9 Disruption 2.0: Advertising wobbles have reignited structural concerns in the media sector - Break point?

FREDERIC LABIA, *Equity Analysis*

The essential

Weaker ad trends in the US and Europe despite a solid macro backdrop have reignited structural concerns, causing agencies and TV stocks to underperform over recent months.

In our view, near-term headwinds are driven more by cyclical factors, namely pressure from CPG marketers, than by structural factors. However, although growth may reaccelerate, we will not consider this to be a full catch-up, as an element of recent underperformance clearly relates to the emergence of lower media intensity business models. Agencies in particular will now have to deal with indirect disruption, that of their clients...

Weaker ad trends in the US and Europe despite a solid macro backdrop have reignited structural concerns, causing agencies and TV stocks to underperform over recent months. The key theme during the Q1 earnings season was clearly the relative weakness in advertising growth despite relatively strong macro data.

- In particular, the weighted average organic revenue growth of the top five global ad agencies was just 1.7% in Q1, the lowest rate of growth for the group in seven years and following a downtrend in growth that kicked off in Q3 2016. The agencies' growth is especially weak in the US.
- Broadcasters also saw soft ad growth in Q1. Q1 average ad growth was -1%, below the market expectation of +1% and down from zero in Q4. Then the Q2 outlook disappointed at ITV (down 6% over the first four months of the year, down 8% in May, down 15-20% in June) and at ProSieben which slightly reduced its outlook for German TV advertising in 2017, from 2-3% to 1.5-2.5%.
- Furthermore, observers indicate that TV advertising has further softened across all European markets in Q2. A survey by DB shows that softer spend by their advertising clients is causing agencies to downgrade full-year forecasts across all major markets.

To some, a pattern is emerging over the past nine months: traditional "linear" TV is failing to grow in line with improving consumer confidence and GDP trends – TV ad spend is dislocating from macro data. Linear TV is not collapsing but new campaigns are seeing a far larger share going to online video, social and mobile. The markets which are seeing the most marked dislocation are also those which are seeing the most rapid change in viewing habits – less time spent watching traditional linear TV in favour of more online and mobile video viewing.

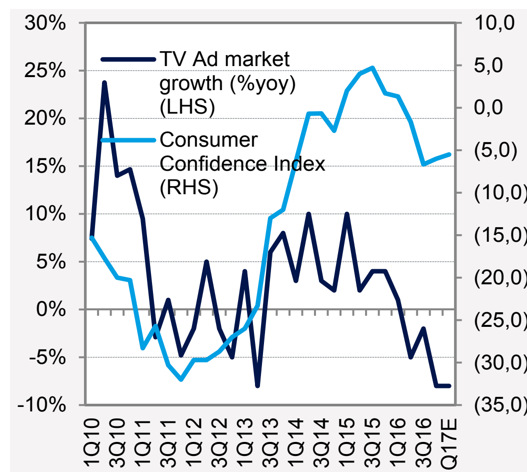
A pattern is emerging – TV ad spend is dislocating from macro data

However, a majority of analysts believe that consumer packaged goods weakness has defined the downturn. Ad agencies, and broadcasters in turn, are currently experiencing a challenging growth environment stemming in large part from soft CPG advertising spend, along with a difficult retail environment in general. Q1 CPG unit volumes were down 2.5% across the industry according to Nielsen, driving companies like P&G, Nestle and Unilever to seek ways to protect margins. CPG is an important sector for ad agencies and broadcasters, comprising on average one-quarter to one-third of agency revenues.

Agencies revenue exposure by customer sector

%	WPP	Publicis	Havas	Omnicom	Interpublic
CPG	31	27	13	23	21
- o/w Food & Drink	15	12	9	13	13
- o/w Non Food	16	15	4	10	8
Healthcare	11	13	16	12	21
Automotive	13	13	8	8	16
TMT	12	13	11	14	21
Retail	5	6	5	6	6
Travel & Entertainment	6	7	12	7	na
Financial	8	14	11	7	9
Other	14	7	24	23	6

1 UK TV vs. consumer confidence



Source: Company Data, Bloomberg Finance, Amundi Research

With falling revenue growth comes a focus on cost savings, and here CPG manufacturers have focused on three areas:

- A growing reliance on cheaper digital ads – this is nothing new as advertisers have followed eyeballs for years toward more cost-effective media.
- A reduction in the overall number of agencies and service providers, increasingly relying on bulk wholesale pricing. Unilever for instance stated it plans to halve its number of creative agency relationships in order to achieve greater scale with its agency partners.
- And simply paying less for the same services, which agencies are forced to accept in exchange for keeping / winning accounts. P&G called out over $2bn of potential savings from marketing spending, with half or more coming from media rates and consolidating their media supply chain, and up to $0.5bn in additional savings from reduced agency fees and ad production costs.

There is some cause for optimism in the near term. While current market growth rates across the broad consumer goods industry are depressed relative to recent history, they are still within normal ranges and many CPG brands are projecting the recent decline in volumes to be cyclical, calling the bottom here and seeing potential for significant upside even if growth expectations are rebased at the 1-3% level. It is likely that companies' absolute level of ad spending will increase / reaccelerate with stronger consumer demand.

NOT SO FAST! Whilst a reacceleration in consumer demand should have positive implications for advertising spending, we think it will be subject to an offsetting brake from other structural external spending headwinds. The fact remains that technological change and business model change are likely to have structurally altered the relationship between advertisers and agencies.

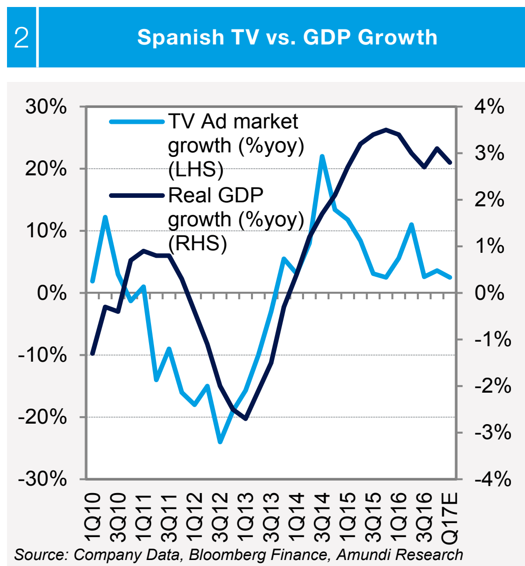
The main structural change impacting A&P spending is the adoption of inherently lower A&P intensity business models. The business model shift includes Direct-to-Consumer strategies (a major part of the rationale behind Unilever's acquisition of Dollar Shave Club), more widespread adoption of stand-alone store formats (such as Unilever's T2 tea brand or any number of cosmetics companies' free-standing stores, such as L'Oréal's Kiehl's, Urban Decay or Estée Lauder's Smashbox) or "no traditional media" brands such as L'Oréal's NYX, which is 100% digitally activated.

On the demand side, more localised craft products, while in some cases more expensive, are increasingly being viewed as more desirable than fast-moving (packaged) goods. This is having a negative effect on agencies as the very nature of niche boutique goods is that they are not mass-produced or mass marketed. This does not require the coordination and breadth of a traditional agency.

Shifting to digital opens new doors to marketers – some leading away from media. The rise of digital is having a profound impact on the way FMCG brands make their way into consumers' consciousness, the way the brands interact with consumers and the way the purchase transaction happens.

- E-commerce changes companies' approach to markets: Amazon is building a new walled garden for online advertising and direct product sales. Its motives are different from online media firms: it's about enacting sales, not driving ad revenue, and this forces advertisers to re-think entire budgets from brand advertising to distribution.
- Marketing tech provides new tools in-house: another, but related, challenge is the rise of marketing technology that enables in-house marketing. As with Amazon, we don't see these companies competing against agencies – but this technology does add automation and efficiency, hence reducing marketers' costs and changing agencies' roles.

2 Spanish TV vs. GDP Growth



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> "Shifting to digital opens new doors to marketers"

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Contributors

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– **PHILIPPE ITHURBIDE**
Head of Research, Strategy and Analysis – Paris

Deputy-Editors

– **DIDIER BOROWSKI** – *Paris,* **RICHARD BUTLER** – *Paris,* **ÉRIC MIJOT** – *Paris,* **MO JI** – *Hong Kong,* **STÉPHANE TAILLEPIED** – *Paris*

Support

– **PIA BERGER**
Research, Strategy and Analysis – Paris

– **BENOIT PONCET**
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