



BSAC Business Briefing

UK Movie Market 2016

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Market overview

British consumers spent £3.58 billion on all forms of movie products and services in the UK in 2015, an increase of 3% compared to £3.48 billion 2014. 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). The IHS methodology to calculate the share of pay TV spending allocated to movies has been improved through 2015. This has resulted in a marginal change to the total market figure published last year.

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

Cinema

Admissions to UK cinemas increased by 9.2% in 2015, reversing two years of decline and bringing the level back to just below that of 2012. A total of 171.9m tickets were sold over the year; the third highest number of the past decade and very encouraging for an industry that is investing heavily in premium technology and a more segmented consumer experience. Average attendance per capita stood at 2.65 visits, the same as 2007 and 2008, but below the period between 2009-2012.

Gross box office takings broke through the symbolic level of £1 billion in 2010, which it has surpassed ever since. Total takings increased in 2015 by 17.3% to reach £1,240.4m; this made 2015 the highest year ever at the UK box office and underlined the strength of last year's film slate. Ticket prices rose by 7.4% in 2015, hitting an average of £7.21. This unusually high rise was driven by the success of the highest-grossing films in premium cinemas with the pricing to match.

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 12.2% 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 had now returned until this year when the new premium technologies have begun to impact the admissions mix. 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. However, other new technologies and more differentiated cinema experiences (Premium Large Format, 4D, Boutique Cinema...) are now driving up revenues.

For all releases that had a 3D version, the average box office taken by 3D screens was 28% in 2015, down from 35% in 2014 and 42% in 2013. We relate this to the lack of credible 3D titles (conceived, produced and marketed as a 3D project, as exemplified by Warner's 2013 release of *Gravity*). The installed base of 3D screens remains high in the UK and globally, but the product coming through will likely not improve while the 3D revenues keep dropping. 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 and brightness issues for 3D screenings.

In 2015, the cinema sector began with optimism for the year due to the titles on offer, especially after a disappointing year in 2014. Unsurprisingly, the highest grossing film in 2015 was *Star Wars: the Force Awakens*, which grossed £114m, followed by the latest Bond outing *Spectre*, earning £94.7m during its release. Even the Secret Cinema release of *The Empire Strikes Back* grossed £6.5m in its summer 2015 run, building up the anticipation to the new film's release. This compares with the highest grossers of 2014 (*The Hobbit: The Battle of the Five Armies*, which earned £40.3m, and *The Lego Movie*, which earned a relatively low £34.3m) and underlines how the success of the leading films drives a good year at the box office.

A relatively high number of films – 734 in total – were released into the market, and UK films (including UK-US co-productions) captured a total market share of 44.5%. This is very high and is driven mainly by the 33.6% captured by UK qualifying films with studio backing, in turn driven by the Star Wars, Bond and Avengers franchises. British independent films' share fell from 2014, taking 10.6% of the market in 2015, down from 16% of the market in 2014, but still at the upper end of recent years' performance. The

leading independent British films were *Legend*, which earned £18.4m, and *The Second Best Exotic Marigold Hotel*, which took £16m – this was slightly lower than the first film’s £20.4m, but was still a healthy result for a British film.

IHS estimates there were 4,123 active cinema screens in the UK by end-2015 (official data is not yet available), which was a net growth of 127 screens during the year, greater than usual. The rising screen count also underlines the consistently growing importance of multiplex cinemas. Of the screen base, an estimated 3,298 screens in 340 sites were classified as being multiplex (five screens or more), meaning that 80% 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 98% of the world’s screens are now digitised. Of the UK’s screens, 1,854 – or a consistent 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 formerly as ‘Alternative Content’ and now as ‘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 was more or less stable in 2015, having approached £36m in 2014 and hitting £36.3m in 2015, 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, 2015’s highest grossing event cinema release was Secret Cinema’s re-release of *The Empire Strikes Back* (see above), followed by NT Live’s *Hamlet* (£2.9m).

Home video

In 2015 the packaged home video business ceased to be the largest contributor to filmed entertainment industry revenues. Growth in box office takings and continuing decline in the overall packaged video market resulted in cinema overtaking physical video as the number one revenue generator. Physical video formats DVD and Blu-ray Disc still continued to generate substantial revenues however, with retail and rental spending combined contributing £1.1 billion, one third of total consumer spending on filmed entertainment. Trends observed in previous years continued through 2015: reductions in shelf space given to physical video reduced availability and choice to consumers, competing forms of non-transactional content delivery – such as Subscription Video On-Demand (SVOD) – increased their share of the market and drew consumers away from traditional forms of consumption.

Total consumer spending (on a retail and rental basis) on packaged video products in the UK fell by 17% last year to £1.14 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 and special interest categories. The vast majority of rental transactions through the remaining bricks-and-mortar stores are movie-based, but the equivalent proportion for online rental services were lower, typically at around 75%, due to a stronger demand for TV boxed sets through this channel.

British consumers bought 104m DVDs in 2015, a decline of 17% from the previous year. The average consumer price of a DVD grew once again from £8.23 to £8.36. This is an indication that the mix of product sales has continued to skew towards higher priced new release product. As a result, the format generated £869m in 2015, a decline of 16%. This marks the first year since 2001 that sales of DVDs generated less than £1 billion in the UK. Sales of the high definition format Blu-ray Disc also continued to decline in 2015. The format recorded 11% declines in both unit sales and consumer spending falling to 15.6 million units and £205m respectively. Despite these declines, this level of consumer spending still exceeds that spent by consumers through alternative digital retail platforms. As a result Blu-ray Disc is the second largest revenue generator for transactional home entertainment.

Though sales of Blu-ray Disc are now firmly in decline and the adoption of Blu-ray Disc hardware in the UK and elsewhere has not been as absolute as it was for the format's predecessor DVD, provided retailers continue to support the format its longevity, as with DVD, is assured. Blu-ray Disc consumption is confined to a relatively high-end audio-visual niche, however. The development of Ultra High-Definition (UHD) or 4K television sets requires content to also be made available in this resolution. To this end, the Blu-ray Disc Association released UHD Blu-ray Disc specifications late 2015 with the format being made available to consumers in 2016.

Consumer spending on physical video rental in the UK has been in decline for 10 years by year end 2015. The value of the market has fallen from its peak in 2005 of £377m to £78m in 2015. The emergence in that decade of rent-by-mail helped to stem the decline but, as video streaming was made available to subscribers to the UK's number one video rent-by-mail service, LOVEFiLM owned by Amazon, the decline continued. Overall video rental declined by 27% in 2015, with both store-based rental and rent-by-mail contributing to this decline as a result of further store closures and consumers' changing consumption habits. Amazon also removed the lowest cost tier for rent-by-mail from their LOVEFiLM service.

Paddington, *Fifty Shades of Grey*, *Jurassic World* and *Minions* were the top four selling DVD titles of the year. These were a very different list of titles compared to the top selling Blu-ray Discs in 2015: *The Hobbit: The Battle of the Five Armies*, *Jurassic World*, *Avengers: Age of Ultron* and *Interstellar*. This is perhaps the clearest demonstration of difference in consumer preferences around Blu-ray Disc purchasing, and studio release strategies, compared to titles on DVD.

Pay TV

Sky is still the only company to offer movies from the Hollywood major studios in the first subscription pay TV window in the UK. The company makes these available to subscribers via broadcast on Sky Movies channels, the Sky Go online service 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. In early 2016, the satellite operator added a further platform to its portfolio with the launch of its premium Sky Q product, orientated around an 'anytime-anywhere' content experience.

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 this 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, Sky is not without competition from internet video streaming services: Amazon holds first window rights for films from StudioCanal, while Netflix has equivalent deals with MGM, Miramax and Lionsgate. Despite this, Sky continues to enjoy partnerships with the six major Hollywood studios. Most recently, Sky's agreement with Walt Disney Co. for first window movie rights on both its linear channels and NOW TV was extended in October 2015. Sky's Disney deal, which was originally agreed in February 2013, resulted in the launch of Sky Movies Disney in March 2013, which offers both classic and new Disney and Disney/Pixar movies via a linear channel and through On-Demand platforms across the Sky services. Sky's renewal of its Disney deal includes first pay TV movie rights for Disney titles that include Marvel Studios and Lucasfilm content. Sky's other recent movie agreements are with Paramount (May 2014), Sony (February 2013), Universal (November 2012) and Warner Bros. (September 2012).

Sky's movie channels are available on other pay TV platforms in the UK, via Virgin Media's cable service and through BT TV and TalkTalk TV's IPTV services. The channels were made available on BT's platform for the first time in October 2013, following allegations of anti-competitiveness from BT. First window movies can also be viewed on the NOW TV service if the consumer possesses a YouView box, or via the Sky Movies packs on TalkTalk TV and BT TV.

IHS estimate Sky's spending on film rights was £354m in 2015, up from £349m in 2014. 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 for 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 2015 total consumer spend of £698m, which was slightly down from £701m in 2014.

TV platform Video On-Demand

In 2015 the UK continued to be the leading On-Demand market in Western Europe, generating £265.5m in revenues and growing 2.0% compared to 2014. Internet connected Set-top-boxes (STB) are the main driver of growth in the market, with Video On-Demand (VOD) and Internet Protocol Video On-Demand (IP-VOD) contributing 92.9% of overall revenues. These two technologies represent what is arguably the most recognisable mode of On-Demand content delivery.

VOD is used by cable and IPTV operators and refers to a method of delivery where content is streamed upon request from a server across the operators' network to the set top box. This method of On-Demand viewing offers the full set of functionality UK consumers have come to expect, including the facility for subtitling, pausing and rewinding. IP-VOD is very similar from a user experience perspective. Unlike VOD however, IP-VOD is a hybrid system where On-Demand content is delivered over the open internet to the STB, whilst the live television signal is delivered via a traditional broadcast medium such as satellite.

In late 2014 satellite operator Sky launched its 'buy to keep' service through the Sky Store. This move placed the operator in direct competition with online distributors such as iTunes and Google Play. As with the most successful online content providers, Sky was able to leverage its device infrastructure to push its buy to keep proposition to consumers. Sky's digital retail system has the additional benefit that the connected STB is a television native device, meaning consumers have instant access to their purchases on their primary TV screens. Through a strong marketing campaign and promotional offers, Sky has successfully grown its service, reaching 1 million transactions a week at the end of 2015. IPTV operators BT and TalkTalk have followed suit, adding their own buy-to-own services. Like Sky, these services centre the experience around the STB. However, both operators have extended their offering through smartphone and tablet applications, allowing consumers to continue their viewing experience on these devices when away from their primary TV screens.

Satellite television saw the largest share of revenue by platform for rented On-Demand content in 2015. Revenues reached £95.4m, an increase of 8.4% compared to 2014. Satellite On-Demand revenues had previously fallen below cable operator's in the UK as Sky withdrew its premium live pay per view football offering in an effort to increase sports subscription revenues. Sky's near VOD proposition, Sky Box Office, continued to decline in 2015 as the number of connected STB's increased; revenues decreased 47.1% in 2015. With the launch of the Sky Q box, a system heavily dependent on internet connectivity, it seems likely the operator will eventually move to shutter the legacy service.

In 2015 Netflix added its subscription VOD service to the retail YouView platform; later this coverage was expanded to the proprietary variations run by BT and TalkTalk. With the Netflix partnership offering a wide range of library content, both BT and TalkTalk moved to focus their own offerings on high value new release titles. IPTV On-Demand television revenues subsequently increased by 6.0% to £85.4m in 2015. Cable operator

Virgin saw a 7.6% decline in On-Demand revenues in 2015 due to waning interest in its own premium live pay per view offering.

Internet Video On-Demand

The market for online movies – movies distributed over the open Internet – continued to grow in 2015 and is an increasingly important segment of the total UK movie market. Much of the sector's growth stems directly from SVOD which, although relatively new, has surpassed the total digital transactional market in terms of consumer revenues. In the UK, total consumer revenue from online movies (retail, rental and subscriptions) increased to £334m, an increase of 19% compared to 2014.

The increasingly mature digital rental and digital retail sectors – also known as Internet VOD (IVOD) and Download-to-Own (DTO) or Electronic-Sell-Through (EST) – declined in the UK in 2015 to £139m, down 2%. This decline is a direct result of changes to UK VAT regulations, which closed a loophole allowing online movie purchases to be routed through countries with lower VAT rates. In 2015 VAT for many online movie purchases increased from 8% to 20%, with much of the cost passed directly on to consumers.

The 'Digital HD' early release window for digital retail content became virtually ubiquitous in 2015 for all movies newly released for home video consumption by the major US studios and some UK independent rights holders. This window is created in the UK by retarding the release of physical video product. The move has proven unpopular with a number of the larger physical video retailers who see themselves as competing with digital retailers for new release sales. Although the launch of the Digital HD initiative was undoubtedly the cause of accelerated digital retail growth in 2013 and 2014, there was no evidence of its impact in 2015 as consumer revenues from the sector declined by 7%.

Digital retail services from the major pay TV operators experienced their first full year of operations in 2015. According to IHS estimates, Sky offers the largest catalogue of titles of any pay TV operator (around 1,200 at the time of writing) and uniquely the digital purchase from Sky also includes a copy of the DVD sent some weeks later by post. Anecdotal feedback suggests that this model of digital retail favours not only new release product more so than traditional digital retail but is also more focused on a number of key movie genres.

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, Amazon and now Sky continue to dominate the transactional market, together accounting for almost 97% of all online movie transactions in 2015.

Online SVOD services are by far the most successful application of online video. The sector accounted for £195m in consumer revenues in 2015. This equates to 58% of the online video market, up from 49% in 2014. With only 4 years of operations in the UK, Netflix, the current market leader in this sector, had acquired 5 million paying

subscribers in the UK at the end of 2015, with Sky and Amazon adding a further 2.3 and 1.3 million respectively. However, it is important to note that Netflix's content strategy – along with its SVOD competitors – has increasingly been centred on TV programming rather than movies and this has resulted in a corresponding shift in viewing away from feature films.

Online video viewing 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.

Consumer spending on digital movie content, in all its forms, accounts for 11% of total consumer spending on movies. Cinema is by far the largest sector, accounting for just under one third of all spending. The remainder is split evenly between pay TV (a combination of Subscription spending and VOD) and physical video.

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