

THE HARMELIN MEDIA REPORT

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2006 Media Spending by The Harmelin Media Research Department

Advertising media spending will show a moderate growth rate in 2005. According to Taylor Nelson Sofres/Media Intelligence (TNSMI), U.S. advertising grew 3.0% during the first nine months of 2005. On the heels of 2004's 9.8% growth, this year's ad spending may seem disappointing, but it was not unexpected. The national media forecasters that Harmelin looked at last year had predicted an average growth of 4.7%. Our own estimate for 2005 advertising spending growth was a bit lower; 4.0% to be exact.

Meanwhile, the latest statistics from the U.S. Commerce Department show that real Gross Domestic Product (GDP) grew 4.3% in the third quarter of 2005 and has averaged 3.8% throughout the first nine months. The Federal Reserve Bank of Philadelphia's latest survey of 51 economists notes that overall 2005 GDP will come in at a 3.6% growth rate. In Harmelin Media's 2005 outlook, it was noted that the economic consensus forecast a 3.5% GDP growth for 2005.

2005 Advertising Growth Slowdown The U.S. economy will over-performed its estimated 2005 growth, while advertising growth will underperform its estimated 2005 growth. It's an oddity. Universal McCann forecaster Robert Coen says that this is the first time in recent memory that U.S. advertising growth failed to outpace the economy during a sustained recovery from a recession. 2005 will be the fourth year of economic expansion since the 2001 recession, and advertising growth outpaced the economy in 2002, 2003, and 2004. The streak will end in 2005. Looking deeper, GDP rose by 3.6% in the first half of 2005 and advertising expenditures rose 4.5% during the first six months. However, in third quarter 2005, GDP rose 4.3% while advertising spending actually decreased 0.2%.

What happened in the third quarter to cause such a dramatic reversal from the first six months of the year? The first reaction is to say "Hurricane Katrina." While the August 30 catastrophe did shut down ad-

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Turn the Radio Up by Jennifer Harmelin

Remember the first time you saw High Definition Television (HDTV) and thought, "Wow! How amazing!" Get ready for the emergence of HD Radio – a technology which has been steadily growing since its inception in 1998. For the consumer, HD radio has more choices than standard FM or AM radio, better sound, and no subscription charge. For the advertiser, it adds to the ability to target locally. This sets it apart from satellite radio, which broadcasts on a national level (you cannot buy spot market or local airtime, except on select channels – local traffic and weather) and charges the consumer a monthly fee.

HD radio offers the listener CD-quality sound on regular FM radio airwaves; it filters most of the static and hiss. It also has the potential to offer more choices for listeners due to its ability to multicast – a fancy word for broadcasting several audio streams on the same frequency. This allows for multiple layers of simultaneous programming per station. For example, WXYZ could offer one stream of classic rock, one stream of 80's rock, and another with soft adult contemporary tunes all at the same time. They can even transmit data directly to the listener's HD radio display – song title, artist, on-demand traffic, weather, and banner advertisements. There are plans for the listener to be able to buy the song currently playing with just the push of a button. The consumer will have to buy a HD radio receiver (there's no HD radio reception on a regular radio). However, unlike satellite radio, there are no subscription fees as the HD stations will continue to be broadcast free over the air.

HD radio is a natural progression of technology, much like the change from black & white to color TV. It is an improvement over the basic radio model. Consumers have consistently made the upgrade from analog to digital media. From vinyl records and cassettes to CDs, and from three basic TV channels to UHF TV

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Watch TV on the PC

by Tiffany Kerper

As more and more TV series make their way to DVDs, are you still wondering where to find all the classic shows? Have you been looking for programs such as *Growing Pains*, *Eight is Enough* or *Perfect Strangers*? Do you miss the early John Travolta days of *Welcome Back Kotter*? Look no further. Warner Brothers and America Online (AOL) have joined together to launch In2TV which will debut in late January 2006.

In2TV will allow web users to stream full-length episodes of their favorite series, supported by advertisers at no cost to the user. There will be over 100 old television series with more than 4,800 episodes available online in the first year. The site will be divided into six genres with additional categories launched at a later date. Search engines will also be available to let users find programs by show title, cast names and other key words or phrases.

Laugh out Loud (LOL) TV will feature shows such as *Welcome Back Kotter*, *Hangin' with Mr. Cooper* and *Perfect Strangers*. You will be able to find dramatic series such as *Scarecrow and Mrs. King* and *Eight is Enough* on Dramarama TV. Toontopia TV will feature top-rated animated series such as *Beetlejuice* and *Freakazoid*. And, if you are looking for Sci-Fi and Horror, there is Heroes and Horrors TV which will include *Freddy's Nightmares* and *Babylon 5*. If action adventure is more your style, Rush TV will feature action adventure favorites such as *La Femme Nikita*, *The Fugitive* and *Dark Justice*. Lastly, for you *Growing Pains* and *Alice* fans, there is Vintage TV.

The plan is to have revolving selections of episodes. In2TV will offer several hundred episodes each month rather than allowing continuous access to all the episodes in a series. This is to deter the potential decrease in DVD sales of these shows. In addition, as demand for these shows by syndication and cable networks increases, the price will be higher if the network wants to keep them off the Internet.

For those viewers who don't want to watch the entire episode, there will be shorter segments and interactive features. One- to two-minute excerpts will be taken from the full length-episode every month. They will feature clips from funny scenes or segments where famous actors played small parts in the television series. These excerpts will be available by email or sent by instant message. Eventually they will be offered on mobile phones.

Web users can also use other interactive features including "Starchives," or episodes featuring "Before They Were Stars." "TV Karaoke" will let you sing along with your favorite TV show themes, and "RetroRunway" will show fashions from the TV series.

Advertisers will be able to purchase 15- or 30-second spots during each 30-minute episode. However, commercials will be limited to one or two minutes within each 30-minute episode as compared to the eight minutes of advertising on broadcast television. A big plus for advertisers is that Internet commercials cannot be skipped. Advertisers will also get the chance for sponsorships and/or banner ads. The Internet websites are also willing to create a variety of ad packages built around supplemental programming features.

We'll soon see if consumers will use their PCs like televisions.

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vertising in the Gulf region, its devastation did not shut down the economy. In fact, relief efforts actually spurred the economy with an influx of government expenditures. Furthermore, ad spending statistics from markets directly affected don't support blaming Katrina for the entire decrease. According to TNSMI, third quarter 2005 U.S. advertising was down by \$67,100,000 from third quarter 2004. New Orleans is the only spot market that TNSMI measures within the affected Gulf region. Using TNSMI estimates, New Orleans saw its third quarter 2005 advertising decline \$32,738,500 from third quarter 2004. That's 48.8% of the total U.S. third quarter advertising decrease. While Katrina can be directly blamed for almost half of third quarter 2005's advertising decline, if the third quarter had kept pace with the first six months of 2005, ad spending should have been \$4.7 billion higher in the third quarter 2005 than it was. The New Orleans decline accounts for just 7.0% of this shortfall.

Several national forecasters have tried to minimize the effects of Katrina on advertising spending. They attribute the slower 2005 growth rate to thriftiness among national advertisers as well as media buyer backlash against rising media costs. However, as Harmelin Media witnessed with many of its own clients, the loss of the Gulf States as a viable marketplace after the storm created actual businesses operating costs as well as caused a drop in sales. Consequently, expense cuts were necessary in geographies not affected by the storm. In many cases, advertising seemed to be one of the first areas curtailed to stem negative cash flow and trim expenses.

Beyond these more direct consequences, Katrina may have also triggered a number of other ripple effects that influenced the third quarter advertising market. Im-

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mediate and subsequent increases in gas prices certainly altered consumer spending throughout the country in September. The skyrocketing price of gas also undermined both consumer and advertiser confidence, which may have translated into the national advertiser "thriftiness" referenced earlier. In any event, TNSMI estimates show dramatic reductions in the rate of ad spending for eight of the top ten business categories. More importantly, TNSMI reported year-to-year spending decreases for nine of the top 10 advertisers. Confronted with these types of statistics, it's very hard to imagine that the Katrina catastrophe, coupled with growing concern over the war in Iraq, did not have a larger impact on ad spending than most forecasters originally believed.

Advertising Growth and GDP So, is there still a relationship between GDP and advertising spending? The old assumption that advertising growth outpaces economic growth was certainly dealt a blow this year. But maybe there's another relationship. Table 1 shows GDP and advertising spending for the past six years.

	GDP change in 2000 dollars	US Advertising Growth
2000	3.7%	13.3%
2001	0.8%	-9.8%
2002	1.6%	4.2%
2003	2.7%	6.1%
2004	4.2%	9.8%
2005	3.8%*	3.0%**
*annualized rate thru 1st 9 months		
**increase thru 1st 9 months		

In years when the GDP growth rate was higher than the previous year's GDP rate, the advertising growth rate exceeded the previous year's growth

rate. In years when the GDP's growth rate decreased from the previous year, advertising's growth rate decreased from the previous year. Under this forecast model, 2005 was not an anomaly. 2005's GDP growth rate fell from 4.2% in 2004 to 3.8% in 2005. Correspondingly, the advertising growth rate fell from 9.8% in 2004 to 2005's preliminary 3.0% growth. Advertising spending continues to move in the same direction as the economy, but as usual, with more volatile changes. So what is the economic forecast for 2006?

2006 GDP The Federal Reserve Bank of Philadelphia released its latest forecast for 2006 in mid-November. While the Bank forecasts the economy to grow at a 3.2% annual rate in fourth quarter 2005, it expects 2006 to grow at a 3.4% rate. This is down from 2005's 3.8% rate. Merrill Lynch released its 2006

GDP forecast on the same date that the Federal Reserve issued its estimate. Merrill's forecast is bleaker with just a 2.5% GDP estimate for 2006. Both the Federal Reserve's and Merrill Lynch's most recent forecasts were revised downward from their previous ones. These signs don't point to a vigorous economy in 2006.

2006 Advertising Growth If 2006's GDP rate is down versus 2005, and advertising's growth rate declines when the annual GDP rate drops, one would expect a modest forecast for 2006 ad spending. But surprisingly, no forecaster is predicting that advertising growth will be less than the anticipated GDP growth (see Table 2).

The average of the six forecasters is that U.S.

Harris-Nesbitt	6.9%
Jack Myers	5.9%
Robert Coen	5.8%
Zenith	5.1%
Standard & Poor	5.0%
Merrill Lynch	4.5%
Average	5.5%

advertising will grow 5.5% in 2006. A 5.5% growth rate would be well above the estimated 3.0% ad growth for 2005 and the 3.4% GDP forecast for 2006 by the Federal Reserve.

The Harmelin Media Research Department believes that 2006 media ad spending will be lower than the forecasters' average, but not as slow as a GDP/Adspend forecast model would indicate. The Research Department feels that Hurricane Katrina's effect on overall U.S. advertising spending was greater than many national forecasters have reported. As the lingering effects of the disaster dissipate, advertising spending will recover – and when third quarter 2006 arrives, the year-to-year growth percentages will have 2005's virtually non-existent numbers to beat. Media ad spending will also be boosted by the bi-annual return of the Olympics and by hotly contested Congressional and Senate elections. With these factors in mind, the Harmelin Media Research Department sees advertising spending increasing **5.0%** in 2006.

(Editor's note: a more detailed look at some factors that will influence 2006 media spending and a 2006 forecast by medium will be published in the January 2006 Harmelin Media Research Department's whitepaper. To request a copy, please contact Terry Maher at 610-668-7900 or tmaher@harmelin.com).

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channels to cable TV, people have embraced rapidly improving technology in many media. Radio has been slow to change. It has used the same basic equipment to broadcast for 75 years. But with HD radio, FM radio can sound as good as a CD and AM can be strong enough to carry every kind of music. And what's more, no one is going to force the change; the radios currently in our homes will still be good for years to come. Unlike HDTV which will replace regular TV and become the only televised platform in the future, HD radio is an improvement that is not intended to make its predecessor obsolete.

HD radio was created by Ibiquity Digital Corporation and the FCC approved its use in 2002. Unfortunately, although many stations have invested in this technology and are currently multicasting, few people have the receivers. Nationally, less than 100,000 people currently have the receivers and few models are on the market. Manufacturers have had software trouble and difficulty obtaining parts which is why there has not yet been a widespread push. The high cost of the receivers (\$269-\$1600) is a deterrent for consumers. However, starting with the 2006 models, some BMWs will come with the option to add an HD Radio receiver for \$500 in the console. In the future, many MP3 players and cell phones will come equipped with HD radio embedded capabilities. As this technology improves, the price of HD radio hardware is likely to decrease and become more competitive with satellite radio.

As of today, nearly 585 stations in the U.S. have made the transition to HD radio. This is an encouraging show of confidence in this new media. Stations in every top 50 market are currently providing HD coverage. Clear Channel Radio plans to broadcast HD on 95% of its stations in the top 100 markets by 2007. Entercom Communications, Cox Radio, and Infinity Broadcasting have also signed on board. In Philadelphia, 18 stations are licensed for HD radio, 14 are on-air and two (WXTU & WRDW) are already multicasting. Gartner Research predicts that by the end of next year HD radio will reach over a million customers and up to 10 million by 2009.

With lower prices, quality of sound, choice and interactivity, consumers are likely to choose HD radio eventually. But the radio industry is already taking a clear gamble on this product and it may just be the best new opportunity for terrestrial radio to retain its audience.

Harmelin Media Welcomes USA 3000

Harmelin Media is pleased to announce that we've been named the media buying service for USA 3000. USA 3000 flies a fleet of Airbus A320-214 aircraft. The cabin's 168 seats are in a single-class section; each seat has a most comfortable pitch of at least 30 inches. USA 3000 flies from many northern cities including Philadelphia, Chicago - O'Hare, Newark, and Pittsburgh to destinations in Florida, Mexico, Bermuda, and the Caribbean.

USA 3000 offers both regularly scheduled flights and chartered flights. Harmelin Media looks forward to a long-lasting relationship with USA 3000.



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