BSAC Business Briefing

UK Movie Market 2015

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Market overview

British consumers spent £3.43 billion on all forms of movie products and services in the UK last year, which was virtually flat on the equivalent figure from 2013. In this total spend figure we include payments for cinema tickets, purchase and rental of DVDs and Blu-ray Discs (feature film share only), premium movie pay TV channels, TV-based on-demand platforms and Internet downloads and streaming (retail, rental and subscription – but again, the movie share only).

As we discuss below, although the total spending level remains stable, this hides significant fluctuations within the different market segments.

Cinema

Admissions to UK cinemas decreased by 4.9% in 2014, the second successive annual decline. 157.5m tickets were sold over the year; these were the worst sales figure since 2006 and only the third time since 2000 that sales had dropped below 160m. Average attendance per capita stood at 2.4 visits, which was the lowest annual figure since 2000 and significantly below the recent peak of 2.8 visits in 2009. Gross box office takings broke through the symbolic level of £1 billion in 2010, which it has surpassed ever since. However, total takings declined in 2014 by 2.3% to reach £1,057.8m; this made 2014 another successive year of decline from 2013, which itself had been the first fall since

2006. This contrasts against a backdrop of healthy box office rises in previous years. Ticket prices rose by 2.6% in 2014, hitting an average of £6.72. However, this is the equal-lowest price rise since 2004.

Over recent years, ticket price rises (breaking the £5 barrier in 2007) have been driven up by the increased presence of premium-priced 3D movie screenings in the overall exhibition mix. However, 3D's total market presence is on the wane and 3D film revenues accounted for only 13.4% of total UK box office in 2014, which was a considerable drop from the 17.7% achieved in 2013 and from the peak of 21.5% in 2011. Until the advent of 3D, ticket prices had grown at a similar rate to inflation, and this pattern has now returned. In other words, the 3D premium is now factored into the overall ticket price and this sub-section of the market seems to have matured.

For all releases that had a 3D version, the average box office taken by 3D screens was 35% in 2014, down from 42% in 2013. We relate this to the lack of credible 3D titles (conceived, produced and marketed as a 3D project), such Warner Bros.'s *Gravity* in 2013. The perception of 3D as a 'superior format' is also under threat from the recent advent of premium cinema tiers and Premium Large Format (PLF) screens. On the positive side, new technologies, such as laser-illuminated projection and High Dynamic Range (HDR), should also help to resolve consumer complaints of presentation quality for 3D screenings.

In 2013, the cinema sector was always going to struggle to match the success of *Skyfall* in the previous year. However, there was no such issue in 2014 and the poor results are explained by a generally disappointing film slate. The highest-grossing films were *The Hobbit: The Battle of the Five Armies*, which earned £40.3m, and *The Lego Movie*, which earned a relatively low £34.3m. These were well below the highest earners of any previous years since 2007. In 2012, three films grossed above £50m and twelve above £25m, compared to one (just) above £40m and nine above £25m in 2014.

A relatively high number of UK films – 156, including UK-US co-produced blockbusters – were released into the market, and captured a total market share of 26.2%. British independent films took 16% of the market, which was a high proportion compared to recent years. The leading British films were *Paddington*, which earned £34.7m, and *The Inbetweeners 2*, which took £33.4m – this was lower than the first outing's £45m, but was still a healthy result for a British film.

There were 3,947 active cinema screens in the UK by end-2014, which was a net growth of 50 screens during the year. The number of cinema sites dropped slightly again (743 in 2014 compared to 747 in 2013) and the gently rising screen count underlines the consistently growing importance of multiplex cinemas. Of the screen base, an estimated 3,112 screens in 322 sites were classified as being multiplex (five screens or more), meaning that 79% of cinema screens in the country are now sited within multi-screen complexes.

The transition towards a digital future for the cinema industry has been fully accomplished in the UK. The final push during 2013 was mainly due to the progress of the Digital Funding Partnership (DFP) and the UK is now one of a growing number of fully digitised cinema markets around the world – over 90% of the world's screens are now digitised. Of the UK's digital screens, 1,772 – or 45% – are equipped with digital 3D technology. This is down from a peak of 75% in 2010, which reflects the fact that later digital conversions have not always included 3D capability.

Digital cinema projection enables new content to be shown in cinemas alongside movies: known as 'Alternative Content' or 'Event Cinema', this is a growing sector around the world. The UK is the strongest market for this form of non-film programming outside of the USA. The market value of this content in the UK approached £36m in 2014, up from £20m in 2013. The most popular content is proving to be that from NT Live, which screens plays live from London's National Theatre; the highest grossing of these to date was *War Horse* in 2014, which earned £3.4m. However, 2014's highest grossing event cinema release was Secret Cinema's re-release of *Back to the Future*, which grossed £3.5m. These results, and the growth rate seen within the UK market, suggest that the potential of such screenings is high, adding a great diversity to cinema's output and increasing public access to a wide range of sporting, cultural, musical and other content.

Home video

Although the packaged home video business continues to be the single largest contributor to filmed entertainment industry revenue, the sector endured a third year of double digit decline. Continuing reductions in retail space throughout the year, especially cut-backs in the shelf space given to physical video in supermarkets, conspired to constrain the availability of discs to consumers. Whilst this is a key contributor to the market decline, the impact of competing forms of content delivery – such as rising Subscription Video on Demand (sVoD) provision, as well as the related rapid demise of physical video rental – were also felt strongly.

Total consumer spending (on a retail and rental basis) on packaged video products in the UK fell by 14% last year to £1.37 billion, and the market now generates less than half of its 2004 peak of £2.95 billion. Almost two thirds of spending on purchased DVDs was generated by feature films, with the rest coming from TV content, children's, music video, special interest, etc. The vast majority of rental transactions through the remaining bricks-and-mortar stores are movie-based, but the equivalent proportion for online rental services is lower, typically at around 75%, which is due to a stronger demand for TV boxed sets through this medium.

126m DVDs were sold to British consumers in 2014, which was a decrease of 12% from the previous year. The mix of product sales continued to skew towards a greater contribution from new release product, which is further evidence of the changing retailer presentation of physical product. However, and for the first time in five years, the average consumer price of a DVD also declined – from £8.27 to £8.23. This is an indication that, despite the increasing reliance on higher priced new release product, retailers are failing to stem overall price erosion, making further declines inevitable.

Seven years after the initial launch of the format in the UK, sales of the increasingly mature Blu-ray Discs also tipped into decline in 2014. UK consumers bought 17.5m Blu-ray Discs, spending £231.2m. This represents a decline of 7% in unit sales and 8% in consumer spending.

Launching in 2007, amid a format war with the now withdrawn HD DVD format, the adoption of pre-recorded Blu-ray Disc in the UK was further hampered by the successful return of home video recording; this was largely through the distribution of more sophisticated pay TV set-top boxes containing DVR (Digital Video Recording) capability from pay TV operators, such as Sky. Greater access to Video on Demand (VoD) and TV catch-up services further reduced consumer reliance on pre-recorded video formats. The simultaneous development of alternative and arguably more aspirational digital distribution platforms also impacted the adoption of the format, effectively consigning Blu-ray Disc to a high-end audio-visual niche.

Despite this, the Blu-ray Disc retail and rental niche still generated a combined £262m in consumer spending in 2014, £18m more than the equivalent retail and rental of digital video in the UK that year.

Rental of physical video formats also recorded considerable declines in consumer spending. Rental of physical video through stores and rent-by-mail services declined by 29% to £106m. Although this was partly caused by store closures, much of this decline was triggered by the amalgamation of the dominant LOVEFiLM rent-by-mail offer into Amazon's Prime service. This encouraged consumers to switch to video streaming rather than physical rental and effectively reduced the visibility of the rent-by-mail service to potential new standalone subscribers.

Frozen, *The Hobbit: The Desolation of Smaug*, *Mrs Brown's Boys D'Movie* and *The Lego Movie* were the top four selling DVD titles of the year. *Gravity* and *Guardians of the Galaxy* replaced *Mrs Brown's Boys D'Movie* and *The Lego Movie* at the top of the Blu-ray Disc chart in 2014, once again demonstrating a clear difference in consumer preferences for Blu-ray Disc purchasing, and studio release strategies, compared to titles on DVD.

Pay TV

Sky remains the only company to offer movies from the Hollywood major studios in the first subscription pay TV window in the UK, both via broadcast on Sky Movies channels and the Sky Go service, which is available to subscribers, and through its standalone online service, NOW TV, which offers non-Sky subscribers access to Sky's films online for a fee of £9.99 a month.

Films typically move into the first pay TV window within six months of cinema release and remain within it for a further 10-12 months, after which point they shift into either a secondary exclusive subscription window or the Free-to-Air (FTA) window. Sky Movies can typically show releases at least 12 months before their online subscription rivals.

However, competition from internet video streaming services is mounting: Amazon now has first window rights for films from StudioCanal, while Netflix has equivalent deals with MGM, Miramax and Lionsgate. However, in its 2014 annual report, Sky said it had renewed exclusive deals with five out of the six major Hollywood studios in the previous two years. The most recent agreement – an output deal, offering Sky access to the studio's movies across all of its platforms – was made with Paramount in May 2014.

Sky's other most recent movie agreements were with Sony and Walt Disney (February 2013), Universal (November 2012) and Warner Bros. (September 2012). The Disney deal included the launch of Sky Movies Disney, which offered both classic and new Disney and Disney/Pixar movies via a linear channel and through on-demand platforms across the Sky services. The deal also included first pay TV movie rights for other Disney titles.

Following allegations of anti-competitiveness from BT, Sky made its movie channels available on the BT TV platform for the first time in October 2013, making both linear channels and on-demand content offerings available on a monthly subscription basis. The launch of YouView in the UK has meant that first window movies can also be viewed via the NOW TV service (available on the YouView box), or via the Sky Movies packs on TalkTalk TV and BT TV.

We estimate Sky's spending on film rights was £352m in 2014, up from £316m in 2013. Due to the complex bundling and pricing of channel packages, it becomes increasingly challenging to calculate a stand-alone figure for 'consumer spend' on subscription movie channels: subscribers typically sign up a package of channels, of which movie services are just one element, so any sub-division is – to some extent – a little arbitrary. For this reason, we have used the proportion of Sky's total programming budget that is allocated to movies as a proxy to allocate a percentage of total consumer pay TV spending to movies. On this basis, we arrive at a 2014 total consumer spend of £998m, up from £955m in 2013.

TV platform Video on Demand

In terms of revenue, the UK is the largest pay TV on-demand market in Western Europe and the third largest in the world. The UK market generated £421m in 2014, having grown by 16.9% from the 2013 figure of £360m. Pay TV on-demand services are increasingly dominated by VoD services in the UK, with only one legacy near-VoD (nVoD) service still currently active. Instead, operators have moved to reinforce their linear broadcast offering with a combination of set-top box (STB) delivered VoD (where the box is connected to a broadband network and content is downloaded over the Internet) and multi-screen services, which are accessible over smartphones, tablets and PC's.

Offering a mix of linear and on demand content, these multi-screen applications are typically free to existing pay TV subscribers and, instead of direct revenue generation, are intended to drive increased user engagement through allowing access to value adding services. However, some incremental revenues can be attributed to such additional add-on services, as typified by Sky Go's option to view content over more than the default two devices in exchange for an additional fee.

Sky remains the dominant Pay TV operator in the UK with more than 10m subscribers in 2014. Within that figure, 6.9m are currently enabled for VoD functionality; this constitutes 52% of the 13.1m true-VoD enabled homes in the UK, with the remaining 6.2m divided between cable TV operator Virgin and IPTV operators TalkTalk and BT respectively. Total Sky on-demand revenues grew to £138.1m in 2014, an increase of 18.5% compared to the 2013 figures.

In terms of platform growth, IPTV continues to lead the UK Market with the total number of subscribers growing to 2.4m in 2014, an increase of 43.5% from 2013. Competition between the UK's two IPTV providers, BT and TalkTalk, continued throughout 2014, with both operators expanding their content offers through the inclusion of services from third party content providers: for example, NOW TV and Netflix were introduced onto the shared YouView platform alongside the launch of multi-screen services that offer customers the ability to access content from mobile devices. Although TalkTalk continues to lead the IPTV market in terms of subscriber growth, the company's transactional revenues remained significantly lower than those of BT's: TalkTalk's revenues reached £6m in 2014, which was equivalent to 4.7% of BT's £126.2m over the same period.

Both Sky and BT have launched services enabling consumers to purchase on-demand content via their set-top-boxes on a retail basis. Although strong growth has been reported for these pay TV 'electronic sell-through' (EST) services, this proposition remains relatively niche. The rental business model continued to make up the majority of television-based VoD transactions in 2014. In terms of views, free VoD dominated the market, recording 2,731m views in 2014 compared to 55m paid-for views.

With only one operator, Virgin Media, the cable TV on-demand landscape remains largely unchanged in 2014. Total on demand revenues for Virgin increased by £10.3m in 2014.

Internet Video on Demand

The market for online movies – the distribution of movies over the open Internet – again experienced significant growth in 2014 and is an increasingly important segment of the total movie market in the UK. Last year saw the sVoD sector grow to become larger than the transactional market, in terms of consumer revenues, for the first time ever in the UK. Total consumer revenue from online movies (retail, rental and subscriptions) increased to £272m in 2014, a 34% rise from 2013.

Growth of digital rental and digital retail – also known as DTO ('download-to-own') or EST ('electronic-sell-through') – again slowed, while the growth of Internet-delivered subscription-based services more than halved as the market matured.

The use of 'Digital HD' as a consumer-facing marketing term for a movie or TV programmes' digital file is now widespread. With these files often bundled with the physical disc there has also been a small but determined initiative to pre-release 'Digital HD' movies online before the traditional retail and rental window opens.

The expected accretive growth in the DTO market for movies and TV shows from the launch of services by pay TV operators BT and Sky has yet to occur. TalkTalk's acquisition of Blinkbox from Tesco in early 2014 will likely result in TalkTalk also entering the EST market in 2015. Sky will also be expanding their 'Buy to Keep' service to their non-TV customer base in the UK and Ireland.

The growth of online sVoD services was again driven by Netflix, which we estimate ended the year with 3.2m subscribers; this boost was helped by their original programming (such as *Orange is the New Black*) and exclusive content (including *Breaking Bad*). The carriage deal between Netflix and Virgin Media remains in place and gives Netflix access to approximately 2.5m Virgin Media homes with a TiVo box. Netflix also partnered with BT to bring the service to BT's YouView customers in 2014 as part of a wider deal with the YouView platform, which began in early 2015.

Amazon's rebranding of LOVEFiLM Instant as Amazon Prime Instant Video was part of the e-retailer shift in the focus of the video service, which is now positioned more to drive consumers towards Amazon's Prime Subscription, with the goal of achieving higher retail/device spending, than to increase the number of video subscriptions per se.

Amazon Prime Instant Video continues to offer more titles than its rival Netflix, including second subscription window pay TV movies with NBC Universal and 20th Century Fox. Netflix has first pay TV window rights to MGM, Lionsgate and Miramax titles, although its original TV productions have been the prime area of new content investment in recent times.

Sky now has an array of online services under its portfolio with varying business models. Its online sVoD service, NOW TV, experienced strong growth in 2014, although this was mainly due to the launch of its Entertainment package, which streams live pay channels to a target market of consumers who have never previously paid for TV.

The Sky Go Extra service, which allows Sky TV subscribers to download and view content on-the-go via mobile devices for an additional £5 a month, has been very successful. Sky has reported attracting more than 1.5m subscribers to this service and generating more than £40m in accretive revenue.

Device-centric online movie services, such as Apple's iTunes, Microsoft's Xbox Video (which serves the Xbox 360 and Xbox One games consoles), Sony's PlayStation Store, Google and, increasingly, Amazon, continued to dominate the transactional market, together accounting for almost 97% of all online movie transactions in 2014. Amazon Instant Video, the fifth largest online movie store in the UK, launched its retail TV service alongside the Prime Instant Video service in February 2014.

Online video viewing still represents a small proportion of overall video consumption. Linear TV channels remain dominant, and therefore it is important to put the impact that these services are likely to have upon the ways in which consumers watch movies over the next few years into context.

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