Spotlight on profitable growth

Media & Entertainment
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Introduction
In the past year, the media and entertainment (M&E) industry has seen a dramatic turnaround. The improving macroeconomic and business climate has advertisers more confident than in recent years. As a result, they are ramping up ad spending. Although spending is not yet where it was before the downturn, the trend is most welcome for ad-dependent M&E sectors.

While M&E companies are benefiting greatly from the improving advertising environment, structural factors continue to weigh on the industry. The impact of alternative modes of content distribution continues to ripple through the various M&E sectors, disrupting audience aggregation, pricing and, ultimately, revenues and EBITDA (earnings before interest, taxes, depreciation and amortization) margins.

However, while the digital revolution was once viewed as a serious threat, it is now seen as a tremendous opportunity. M&E companies are developing new products and embracing new platforms. Although digital revenues are still small for most M&E companies, they are growing rapidly. Having learned much from early endeavors, M&E companies’ digital business models are now more profitable than before.

During the downturn, M&E companies focused heavily on cutting costs to preserve margins. They restructured their back offices through consolidation, standardization, shared services, outsourcing and offshoring. While most efforts are largely complete, M&E companies are being very careful to not let costs creep back up as external conditions improve.

The confluence of an improving ad market, digital success and a slimmer cost base is having a positive impact. In 2010, EBITDA figures improved for most M&E sectors, and estimates for 2011 confirm the upward trend.

This report examines market conditions in the various M&E sectors, taking into account both structural and economic factors. This helps provide a framework for understanding changes in revenues and EBITDA dollars and margins.
Study overview
In times of change, knowing what the competition is doing has become increasingly important to M&E companies across the globe. In support of our commitment to keeping a finger on the pulse of change that continues to transform this industry, Ernst & Young conducts periodic studies with CEOs, CFOs and other key executives to determine significant trends and identify the potential issues and challenges arising in each of the M&E sectors.

In 2004, Ernst & Young began examining and comparing EBITDA of M&E companies. Although EBITDA is not a standardized term under generally accepted accounting principles (GAAP), and may be calculated differently from one company to another, it nevertheless serves as a widely available metric used by analysts, investors and reporting companies to look at the financial performance of companies in the M&E industry.

This 2011 update is based upon a study group of 86 of the leading companies and conglomerates* comprising 10 distinct M&E sectors that, in the aggregate, will generate an estimated $170 billion of EBITDA in 2011.

It is designed to help companies:

- Evaluate their own performance against that of their sector
- Provide input for setting goals and performance targets
- Target sectors of the industry for investment, acquisition or divestiture
- Better understand the changes in performance for different sectors over time, including both the actual financial results and the drivers of those changes

In this study, we analyzed actual performance between 2007 and 2010 and estimated performance for 2011.

*A company that appears in two or more sectors is considered to be a conglomerate.
Cross industry

Based on Ernst & Young’s analysis, the M&E study group taken as a whole is outperforming many key cross-industry stock market indices in terms of EBITDA dollar growth, and it ranks near the top in EBITDA margins. Between 2007 and 2011E, the M&E industry saw its EBITDA dollars grow by an estimated compound annual growth rate (CAGR) of 6%. In the past year, the M&E group has seen a rise in EBITDA margins along with all the major indices.

* "EBITDA margin percentage" is EBITDA dollars divided by revenue dollars.
** "2007–2011E CAGR (EBITDA $)" is the compound annual growth rate of EBITDA dollars.
Underlying the industry’s performance relative to these broad market indices is the performance of the sectors comprising it. For example, the interactive media and cable networks sectors both enjoy high EBITDA margins and fast growth in EBITDA dollars. By contrast, cable operators have the highest EBITDA margins, but their EBITDA dollar growth is a little slower than some other sectors. What actually drives these sector performance trends varies: for interactive media, it is the migration of advertising dollars to the internet, while for cable networks, it is the ability to command growing affiliate fees from distributors.

**Figure 2**
EBITDA Margin Percentage* (2007-2011E)

**2007-2011E CAGR (EBITDA $)**
- Interactive media 17%
- Electronic games 16%
- Cable networks 12%
- Cable operators 7%
- Satellite television 7%
- Conglomerates 4%
- TV broadcast 0%
- Film and TV production 0%
- Music 0%
- Publishing -1%

* "EBITDA Margin Percentage" is EBITDA dollars divided by revenue dollars.
** "2007-2011E CAGR (EBITDA $)" is the compound annual growth rate of EBITDA dollars.

**Sector performance**

During the past several years, alternative methods of content creation and distribution have taken hold. This is having a profound effect on individual M&E sectors. It is not surprising that the interactive sector is growing faster than most of the more “traditional” sectors, which continue to feel the brunt of changing consumption patterns. The TV broadcast, film and TV production and music sectors will see no EBITDA dollar growth during the 2007-2011E period, while publishing will see its EBITDA dollars fall, despite of having higher EBITDA margins than these other traditional sectors.
Interactive media

The interactive media sector includes companies that provide access to information and entertainment content through search engines, portals and other internet-based formats. Many of these companies provide content created by other sources; a few create their own content. Advertising is the predominant business model for internet companies. The segment continues to benefit from the ongoing shift of consumers and advertisers away from traditional media to new media. In recent years, online advertising has been the fastest growing of all ad platforms. Advertisers like the internet’s ability to measure return on investment and track user behavior, which then can be used to deliver targeted advertisements. However, interactive media companies are increasingly supplementing ad revenues with subscriptions, microtransactions and other revenue sources. As these companies scale operations and grow their customer bases, EBITDA dollar growth has followed.
The economic downturn took a toll on this sector. Internet advertising fell by 3.4% in 2009, causing interactive media EBITDA dollar growth to slow from 20% in 2008 to 7% in 2009. However, like other M&E sectors, interactive media is bouncing back. In 2010, internet advertising revenues recovered, and analysts expect this to continue in 2011, as the medium continues to gain market share in ad spending. And there is ample room to grow, as there is still a large discrepancy between time spent online and ad spend. Interactive media accounts for nearly 30% of consumer time, yet only 13% of total marketing dollars spent. Analysts expect that discrepancy will close as online ad expenditures grow. Industry watcher eMarketer expects global online ad spending to rise from $63 billion in 2010 to $94.4 billion in 2013.

In 2010, interactive media EBITDA dollars grew by 21% EBITDA margins, meanwhile, have steadily improved, as these companies become more scaled and efficient. In the 2007-2011E period, interactive media companies are expected to have the highest EBITDA dollar growth rate, while in 2011, EBITDA margins are expected to be second-highest among the M&E sectors.

Another growth catalyst for internet companies is the underserved local advertising market. The local internet advertising business, comprised mostly of small businesses, is a relatively small market, yet about 20% of searches are local in nature (e.g., Savannah, GA, and pizza), which presents considerable opportunities. Most of the large internet companies are increasing their investment to capture more local ad dollars.

However, the companies in our study group will see increased competition. Traditional media companies are adapting to a digital world via new tablet and mobile apps, social media and more. Their digital revenue streams are still a very small portion of overall revenues, but they are growing rapidly. Additionally, social media—blogs, social networks and the like—is growing at a phenomenal rate, and as it does, advertisers will ramp up social media ad spending. As Figure 3 shows, worldwide ad spending on social networks will grow rapidly over the next few years. Social media is very appealing to advertisers because the data it provides is a good indicator of users’ interests.

Figure 3
Social network advertising forecast (in billions of US dollars)

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<tr>
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<th>2011E</th>
<th>2015E</th>
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<tr>
<td>United States</td>
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<td>International</td>
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Electronic games

During the 2007–2011E period, electronic game companies’ EBITDA dollars grew an estimated 16%, second only to the interactive media sector. The video game sector has been fairly volatile over the last few years. In 2009, falling revenues drove a drop in EBITDA dollar growth. In 2010, sales rebounded, leading to a sharp rise in EBITDA dollar growth. However, EBITDA dollar growth is expected to decline again in 2011 by 10%. In 2011, EBITDA margins in the sector are expected to rise to 17%, an improvement from 16% in 2010.

The sector is transforming. Once the mainstay of the game market, the sale of packaged games is in a long-term decline as consumers migrate to new forms of gaming (social/casual, mobile and massively multiplayer online games). The industry also continues to see a shift in platforms. The console game segment is expected to shrink, as consumers move toward other game platforms, such as online and tablets. Hardcore gamers who grew up on console games will remain loyal to the platform, but the next decade will see a huge shift: the next generation of gamers is growing up playing social or casual games on handheld devices.6

Social and casual games are rapidly and radically reshaping the game sector landscape. Social games allow gamers to play with friends in a virtual environment, while casual games are easy to play, require less commitment and have shorter sessions (e.g., card games and word games). Most users play these games for free. However, game companies are working to improve conversion rates (i.e., converting playing users to paying users). In the western world, the conversion rate for free-to-play online games ranges from 1% to 3% for most social games. Companies think that this rate can grow based on increased user engagement, better product recommendation engines and widening penetration of payment mechanisms.7

Social and casual game revenues are growing rapidly, largely driven by a strong adoption on Facebook. However, experts expect to see these games grow on additional platforms. These platforms may be smaller than Facebook, but—depending on the revenue share—may monetize at a higher rate for game publishers.

The proliferation of platforms is good for game industry profitability, as the incremental cost of porting existing games onto a new platform is minimal. Even after giving a revenue share to the platform (Facebook, Apple or other), games sold through these environments and channels are still very profitable.

Virtual goods—in-game items that users can buy—are becoming a big revenue driver. Much of the growth in virtual goods will come from western markets, which lag behind Asia where the virtual goods model is more mature. Analysts also expect strong growth in the BRIC markets, largely driven by rising internet penetration. In-game advertising is also a growing revenue source. Advertisers are selling branded virtual goods in games, and creating branded virtual environments.8

Just as platforms are shifting, so too are business models. Games-as-a-physical product models are giving way to games-as-a-service models, where games are stored “in the cloud” to be enjoyed on any platform.9

Incumbent game companies are reacting to industry changes. They have strong brands and franchises to leverage on new platforms, and they are developing their own social or casual games—or buying companies that make them. They are also focusing their energies on their most profitable games and technologies. For example, several are pruning their portfolio to focus their energies on their most profitable games, franchises and platforms. Such pruning will invariably cause short-term pain in revenue growth, but will drive margins in the long term.10 At the same time, incumbent companies have done much to rationalize their costs and are focused on digital delivery of games, which helps improve margins.11
Cable networks

Subscription-based television content providers, commonly called “cable networks” or “cable channels,” have prospered in the past few years. Cable networks’ audience share continues to grow, somewhat at the expense of broadcast networks. As they grow, the rates they charge advertisers (cost per thousand, or CPM) are also rising, positively impacting EBITDA dollars and margins.

Cable networks’ dual revenue model (advertising and subscriptions) makes them somewhat more resistant to economic downturns. In 2010, US cable network advertising grew by 9.8%. Carriage fees — payments from cable, satellite and telecom distributors — grow at contractually obligated rates, regardless of the economic environment.

After slowing a bit in 2009, cable network EBITDA dollar growth reaccelerated to 13% in 2010 — one of the higher growth rates in the M&E group. In 2011, cable networks EBITDA growth is expected to fall slightly to 12%. Meanwhile, EBITDA margins have risen steadily in the 2007-2011E period, and are expected to rise to an estimated 37% by the end of 2011.

Cable networks’ ability to deliver niche audience segments is attractive to advertisers. Much of cable’s ratings success is due to their growing investments in original programming, as well as major events and shows moving to cable. In addition, cable networks rerun their programming more often than broadcast networks, thereby generating more ad dollars per show. Investments in cable programming are expected to grow more than 25% over the next three years.

Cable networks are seeing healthy international growth as the number of multichannel households grows worldwide. This creates additional revenue opportunities, boosting EBITDA margins. In addition to growing distribution in BRIC countries, cable networks are also aggressively seeking opportunities in other parts of Latin America and Central and Eastern Europe, where the cable network business is just now taking off.

Cable networks are exploring alternative distribution methods, but they are doing so within the current pay TV ecosystem. They are making content available to multiple devices through “TV Everywhere” (where subscribers to pay TV services receive on-demand access to TV shows across multiple devices). None of the current online distribution platforms offer cable networks the benefits they currently receive from traditional distributors. Unlike the broadcast TV network/studio business, cable networks rarely own their own shows, so monetization through syndication or other windows isn’t an option. Also, it would cause a potential conflict with current distributors.

Cable networks are seeing healthy international growth as the number of multichannel households grows worldwide. This creates additional revenue opportunities, boosting EBITDA margins. In addition to growing distribution in BRIC countries, cable networks are also aggressively seeking opportunities in other parts of Latin America and Central and Eastern Europe, where the cable network business is just now taking off.
Cable operators continue to see a mixed operating environment. New technologies allow them to unlock their tremendous bandwidth in exciting new ways, but they continue to struggle against cyclical and structural headwinds.

The economic downturn—more specifically, the downturn in the housing market—has hurt cable operating results. Housing conditions (home sales, construction and vacancy rates) play a big role in cable industry growth, and reduced housing activity results in fewer sales opportunities. At the same time, some customers have scaled down to less expensive programming packages.

All of the major US cable companies are losing basic subscribers. However, these losses aren’t as alarming as headlines suggest. Industry-wide, cablers are generally losing their least valuable subscribers, so the financial impact hasn’t been that significant. For most cablers, other services such as high-speed data (HSD), DVR and telephony, are still growing, albeit more slowly than before.

Cable operators are also focusing more on profitability than market share. They are screening their customers better to drive down churn, which, in turn, reduces bad debt expenses. They are also using technology to reduce costs, such as deploying self-installation kits and remote DVRs. This practice has the dual benefit of improving the customer experience as well as saving service calls, which are a considerable operating expense.17

Cable operators saw EBITDA dollar growth fall in 2010, but it is expected to reaccelerate in 2011. EBITDA margins, meanwhile, are expected to be fairly steady in the 2007-2011E period.

As a potential threat to cable operators, so called over-the-top (OTT) video is getting a lot of attention. OTT video is television content that flows directly from the internet to TVs, without being packaged by a pay TV provider. If a critical mass of free or low-cost TV content becomes available on the internet, subscribers could drop their pay TV services (or “cut the cord”) in favor of online alternatives. Some analysts think that OTT and technology companies have replaced DBS and telcos as the biggest long-term threat to the cable industry. One reason is that new technology competitors typically have shorter product development cycles and can get products to market faster (months or a few quarters) than the cable operators (one to three years).18

There is considerable debate on the potential impact of OTT on cable operators. OTT distribution is not expected to become a viable substitute for pay TV in the next few years, and there is currently limited evidence of cord cutting. Still, cable operators are reacting to the changing market environment. They have launched so-called TV Everywhere services. Several operators have launched iPad apps that give their customers access to live programming and/or a selection of video-on-demand (VOD) content.19 As a corollary benefit, TV Everywhere services will drive demand for high-margin high-speed-data (HSD) services.20
Cable operators are also increasing the number of available VOD titles, and are developing more user-friendly program guides, with better recommendation features — one area where OTT providers have outperformed cable operators. Cable operators report that these efforts have already resulted in increased VOD buy rates.\(^2\) Some cable operators are experimenting with lower priced tiers with fewer channels.

Even if cord cutting increases, cable operator margins may not be affected that much. The growth outlook for HSD services is strong, and cable companies have good pricing power because other than telco fiber, which is not available in many markets, there is no direct substitute for cable’s HSD products. HSD margins are higher than video margins, which are continually being squeezed by content owners.

Providing telecommunications services (voice and data) to small- and medium-sized enterprises (SME) has become a significant growth driver for most cable operators. Going forward, cable operators will provide more than the pipe to businesses — they will increasingly offer higher-margin enterprise-class hosting and managed applications and services.\(^2\) The SME market represents an opportunity to create incremental revenue streams using existing assets. Today, cable operators have a relatively small share of the market (roughly 5% to 15%), but it is growing. Also, business margins are higher than the residential business, and this will only improve as this service scales.

In addition to the SME market, cable operators have many ways to use their “pipes” other than video: security monitoring services, in-home health care applications and home-energy monitoring, just to name a few. These new marginal revenue streams come with little incremental costs, whereas a new entrant would have to build an expensive wired infrastructure.\(^2\)

In Europe, cable operators are losing subscription TV market share to competitors. However, they are gaining market share in the telecom market (telephony and high speed data). Since the telecom market is bigger than the cable market, cable operators are gaining overall communications industry revenue share.

As in the US, European cable operators are benefiting from consumers upgrading to more feature-rich and higher-revenue digital cable services. European cable operators are seeing greater penetration of advanced services such as telephony and broadband, which is leading to growing average revenue per user (ARPU). Digital penetration rates in Europe lag US levels, leaving plenty of room for growth.\(^2\)
**Satellite television**

The 2007-2011E EBITDA dollar growth rate for the satellite television sector is estimated at 7% with EBITDA margins staying relatively stable for the same period. The direct broadcast satellite (DBS) sector has performed relatively well in recent years. In the US, DBS has won market share by offering an excellent viewing experience—an extensive HD channel lineup and enhanced services such as DVRs with multi-room viewing.25

In Europe, the satellite operators are also performing well. Western European satellite operators generated €13.7 billion in subscription revenue last year, a 12% increase over 2009 and one of the strongest years since 2004. Of the major pay-TV markets in Europe, only Spain experienced a decline in DBS subscribers in 2010. Satellite operators in other countries (UK, France, Germany and Italy) all experienced an increase in their subscriber base in 2010.26

However, some of the industry’s advantages are eroding. Cable operators now offer similar advanced services, and they have rapidly increased the number of HD channels they offer. At the same time, the growth of online video has pushed cable operators to improve their VOD services. Also, the overall multichannel video business is mature, so while DBS providers are still adding subscribers, they are doing so at a slower rate. However, continued cost controls and improving revenue trends helped boost EBITDA dollar growth and have helped keep EBITDA margins relatively steady, despite rising programming costs. Margins will also be helped by a focus on subscriber profitability. DBS providers are focusing less on lower-end subscribers that provide low returns and more on attractive customers. This will modestly reduce subscriber counts, but it should result in a more profitable and valuable business over the longer term.27 Technology can also boost margins. DBS providers are standardizing and improving their set-top boxes, which will result in fewer customer complaints and lower customer service costs.

Like cable operators, DBS providers also face the disruptive threat of OTT video. However, DBS players are responding to the threat by harnessing the power of the web themselves. They are rolling out internet-connected set-top boxes (that, ironically, use their competitors’ pipes). These have significantly boosted the number of VOD titles—as many titles as the DBS providers have the rights to. This could rejuvenate premium and VOD buy rates, which have been declining for the last several years. In fact, DirecTV plans to connect 40% of its subscriber base by 2013.28

Like the M&E industry as a whole, conglomerates were greatly affected by weak advertising trends. However, 2010 saw a dramatic recovery in the ad market that continues into 2011. This, combined with cost controls, will help drive higher EBITDA margins in 2011.

Most of the major conglomerates also own movie studios. These have been negatively impacted by the declining DVD market. In addition, the North American theatrical business has been somewhat inconsistent in recent years. However, the international box office continues to grow, and studios are taking advantage of the growth of new distribution platforms.

Conglomerates are also taking advantage of global opportunities. Many of the conglomerates’ cable networks are seeing growing international audiences. This allows them to generate incremental revenues from emerging markets, while spreading the associated content costs across multiple distribution channels.

These and other factors have resulted in an estimated 23% EBITDA margin for 2011E, up slightly from 2010.
Television broadcasting

In recent years, broadcasters have lost some prominence in the television world as viewers have migrated to cable programming, the internet and other entertainment choices. This has pushed down the networks’ share of advertising dollars and viewers.

Also, as a primarily ad-supported business, the economic downturn significantly impacted US television broadcasters’ results, particularly at the local station level. A decline in auto advertising was especially harmful for TV stations: auto advertising accounts for about 25% of advertising for most local TV stations. European television advertising also declined as advertisers drastically cut marketing budgets.

However, the television advertising market began to recover globally in 2010, and that strength has carried over into 2011. In the US, much of that recovery has been driven by a revival of automotive advertising. Likewise, European TV advertising revenues rebounded strongly in 2010. Among the largest markets, the UK and Germany experienced the highest year-over-year growth in TV advertising revenues, at 15% and 10%, respectively. This rebound has led to a sharp turnaround in EBITDA dollar growth. In 2009, the sector saw a 25% decline in EBITDA dollars, followed by a 31% increase in 2010. However, for the 2007-2011E period, EBITDA dollar growth will remain flat, largely reflecting the severe ad downturn in 2008-2009.

In the US, broadcasters are generating increased subscriber fees or “retransmission” fees from cable companies. These are expected to grow into a meaningful revenue source. CBS, for instance, expects to receive an estimated $250 million in retransmission payments in 2012. This is a very positive development for TV networks and their affiliates because retransmission cash goes straight to the bottom line, giving a boost to long-term EBITDA dollars and margins. Broadcasters are also looking to receive so-called reverse compensation, where affiliates pay them for network programming. As additional sources of revenues beyond advertising, retransmission and reverse compensation fees make broadcasters less vulnerable to advertising cycles.

Broadcast networks are also leveraging content through interactive media. Revenues are still small, but online viewership of shows is growing through mobile devices and websites like Hulu. These outlets allow networks to leverage their existing programming investments and generate incremental advertising revenues. However, online business models are still evolving. Broadcast networks are moving away from offering free online content toward subscription models, which they view as more attractive than ad-only models. In addition, the networks have been very careful to protect their traditional businesses. The online distribution deals they have struck are for library titles, so they don’t affect the “food chain” from advertising and syndication. As one television executive says: “you are not going to risk billions for tens of millions.” They are also signing short-term deals that allow for flexibility as conditions change.
Film and TV production

The film and TV production sector is seeing mixed operating conditions. The global box office performed relatively well in 2010, with box office receipts rising 8% to $31.8 billion. Virtually all of the growth in 2010 came from the international market, which grew by 13%. Latin America saw the highest box office growth at 25% in 2010, followed by Asia-Pacific (21%) and EMEA (5%).

In 2010, North American box office receipts were flat at $10.6 billion. Although box office attendance fell by 5.7%, lower attendance was offset by a 5.8% increase in the average ticket price. Though 2009 saw a strong gain in attendance, the overall trend in the last decade is downward: attendance has fallen at a CAGR of 2.2% from a peak of 1.61 billion in 2002. In early 2011, the North American box office continued to struggle.

The DVD business continues to decline, due to the format’s maturity and competition from other forms of entertainment. This greatly affects the industry’s revenue and profitability. Falling DVD sales are only partly offset by gains in rental and digital transactions. Likewise, while falling Blu-ray device prices have pushed up the number of Blu-ray households, analysts don’t expect Blu-ray adoption to offset declines in DVD sales. Consumers aren’t rebuilding their DVD libraries in high-definition like they did when home video shifted from VHS tapes to DVD.

Despite these challenges, the film and TV production sector saw EBITDA dollars grow by 53% in 2010, after falling by 32% in 2009. However, during the period between 2007 and 2011, the sector’s EBITDA dollar growth is expected to be flat. This largely reflects the segment’s difficulties in the 2008-2009 period. In 2011, analysts expect EBITDA dollars to fall by 3% however, revenue and earnings are notoriously difficult to predict in the film sector because it is hard to gauge how the upcoming film “slate” will resonate with audiences.

Over the last decade, the home entertainment market has migrated from rental to sell-through and in the last few years back to rental. Unfortunately, this mix toward rental hurts revenues and profitability because the growth in rental is coming from lower-cost kiosk and DVD-mail channels. Meanwhile, sell-through continues to decline.

Morgan Stanley estimates that rental revenue will move from roughly 45% to 50% of revenue today (excluding premium movie channels such as HBO) to more than 55% by 2013.

To protect margins, studios have spent considerable effort restructuring their operations. In addition to workforce reductions, most have reduced the number of film releases in their “slate,” while others have closed their specialty units. They are also working to reduce rising film production costs. Several are limiting the number of so-called “first dollar gross” deals, in favor of pay-for-performance deals, where compensation is paid as a percentage of box office revenues instead of a fixed sum up front. Studios are also streamlining their marketing departments by consolidating divisions that previously sold films to theaters and home entertainment separately.

Eager to offset falling DVD sales, studios are making content available through a growing number of distribution platforms, including online content aggregators. New platforms provide a welcome new revenue stream for so-called “long-tail” content that has already appeared in all the traditional windows. Electronic sell-through continues to grow — albeit from a small base — and this trend should continue over the next few years. Digital distribution presents a margin opportunity for studios because it eliminates manufacturing and packaging costs and greatly reduces other distribution costs.

The studios’ TV production business is performing well. The proliferation of distribution options, such as Netflix, has put upward pressure on pricing for content owners.

Domestic syndication remains a very healthy business. This both reduces the risk of costly TV production and increases the return on capital. In the US alone, cable channels provide content suppliers with $13 billion worth of sales annually. This is a high-margin revenue source since most programs have already been produced for a prior broadcast network run. The growth of cable networks around the world is also driving syndication growth.
The music sector continues to be one of the most impacted by alternative distribution. The value of the industry continues to shrink. Overall global recorded music sales (including physical and digital products) declined 8.6% in 2010 to $15.9 billion. CD sales fell by 14% to $10.4 billion. In the last seven years, there has been a 31% decline in the value of the global recorded music industry.

The digital music market has grown 1,000% since 2004, and was worth an estimated $4.6 billion in 2010. There are now more than 400 legal online music services. However, digital sales haven’t offset falling CD sales. What’s more, digital revenue growth rose by only 5.3% in 2010, after increases of 12% in 2009 and 37% in 2008.

Piracy continues to take a high toll on the industry, despite the success of paid models. The International Federation of the Phonographic Industry (IFPI) estimates that 19 out of 20 music tracks downloaded from the internet were illegal in 2010. This is rippling through the music industry, threatening jobs, investment and the discovery of new artists.

For the 2007–2011E period, music EBITDA dollars are expected to be flat. Meanwhile, in 2011, analysts expect the sector to have the lowest EBITDA margins among the various M&E sectors.

Music companies are working to improve EBITDA margins through aggressive cost-cutting. The transition to digital will help margins because it greatly reduces manufacturing and distribution costs, along with lower inventory and returns handling costs. Online delivery costs are minimal given that third parties usually perform the actual delivery.

Industry executives hope that new cloud-based music services will drive music industry growth. These services allow users to customize their music listening experience. Music is streamed from the “cloud” to any computer or mobile phone rather than residing on a consumer’s device. Cloud-based services are growing rapidly. Pandora has an estimated 80 million listeners. Many players, ranging from large players like Google, Amazon and Apple to smaller ones, have either launched cloud-based services or are thought to have plans to.

The industry is exploiting new revenue opportunities, including ad-supported music, and licensing music to video games. Most of the companies have adopted a “360 degree” model, where labels get a percentage of all revenue that an artist generates (e.g., live performances, merchandising and sponsorships).

In contrast to the recorded music business, the music publishing business is a healthier and much more stable business. It also generates higher margins, thanks to a very low cost structure. In 2010, for instance, Warner Music’s EBITDA margins for recorded music and music publishing were 13.2% and 28.6% respectively—a situation that is consistent across the major music companies.
Of all the M&E sectors, newspapers are among the most challenged. Newspaper advertising revenue has deteriorated significantly since December 2007. While the ad environment is improving, the core newspaper business remains challenged. During the 2007-2011E period, EBITDA dollars are expected to contract by a CAGR of 1%. However, due to cost-cutting efforts, EBITDA margins have been relatively constant during the period. In 2011, EBITDA margins are expected to be 21%—up from 19% in 2010.

In 2010, US advertisers spent $25.8 billion on newspapers’ print and digital editions—the lowest amount since 1985. After adjusting for inflation, newspaper advertising is where it was nearly 50 years ago. Print ads dropped 8% to $22.8 billion in 2010.50

Since 1990, newspaper circulation has been in a steady decline due to both adverse structural and cyclical factors. More consumers are getting their news and information from new media formats such as online and mobile and other free non-print competition (such as broadcast TV and radio). Cyclical factors have also played a role—due to a weak economic environment, consumers’ personal consumption expenditures have fallen.51 At the same time, newsprint costs remain volatile. This has margin implications because newsprint can be up to 15% of total newspaper costs.52

In response to weak industry conditions, newspapers in developed countries have cut costs in an attempt to right-size their businesses. They have reduced staffing, consolidated facilities and centralized back office functions. However, analysts are worried that newspaper companies have run out of “fat” to cut and that further reductions will harm the quality of their product.

Like their US counterparts, newspapers in most advanced economies are seeing similar advertising and circulation trends. Although advertising is improving, it is still expected to be in decline in many countries. However, in India, the newspaper industry continues to expand due to increasing literacy and the growth of the middle class. Additionally, the country is seeing the rapid growth of regional language newspapers. The internet is not considered to be a threat to print media in India because broadband penetration, though rising, is still quite low.53
While the industry is certainly challenged in its traditional realm, it is making headway online. As a portion of the total, digital revenue continues to rise for most newspapers. In 2010, US newspapers’ online advertising rose 11% to $3 billion. The internet now accounts for about 12% of US newspapers’ ad revenue, up from 4% in 2005.\textsuperscript{54}

Yet rising online revenues have not made up for shortfalls in print advertising. This has newspapers experimenting with a variety of new models, such as paywalls, selling individual articles through micropayments and applications (apps) on tablets. Newspapers feel that new platforms will be complementary to the paper edition, rather than substitutes. Moreover, as tablet sales grow, newspaper publishers could see a lift in subscriptions, both online and in print. After years of circulation declines, this would be welcome news.

It’s still too early to gauge the impact of these efforts. However, if these endeavors are successful, they promise to add a profitable new incremental revenue stream for publishers. To date, newspaper app downloads have been promising, which gives the newspaper industry hope that current paid models will see more success than earlier ones.\textsuperscript{55}

In the past two years, magazines have experienced many of the same trends as newspapers: falling readership and lower advertising sales. These trends are evident in both the US and Europe. The good news is that the segment is beginning to recover. Much like newspapers, magazines are very optimistic about distribution through tablets and mobile phones. These devices offer magazines the opportunity to expand the footprint of magazine brands. According to eMarketer, worldwide tablet shipments are expected to grow from an estimated 47.9 million units in 2011 to 79.6 million in 2012.\textsuperscript{56} Tablets and smart phones offer a richer experience and greater functionality than paper magazines, which is attractive to advertisers.

The growth of e-readers presents a significant opportunity for newspapers, magazines and books to increase consumption, and grow revenues. Additionally, the growth of electronic markets is leading to a significant reduction in costs for print publishers. Operating benefits are achieved through a reduction in inventory carrying risk, lower distribution costs and decreased raw material costs (less paper).\textsuperscript{57} Industry forecasts suggest that tablet and iPad subscriptions alone could add $1.3 billion to industry revenues by 2014.\textsuperscript{58}
Study methodology and study group
Study methodology

This current report provides an examination of actual EBITDA within the media and entertainment industry for the years 2007 to 2010 and estimated EBITDA for 2011. Specifically, this report measures and compares EBITDA dollar growth (measured as a compound annual growth rate, or CAGR) as well as EBITDA margins. It is understood that EBITDA is a non-GAAP financial measurement and that different companies report EBITDA in different ways. Nonetheless, it is a widely available metric for comparison purposes. Accordingly, it is used in this study as reported by the companies themselves, as well as by research institutions and investment analysts.

Currencies

All EBITDA dollar CAGRs are calculated in US dollars. Where necessary, Ernst & Young converted revenue and EBITDA provided in other currencies into US dollars. The conversion ratio was based on the rate existing between each currency and US dollars on 31 December for 2007 to 2010 and a 64-business day average for 2011.

GAAP

In most cases, financial data was prepared in accordance with accounting principles generally accepted in the United States (US GAAP). Otherwise, the financial data was prepared in accordance with International Financial Reporting Standards (IFRS) or local GAAP and has not been converted to US GAAP.

EBITDA

In most instances, we have used EBITDA amounts as reported by each company in the study. However, a few companies did not report EBITDA; in these rare cases, we have used operating income as a proxy for EBITDA.

Study group

This report examines 86 companies from around the world, including those headquartered in the Americas (40 companies), Europe (32 companies) and Asia-Pacific/ Africa (14 companies). This report looks at EBITDA for conglomerates and nine separate sectors of media and entertainment: cable networks, cable operators, electronic games, film and television production, interactive media, music, publishing, satellite operators and television broadcasting.

Conglomerates are considered to be global companies with business activities reported for two or more sectors and leaders who drive innovation across the industry. The media and entertainment businesses of the nine conglomerates in the study account for 2011E global EBITDA dollars of $51 billion, which is almost a third of the total estimated EBITDA dollars for the media and entertainment study group in 2011. Ernst & Young's EBITDA perspective is based on secondary research, using publicly available data and analyst reports, as well as Ernst & Young's own analyses. In many cases, this report includes an individual line of business within a larger corporation. As a result, some companies are represented in more than one sector.

Study group selection

Companies were selected based on the following criteria:

- They are publicly traded.
- Their operations are reviewed by an industry analyst, and their results are published in an analyst’s report.
- They had a minimum of US $1 billion in annual revenues, or, in the case of media conglomerates, a minimum of US $5 billion in annual revenues.
Study group companies

**Conglomerates**
- CBS Corporation (Total company)
- Comcast Corporation (Total company)
- General Electric Company (NBC-Universal segment for 2007 through Q1 2011)
- News Corporation (Total company)
- Sony Corporation (Movie and Music segments only)
- Time Warner Inc. (Total company)
- Viacom Inc. (Total company)
- Vivendi S.A. (Canal+, Universal Music Group and Activision Blizzard segments only)
- The Walt Disney Company (Total company)

**Cable networks**
- CBS Corporation (Cable Networks segment only)
- Comcast Corporation (Pro forma NBC Cable Networks segment only)
- Discovery Communications, Inc. (Total company)
- Liberty Media Corporation (Liberty Starz segment only)
- News Corporation (Cable Network Programming segment only)
- Time Warner Inc. (Cable Networks segment only)
- Viacom Inc. (Cable Networks segment only)
- Vivendi S.A. (Canal+ segment only)
- The Walt Disney Company (Media Networks — Cable segment only)

**Cable operators**
- Cablevision Systems Corporation (Telecommunications segment only)
- Charter Communications, Inc. (Total company)
- Cogeco Cable Inc. (Total company)
- Comcast Corporation (Cable segment only)
- Jupiter Telecommunications Co., Ltd. (Total company)
- Liberty Global, Inc. (Total company)
- Net Serviços de Comunicação S.A. (Total company)
- Rogers Communications Inc. (Cable/Telecom/Retail segment only)
- Shaw Communications Inc. (Cable segment only)
- Telenet Group Holding NV (Total company)
- Time Warner Cable Inc. (Total company)
- Virgin Media Inc. (Total company)

**Electronic games**
- Activision Blizzard, Inc. (Total company)
- Electronic Arts Inc. (Total company)
- Square Enix Holdings Co., Ltd. (Total company)
- Take-Two Interactive Software, Inc. (Total company)
- THQ Inc. (Total company)
- Ubisoft Entertainment (Total company)
- Vivendi S.A. (Vivendi Games segment only for 2007 and 2008)
**Film and television production**

Lions Gate Entertainment Corp. (Total company)
News Corporation (Filmed Entertainment segment only)
Sony Corporation (Pictures segment only)
Time Warner Inc. (Film segment only)
Viacom Inc. (Entertainment segment only)
Village Roadshow Limited (Total company)
The Walt Disney Company
(Studio Entertainment segment only)

**Interactive media**

AOL Inc. (Total company)
Baidu, Inc. (Total company)
Google Inc. (Total company)
IAC/InterActiveCorp (Total company)
Microsoft Corporation (Online Services segment only)
Netflix, Inc. (Total company)
NHN Corporation (Total company)
Tencent Holdings Limited (Total company)
Yahoo! Inc. (Total company)
Yahoo Jap an Corporation (Total company)

**Music**

Live Nation Entertainment, Inc. (Total company)
Sony Corporation (Music segment only)
Vivendi S.A. (Universal Music Group segment only)
Warner Music Group Corp. (Total company)

**Publishing**

Arnoldo Mondadori Editore S.p.A. (Total company)
Axel Springer AG (Total company)
CBS Corporation (Publishing segment only)
Daily Mail and General Trust plc (Total company)
Dow J ones & Company, Inc. (Total company for 2007)
Fairfax Media Limited (Total company)
Gannett Co., Inc. (Newspaper segment only)
Gruppo Editoriale L’Espresso S.p.A. (Total company)
Independent News & Media PLC (Total company)
Lagardère SCA (Total company)
The McClatchy Company (Total company)
The McGraw-Hill Companies, Inc. (Total company)
Mecom Group plc (Total company)
Nielsen Holdings N.V. (Total company)
The New York Times Company (Total company)
News Corporation (Publishing segment only)
Pearson plc (Total company)
RCS MediaGroup S.p.A. (Total company)
Reed Elsevier NV (Total company)
Reed Elsevier PLC (Total company)
Sanoma Corporation (Total company)
Schibsted ASA (Total company)
Thomson Reuters Corporation (Total company)
Time Warner Inc. (Publishing segment only)
Torstar Corporation (Total company)
Trinity Mirror plc (Total company)
Wolters Kluwer nv (Total company)
Study group companies (continued)

**Satellite operators**
British Sky Broadcasting Group plc (Total company)
The DIRECTV Group, Inc. (DIRECTV US and DIRECTV LA segments only)
DISH Network Corporation (Total company)
Eutelsat Communications S.A. (Total company)
News Corporation (Sky Italia segment)
SES S.A. (Total company)
Sky Deutschland AG (Total company)
SKY Perfect J SAT Holdings Inc. (Total company)

**Television broadcast**
Antena 3 de Televisión, S.A. (Total company)
CBS Corporation (Entertainment and Local Broadcasting segments only)
Fuji Media Holdings, Inc. (Total company)
Gestevisión Telecinco, S.A. (Total company)
Grupo Televisa, S.A.B. (Total company)
ITV plc (Total company)
Mediaset S.p.A (Total company)
Métropole Télévision (Total company)
Modern Times Group MTG AB (Total company)
News Corporation (Television segment only)
Nippon Television Network Corporation (Total company)
ProSiebenSat.1 Media AG (Total company)
RTL Group S.A. (Total company)
Télévision Française 1 S.A. —TF1 (Total company)
Tokyo Broadcasting System Holdings, Inc. (Total company)
TV Asahi Corporation (Total company)
The Walt Disney Company (Media Networks —Broadcasting segment only)
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# Global Media & Entertainment — Key contacts

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Whether it’s the traditional press and broadcast media, or the multitude of new media, audiences now have more choice than ever before. For media and entertainment companies, integration and adaptability are becoming critical success factors. Ernst & Young’s Global Media & Entertainment Center brings together a worldwide team of professionals to help you achieve your potential—a team with deep technical experience in providing assurance, tax, transaction and advisory services. The Center works to anticipate market trends, identify the implications and develop points of view on relevant industry issues. Ultimately it enables us to help you meet your goals and compete more effectively. It’s how Ernst & Young makes a difference.

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