



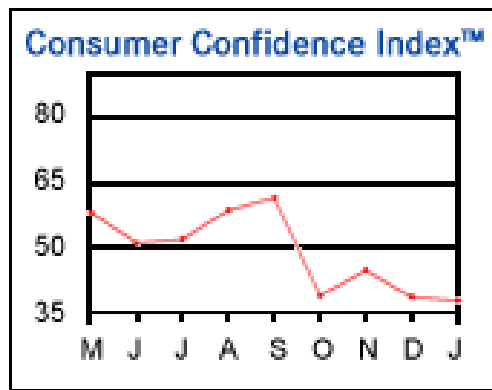
## **THE ECONOMIC CRISIS:**

### **IMPACT ON DRTV**

The current state of the American economy has been front page headline news for months. Hardly a day goes by without some new element added to the declining nature of our country's economic system. This will be an attempt to analyze how the current and perceived immediate future of the economy will impact on advertising, in particular television and, within that, Direct Response TV.

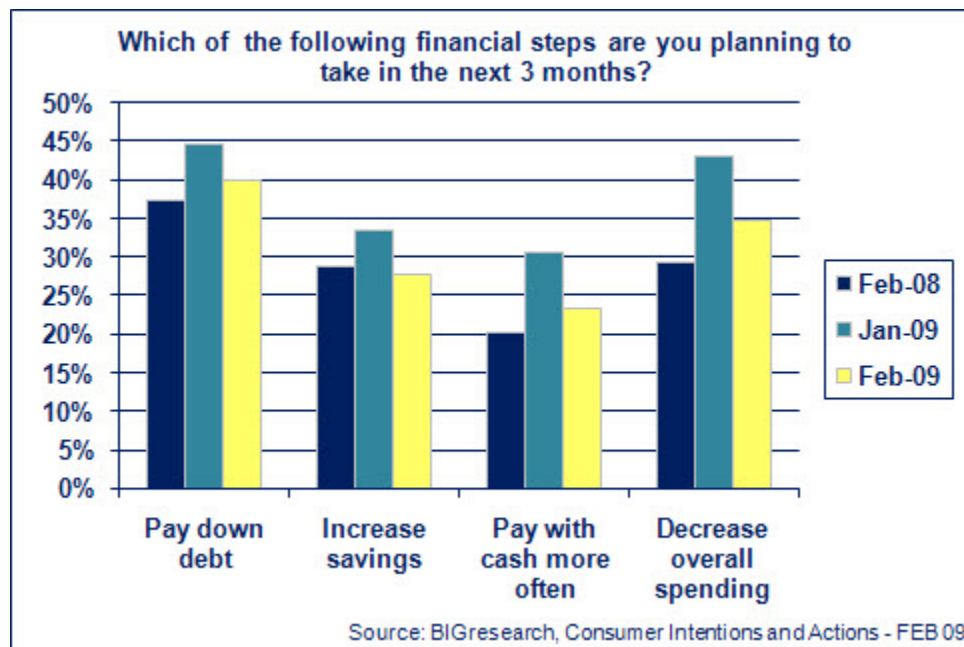
As this is being written, the economy continues to struggle. Today, in late February, the Dow Jones Industrial Index has further declined another 251 points to an 11 ½ year low and is poised to slide below 7,000. Reports on consumer spending, rising unemployment rates to the highest level since the early 1980s, and results from the fourth quarter (Oct-Dec08) showing the biggest drop in the Gross Domestic Product in 27 years all combine to let us know we are in the middle of a tough economic cycle. January saw a 0.3% rise in Consumer Prices, the first increase in six months, easing concerns about deflation but starting to create new fears of inflation among many observers.

We will not attempt to dissect the economy or predict its future. The Federal Reserve sees the recession lasting at least until mid-2009 and many believe it will be much later before any significant improvement takes place. While many economists tend to dismiss surveys of consumer confidence as not being very predictive of overall consumer spending, we believe that it has a strong bearing on advertising response. Regardless of the source, all consumer tracking surveys are documenting January 2009 measured levels at record lows. The Conference Board January Consumer Confidence Index came in at 37.7 (1985 = 100), a decline of 0.9 points from December and an all time low.



The Reuters/University of Michigan Survey of Consumers showed a slight increase in consumer sentiment in January, rising to 61.2 from December's 60.1, but still well below the level from twelve months ago (78.4). The survey respondents increased their expectations for rising unemployment and two-thirds indicated their financial situation had worsened. The RBC Consumer Attitudes and Spending by Household (CASH) Index fell to 1.6 earlier this month, down from a 13.3 index in January. This index has only been measured for the last 7 years and it marked the first time it has been in single digits.

And BIGresearch also reflected a steep decline in their February measurement, with only 19.4% expressing confidence in the economy, a 5+ point rating drop from January. This service also measures consumer intent and continues to report indications of lower consumer spending.



The Harris Poll<sup>®</sup> conducted a poll right before the inauguration last month and expectations for the job market and the overall economy fell to the lowest point in their tracking history, and raised the question that even on the eve of a new administration there was widespread pessimism over the economy.

While none of the polls referenced above took place after the recently passed so-called stimulus bill, most everyone agrees that the job creation in this legislation will not be in effect until we are well into 2010 and even into 2011. So the immediate future of the economy remains very much in doubt.

When we look at advertising, much of the products/services being promoted target discretionary spending. And in the world of direct response, a lot of the advertising is

attempting to drive impulse decisions. In times with consumer confidence and expectations at an all time low, response to advertising has to be negatively impacted.

Both Nielsen and TNS are still compiling results before releasing their estimates of 4<sup>th</sup> Quarter 2008 advertising spending. Earlier last month, Nielsen released its estimates of 3<sup>rd</sup> Quarter spending for last year and noted that comparing the nine month (Jan-Jun) period of 2008 with a year earlier, overall ad spending had declined 0.6%. However, within that number Cable TV was up 8.4%, Syndication TV grew by 2.5%, and even Network TV was up 0.9% - although this was largely due to the Summer Olympic broadcasts in August that turned around a 6% decline in spending for the first 6 months of last year. Local Sunday Supplements had the biggest year to year drop of almost 10% and the four lowest-performing categories in terms of percent change were all print-based media.

Virtually every source that had projected advertising revenues for 2009 and beyond has recently issued revised forecasts, with dramatic reductions in estimated spending. TV spending is now being projected to decline. ABC and CBS revenue are being projected to decline by 15% in 2009, according to Mediaweek. Fox could decline by as much as 24%. TvB is now projecting local TV revenue to drop by 7 to 11%. The automotive category, typically 25% of a local TV station's ad revenue, is rapidly disappearing.

Zenith Optimedia projects a decline in ad spending of almost 6% in 2009. WPP's Group M predicts a decline in US Ad spending of 3%. Interpublic's Magna has revised their projections as well: in June 2008 they predicted a modest growth of 3% in 2009 and have now revised that projection to a decline of 4 ½%. Within this report, Network TV is projected to decline 7 ½%, Spot TV is estimated to drop by 11%, while Cable TV (+1%) and Syndication TV (+2%) will have much smaller year to year increases than has been customary. More to the point, the Magna forecast is now projecting a three year decline in ad spending (2007-2009), which has not happened since the Great Depression.

The Association of National Advertisers surveyed 1200 client-side marketers last fall and two-thirds felt that ad spending would be either reduced or reallocated in 2009. A follow-up study by this same group shows that hiring freezes and ad agency cutbacks are increasing among its members. An advertising budget is one of the more flexible sources of capital that many companies have. It is one of the first to be cut in tough times and tends to be one of the last to get restored later on.

A report by Citigroup, released in November, projected an ad spending decline of 1.8% for 2008, doubling to a 3.6% reduction in 2009. The RAB now estimates 2008 radio revenue to have dropped by 9%, with local revenue down 10%. Wachovia just released a projected revenue decline of 13% for radio in 2009.

The headlines in the trades report on a regular basis of local newspapers losing millions in revenue and reducing staff by thousands. Over 500 magazines ceased publishing in 2008.

This past week UBS Investment Research revised their forecast to reflect a projected decline in ad spending for 2008 of 4.8%, followed by a further decline of 11.6% for this coming year. More intriguing was that they also forecast significant declines in all media for 2009: Radio -9.2%, TV -14.2%, Newspaper -17.6%, Cable -6.3%, and even online at -6%.

Last week also saw CBS report a Q4 2008 drop of 52% and a projected loss of \$11.7 billion in 2008. Viacom reported its 4<sup>th</sup> quarter profit fell 69%.

Those in the online media world are trying to paint a rosy picture amid all this gloom. They point to studies showing an increase in online video viewing and the trend of more consumers doing their shopping online during a recession. The success of the iPhone and other new entrants in the smartphone category should continue to drive more mobile internet penetration in 2009. But other studies show that as ad budgets get squeezed, many marketers tend to reduce or eliminate spending allocated to the perceived more secondary media first, struggling to maintain as much of their planned spending in the primary medium if at all possible. For many major advertisers, this remains television.

Last year, we wrote an article about the Television Upfront. We pointed out that the increased spending in both the broadcast and cable upfronts made little sense in the face of:

- Declining advertising spending
- Sluggish economy
- Shrinking average program audiences in broadcast
- The aftermath of the 3 month writers' strike
- No Summer Olympics or Presidential race to prop up advertising demand
- The conversion to DTV

So what has changed?

As this year's TV Upfront season progressed, there has been very little change initially. Despite a summer of economic concerns, only a fraction of the \$9 billion in TV upfront commitments were dropped as the "holds" went to "order" status. Last Fall Mediaweek reported that roughly 98% of the holds became orders, slightly better than the recent average of 3% cancellations. Categories expected to increase their spending included movies, retail, wireless, pharmaceuticals – and the auto industry was looking stronger.

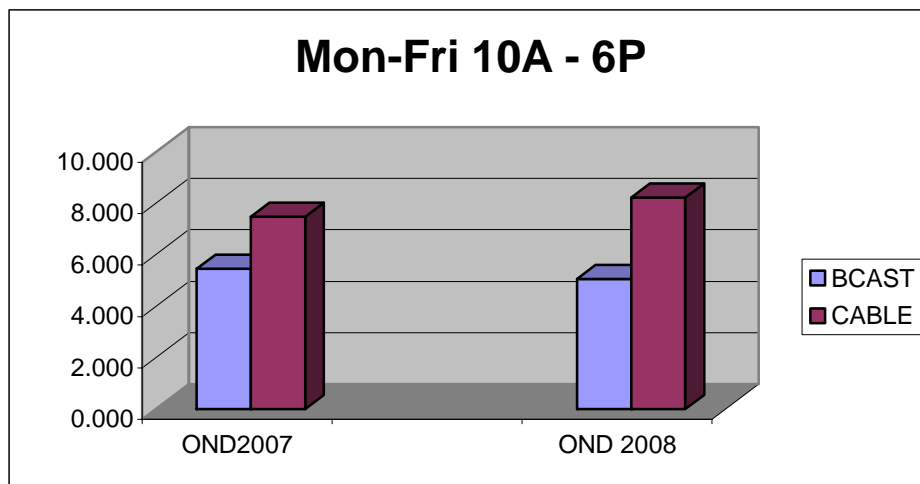
In a typical upfront package, once ordered, the first quarter of the season (Oct-Dec) is firm, non-cancellable. Each subsequent quarter has portions of the buy on option with a notification date by which an option (reduction) has to be exercised. Usually 25-30% of the next quarter's buy (Jan-Mar) could be on option, with the customary option notification date 60 – 75 days before the start of the quarter. In early October last year the financial markets took a major hit and there was speculation that the advertising marketplace would react. But surprisingly, while overall advertising spending declined, the upfront marketplace held pretty steady. By the end of October, very few options had

been exercised. In the prior year (2007-2008), scatter inventory was tight and cost more than the upfront price. With more total inventory having been allocated to this year's upfront (85% of total inventory estimated versus a more typical 75%), combined with declining ratings and demand for audience deficiency units, there was very little inventory left for the scatter market. This was probably a blessing for the broadcast networks, as it turned out that there was very little demand in the 4<sup>th</sup> quarter for scatter inventory. Ad sales for NFL football were down 10%, according to Sports Business Journal. A similar situation also existed in cable, where usually about 50 – 60% of total inventory is sold in the upfront.

Perhaps buoyed by the hope that the end of the political Presidential race and with a new incoming administration, many advertisers hoped the economy would stabilize and everything would be O.K.

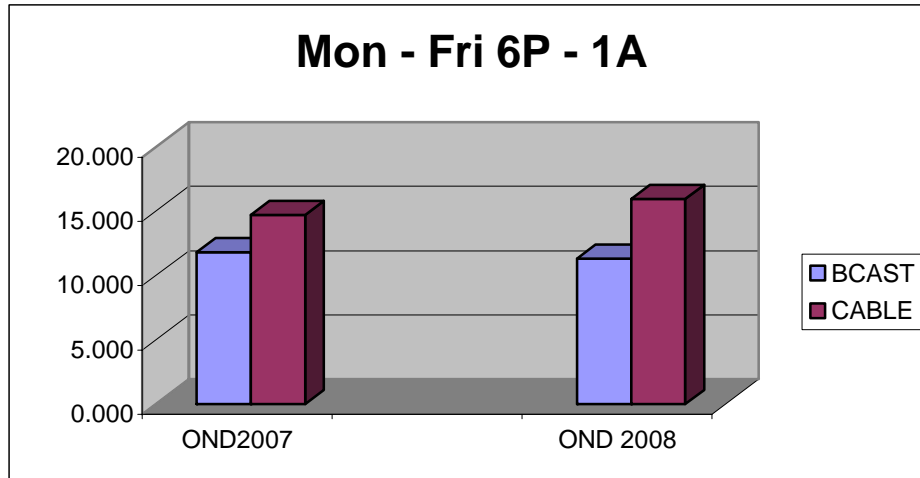
The situation now that we are into 2009 has changed. On the programming side, Nielsen audience data continue to demonstrate that viewers are shifting from broadcast to cable.

The charts below detail viewing among adults 25 - 54:



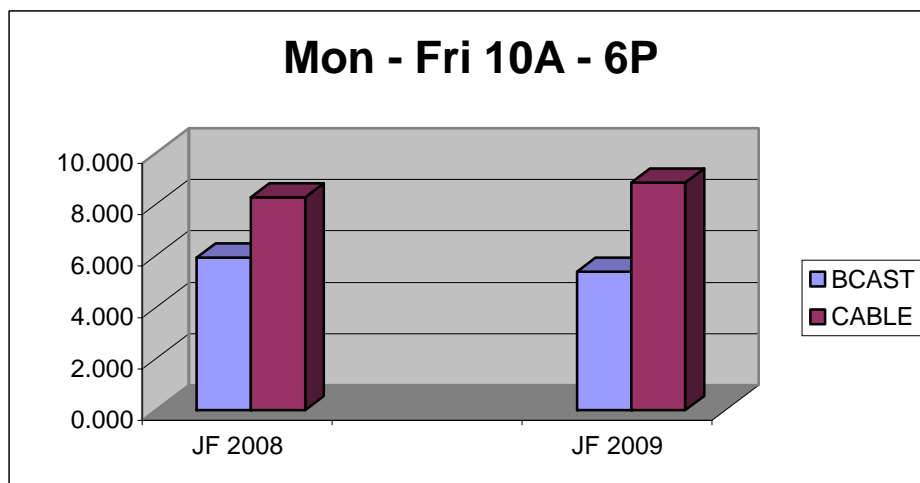
For the 4<sup>th</sup> quarter, daytime viewing levels to broadcast were down 7 ½% while cable adult 25-54 viewing increased 10%. Against total households (not shown), a similar pattern occurred, with broadcast viewing down 5 ½% while cable viewing increased by more than 7%.

The next chart looks at evening viewing levels:



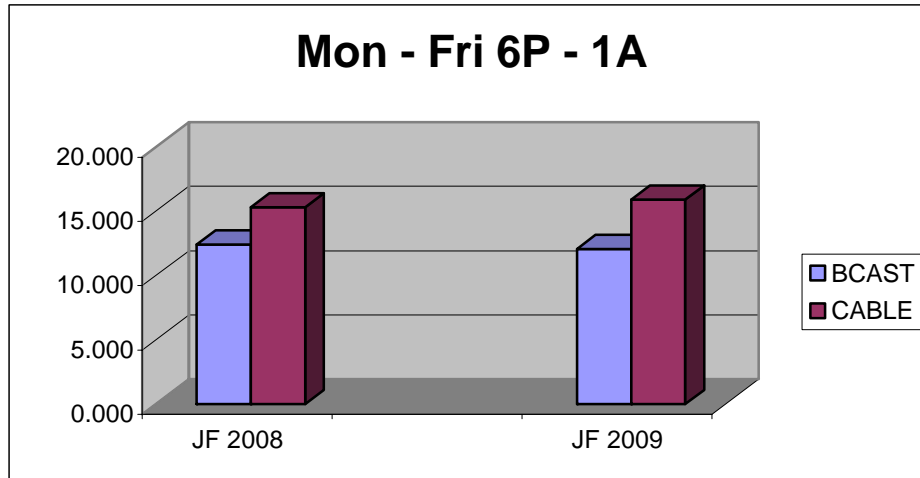
The changes were smaller, with broadcast viewing levels for adults 25-54 down 4% and cable viewing increasing 9%. Similar patterns also took place among total households in Prime Time, while Late Night held up in broadcast against total homes.

In the most recent period (Jan-Feb 2009), there continues to be a shift from broadcast to cable, although by a much smaller margin:



Daytime broadcast viewing levels among adults 25-54 dropped 10% from prior year levels. Cable showed a 7% increase. Among total households, the broadcast drop off was under 1% while cable posted an increase 4%.

In the evening:



Among 25-54 year olds, broadcast came in 3% below year ago levels while cable was up by the same margin, 4%. Against total homes, broadcast dropped by 4% while cable increased by 2 ½%.

In comparing these periods, remember that year ago levels were mostly during the writers' strike against the studios that impacted a lot of broadcast programming. Also, in looking at 2009, there have been fewer first run programs in broadcast this year in February as well, as the networks have been waiting for the March sweep period. Nielsen has delayed the winter sweep to March from its customary February period due to the anticipated transition to DTV.

What do these rating shifts mean? For one thing, the broadcast upfront is more vulnerable to cut backs than cable. Another aspect will be the increased need to use unsold time for audience deficiency unit weight in the coming weeks. NBC has also announced that starting this Summer, Jay Leno will host a show at 10 PM, eliminating all scripted entertainment for that final hour of prime time. This may further weaken broadcast's standing against cable. Fox never has programmed the 10 PM time period.

It used to be that cable tried to resemble broadcast by airing repeats of off network shows such as Law & Order or CSI. Now broadcast is starting to emulate cable as Fox has ditched Saturday morning kids programming for its "Weekend Marketplace", which runs long form Infomercials on Saturday morning. And that's not the only incursion being made by DRTV into more mainstream channels. With lower demand for advertiser time, more cable and even broadcast networks are accepting DRTV ads. It is now getting to the point that pitchman Billy Mays is getting almost as much prime time exposure as Ryan Seacrest!



Thumbs up for Billy.....



...sharing the spotlight with Ryan.

Amid all of these programming/rating changes, much is now being written about aggressive price negotiation on the advertising front. As mentioned earlier, each quarter's option notification dates are typically 60 -75 days before the start of the quarter. Due to the uncertainty in the economy, many upfront advertisers have been granted extensions on their notification deadline, with many not needing to be exercised until the early part of March. So right now it is too soon to determine to what extent upfront inventory may be released back into the marketplace.

Earlier this month, a headline in Broadcasting and Cable proclaimed "Broadcast and cable hit in mass slaughter as agencies take second quarter options." The article went on to state that up to 50% of some advertiser's commitments were being cut back. The nation's top advertiser, Procter & Gamble, exercised its 2<sup>nd</sup> quarter options, reported by some to be a full scale cancellation across the board. Some saw this as a cost cutting move given that P&G's fiscal year ends in June. The ANA released an updated study stating that 71% of their marketer sample had already cut back ad spending, 77% plan to cut back even more.

Until all of the options have been exercised, it is hard to speculate on what will be the inventory situation over the next 6 months. Some believe that some major advertisers such as P&G may be releasing upfront negotiated inventory and then trying to turn around and buy it back in scatter at a reduced rate. Several people on both the broadcast

network and cable side have indicated that several upfront advertisers have done this. Those willing to be quoted claim that scatter prices are still being kept at or above upfront levels.

In this environment, there is growing pressure on TV sales to discount their rates. No one is yet publicly proclaiming that this has happened. As stated earlier, national TV, both broadcast and cable, are holding up better than any other advertising medium. Nielsen continues to document that Americans are watching more TV than ever before. The average American is watching over 142 hours of TV in a month, despite the fact that video is now available on computers and cell phones. But within these numbers is the fact that the older one is, the more likely they are to watch more TV. Among the so-called “millennials” (persons 14 – 25 years of age), average TV consumption is just 10 ½ hours per week. Generation X (adults 26 – 42) watch 15.1 hours, Baby Boomers (43 – 61) watch 19.2 hours, and matures (62 – 75) watch 21 ½ hours per week.

In addition to TV program viewing, Nielsen also provides measurement of DVD and VCR playback and Video Game play. Both DVD playback and Video Game play are up in double digits over a year ago on a total household basis. While not being counted in the HUT/PUT levels used to calculate audience ratings, this does potentially lower the available audience to watch commercial TV.

Within the area of DRTV, most of it still takes place in Cable. Many of the larger cable networks allocated their inventory during last year’s surprisingly strong upfront. A certain amount of inventory was set aside for DRTV. As upfront options are exercised, that returned inventory does not always become immediately available to DRTV advertisers. For some networks there now exists the situation of a fairly tight inventory supply for DRTV while having unsold inventory on the general side. Some forward thinking cable sales organizations are finding ways to better coordinate these two areas to deal with advertiser demand, but the situation is different from one network group to another.

While it is too soon to begin to predict the situation surrounding this coming year’s TV upfront, many of the circumstances highlighted a year ago remain in effect. The economy is not on the road to recovery, overall ad spending is in decline, TV viewing levels in broadcast continue to erode, the writers’ strike of last year may be replaced by a SAG strike against the producers – although no strike vote appears to be imminent, the DTV transition is still taking place – now delayed to June 12 but with over a third of all stations having already converted. So many of the same conditions remain to suggest that this time the upfront will be smaller. But the sellers are claiming that 3 - 5% rate hikes are realistic while buyers believe pricing will be flat or even down a few percentage points. Some upfront advertisers may decide to go back to scatter. One thing is pretty certain: the upfront market will drag on much longer this year and be a slower and more deliberate process. There is too much uncertainty in the economic picture for it to be otherwise.

So what advice is there for marketers? We believe strongly that this is an excellent opportunity for advertising. Consumers still need to consume and are even more focused on finding bargains than ever before. In many categories, one or more competitors may be trimming budgets, so this is an excellent time to promote your product or service. It will be easier to stand out and gain market share. If a marketer decides to cut back, they might wind up where a competitor continues to advertise and consumers may shift their allegiance. Advertising works on the laws of physics. It is easier to maintain momentum than to stop and then start back up again. Direct Response advertising, especially DRTV, can be very beneficial at times like this to help an advertiser present a sales message with a clear “value” proposition. We believe 2009 will only see the economic climate get worse before recovery begins. Variety and convenience will become secondary to value. Advertisers need to be more focused on the ROI of their advertising investment. DRTV provides an immediate measurement of advertising’s effectiveness and minimizes the investment against a strategy that is not producing desired results. In the months ahead there will be more inventory for DRTV as general advertisers cut back on their planned spending, which will result in a more affordable media cost to make the advertising campaign even more efficient.

As people bunker down in their homes to ride out the storm, TV viewing will increase. Smart marketers will see growth result from seizing this economic situation to build a competitive advantage, differentiation from the competition, and customer loyalty through a sustained advertising presence.