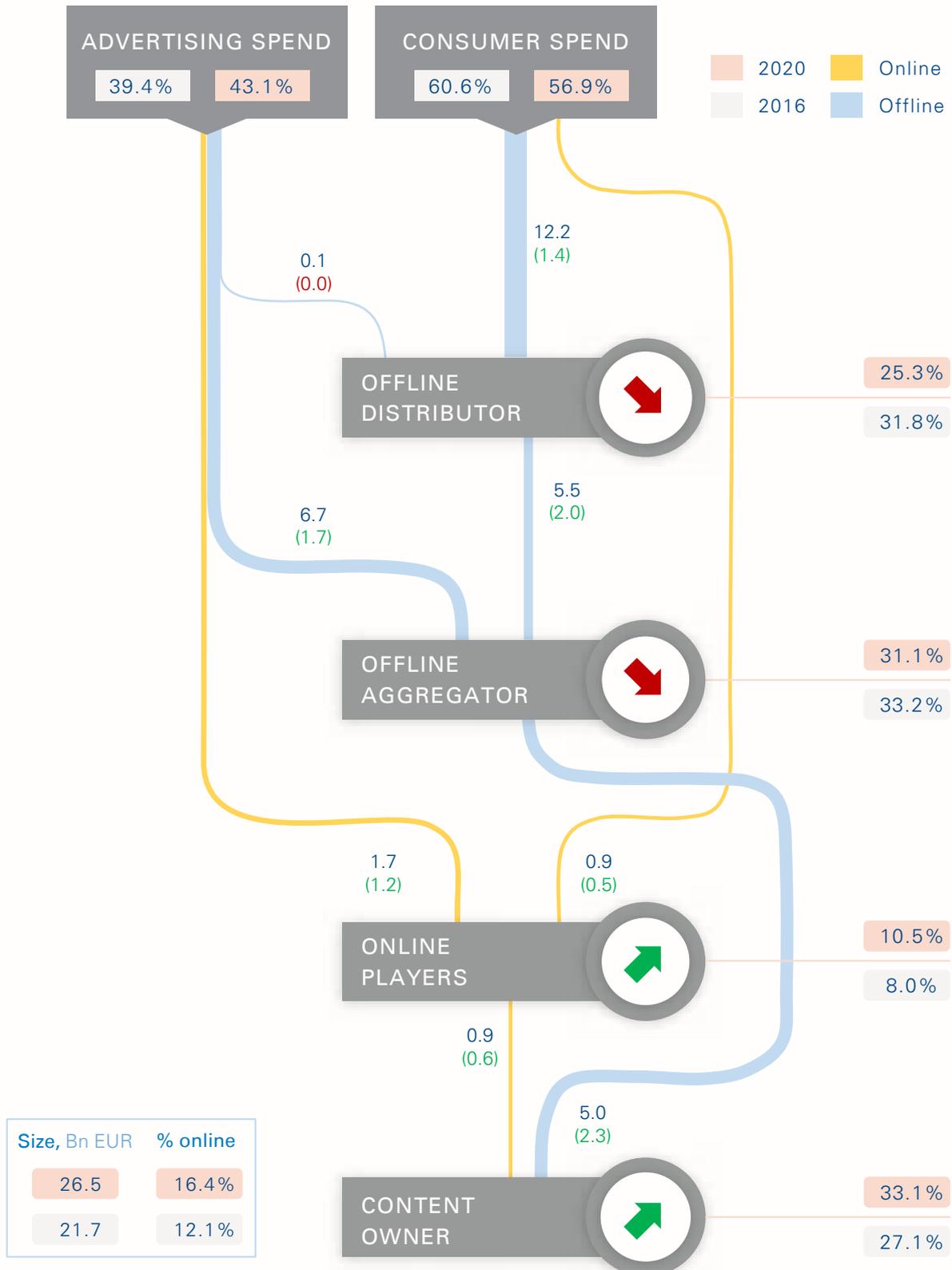


Figure 10: Brazil - Online share per segment, 2020



Source: Arthur D. Little Media Flow of Funds database

Figure 11: Brazil - Flow of Funds, all segments in bn EUR, 2016 vs. 2020



Source: Arthur D. Little Media Flow of Funds database

Mexico

Mexico is the only country in the region that will reach an online share above 20 percent by 2020. As the second economy in the region with a 22 percent share, and with a specific media & entertainment share of 23 percent, Mexico could be a very relevant player in the regional online transition given its size and market specifics.

To the total Latin American media & entertainment industry's expected online growth of EUR 4.3 bn from 2016 to 2020, Mexico will contribute EUR 1.3 bn, accounting for more than 30 percent of total growth. This contribution is almost 50 percent higher than its 23 percent regional industry share, which indicates Mexico's leading position in the region's media & entertainment disruption.

Like all other countries in the region, the TV & video segment is carrying most of the country's absolute industry growth, but Mexico is the only country that is experiencing a TV & video growth share below 50 percent. It is also important to note that the online advertising segment accounts for more than 34 percent of total growth, which reinforces Mexico as the leading country in Latin America for online growth in its media & entertainment industry.

This high online growth is mainly driven by a high increase in online advertising spend through sponsored OTTs and targeted advertising campaigns in news & print and music & radio. Thanks to the existing free-trade agreements with the US and Canada, Mexico is experiencing a stronger digitization influence

than any other country in the region. This provides a small compensation for the low connectivity of the population.

By 2020 Mexico will have a 5 percent online share in its TV & video segment, which will be above the regional average of 3.5 percent, in addition to a fairly representative online advertising segment with 13.4 percent, almost doubling the regional average of 7.3 percent.

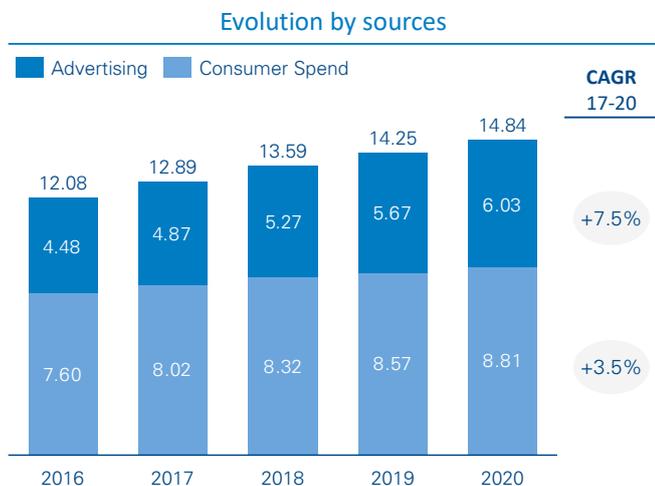
Mexico's flow of funds shows a consistent revenue increase for all the online and offline players in the media-industry value chain, with the only exception of offline distributors' advertising spend. Even though offline distributors and aggregators will enjoy a mild revenue increase, it is important to note that their market value share will erode during the observation period. Offline distributors' share will experience a strong erosion of 6.3 percentage points (20 percent relative), mainly driven by a lower increase in consumer spend due to the new online players' competition attracting consumers directly, without distribution needs.

Offline aggregators will also experience a mild erosion of their share, mainly caused by an increasing preference of advertisers for online players.

Last but not least, besides online players, content owners are the big winners during the observation period, with a EUR 1.7 bn revenue increase and a 5.7 percentage-point share ramp-up. This effect is the result of new online players and business models with less intermediation being willing to share a higher piece of the value captured from the final consumers.

Figure 12: Mexico - Evolution of sources of funds

Bn EUR



Source: Arthur D. Little Media Flow of Funds database

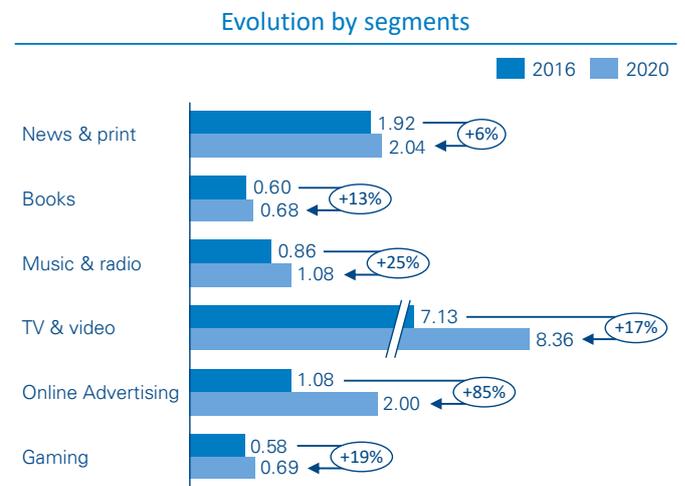
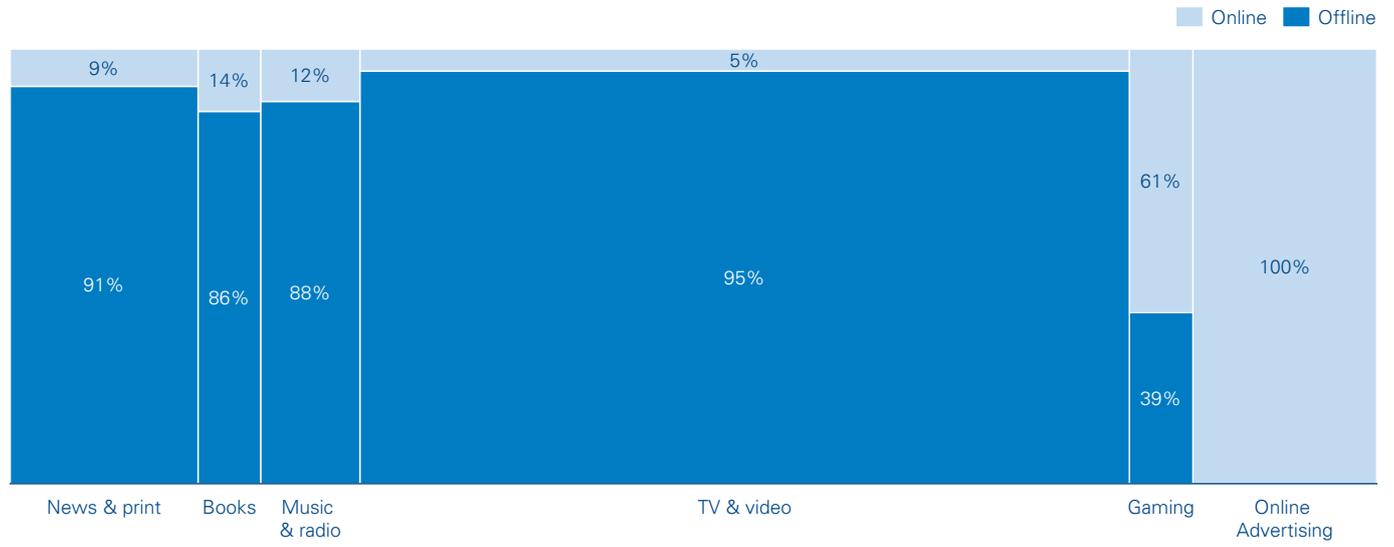
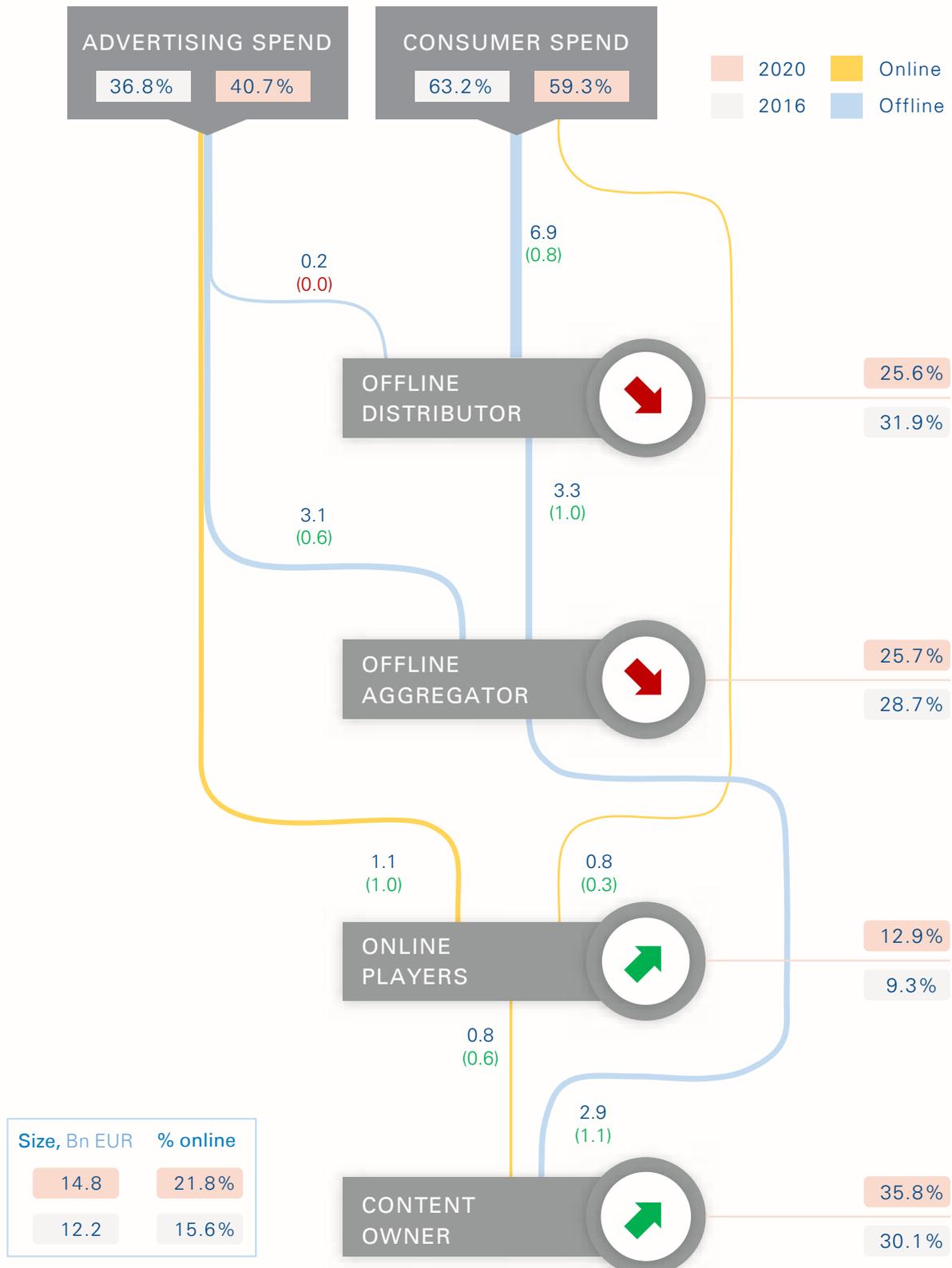


Figure 13: Mexico - Online share per segment, 2020



Source: Arthur D. Little Media Flow of Funds database

Figure 14: Mexico - Flow of Funds, all segments in bn EUR, 2016 vs. 2020



Source: Arthur D. Little Media Flow of Funds database

Argentina

Since 2016 Argentina has been experiencing an economic stabilization process as a result of a major shift in its internal political environment. This major change improved many of the country's industry-growth projections, including the media & entertainment industry. We expect Argentina to be the fastest-growing media & entertainment market in the region with a consolidated growth rate of 8.4 percent, versus a regional average of 5.7 percent. This effect can be noticed in both offline and online revenues, with 7.5 percent and 15.5 percent, respectively, and far over the regional 4.4 percent and 14.1 percent.

Argentina's growth is heavily focused on advertising spend, with a strong growth rate of 12.3 percent, and far ahead of Mexico's 7.7 percent as the closest follower. This ramp-up in advertising spend is likely to increase the TV & video segment's revenues, which will account for more than 70 percent of the total media & entertainment market for Argentina in 2020.

Currently Argentina's online share is small compared to that of other countries in the region, with a total size of EUR 0.7 bn, barely accounting for 10 percent of the total market. This rather small share of the online businesses in the market will be a clear advantage for the traditional offline players, which will have little to worry about with their online revenue growth. Even with a 15.5 percent growth rate, online businesses are starting from a much smaller size, and the market has plenty of new income for traditional players.

As already mentioned, Argentina's media & entertainment market is highly dependent on the TV & video segment. With

online revenues only representing 2 percent of the total TV & video segment by 2020, this segment is expected to remain resilient against the digital disruption already seen in more advanced markets.

The "online advertising" segment share for Argentina is in the regional average of 7.6 percent. With no exceptionally high online shares in the other segments, there is no critical mass to compensate for the lack of digital businesses in the TV & video segment.

With all these key factors, Argentina stands in with the second-lowest online share, at 12.2 percent – just over Peru's 11 percent – despite having the highest connectivity and banking levels of the region.

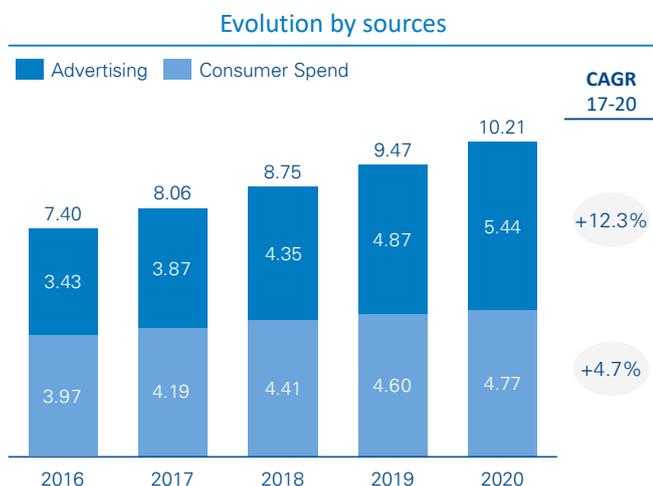
Argentina's flow of funds shows a consistent revenue increase for all the online and offline players in the media-industry value chain, with a strong focus on the advertising spend flipping the 2016 consumer/advertising spend backwards by 2020.

Offline aggregators, besides gaining important extra advertising revenue, are also gaining share in the value chain. This share increase is unique across the region and driven by the high concentration of TV & video revenues in the Argentinean media & entertainment market.

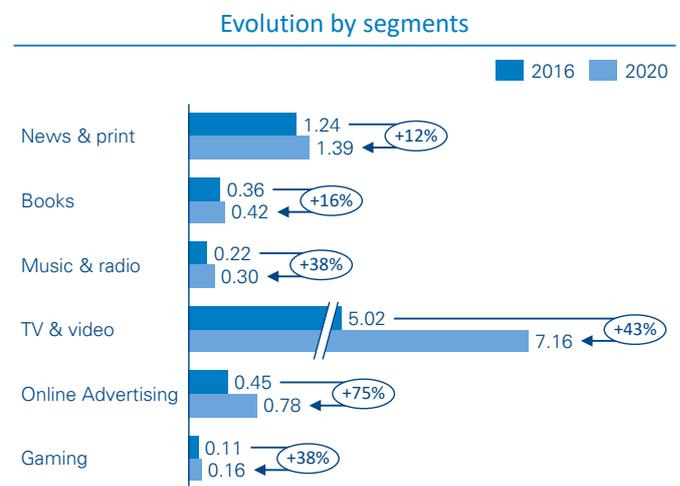
Even though offline distributors will enjoy a mild revenue increase, it is important to note that their value share will erode during the observation period. Offline distributors' share will experience a strong erosion of almost 10 percentage points (30 percent relative), mainly driven by higher content cost in TV & video and a lower increase in consumer spend due to

Figure 15: Argentina - Evolution of sources of funds

Bn EUR



Source: Arthur D. Little Media Flow of Funds database

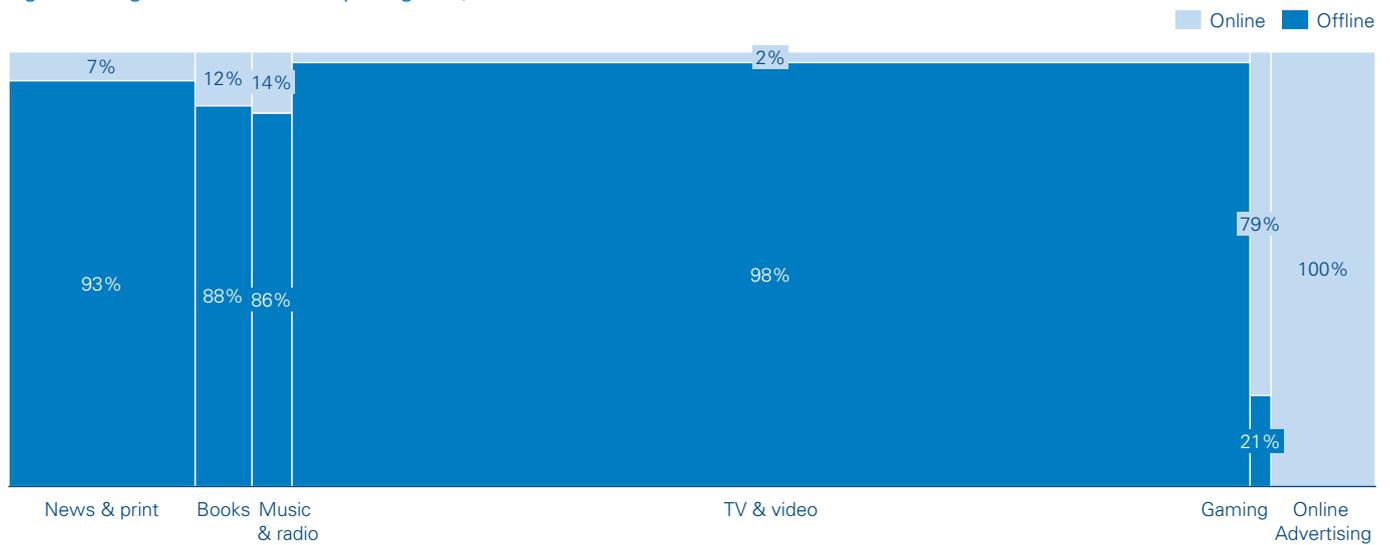


competition from new online players attracting consumers directly, without distribution needs.

Last but not least, besides online players, rights holders and content producers are the big winners during the observation

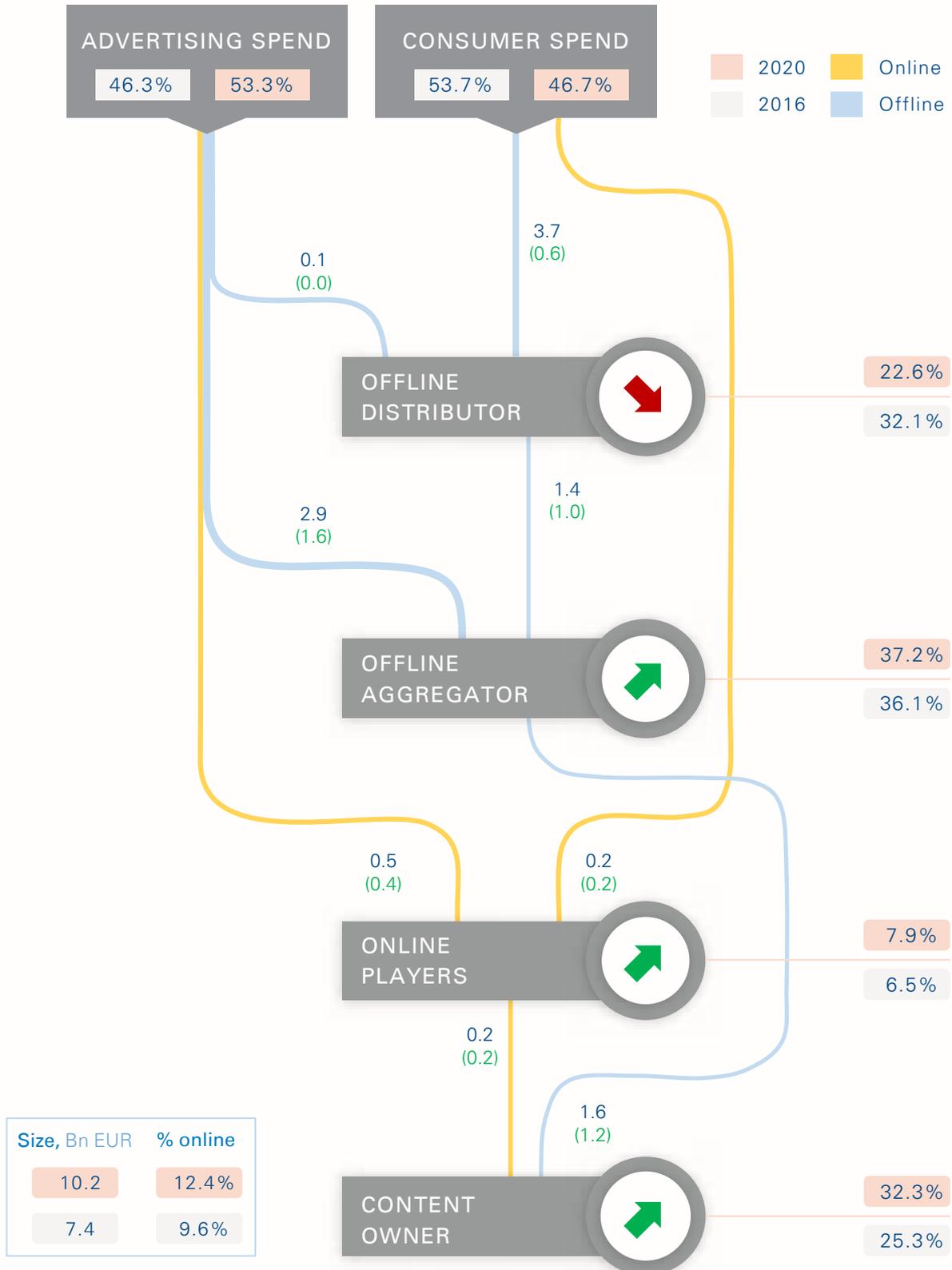
period, with a EUR 1.4 bn revenue increase and a 7 percentage-point share ramp-up. This effect is the result of new online players and business models with less intermediation being willing to share a larger piece of the value.

Figure 16: Argentina - Online share per segment, 2020



Source: Arthur D. Little Media Flow of Funds database

Figure 17: Argentina - Flow of Funds, all segments in bn EUR, 2016 vs. 2020



Source: Arthur D. Little Media Flow of Funds database

Colombia

Since 2010, Colombia has been implementing a very ambitious, nationwide plan for technology adoption. This plan, called “Vive Digital”, has as its primary objective the connectivity inclusion of the Colombian population in all the country’s urban areas with mobile and fixed broadband availability. As a result of this connectivity promotion plan, Colombia has been able to place its internet-usage levels at the same level as those of Chile and Argentina, regional leaders in this area.

This technology adoption campaign has also promoted the usage of digital applications, functionalities and content in the general population, helping online players to grow in the different industries.

The Colombian media & entertainment market in 2016 had a total size of EUR 3.1 bn, accounting for a 6 percent regional share and with an expected 6.3 percent growth rate, well above the 5.7 percent regional average. The media & entertainment online businesses in the Colombian market accounted for 14 percent share in 2016, the second-largest share behind Mexico in the region. Additionally, a 15 percent growth rate is expected from 2016 to 2020, making Colombia the only country in the region with above-average online penetration and online growth rate of 15 percent or higher.

Colombia’s growth-rate GAP between advertising and consumer spend results in a more distributive growth among the different media & entertainment sectors. As in all countries in the region, TV & video is the most important sector in the Colombian media & entertainment market, but the non-print sectors will be experiencing important growth until 2020.

We expect Colombia’s TV & video segment to have an 8 percent online revenue share, which will be the highest in the LATAM region. This effect is, in part, the result of the connectivity and digital content promotion efforts implemented in the “Vive digital” plan.

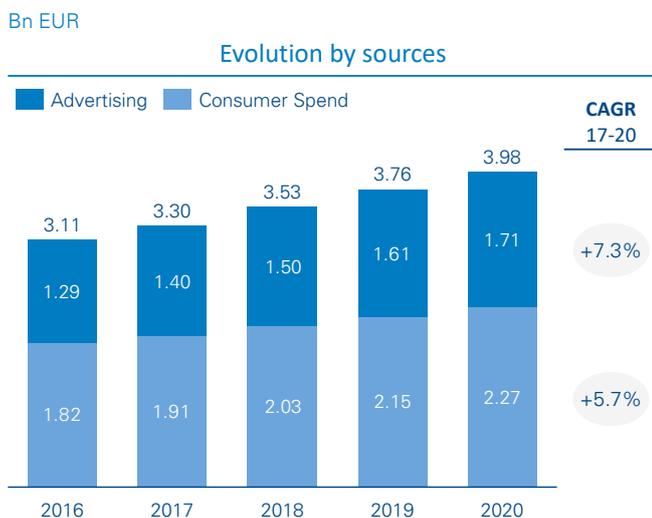
It is also important to note that the music & radio and gaming segments also show an above-average level of online share thanks to the high connectivity levels and availability of OTT services in local telecom offers.

Colombia’s flow of funds show a consistent revenue increase for all online and offline players in the media industry value chain. Unlike the other countries in the region, the consumer- and advertising-spend shares remain stable between 2016 and 2020, with only a 1.4 percentage-point change.

Even though offline distributors and aggregators will enjoy a mild revenue increase, it is important to note that their value share will erode during the observation period. Offline distributors’ share will experience erosion of 5.8 percentage points (20 percent relative), mainly driven by a higher share of consumer and advertising spend shifting to online players. Offline aggregators will also experience a mild erosion of their share, mainly caused by an increasing preference of advertisers for online players.

Last but not least, besides online players, content owners will gain an extra EUR 0.5 bn revenue increase and a 6.6 percentage-point share ramp up. This effect is the result of higher content cost in TV & video, as well as new online players and business models with less intermediation being willing to share a larger piece of the value captured from final consumers.

Figure 18: Colombia - Evolution of sources of funds



Source: Arthur D. Little Media Flow of Funds database

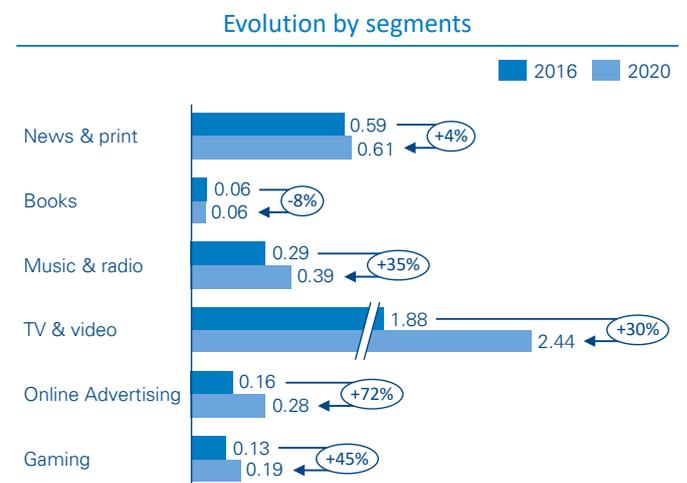
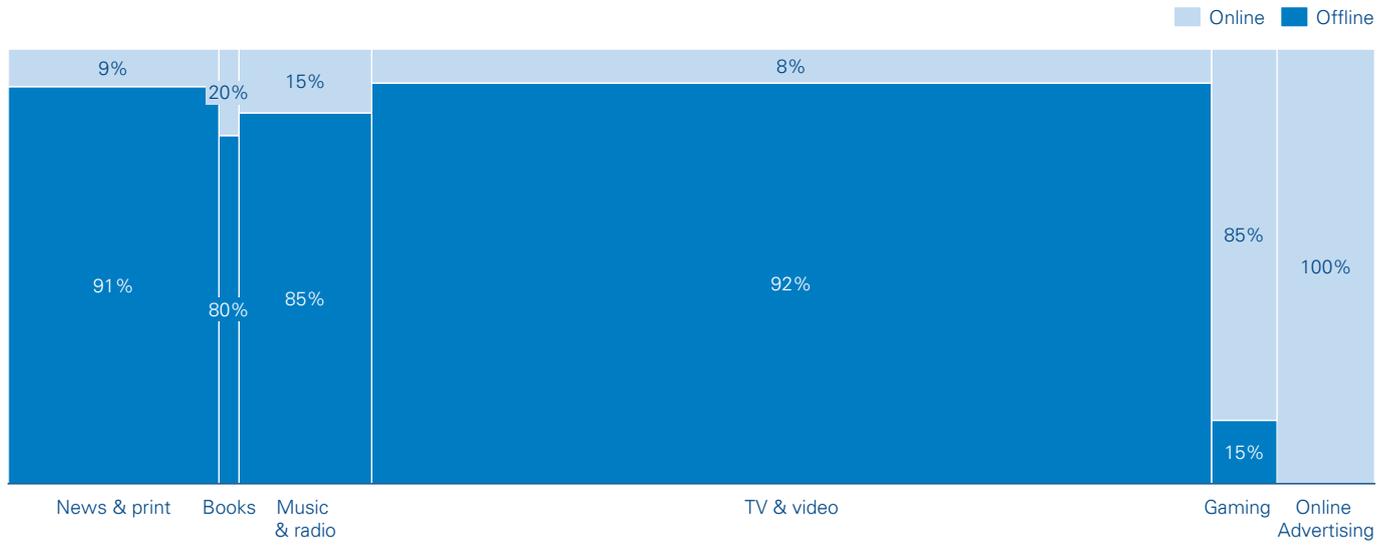
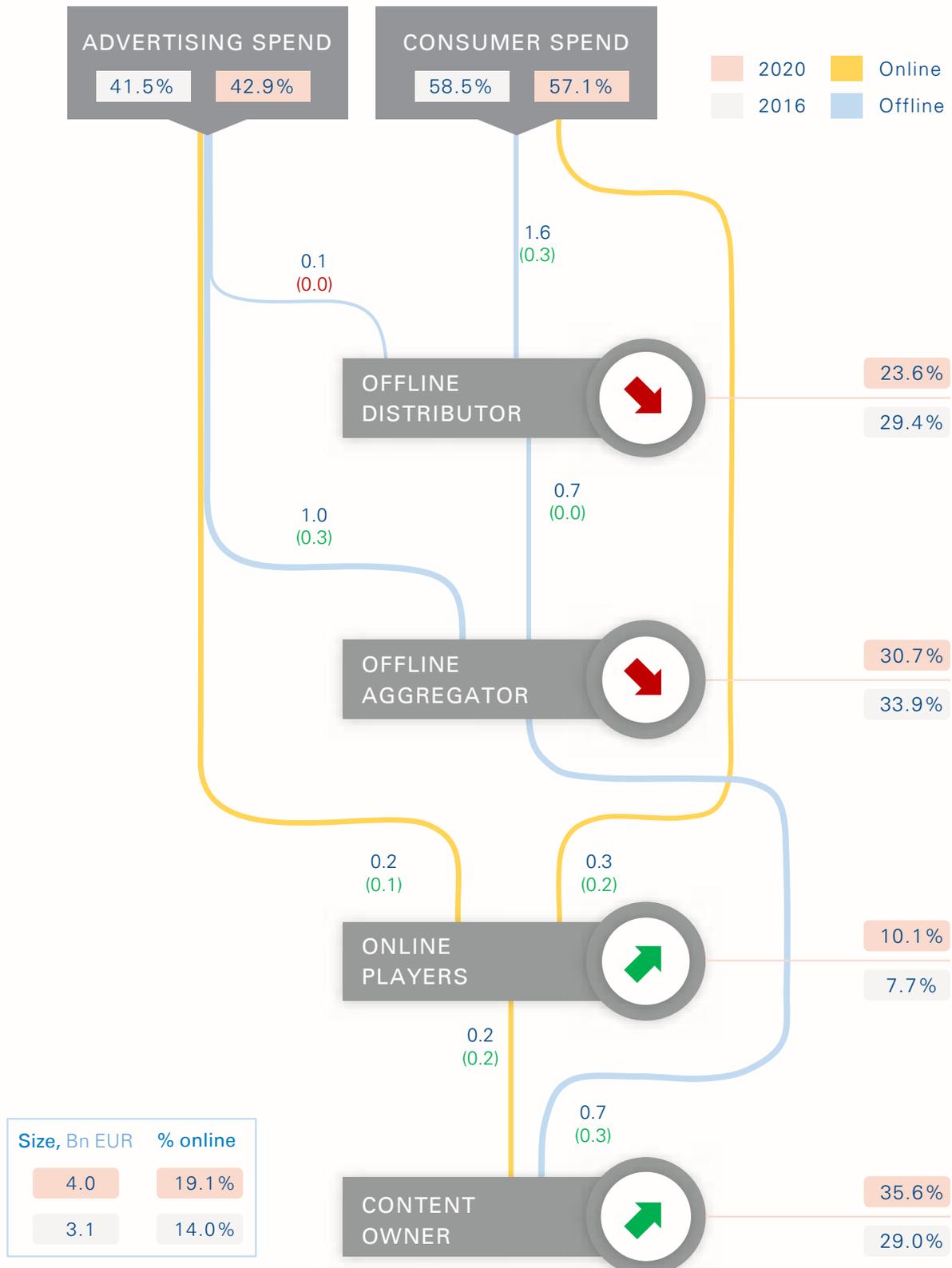


Figure 19: Colombia - Online share per segment in 2020



Source: Arthur D. Little Media Flow of Funds database

Figure 20: Colombia - Flow of Funds, all segments in bn EUR, 2016 vs. 2020



Source: Arthur D. Little Media Flow of Funds database

Chile

Chile has the highest living standards and GDP per capita in the region. This also results in a consolidated middle class with higher income and connectivity levels compared to the other countries in the region.

By 2016 Chile had 11.9 percent of online revenue share in its media & entertainment industry, just below the regional average. By 2020 we expect this share to grow to 15 percent – just 0.5 percentage points less than the regional averages, mainly driven by slower growth in online advertising revenues.

Chile's TV & video segment has reached a higher maturity than that of other players in the region, and this effect will limit the advertising-spend growth in the market. In fact, Chile is the only market in the region where advertising spend shows a lower expected growth rate than consumer spend.

From our segment evolution analysis it is important to note that most segments of Chile's market show comparable absolute growth. With the exception of TV & video, all other segments will grow by less than EUR 50 million.

As already mentioned, Chile's total media & entertainment growth rate will remain at a 5 percent, meaning Chile will be the country with the least total growth in the region – and at the same time, with lower fluctuations its offline/online shares.

By 2020 Chile will have comparable online revenue shares to 2016 in most segments. The only important highlight will be the 11 percent online share in the news & print segment driven by high penetration of smartphones and internet usage, which will

allow users to access all news content through portable devices instead of buying printed versions of the news.

Chile's low market growth from 2016 to 2020 leaves little space for important flow-of-funds changes. The advertising- and customer-spend share remain very similar, and only EUR 500 million incremental revenues are created in the market during the observation period.

Offline aggregators will receive EUR 100 million until 2020, but this increase will only help them to protect their value share (i.e., loss of more than three percentage points).

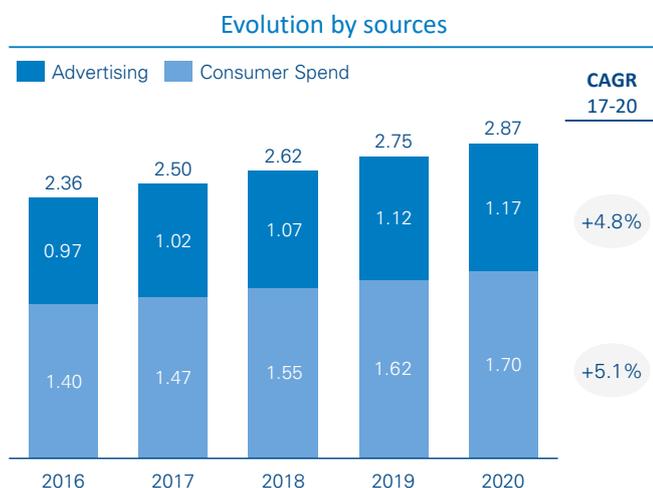
Offline distributors will experience a small revenue increase, but their value share will experience a strong erosion of more than 6 pp (19 percent relative). This will be driven solely by a lower increase in consumer spend due to new online players' competition attracting consumers directly, without distribution needs, especially in the news & print segments.

Content owners will be the main winners of the industry, with more than a seven percentage-point share increase. As it happens, in all the other countries, this effect is the result of new online players and business models with less intermediation being willing to share a larger piece of the value captured from the final consumers.

Chilean companies won't be as comfortable as their peers in other countries investing part of their core profits in transforming their business models to be prepared for the digital disruption already seen in the more advanced economies, but this is definitely a must.

Figure 21: Chile - Evolution of sources of funds

Bn EUR



Source: Arthur D. Little Media Flow of Funds database

Evolution by segments

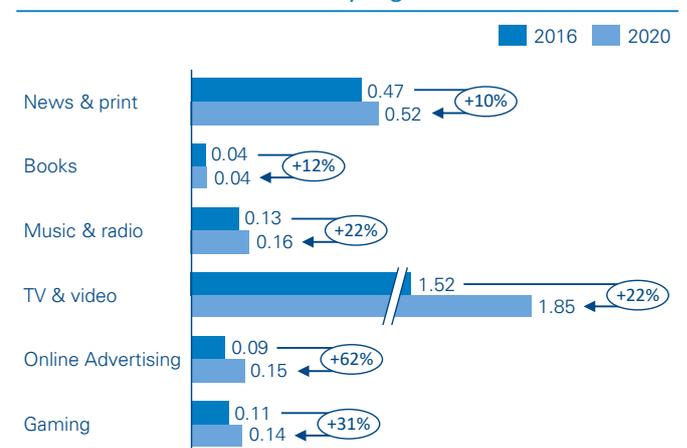
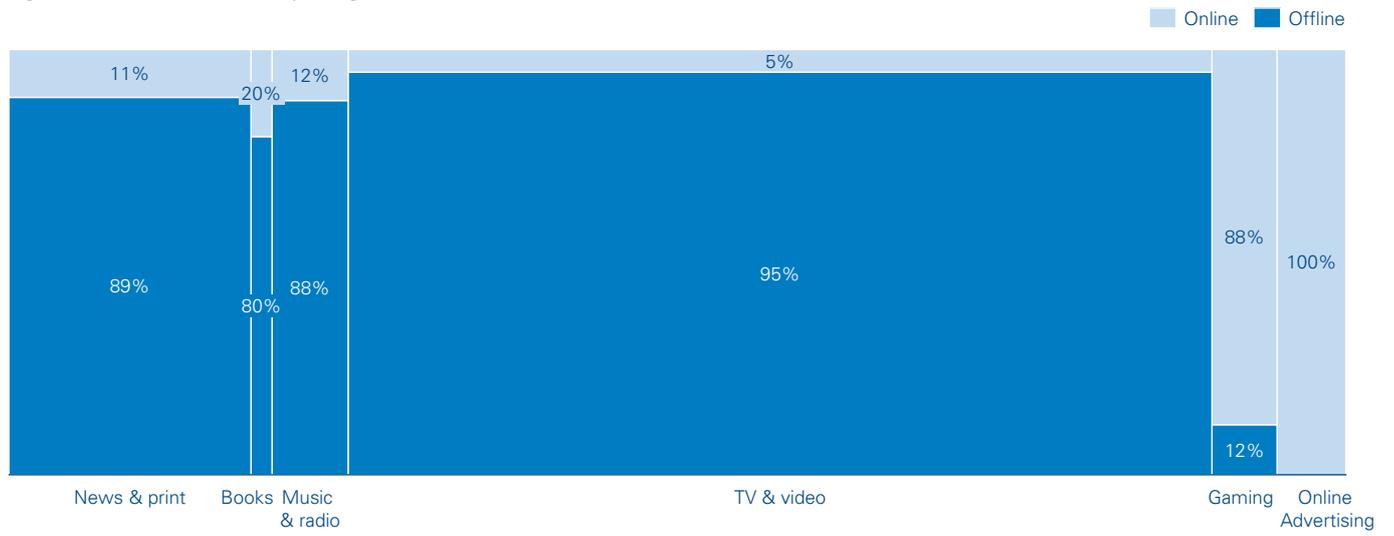
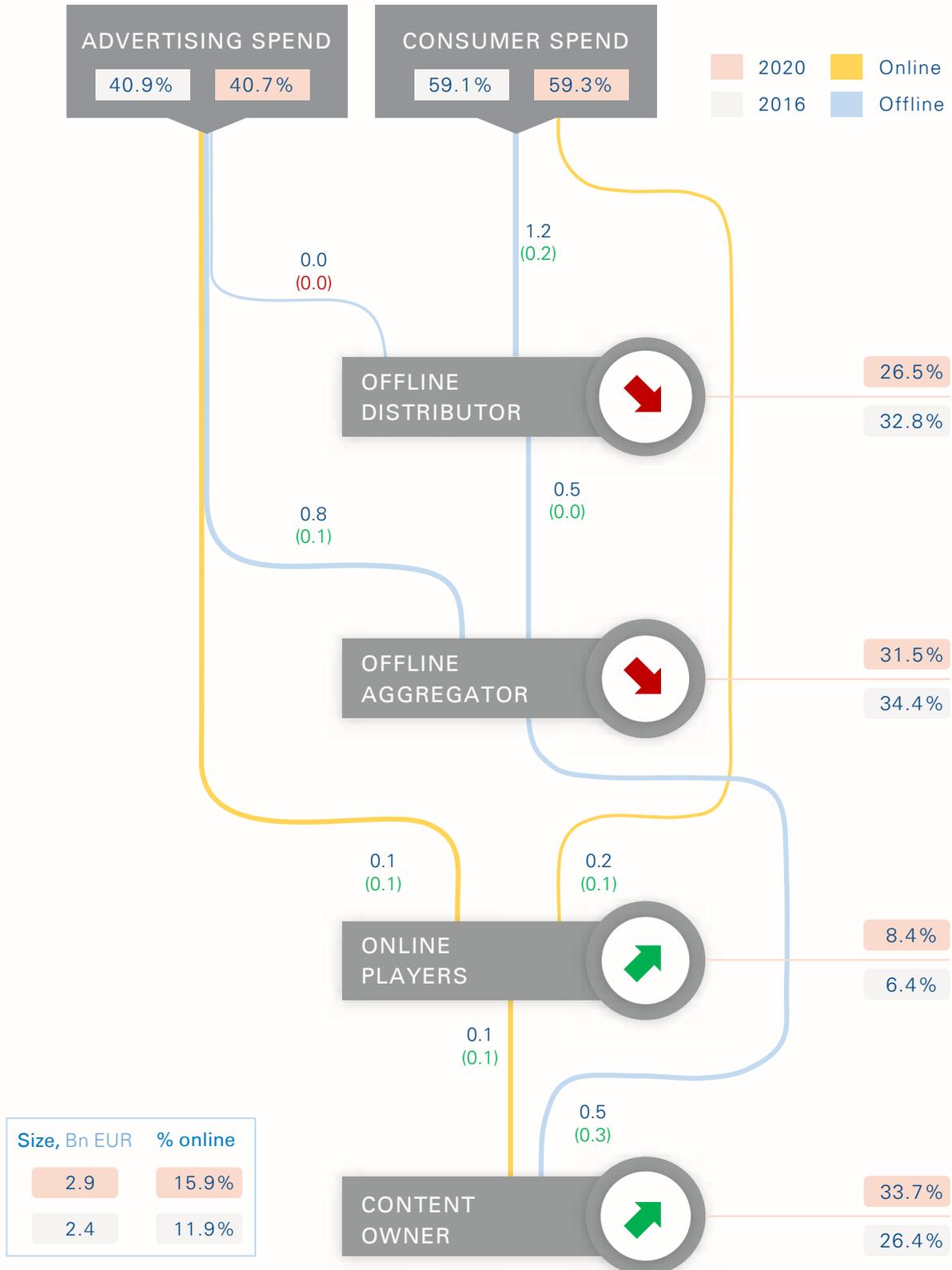


Figure 22: Chile - Online share per segment, 2020



Source: Arthur D. Little Media Flow of Funds database

Figure 23: Chile - Flow of Funds, all segments in bn EUR, 2016 vs. 2020



Source: Arthur D. Little Media Flow of Funds database

Peru

Peru has been experiencing constant economic growth during the last 20 years, including an average GDP growth rate of 4.6 percent from 2010 until 2016. This constant growth led Peru to the path of becoming a more globalized market, with many new entrants and a growing middle class.

This transformation process is still ongoing, and there are some gaps to be covered versus the other main Latin American economies. One key point to take into account is Peru’s lagging connectivity, with only 6.7 fixed broadband connections, versus a 10.5 average in Latin America, including secondary economies. This lag repeats for internet usage, in that only 45 percent of the population has a constant interaction with the internet. These low connectivity levels, together with the small size of the media & entertainment industry, leaves Peru’s 2016 online market size at EUR 179 million and accounting only for 8.1 percent of total industry size. This small initial online share and size restrict the absolute impact of the 16.2 percent online growth rate to EUR 148 million, representing a 3.8 percent share increase.

Peru has the most relevant news & print segment in the region in terms of media & entertainment market share, at the same time that its TV & video segment has the lowest share of all the studied countries. This high relevance of news & print generates a growth opportunity for online players in this segment, and all of the EUR 25 million growth is attributable to non-traditional online business models.

Additionally, the TV & video segment will still account for most of the absolute growth, but this growth will have a higher online share than other studied countries. The online share of the

Peruvian TV & video segment will increase from 1.9 percent in 2016 to 3.1 percent in 2020.

Peru’s online shares by segment are average when compared with those of the other economies in the region. The only highlight is the large share of the news & print industry and its contribution to online revenue growth thanks to its online share passing from 4.3 percent in 2016 to 7 percent in 2020.

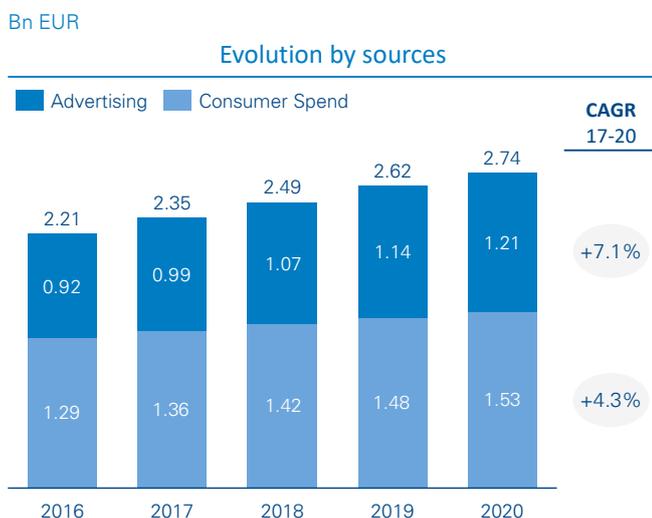
Peru’s flow of funds shows a limited but consistent revenue increase for all the online and offline players in the media-industry value chain, with the only exception of the value transferred from the offline distributor to the offline aggregator.

Offline distributors and aggregators will receive small revenue growth from consumers, but this won’t be enough to compensate for their 3.5 percentage-point value share erosion throughout the value chain. New online players attracting consumers directly without distribution needs mainly drive this effect.

Offline aggregators will also experience a five percentage-point (11 percent relative) erosion of their share, mainly caused by an increasing preference of advertisers for online players. However, this impact is contained, thanks to the limited size of these players in the value chain.

Content owners are still winners in Peru during the observation period, with a EUR 0.3 bn revenue increase and a 6.3 percentage-point value share ramp-up. This effect is the result of new online players and business models with less intermediation being willing to share a larger piece of the value captured from the final consumers.

Figure 24: Peru - Evolution of sources of funds



Source: Arthur D. Little Media Flow of Funds database

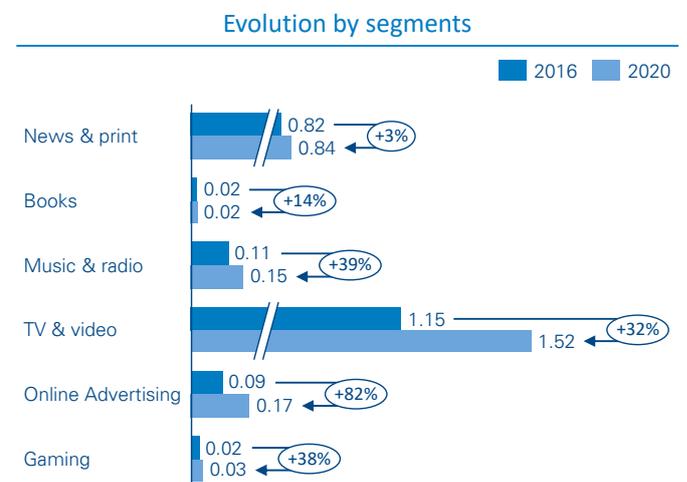
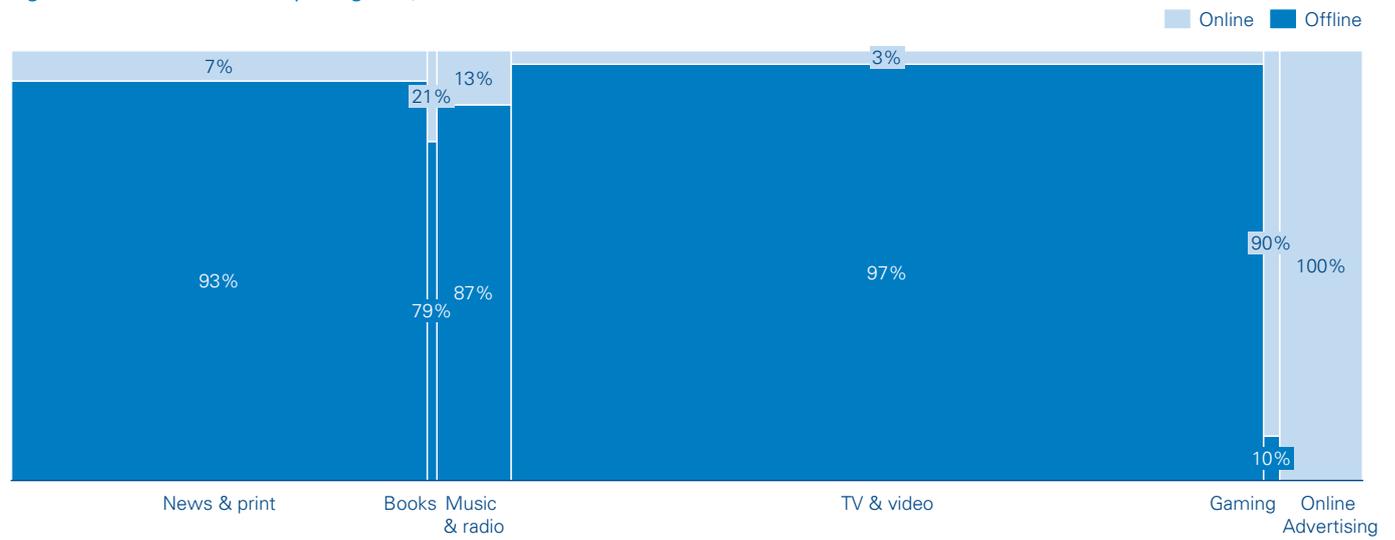


Figure 25: Peru - Online share per segment, 2020

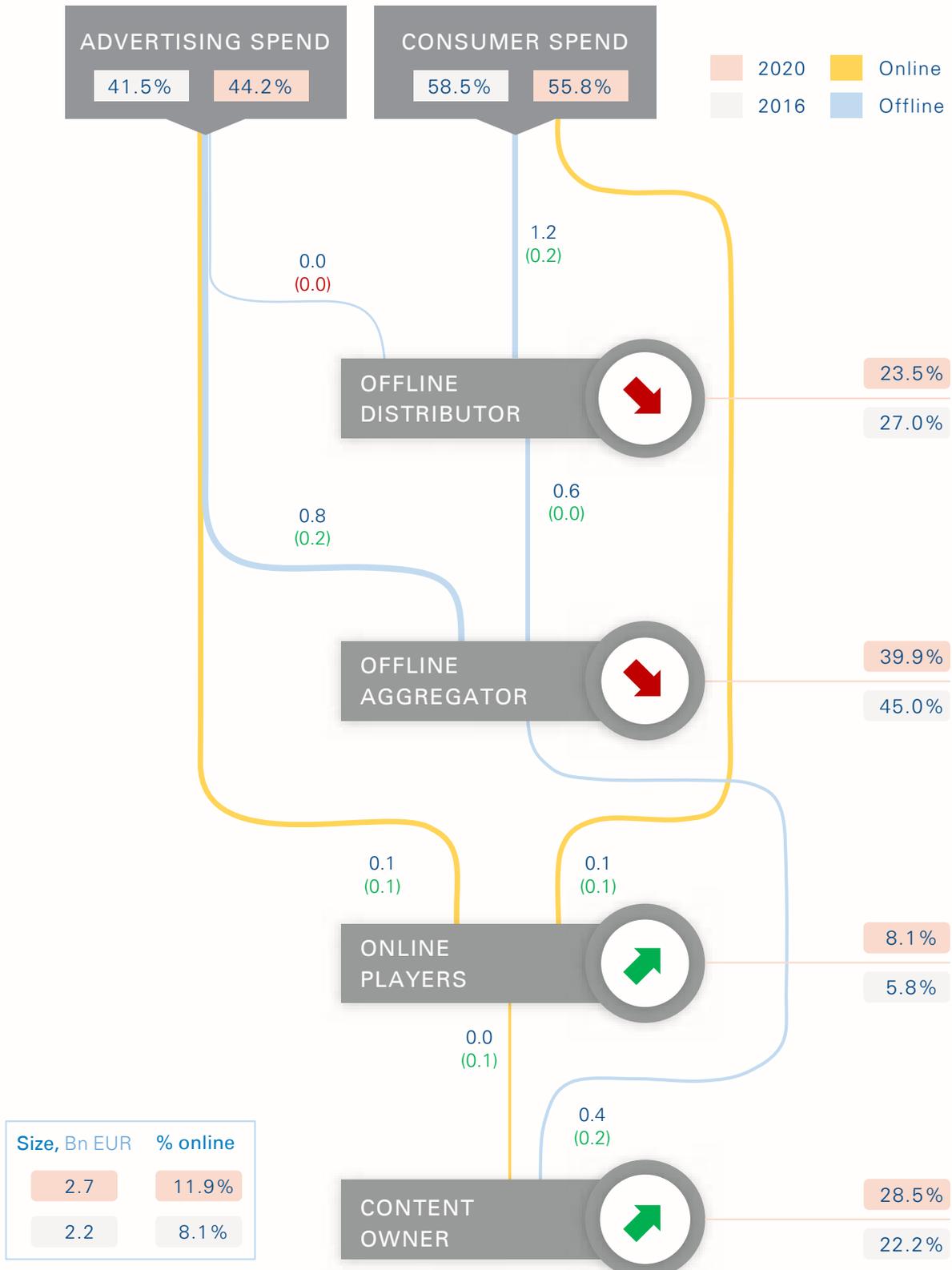


Source: Arthur D. Little Media Flow of Funds database

At the end of the exercise, we have noticed that, at least for the next three years, all players in the value chain will enjoy a revenue increase, unlike in European markets. Even with an erosion of their market value share (and power), Peruvian media

companies should take advantage of these next few years to invest part of their core profits to transform their business models to be prepared for the digital disruption already seen in the more advanced economies.

Figure 26: Peru - Flow of Funds, all segments in bn EUR, 2016 vs. 2020



Source: Arthur D. Little Media Flow of Funds database

Conclusion – Learn and transform, or perish

Our analysis suggests that the offline revenue growth in the media & entertainment sector in LATAM will amount to EUR 6.6 bn (4.4 percent growth rate) from 2016 until 2020. All traditional media companies in LATAM thus have a golden opportunity to start investing part of their (still)-growing offline profits in transforming their business models and preparing for the upcoming digital disruption already seen in more advanced economies.

As a region, LATAM has a clear (and rare) “last-mover advantage” that has to be exploited through a detailed learning process of what is happening today in the more advanced economies. In these economies, the media industry is experiencing a massive digital transformation.

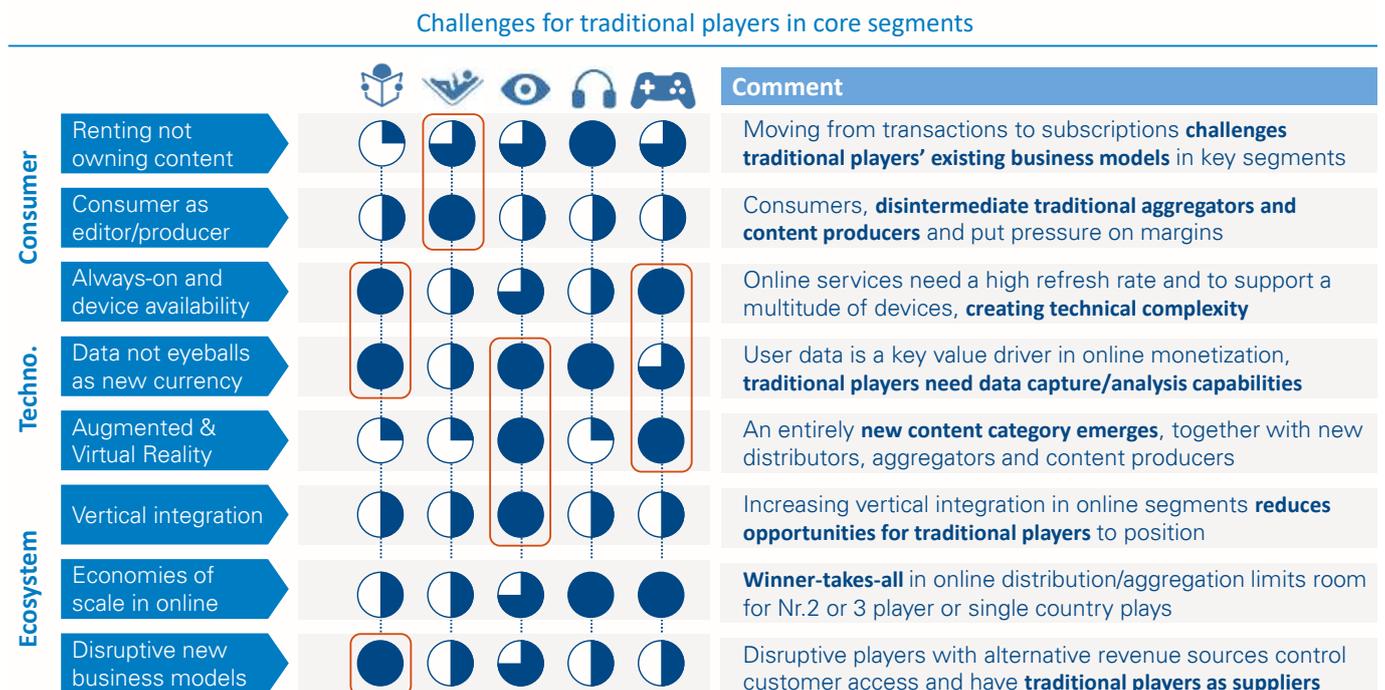
New online competitors and business models are challenging traditional media players. At the same time, consumers are gaining access to myriad new opportunities to consume media.

This creates a complex and volatile environment for media companies, and the transformation will significantly affect value flows going forward. There are many different success stories and failures to learn from. LATAM’s traditional companies thus can prepare for a well-understood disruption.

So far our analyses show that all media & entertainment segments will enjoy stable offline revenues, no matter what country or value-chain step they are in. This situation is, in fact, a great advantage against advanced-market companies for which no information was available about potential changes or consequences that could come with the digital disruption in the industry.

After working with many key players in more advanced media & entertainment sectors in Europe, Arthur D. Little has identified eight main challenges for traditional players, grouped by three root-causes. Each challenge will affect segments in different

Figure 27: Main challenges for traditional players in the media & entertainment industry



Source: Arthur D. Little analysis

Minor impact — Major impact

ways, and companies from those segments will have to prioritize accordingly:

From a value-chain perspective, content owners and producers are starting to have a stronger hand as the digitization of the media industry progresses. We expect that they will benefit from overall increased demand for their products through offline and online players alike, once LATAM population connectivity reaches higher levels. Secondly, both online and offline players will be willing to pay higher prices for premium content in the search for differentiation.

This higher content cost and a loss in market share need to be a red flag for traditional offline aggregators and distributors to integrate and diversify. Otherwise they can end up in a double squeeze driven by lower revenues and higher content costs, like that which is happening today in more advanced economies.

Digital is challenging traditional business especially in distribution

We believe in the Digital explosion. Even when its development is diverse among countries and segments it will see strong growth everywhere and is far from its potential. Its three pillars – broadband connections and devices, consumer habits and digital offerings - are advancing fast and when ‘planets align’ it will boost and challenge the offline world. For example, the US book market has already reached higher online revenues than offline and we should not be waiting a decade for this to occur in some EU countries also. Some digital markets show “hockey stick” demand curves and in the next five years some things we cannot think of today will be the norm.

Will LATAM players be there to capture the digital value? So far, LATAM has no real global online champions compared to the U.S., Europe or Asia. LATAM companies are clearly in a defensive rather than an attacking mood.

Attractive diversification options exist for traditional aggregators

Examples of more advanced markets show that traditional publishers and broadcasters have attractive diversification options available to them. A number of European traditional print players monetized their strong grip on specific niche audiences by growing their share of wallet in this audience (e.g. through specialized e-commerce offerings or live events). Leading

commercial broadcasters such as German ProSiebenSat1 exhibit their power of steering mass audiences towards online market-places and lead-generation websites (e.g. hotel/flight/rental car comparison sites) and participating in the resulting enterprise value growth of these companies.

Customer data becomes more and more important

Going digital does not mean delivering Newspapers in pdf. Products have to be truly digital and be conceived digital. That is for a media group to gather articles, video, interactivity, etc. It also means understanding distribution: channels, business models, etc. But most important of all: know your customer” by engaging in customer analytics/big data!

International companies, such as Netflix or Amazon, spend millions in big data, customer experience, talent, etc. Traditional media are known for their coherency and/or credibility but they are not yet known for their knowledge about their customers. Some questions such as: “Who reads your newspaper? Who reads your books? Who watches your channel? Who is going to the theaters?” are hard to answer by Newspapers, Pay TV operators, FTA, etc. Amazon or Netflix are closer to answering them, and this information will unleash its value sooner than later. Traditional media players (from print to TV) thus are redoubling their efforts and investments in acquiring these key capabilities. However, in most LATAM markets this game is still to be played, and many telecom operators and established media players still have the chance to win if they move in early.

If you enter, enter bold!

When taking strategic decisions related to the online market, traditional media players should make an honest assessment regarding their ability to achieve economies of scale and to create lasting network effects, both of which are the key ingredients to sustainable success in online media. A gradual organic diversification into online media or buying the 2nd player in a given online segment most likely results in neither achieving economies of scale nor achieving network effects sufficient to be successful in the long-term. Instead of all-things-to-all-people online portfolios with limited economies of scale and network effects, media groups should thus focus on achieving scale in specific verticals of the online market.

Organizations are not ready and need to change

Generally speaking traditional companies have dealt poorly with organizational change regarding digitalization. This is a hurdle for any initiative. Initially some companies created an online unit which usually did not have their own P&L. They were perceived as 'the cheap team' by the traditional business units and had difficulties to push their initiatives. The situation is even worse when they start to have success and from then on they are seen as 'co-opetitors'. Traditional players need to understand that online and traditional media should be strongly integrated also organizationally, even if this proves to be challenging. In some cases, digital natives should reach higher organizational positions and a generational renewal might be required.

Policy makers should ensure 'same rules of the game for all'.

All competitors should face the same taxation regimes. Currently, international companies have a big advantage by choosing the location of delivery of services in low tax countries, rather than where their services are actually consumed. Regulation has to adapt to the fact of media ubiquity to avoid creating artificial competitive advantages. In this sense, LATAM executives do not ask for protection against international companies, they should just demand a 'fair fight'.

Notes

Notes

Contacts

If you would like more information or to arrange an informal discussion on the issues raised here and how they affect your business, please contact:

Austria

Karim Taga
taga.karim@adlittle.com

Italy

Giancarlo Agresti
agresti.giancarlo@adlittle.com

Sweden

Martin Glaumann
glaumann.martin@adlittle.com

Belgium

Gregory Pankert
pankert.gregory@adlittle.com

Japan

Shinichi Akayama
akayama.shinichi@adlittle.com

Singapore

Yuma Ito
ito.yuma@adlittle.com

China

Russell Pell
pell.russell@adlittle.com

Korea

Hoonjin Hwang
hwang.hoonjin@adlittle.com

Spain

Jesus Portal
portal.jesus@adlittle.com

Czech Republic

Dean Brabec
brabec.dean@adlittle.com

Latin America

Guillem Casahuga
casahuga.guillem@adlittle.com

Switzerland

Clemens Schwaiger
schwaiger.clemens@adlittle.com

France

Julien Duvaud-Schelnast
duvaud-schelnast.julien@adlittle.com

Middle East

Sander Koch
koch.sander@adlittle.com

Turkey

Coskun Baban
baban.coskun@adlittle.com

Germany

Michael Opitz
opitz.michael@adlittle.com

The Netherlands

Martijn Eikelenboom
eikelenboom.martijn@adlittle.com

UK

Jonathan Rowan
rowan.jonathan@adlittle.com

India

Srini Srinivasan
srinivasan.srini@adlittle.com

Norway

Diego MacKee
mackee.diego@adlittle.com

USA

Sean McDevitt
mcdevitt.sean@adlittle.com



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