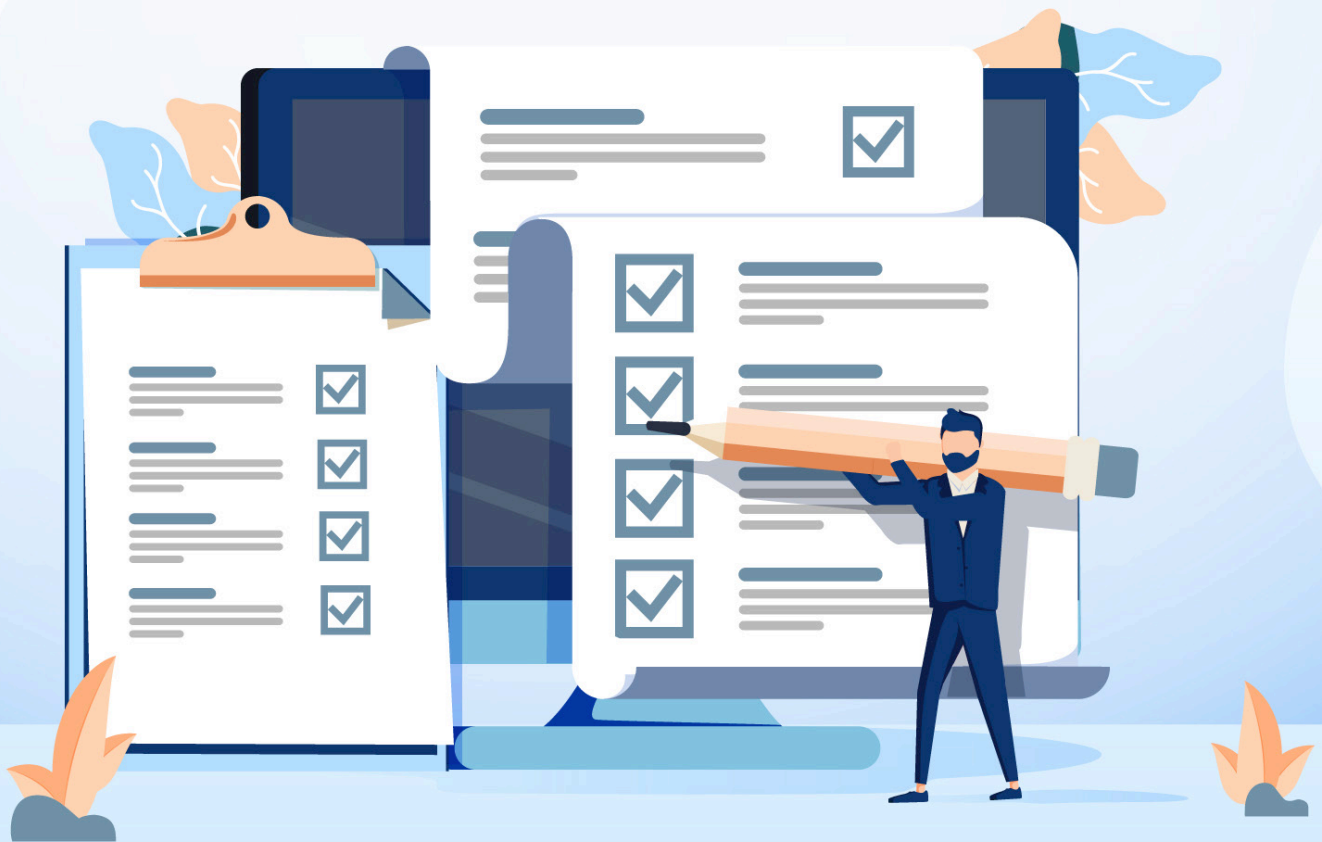


2019 PUBLISHING YEAR IN REVIEW

AN FTI CONSULTING REPORT



EXPERTS WITH IMPACT[™]

2019 | YEAR IN REVIEW



As we approach the end of 2019, our thoughts turn to the changes we saw this year and the lessons we learned from them. As is our practice, we want to share those lessons we learned with you, our clients, industry colleagues and friends.

Three issues stand out:



What does a sustainable business model look like? Is the subscription-based model for everyone?



When is the right time to convert to substantially digital or digital-only?



As each company's approach and timing may differ, newspapers, magazines and digital natives might adopt different business models overtime.

2019 | YEAR IN REVIEW

THE RIGHT TIME TO CONVERT TO DIGITAL

The answer to these questions is situation-specific; there's no one-size-fits-all approach. To the extent that print is generating substantial cash flows for the business, it is important to nurture those cash flows as well as reinvesting the cash flow to support digital migration. The volume and speed that the print cash flow is declining will determine the right time to convert to digital. FTI Consulting's forecast, powered by eMarketer and Magna Global, shows newspaper print advertising

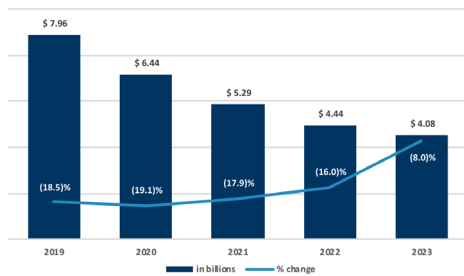
declining in double digits, and tapering off in 2023 to 8.0% of revenues and 50% of volumes in 2019. (See Figure 1.)

Magazine print advertising is also expected to continue to decline in double digits, with total revenues in 2023 equaling only 65% of the level in 2019.¹ (See Figure 2.)

The core question remains: **is there a sustainable digital model?** FTI Consulting

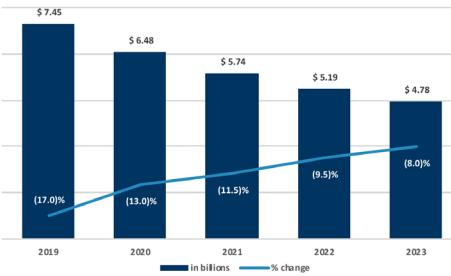
models indicate yes; it will be in place sooner for some, later for others. Our views and analysis show that most newspapers and many magazines will be predominately digital within the next five years. Some within two to three years. We estimate that digital advertising's double-digit growth will moderate into high single digits beginning in 2022, and the large platform companies will continue with an out-sized share of the growth. (See Figure 3.)

Figure 1
Newspaper Print Ad Spending (U.S.)



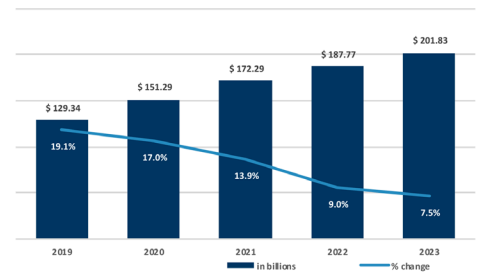
Source: eMarketer, October 2019

Figure 2
Magazine Print Ad Spending (U.S.)



Source: eMarketer, October 2019

Figure 3
Digital Ad Spending (U.S.)



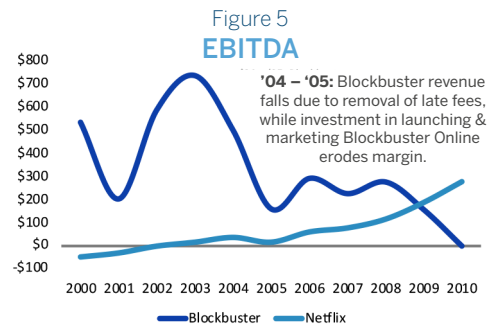
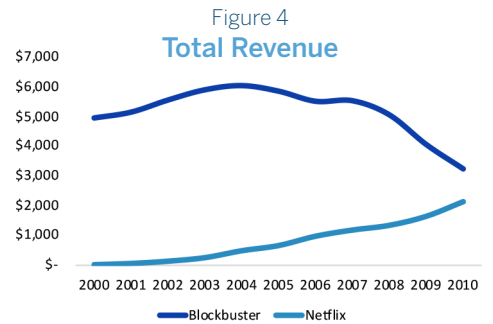
Source: eMarketer, October 2019

As you begin thinking about sustainable business models for newspapers, magazines and digital natives, consider Netflix at its inception 22 years ago, and its largest competitor Blockbuster. In many ways, the battle between Netflix and Blockbuster is a case study that mirrors the current dynamics of the news media industry: The legacy print segment still accounts for the majority of gross revenue, but the existing distribution model is beginning to splinter under stress from thinning route density and fixed production and distribution costs (think Blockbuster circa 2007). (See Figure 4.)

Meanwhile, digital subscriptions, offering a customer-centric experience focused on convenience and accessibility akin to Netflix's online ordering, and eventually streaming, represent a significantly smaller, yet consistently growing, portion of revenue. The content largely remains

the same, but the delivery mechanism is transformed. The question many newspaper and magazine publishers are faced with is how to execute a business transformation from print to digital within the confines of existing revenue mix, cost structure and balance sheet. However, returning to *The Innovator's Dilemma*, Christensen observes that "it is precisely when emerging markets are small — when they are least attractive to large companies in search of big chunks of new revenue — that entry into them is so crucial."²

From the days when Netflix was sending DVDs to consumers in the mail and competing with Blockbuster stores, Netflix now has over 150 million subscribers and almost 50% penetration of U.S. population (estimated by 2021). Netflix, with lower but growing revenue, far out-paced Blockbuster's declining EBITDA. (See Figure 5.)



1. FTI Consulting Data, we relied upon several data sources throughout for consistency in comparing estimates and figures over time, 2019.

2. Christensen, Clayton *The Innovator's Dilemma*, 1997.

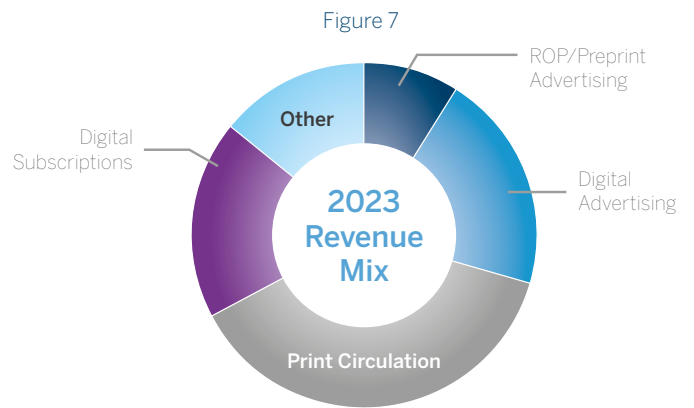
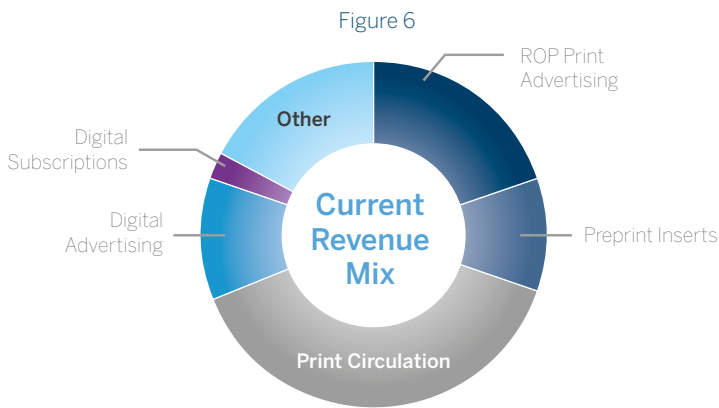
2019 | YEAR IN REVIEW

NEWSPAPERS

FTI Consulting recently worked with several corporate and independent newspapers on the issue of digital sustainability. As part of that work we are now able to demonstrate aggregate revenue mix for these newspapers and which segments are growing or declining. (See Figure 6.)

For the papers, we found that legacy segments were declining, “other” revenue was essentially flat and digital advertising and digital subscribers were positive. However, digital revenue — advertising plus subscriptions — still comprised a relatively small portion of total revenue.

The decade old dilemma, however, is that print subscriber revenue remains significant despite the double-digit year-on-year declines mentioned above.



In response, FTI Consulting developed a print-to-digital sustainability model that forecasts what a future revenue mix could be — 2023 shown in Figure 7 — and how a mostly digital business model would perform. Will revenues be lower? Yes. Can EBITDA be similar to today? Yes, depending on the current revenue mix, profitability and growth trends. For many newspapers the EBITDA may be lower than it is today but higher than it will be in two to three years as trends continue.

Some newspapers are doing better in digital marketing services (shown in digital advertising segment) than others, some finding revenue in events. However, the

viability of the business is linked to the sustainability of its digital revenues, whether via an ad-based model or subscription model. They will continue to mitigate the inevitable declines in the legacy business.

Whatever way it shakes out, the revenue mix will be quite different several years from now. We estimate that legacy print revenue, including advertising and circulation, will fall to approximately 55%; consumer revenue, including print and digital, will be over 65% of total revenue as newspapers move away from an advertising dominated model. We believe that digital advertising and digital consumer revenue will be nearly the same.

Beyond the revenue mix shown above, the print-to-digital model we used creates a baseline forecast of revenue and EBITDA without eliminating print but while aggressively growing digital subscribers. EBITDA (Figure 8) is shown to fall faster than revenue (Figure 9) because print revenue historically is higher-margin than digital advertising and most newspapers have approximately 35% fixed cost basis.

This model below was run for Sunday-only print plus digital and assumes a transformation year of 2021. Any print frequency can be modeled.

Figure 8
Annual EBITDA Comparison (\$MMs)

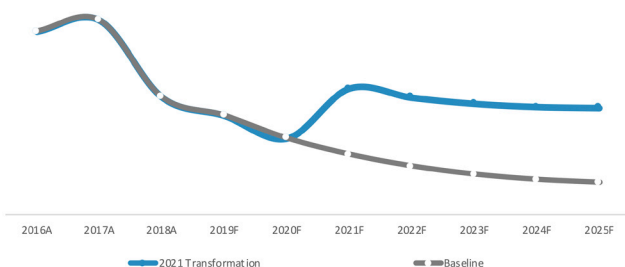
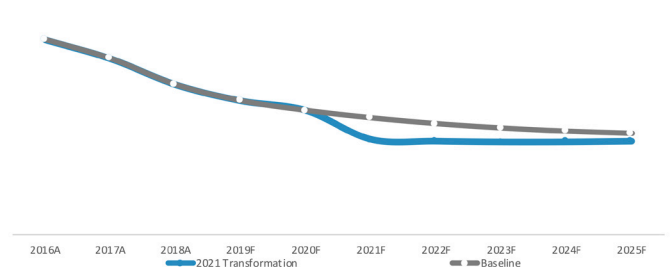


Figure 9
Annual Revenue Comparison (\$MMs)



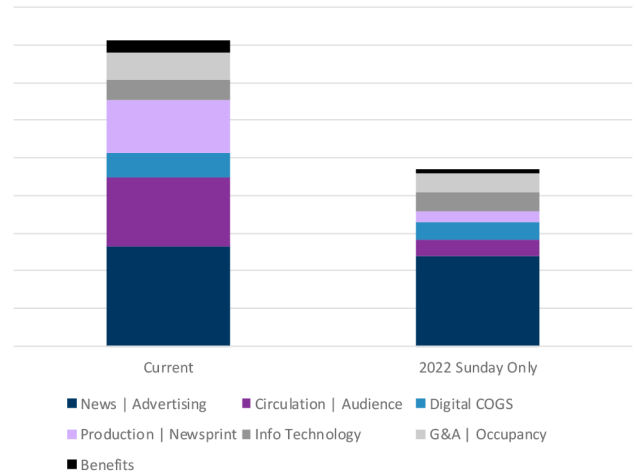
2019 | YEAR IN REVIEW

The model output shows that Sunday plus digital when converted in 2020 would stop the decline of EBITDA, return EBITDA to 2018 levels and remain generally flat thereafter. In nearly all print-to-digital conversion models that FTI Consulting has built, Sunday plus digital performs better than digital-only, as noted earlier.

While changing revenue mix — aggressive digital subscription growth — is important in the model, the dramatic reduction in the legacy cost basis is a key to improving and growing EBITDA again. Sunday plus digital eliminates ~40% of expenses. (See Figure 10.)

So far, growth in digital advertising revenues have only partially mitigated the declines in the legacy print business. Looking ahead, we think newspapers' sustainability is critically linked to digital subscriptions.

Figure 10
Expense Change



CASE STUDY

GNI SUBSCRIPTIONS LAB

In 2019, FTI Consulting partnered with the Google News Initiative (GNI) and Local Media Association (LMA) to launch the GNI Subscriptions Lab, an intensive, cohort-based strategy and enablement program designed to help 10 local publishers in North America develop a sustainable business model powered by digital subscriptions.

Over the course of the nine-month program, publishers have gone through an extensive benchmarking program — comparing operating metrics throughout the customer journey against both the 10 cohort participants and industry peers — participated in market sizing exercises, defined their short- and long-term strategic roadmaps, and designed and launched tactical, optimization experiments. In addition to receiving personalized recommendations from FTI Consulting, participating publishers have actively shared key insights and best practices to help accelerate digital subscriptions growth.

In Q3'19, the first full quarter of the GNI Subscriptions Lab, the average quarterly growth rate for digital subscription starts for cohort publishers grew from 7.9% to 36.8%; a **4.8x increase in starts growth**. This growth equates to nearly 40,000 incremental starts on an annualized basis and an estimated \$6.3 million in lifetime value. In addition, the average monthly churn rate across the cohort decreased from 4.7% to 3.9%, which represents a **25% improvement in churn**. In conjunction with the Lab, FTI Consulting published a [Digital Subscriptions Playbook](#) and [Benchmarking Report](#) to share insights from the Lab.

At the beginning of the GNI Subscriptions Lab, many of the participating publishers still reflected print-centric operations, with digital maturity in the early stages. We found that small, tactical changes produced significant lifts in subscriptions performance. Finally, and perhaps most importantly, market sizing projections for digital subscriptions businesses were often higher than the publishers initially expected and were viewed as viable to sustain local journalism in their respective markets.



2019 | YEAR IN REVIEW

MAGAZINES

FTI Consulting recently worked with a magazine company looking at overall sustainability and print-to-digital for most of its titles. Magazines have a much different revenue profile than do

newspapers. Other revenue mix includes events, content syndication, sponsored, TV and books, which is mostly nascent in newspapers. However, print consumer circulation revenue is much lower for

magazines. Here again, the largest two segments are declining and three of five of the larger revenue streams are declining.

Figure 11

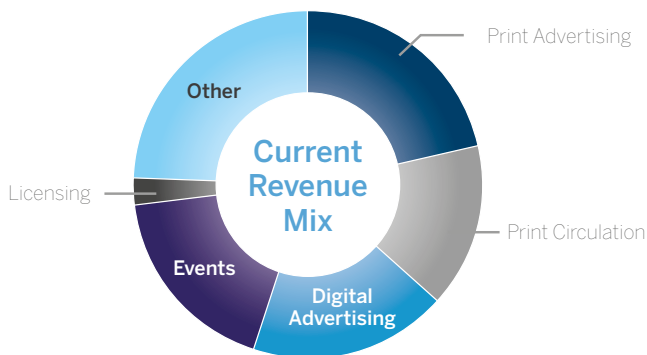
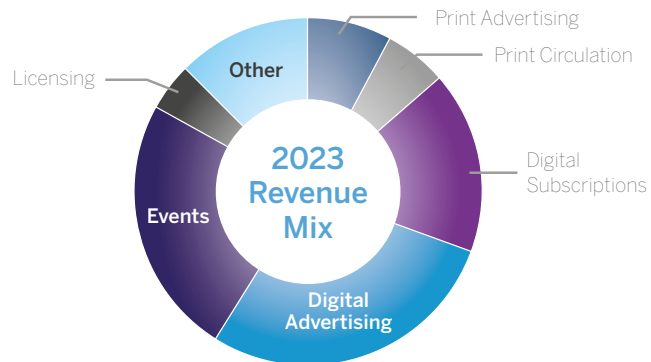


Figure 12



Magazines not only have a different revenue mix profile, but, until recently, they also were able to offer print subscriptions at low relative prices because print advertising allowed magazines to prosper with negative circulation margin (revenue less Printing, Postage and Delivery PP&D). Few magazines have paywalls; consequently, digital consumer revenue does not really contribute today.

Magazines do have additional revenue opportunities such as e-commerce, licensing, events, etc. (See Figure 11.)

Just as we illustrated for newspapers, the revenue mix will change significantly and could look more like the 2023 mix if you apply historic growth and decline rates. (See Figure 12.)

The revenue mix such as that shown in 2023 would mandate a totally different organization, and one in which print media would likely provide no positive contribution.

FTI Consulting has developed several print-to-digital models for magazines and have found that they yield results very similar to those of newspapers — some titles would create more EBITDA as a digital-only or substantially digital business in the five-year forecast period.

Digital subscriptions or memberships are shown in the model based on FTI Consulting forecasts.

ALL-IN-ONE SUBSCRIPTIONS

Several all-in-one subscription services such as Apple News+ and Readly are currently trying to tap the products' intrinsic appeal while offering an alternative business model.

Apple News+ offers its all-in-one subscription service to 300 magazines plus the *Wall Street Journal*, *Los Angeles Times* and *Toronto Star* for \$9.99 per month. Apple is also taking a substantial

share (50%) of the paid subscription revenue stream, leaving little for the publishers. Many publishers see Apple News+ as a windowing strategy, more a testbed rather than the savior. *The New Yorker* and *Los Angeles Times* only allow access to limited content via Apple News+, while *Vox*, *theSkimm*, *New York Magazine* and the *Wall Street Journal* are producing custom content via Apple News+.

Emerging competitors like Readly, on the other hand, offer \$9.99 for subscription to over 4,500 magazines, but distribute more than half of subscription revenues to publishers based on the interest their titles garner, offering a new revenue stream to an industry in decline. Readly also gives publishers detailed consumer behavior data on the articles people read, where on the page they stop and what ads garner the most attention.

2019 | YEAR IN REVIEW

DIGITAL NATIVES

Nearly all digital natives were built on advertising-based models with *The Athletic* being a current exception. Advertising-based models monetize with paid ad impressions from unique visitor traffic. Unlike their traditional counterparts, digital natives (as implied by the name) never underwent the print-to-digital transformation. Many were deemed “digital darlings” by venture-capital funds

and had received significant venture funding with rich valuations. As a result, many are struggling to fulfill high-revenue growth and profitability expectations of its investors, and likely do not have a currently sustainable model.

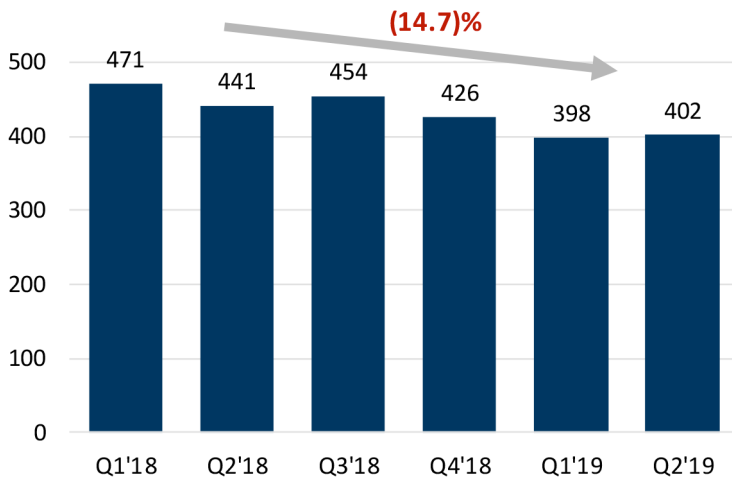
MACRO TRENDS

Overall, traffic is declining for digital native publishers, and programmatic digital

display ad spend is also exhibiting slowing growth rates.

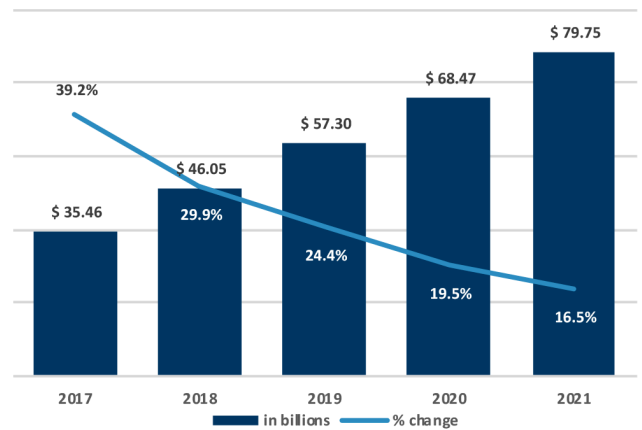
FTI Consulting aggregated unique visitor data from the 50 largest digital native sites over the recent six quarters and saw total audience decline by 14.7% during that period. (See *Figure 13*.)

Figure 13
Digital Native Monthly Unique Visitors (Q1'18–Q2'19)



Source: SimilarWeb data

Figure 14
Programmatic Digital Display Ad Spending (U.S.)



Source: eMarketer, October 2019

Programmatic advertising is a key revenue source for digital natives. Growth for programmatic digital display ad spend is slowing significantly; this could imply digital ad spend is peaking and that growth going forward is a zero-sum game. (See *Figure 14*.)

INCREASE SCALE THROUGH CONSOLIDATION

To combat some of the adverse trends, companies are focused on scaling up through consolidation, thinking scale will let them improve profitability and better

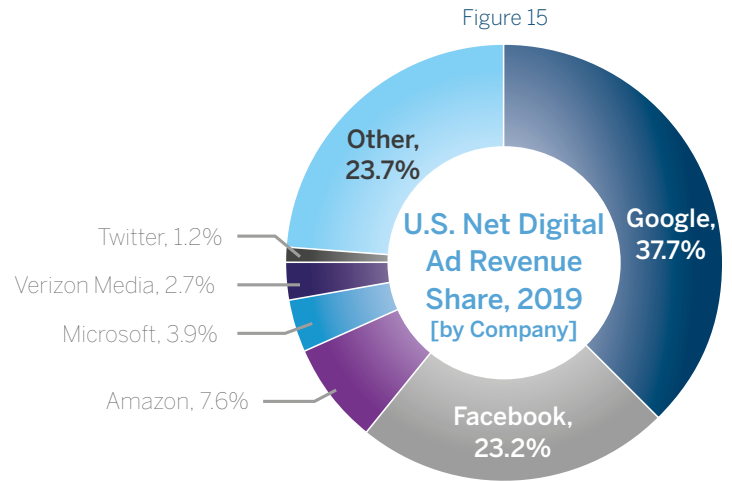
compete. Examples include the recent acquisitions of *New York Magazine* by Vox Media (Sept 2019), *Refinery29* by Vice Media (Oct 2019) and *PopSugar* by Group Nine (Oct 2019). This is a similar trend to the publisher consolidations happening in the newspaper industry.

2019 | YEAR IN REVIEW

Scale can help, but how long can digital natives sustain revenue growth in digital advertising given the dominance by the Google-Facebook duopoly? Google and Facebook's share of the advertising market has remained strong. In 2018, the two companies accounted for 57.7% of all digital ad spending in the U.S., compared with 57.2% in 2016, according to eMarketer. The market research group forecasts the market share of these two companies to grow by 75% between 2017 and 2020, compared with 15% for a group it calls "other," which includes digital media companies. (See Figure 15.)

Many publishers are exploring opportunities to diversify revenues to other digital platforms (including video, podcast, etc.) to gain audience reach and increase customer touch points. In addition, we expect many will attempt to use pay models to monetize their digital audience. FTI Consulting's partnership with the Google News Initiative Subscriptions Lab suggests prioritizing digital subs, and the right level of focus can drive meaningful improvement.

It has become abundantly clear that digital natives do not behave like digital markets characterized by network effects and out-sized returns with low marginal costs. While serving the same content again is virtually free, keeping traffic levels up requires high volumes of material refreshed constantly, as well as marketing spend. Rather than so-called winner-takes-all markets, we have settled into a world where "survival is success."



LOOKING FORWARD

Publishers, whether traditional or digital natives, need to rethink their current offerings to combat:

- (i) consumers' low willingness to pay for digital subscriptions;
- (ii) relatively high fixed cost of the declining legacy business;
- (iii) increasing competition to attract and retain online traffic given the low entry barrier and flood of content online; and
- (iv) the digital advertising space continuing to be dominated by the duopoly of Google and Facebook, leaving publishers with little bargaining power to improve revenue share.

However, FTI Consulting believes and has shown through financial forecast modeling that a sustainable business model is possible. This will clearly require tough choices on when to more aggressively begin or continue the pivot to digital consumer revenue while maintaining digital advertising and other diversified revenue sources. Determining your north star will be essential to sustainability.



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About FTI Consulting

FTI Consulting is an independent global business advisory firm dedicated to helping organizations manage change, mitigate risk and resolve disputes: financial, legal, operational, political & regulatory, reputational and transactional. FTI Consulting professionals, located in all major business centers throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities. For more information, visit www.fticonsulting.com and connect with us on Twitter (@FTIConsulting), Facebook and LinkedIn.

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