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Will Internet TV Replace Pay TV As We Know It?

With almost daily announcements of new and tweaked internet video services that are intended to provide mainstream TV to homes, the warnings of the impending death of traditional pay TV are constantly evoked. But does Internet delivery of mainstream video content really have the potential to displace an industry as successful and entrenched as pay TV has become over the past fifty years?

The easy answer to this question is no. However, the real threat is forcing traditional pay TV providers to adapt to an internet future.

In simple terms, traditional pay TV isn't going anywhere. Indeed, despite worldwide economic recession, digital pay TV subscribers have grown steadily worldwide in recent years. According to DTC estimates, digital pay subscribers grew from 316 million in 2009 to an estimated 372 million in 2010, and are expected to surpass 590 million by 2015.

Service providers offer a variety of package prices with the most recent being higher end HD, on-demand and 3D services. In addition, the TV, telephone and high-speed service bundling is boosting subscriber acquisition and revenue per subscriber.

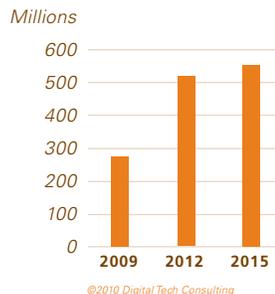
Still, there is no denying the growth in Internet video usage and the potential that lies therein. Video consumption via the Internet is on the rise exponentially, with nearly half a billion Internet video viewers estimated at year end 2009, a number expected to exceed 700 million by 2015 according to DTC's latest research.

Only a tiny fraction of these are paying to watch TV delivered over the internet, but content providers can't ignore the sheer size of the market. Further, Internet based video services can offer unprecedented on-demand access to super niche libraries, and content delivery to multiple devices.

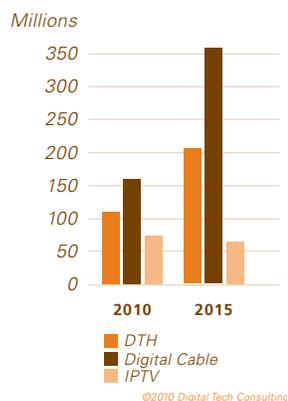
But like previous era's debates over the cannibalization of the old by the new (the home video business was going to kill the movie theater business, etc.), the Internet is far more likely to stimulate greater media usage overall, rather than eradicate pay TV, though it is poised to influence profound changes to what pay TV looks like. Already, pay TV providers

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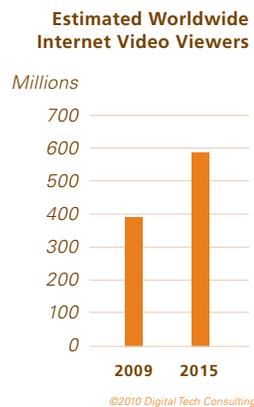
Estimated Worldwide Digital Pay TV Subscribers



Estimated Worldwide Digital Pay TV Subscribers by Platform



are seeking ways to integrate some of the key advantages of the Internet within their service structures, such as AT&T's U-Verse offering access programming with an iPhone application. Ultimately, the method by which a subscriber gains access to content, whether it is through the open Internet, one of several types of pay TV network, or some combination of the above, is likely to lose distinction over time.



The key to a successful business in the future won't be how a service is connected to a subscriber, but rather the strength of that connection. Pay TV operators start with a natural advantage because they have a strong tie to existing paying subscriber bases. But their future success will hinge on how they leverage this into a new era of pay TV. Internet players like Google and Hulu have an opportunity to utilize their early "impressive viewer-share" into paying subscribers. It won't be easy but if they can offer a high-quality and convenient viewer experience that has a clear differentiation from current choices, there's no reason why it can't be a viable mass-market business. The real winner in all this is the consumer, who is likely to see an increasing amount of choice and diversity in both the type of content available and how it's packaged.

Video Game Console Households: Largest Existing Ripe for 3D TV Picking

Video game console owners are the biggest existing consumer base for source devices that will get 3D content to 3D TVs. 3D TV suppliers would be well served if they did more target marketing to the large installed base of game console households, which in turn would encourage greater development of 3D games.

“There will be more than 68 million 3D-ready console households worldwide by the end of 2010.”

It is estimated there will be more than 68 million 3D-ready console households worldwide by the end of 2010. All of these are potential 3D households once 3D TV sets have been purchased. Breaking that number down identifies the type of consoles and the 3D content that can be played on them. As of February 2010, there were over 30 million PlayStation 3 consoles around the world that are capable of receiving the 2 firmware updates required to play games and watch 3D movies on a 3D TV set. In other words, about 30 million households have a future 3D Blu-ray player sitting in their living room. The firmware update allowing PS3 owners to play 3D games went through this summer, and Sony says the update that allows the PS3 to play 3D Blue-ray discs will come in October. This group alone makes the gaming community a leader in providing devices and content for new stereoscopic 3D TV sets.

When including the installed base of Xbox 360s to the pool, there are more than 23 million more households as of January 2010. The Xbox 360 is not capable of playing 3D BDs, but game makers and Microsoft officials say it will be able to play stereoscopic 3D games. There aren't any 3D games slated to come out for Xbox until Spring 2011, according to developers announcements. Microsoft is not pushing 3D gaming, but game makers are doing the work for them.

But the 3D-ready console is only a third of the equation to bring 3D into homes around the world. TV makers would serve themselves well by focusing on this group when promoting their TVs. After these consumers are set up with a 3D TV that they have bought in the all important 4th quarter they need content to watch and play. There have been many big 3D game announcements over the past few months (such as Killzone 3, Crysis 2, Avatar the game, and Gran Turismo 5), but in order to convince people to take the 3D plunge there needs to be a large stable of games on the market, not to mention 3D movies on BD, of which there are currently very few.

Industry players are betting on 3D with game development dollars, hoping valuable content franchises can bring the hardcore gamers to spend their money on 3D TVs, and this seems like a perfect place for TV makers to focus their attention.

The Converged Gadget: The Real Cost of Convergence

The video technology sector has more than delivered on the promise of converged devices and services for consumers. From mobile phone cameras that record video to portable video game devices that play movies, and miniaturized computers that masquerade as mobile phones, consumers can watch video on just about any available class of gadget.

“On-the-go” viewing over new delivery platforms has resulted in overall increased consumption of programming. But it’s not all good news as some consumer electronics suppliers scramble to make their single-use products relevant in this Swiss Army knife gadget era.

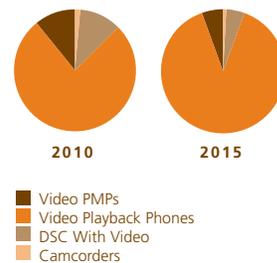
A sense of urgency is advised. Not only have sales of smart phones soared in one of the worst economic landscapes in decades, but a cannibalization in digital still camera and portable media player sales have surfaced in DTC’s market research. And although digital camcorder sales are currently benefiting from new-technology adoption that makes camcorders more compact and affordable, camcorder makers are advised to look over their shoulders as smartphone and other multifunction devices’ imaging and battery technologies improve. Cheap enough or good enough may no longer work for products that only perform one or two functions.

The subsidy business model for smartphones creates an uneven competitive playing field for consumer electronics suppliers that sell devices that aren’t tethered to a monthly service. There aren’t any mobile phone service providers or ISPs that share the cost of the camera or camcorder. And although consumers are willing to pay more in monthly service charges and to be locked into a contract in exchange for the smartphone, most are unwilling to shell out the \$500-\$700 for one off the shelf.

DTC estimates that more than 340 million smartphones will ship worldwide in 2010, which represents more than an 80% growth rate over 2009. And in 2011 we estimate more than 400 million will ship representing more than 42% of all video playback mobile phones (phones with any video capability including video clip functions from imbedded cameras). The inclusion of a camera is practically a standard feature in most phones with an estimated 826 million camera phones forecasted to ship in 2010 and more than 1 billion estimated to ship in 2012.

The low quality of imaging on feature phones hasn’t been much of a competitive threat to digital camera and camcorder makers in the past, but the latest crop of high-end smartphones are satisfying the “good enough” imaging test with many consumers. This has driven some DSC suppliers to adjust their offerings to focus on higher-quality digital SLR cameras and leave the “good enough” imaging to Apple. Devices with higher price points result in fewer shipments but also result in the possibility of higher margins. Besides, competing on quality and not on price may be the only way to survive in today’s super gadget climate.

**2010 Worldwide Estimated
Select Handheld Video Devices**



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DTC’S PLANNING SERVICE FOR DIGITAL TERRESTRIAL TV TRANSITIONS

Nearly 80% of the world’s countries have yet to build a digital terrestrial TV system and many government agencies that manage spectrum and broadcasting are facing the important task of designing and implementing DTT systems in the near future. Selecting standards and specifications, creating a timetable, and educating broadcasters, retailers and consumers about the DTT transition plan takes time, expertise, and a well-rounded team.

DTC has been involved in planning and analysis for several DTT transitions around the world. From the Middle East to the Caribbean,

and North America, DTC has aided countries in assessing receiver requirements and availability, set-top box cost analyses, and the creation of educational materials for retailers and consumers. DTC has the market expertise to aid transitioning countries as they build out DTT systems and plan for the shut off terrestrial TV analog systems. If preparing for a DTT system and/or an analog shut off, planning and guidance is essential. DTC makes available a free DTT Transition Guide at http://dtcreports.com/documents/dtt_dtc.pdf. To learn how DTC can help you with your transition, please contact Myra Moore at 214-915-0930 or myra@dtcreports.com.

DOMESTIC CHINESE LCD DTV QUARTERLY TRACKING SERVICE

April 2010 - January 2011 US | **\$20,000**

The Chinese digital TV market is one of the most important and fastest growing markets in the world. DTC, in a joint project with China-based RedTech Advisors, now offers a LCD DTV quarterly tracking service that delivers difficult-to-obtain reliable data and creates a roadmap for the domestic Chinese TV market and its primary players.

Each report includes:

- Current and cumulative quarterly shipment estimates for LCD DTVs shipped into the Chinese market broken down by:
 - Screen size by top brands
 - Market share by top brands (including video compression technology and chip supplier by top brands)
 - Top brands by manufacturer (where available)
- Identification of 2nd and 3rd tier brands
- Concise analysis on the market, industry players and trends for each quarter.
- Mapping of brand/OEM/ODM relationships (where available)

To order the service, or for more information, please contact Myra Moore at 211.915.0930 or myra@dtcreports.com.

Digital Tech Consulting is a market research firm providing strategic information and analysis to help companies succeed in the consumer digital marketplace. To learn more about DTC and how our analysts might help your company, please contact us at the information below.

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