DIGITAL · DIGEST

IN THIS ISSUE

NEW RESEARCH

This market research digest is designed to give you a glimpse of some of the research that Digital Tech Consulting is preparing for publication. Here is some of the research currently available from DTC:

NEW REPORT!
Online Media Services: *Forecasts, Business Models and Analysis*

U.S. Digital Terrestrial TV Market: *From HDTV to Multicasting*

The Business of Digital Copyright: *Content Protection and Management in the Consumer Digital Era*

For more information, please visit us online at: www.dtcreports.com.

Online Media Services: The Next Revenue Pipeline for Music and Video

Last year was the year the Internet became a viable commercial pipeline for consumer media entertainment. The debut of Apple's iTunes Music Store nearly one year ago, offered the first successful mainstream online music service with copy-protected downloads. Video-based subscription services, like RealOne SuperPass and Sony's SoapCity, gained traction in 2003, though on a less dramatic scale.

This edition of Digital Digest provides a unique snapshot of this fast-moving market. A more detailed and comprehensive analysis can be found in Digital Tech Consulting's (DTC's) newest report, *Online Media Services: Forecasts, Business Models and Analysis.* For more information and the table of contents, please go to www.dtcreports.com.
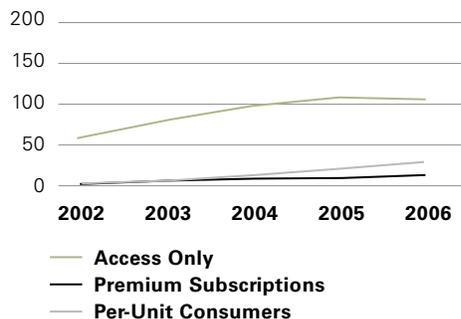
There are three fundamental elements DTC examines in this online media services analysis: broadband access, digital rights management (DRM) efforts and the willingness of consumers to pay for content that can otherwise be obtained free (but illegally).

Because broadband users are the likely customers for online media services, we begin our analysis with that group. Broadband access users worldwide are nearing 100 million, providing a promising potential consumer base able to receive high-quality content.

DRM can now be accomplished with a handful of quasi standards, although a single standard that provides seamless integration across all transactions and platforms does not exist. Still, the three dominant online media software vendors, Microsoft, Apple and RealNetworks, have integrated DRM into their respective platforms. This has laid the foundation for once-reluctant content owners to license their catalogs.

Finally, aggressive legal action against peer-to-peer network operators and users has promoted the concept of purchasing multimedia content online. Based on these factors, DTC expects a significant percentage of worldwide broadband access homes will purchase premium subscriptions or per-unit media content by 2006 (see chart).

Worldwide Broadband Subscribers

Legend:
— Access Only
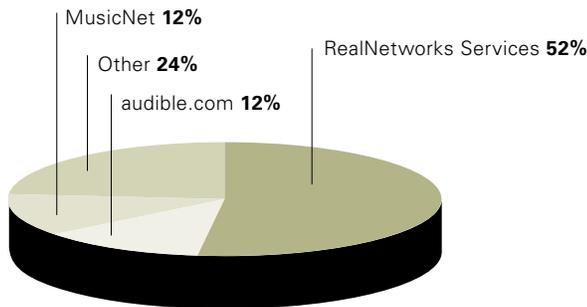— Premium Subscriptions
— Per-Unit Consumers

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Though per-unit downloads began in earnest during 2003, we believe they will represent the majority of online media content sales over the next five years, predominately through music. Content that is distributed with some copying ability and device portability closely resembles existing distribution models for music and movies. Consumers will seek this model as they are accustomed to some copying and use on multiple devices. Apple successfully pioneered this model with its success illustrated in both sales and imitators.

At the end of 2003, RealNetworks held the top market-share position for online subscribers (more than 1.3 million) through its family of services, which includes the Real Rhapsody, Real One Radio and various video offerings from mainstream content providers like CNN, ESPN and ABC News. AOL's MusicNet (formerly a joint venture with RealNetworks), held a 12 percent market share, on par with niche player audible.com (see chart below).
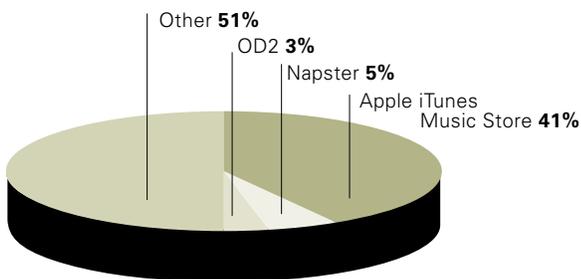
2003 Year-End Online Media Subcribers Service

MusicNet **12%**

Other **24%**

audible.com **12%**

RealNetworks Services **52%**

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For downloads, Apple is the clear leader, though the market will shift this year with new entrants (see chart below). Apple, however, will remain a leader as it has successfully migrated the two key elements—the iTunes software and the iPod music player – into the Windows platform. Other services to watch are the new Napster and OD2.
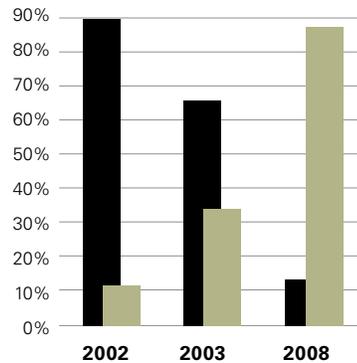
2003 Year-End Online Media Downloads Service

Other **51%**

OD2 **3%**

Napster **5%**

Apple iTunes Music Store **41%**

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Though we expect per-content revenues will clearly dominate in the music space, making up some 80 percent of revenues by 2008 (as the chart below illustrates), subscriptions will remain at a significant, as well as higher margin, revenue stream for music-based content.

Online Music Revenues

■ **Subscriptions**
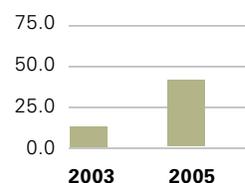■ **Per Unit**

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The picture is different when it comes to video and movie content, with subscriptions making up a clear majority for the next few years. Streaming-based video subscriptions have proven to be quite popular, with content primarily repurposed from broadcast TV. Movies are dominantly distributed in the per-unit model, but make up a small percentage of both consumers and revenues, due to immature services with very limited movie catalogs.

For more information on online media services, please see the enclosed brochure for our latest report, Online Media Services: Forecasts, Business Models and Analysis. Additional information is available at www.dtcreports.com.

Growing Recordable DVD Market Spurs New Trends in Authoring Software

Desktop DVD recorder sales more than doubled in 2003 with 11 million-plus units shipped (see chart below), and those sales have transformed the once-sleepy DVD authoring market. Previously planted in the professional-product category, DVD authoring packages are rapidly growing into the consumer/ prosumer market.

Total DVD Authorizing Units (in millions)

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Today, most DVD authoring software products offer limited functionality and low costs, and are distributed by OEM makers in DVD PCs and aftermarket drives. Only a small portion of unbundled DVD authoring packages are sold at retail, but retail sales are growing, as well. This fact is creating a new class of DVD authoring consumers, which is radically changing the market.

Since the introduction of DVDs in 1996, most DVD authoring systems have been sold to movie studios and commanded prices of as much as $50,000, and were coupled with high-end work stations. Now the category of prerecorded DVD content has grown beyond just mainstream Hollywood, extending into television and special-interest programs, as well as professional and educational/training programs. As this initial market segment has grown, prices for all components for DVD authoring have dropped, enabling expansion into a new category – prosumer and consumer packages.
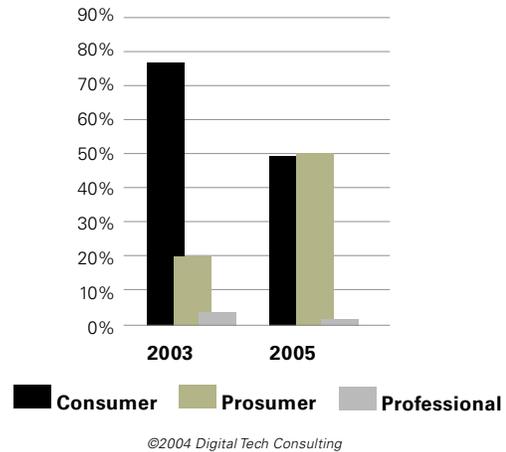
As a result of these parallel trends, DTC's most recent research finds three main categories of DVD authoring software (see below):

- **Consumer.** These products use software-based MPEG-2 encoding and have limited functionality in feature sets, speed and video quality. Distribution consists mainly of OEM product sales with new PCs and aftermarket burners, though a small percentage are sold through retail distribution. Examples include, Apple's iDVD, Roxio's Toast Titanium and Sonic's MyDVDit. Retail prices range from $50 to $150.

- **Prosumer.** This category also uses mostly software-based MPEG-2 encoding, but includes support for multiple video formats, greater speed and more extensive authoring features. Prices vary from $200 to $1,000, though price points have been dropping. Market leaders in this category include Sonic's DVDit! 2.5 PE & ReelDVD 3; Apple's DVD Studio Pro; and Pinnacle's Impression DVD Pro. More recent notable entrants to the market are Adobe's Encore (which licenses its encoding engine from Sonic) and Sony's Vegas+DVD.

- **Professional.** These are high-end, hardware-based authoring systems used primarily for feature films and corporate videos. Sonic, as an early market entrant, has a solidly dominant position in this category with both Mac and Windows products. Prices range from $5,000 to $20,000.

Although the aftermarket category is currently a small percentage of the overall DVD authoring market, as noted above, it is growing and worthy of further analysis.

As the following chart illustrates, some of the most dramatic aftermarket growth comes from the prosumer segment, nearly doubling its share of units shipped between 2003 and 2005. Both Sonic Solutions and Apple, current market leaders in prosumer DVD authoring, are vying to keep their leading positions as the market evolves.

Retail Authoring Units by Product Segment

Consumer   Prosumer   Professional

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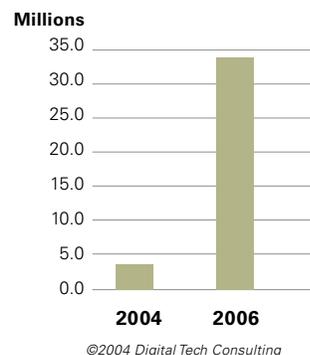# *DivX Set to Fuel TV/PC Cross Compatibility*

The DivX format, designed for downloading and playback of Internet video programs, is making its way into the consumer-electronics space, as DVD suppliers add the video format to select DVD players.

The company already has a strong presence, with an MPEG-4 compliant Internet media player with annual media-player downloads estimated to hit 50 million in 2004, growing to more than 78 million in 2006.

The company has now forged alliances with chip makers and consumer-electronics manufacturers to include DivX decoding in DVD players. Among the suppliers announcing they will ship DivX-compatible DVD players are V Inc., Jamo and Thomson. In addition, companies like Lynksys have announced they will make a DivX-compliant home networking router, which will allow users to access DivX content down-loaded from a PC and make it available to any DivX-enabled-networked device.

Based on this strategy, DTC expects that DivX will rapidly expand its shipments from Internet media players to TV set-top devices (mainly DVD players), with device shipments rising from fewer than 5 million in 2004 to nearly 35 million in 2006 (see chart below).

DivX Set-top Player/ Recorder Shipments

Millions

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ABOUT DTC

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 visit us online at www.dtcreports.com or call 214.915.0930.

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