ENDERS | ANALYSIS

Enders Analysis looks at 2022

Enders Analysis is the independent supplier of insights on the digital age to ~150 subscribers spanning the corporate, investor, policy and regulatory sides of the technology, media and telco (TMT) sectors in the UK, the US, Europe and Asia. Our research agenda in 2022 has shifted from the pandemic to the impact of the burgeoning energy crisis, and more broadly cost-of-living pressures on discretionary household incomes, and thus expenditure on telco and media services. As always, our research agenda continues to track media consumption across traditional and new media, spanning the venerable TV, subscription VOD and news services, alongside advertising supported digital media and gaming, which is the big winner of the pandemic's shifts.

The energy crisis changes everything...again

While 2020 and 2021 are now remembered mainly for the pandemic's disruptions to patterns of life, work, mobility and international travel, 2022 is the year we celebrate the release from these disruptions and the return to face-to-face encounters, such as the delegates to this Conference will enjoy! On the downside, the UK's recovery, like that of other economies around the world, is facing headwinds from the cost-of-living crisis hitting consumers.

As countries moved away from lockdowns in mid-2021 thanks to vaccination drives, their economies sprang back to life and prices of energy and many goods and services soared. Russia's war in Ukraine, besides the human tragedy that it has sparked, further stoked the energy crisis, forcing many countries in Europe to make long-term adjustments to supplies.

Fuel is the most significant pressure point on both consumers and businesses, as energy prices skyrocketed to historic highs. The discrepancy between the value and volume of fuel sales increased by 10.9% in March, five times more rapidly than in the month before the war in Ukraine, creating a stark 27.2% difference that will impact affordability at all levels of the supply chain and continue to drive inflation for consumers and producers alike.

Higher fuel costs already affected consumer spending in February and especially in March, with the retail sales index for volumes down by 1.4% on February, while equivalent values fell 0.2%. Increasing the pressure on all sides from April, the 54% increase in average home energy prices and increase in NI contributions for workers create an increasingly difficult retail environment across the board.

According to a YouGov poll we commissioned in the third week of April, 70% of the UK population are making lifestyle changes in preparation for the financial situation to further deteriorate this year. Most individuals with families are planning to cut back, while those over 55 are less likely. Every region of the UK is affected.

While the narrative is defined by the outbreak of Russia's war in Ukraine, the base effects of the pandemic remain a factor. Mobility remains a third lower than the pre-pandemic baseline due to ongoing work-from-home (WFH), in hybrid form, in sectors that can support it. Many employers accept that WFH could be at least as productive as offices, thanks to the portable nature of skills, the scope and depth of the UK's telco infrastructure in residential areas, and the service layers available to support collaboration. Hybrid WFH is likely to endure as well due to the endemic nature of COVID-19, with its silver lining being the decarbonisation of work, a crucial response to the climate crisis.

Employee preferences for WFH are persisting and could increase due to spiking fuel costs. A significantly larger proportion of ABC1 individuals plan to reduce their recourse to driving—51%, as opposed to 39% of C2DE individuals—further feeding social inequality. This will further dampen B2C businesses as fuel costs impact already limited footfall.

This energy price shock to household finances could well trigger a technical recession of two consecutive quarters of quarter-on-quarter declines in GDP starting as early as Q2 2022. Household energy bills are predicted to rise sharply again in October, causing fuel poverty in the bottom third of the income distribution, according to the Resolution Foundation. The UK looks to be entering a period of stagflation, combining high, possibly double-digit inflation, and declining or stagnant growth.

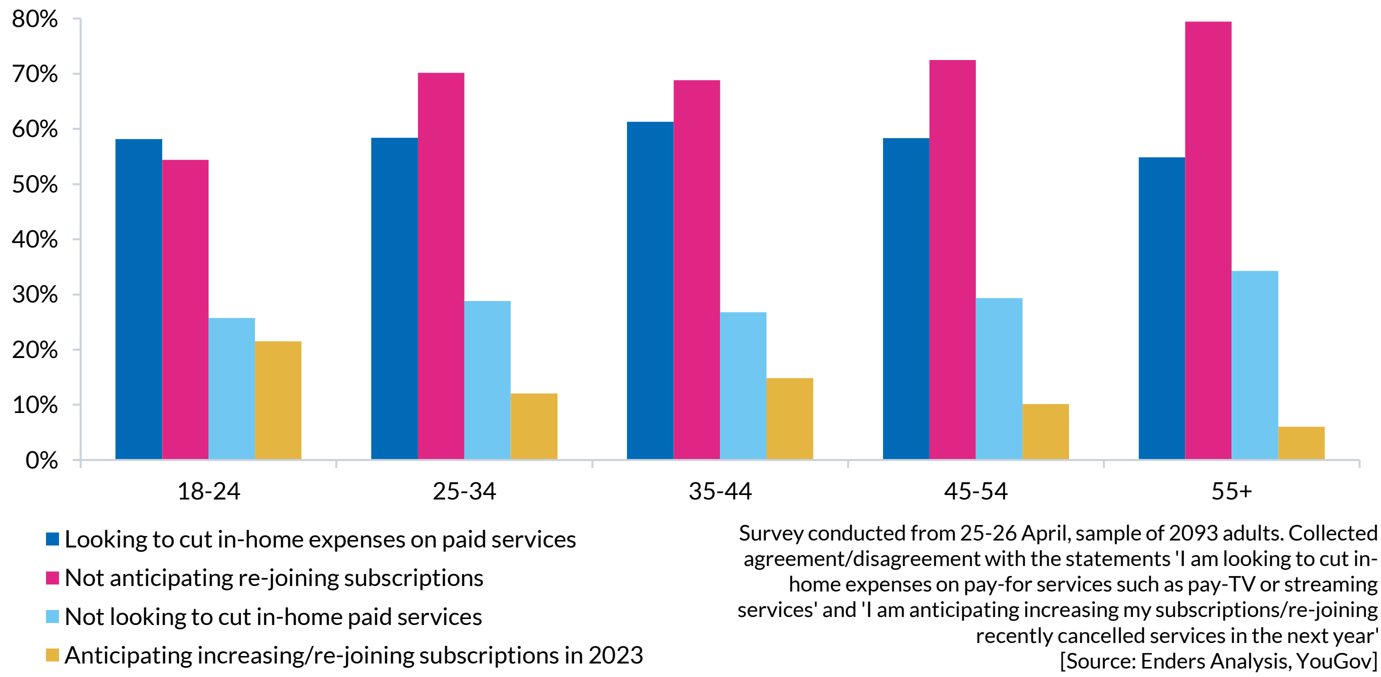
Media economy: energy crisis stifles sunny uplands

The unpredictable longevity of Russia's war in Ukraine is causing great uncertainty to weigh on the economy. Thanks to 'base effects' from the steep declines in advertising in 2020 and into mid-2021, we anticipate the annual growth rate of UK advertising revenues in 2022 will be strongly positive. This 'sunny uplands' scenario will start to crumble under pressure, making a more qualitative assessment by medium of the likely situation in 2022 preferable to point estimates.

Pure play online display advertising was the big winner of the pandemic due to the leap in ecommerce, the most marked consumer trend of 2020, continuing in 2021 and in 2022 despite abatement. Ecommerce share of retail sales (excluding fuels) continues to decay towards our predicted elevated baseline of 25%, anchored by hybrid WFH, but will not escape from the energy crisis as fulfilment costs increase. The demand side is also impacted, as businesses are forced to pass costs on to consumers. The search for value for money will drive even more activity on the internet.

The clear winners in commercial terms of the pandemic proved to be subscription over-the-top (OTT) streaming services, such as Netflix and Disney+, but the return to normality and the cost-of-living crisis have already partly reversed gains in subscribers. In the UK, although more adults plan to reduce spending on in-home essentials than plan to reduce paid subscriptions, 58% of UK adults are likely to reduce expenditure on in-home paid OTT services, and the attrition will be long-lasting or permanent, with only 11% expecting to re-join or increase subscriptions in 2023 (Figure 1).

Figure 1: UK attitudes to in-home subscriptions by age group



Survey conducted from 25-26 April, sample of 2093 adults. Collected agreement/disagreement with the statements 'I am looking to cut in-home expenses on pay-for services such as pay-TV or streaming services' and 'I am anticipating increasing my subscriptions/re-joining recently cancelled services in the next year'
[Source: Enders Analysis, YouGov]

The headwinds facing the economy inevitably also pressure mass market advertising and thus revenues of broadcasters, impairing their expenditure on content, although their transition from linear to digital advertising will help mitigate the economic impact.

In this context, the pressure on the funding model of the BBC is also of concern. In addition to being the largest producer of news for radio and TV, alongside its sizeable online presence, the BBC is also by far the most important commissioner of British content in the UK. The future ownership of Channel 4 remains uncertain, and with it the potential impact this might have on the UK production sector. While this has benefitted from investments by Netflix and US studios, the broadcasting sector makes an irreplaceable contribution to the creation of British content. The UK's creative industries can only gain from investment in content from all sources.

Sky's focus on aggregating the best available content, its push towards fibre and disciplined approach to sports rights across Europe places it in a good position to withstand the economic headwinds, as it previously did in 2008-09.

After the pandemic shock in 2020, newspaper circulation returned to 2019 levels of decline in 2021, as footfall returned to city centres; we expect print circulation to continue to structurally decline in 2022, with local newspapers particularly vulnerable to soaring print costs. Thanks to the pandemic, the UK's hosting of COP26, and Russia's war in Ukraine, appetite for news produced by trusted sources remains high, benefitting digital advertising across publishers which continues to grow. Leveraging this appetite, many trusted news publishers operating reader-first subscription revenue models have benefitted. The 'one million' club of UK news publishers now includes *The Guardian* alongside the *Financial Times*. They may also anticipate payments of some kind from Google and Facebook, as the tide of regulatory pressure reaches the shores of the UK, after Australia and Canada adopted regimes enabling them.

The return of blockbusters has aided cinema's recovery into 2022, with *Spiderman: No Way Home* surpassing $1.8 billion in global box office takings despite not releasing in China. UK admissions could double this year, returning to levels comparable to those seen at the start of the millennium, though they remain slightly down on 2019. Advertising spend on cinema is projected to follow suit.

Out-of-home (OOH) advertising is slowly bouncing back, aided by further recovery in travellers using public transport and airports. Whilst reach has returned across all outdoor environments, frequency is still depressed as international travel lags previous peaks and WFH persists. Expected ad spend on OOH in 2022 will remain well under peak 2019 levels. Digital continues to drive the OOH medium, offering advertisers greater flexibility to change campaign locations to mirror evolving footfall trends.

Telecoms: economic concerns, convergence savvy and consolidation hope

The UK telecoms industry has recently been boosted by supra-inflationary price increases across most operators, which has boosted growth but barely recovered market revenue to pre-pandemic levels, with the scale of consumer backlash as yet unknown. The telecoms sector has in the past been somewhat vulnerable to consumer slowdowns; it is likely to be less so now, with voice calling a much lower proportion of revenue, and telecoms services much more vital to everyday life, now going beyond personal communication into a standard enabler of work life and an intrinsic component of TV and other home entertainment. Nonetheless, the cost-of-living squeeze will likely both boost the discount providers and encourage discounting from others, while fewer/cheaper smartphone sales will likely place pressure on mobile service revenue.

A tighter economic environment will also make it harder for the telcos to take full advantage of new network capabilities, with higher speed full fibre upgrades likely to be a harder sell, and services enabled by 5G are likely to continue to prove elusive at the mass market level. The cost and capacity benefits of these technologies may have to take more of a centre stage.

The UK has historically lagged behind many European markets in terms of the degree of fixed-mobile convergence, but this is mainly due to players avoiding value-destructive high discount levels, a wise move in our view. More savvy forms of convergence are now gaining traction in the UK, with service innovation (e.g. mobile broadband backup), more sophisticated discount structures, and consolidated sales and distribution functions. This will likely continue with the two largest telco players (BT and VMO2) now fully converged outfits.

Finally, as VMO2 continues its integration efforts after last year's mega-merger, discussion of further consolidation continues. Vodafone and H3G are particularly keen in the mobile sector (presumably with each other), TalkTalk is reportedly considering approaches, and the multitude of altnets building full fibre networks must surely thin out in the near future. There will be high regulatory hurdles with the larger transactions, but in our view, very substantial benefits in terms of cost savings, and ultimately benefits to consumers in terms of the extra investment enabled.

Have a great day,

The analyst team at Enders Analysis