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ASIA VIDEO INDUSTRY ASSOCIATION

Online Video Industry
China 2018

Executive Summary

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1. China TV Market Overview

Broadcast television has long played an important role in China both as a medium for entertainment and the spread of government approved ideology thanks to its wide reach. According to the latest official government statistics, the percentage of households in China that owned a TV set was 99% in 2014. That is equivalent to 455 million households at the end of 2014 and 495 million at the end of 2017 assuming the penetration rate held steady.

Currently, there are more than 2000 television stations in China including FTA and pay TV stations. Advertising on FTA channels is estimated to have generated US$12.5 billion in 2016 and is forecast to shrink slightly to US$12.3 billion by 2020.

Parallel to the preparation of this report, Pioneer Consulting Asia (PCA) conducted a consumer study on the topic of general audience trends/ preferences in China and agreed to share with AVIA and its members some of the findings in this report. Below is a summary of consumer viewing trends in China from this research:

- High daily incidence (91%) of urban online consumers viewing video on their mobiles
- Significant amounts of time spent watching video on mobile devices with over 60% of

China's Pay TV subscribers in 2016-2022F
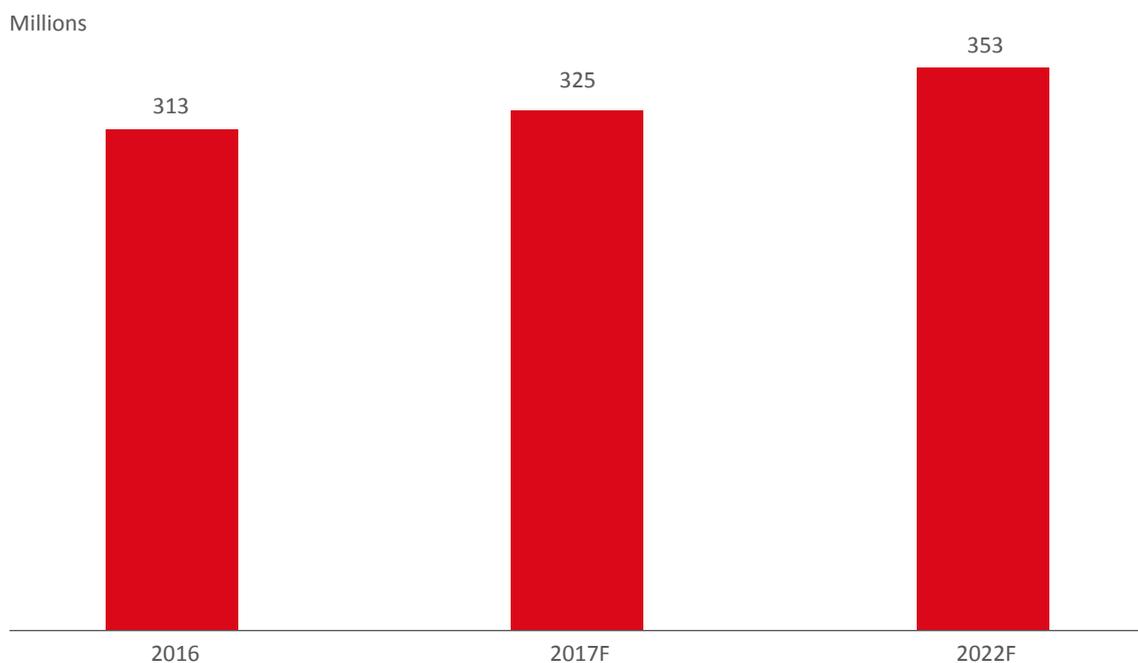
Source: All View Cloud (AVC)

respondents watching over 30 minutes of video per day on their mobiles

• Content preferences of respondents to watch both short-form and long-form content on their mobiles

• Dominance of iQiyi, Tencent and Youku respectively both in terms of online viewers and paying subscribers
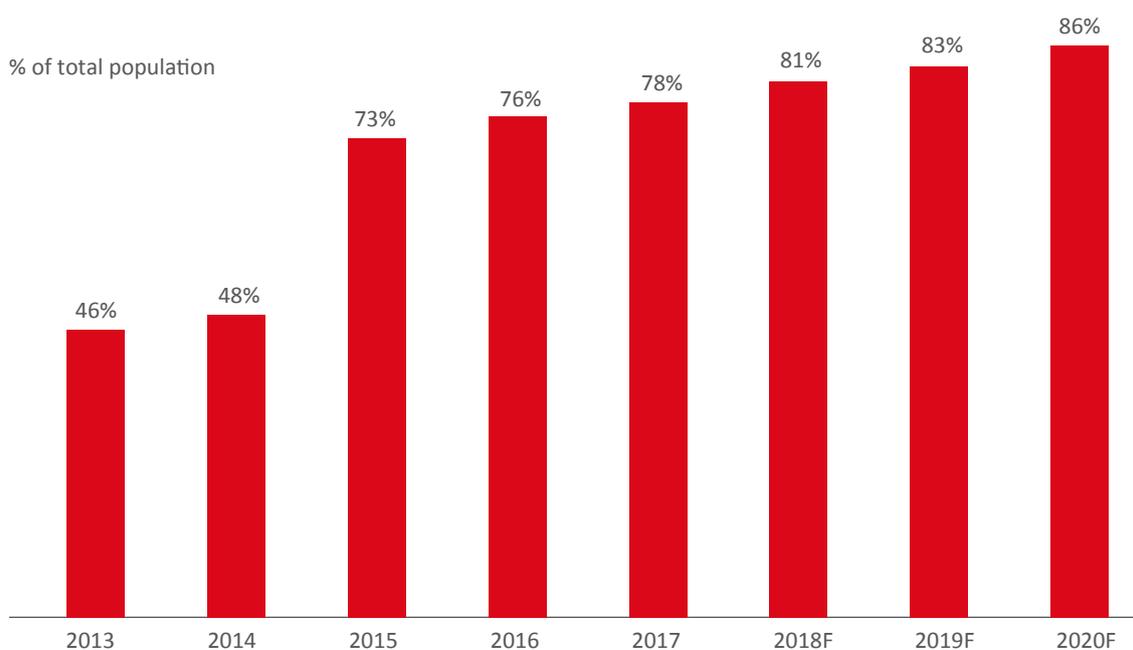
2. China Pay TV Market Overview

The overall size of the pay TV market across all technologies was estimated to be 325 million subscribers at the end 2017, roughly equivalent to 65% household penetration which makes it the largest pay TV market in Asia Pacific by subscriber

numbers. This number was up 3.8% from 313 million households in 2016. By 2022, the number is expected to grow to 353 million, representing a CAGR of 2.4%. Cable TV is the most widely adopted pay TV distribution technology in China. It is estimated that around 160 million households were subscribed to cable pay TV services in June 2017 representing a household penetration rate of 35%.
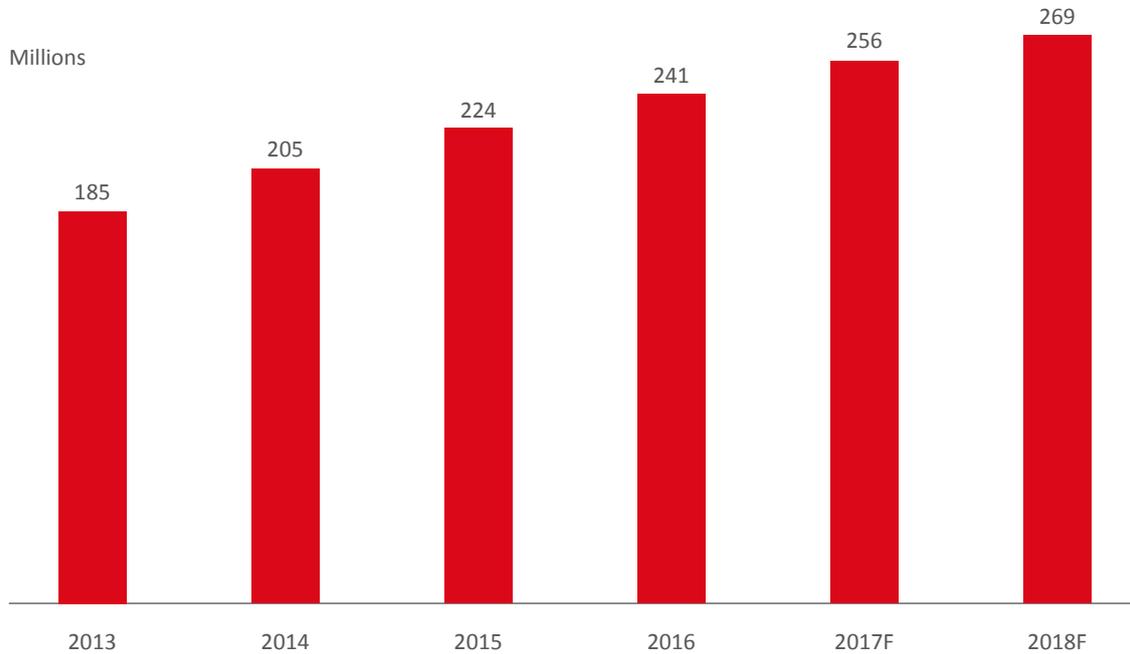
Licensed IPTV has been growing rapidly in recent years and reportedly reached 102 million households in June 2017, a household penetration rate of 22%. To be a licensed IPTV provider in China with permission to provide domestic subscription television, platforms must obtain an "Information Network Audio-visual

China's mobile penetration growth

% of total population

Year	Percentage
2013	46%
2014	48%
2015	73%
2016	76%
2017	78%
2018F	81%
2019F	83%
2020F	86%

Source: GSMA

Total Fixed broadband subscribers in China, 2013 to 2018F

Millions

Year	Value
2013	185
2014	205
2015	224
2016	241
2017F	256
2018F	269

Source: HSBC Industry Report

Program Broadcast Permit" which requires the platform to have a private ecosystem that is not linked to websites on the public internet.

Household penetration of any form of pay TV reaches over 90% for urban areas in China. However, in rural areas, licensed Satellite TV is more widely used and overall reaches an estimated 63 million households. It should be noted that the size of the unlicensed satellite TV market in China is estimated to be comparable in size to that of the licensed market. Unlicensed satellite TVs in China receive channel signals that are officially being targeted at foreign countries such as Taiwan and Thailand, hence the content is not censored by regulators and fees for the content do not get distributed to the rightful IP holders.

Advertising on pay TV platforms generated revenues of US$5 billion in 2016 and represented 29% of total TV advertising in that year.

3. China Telecom Industry Overview

Our overview of China's telecom industry covers two major services:
- Mobile
- Fixed broadband

China's mobile penetration rate was 76% of the total population in 2016 and is expected to grow to 86% of the total population by 2020. It's worth noting that penetration at end-2014 was only 48% but by the end of 2015, this had increased by almost 52% to reach 73%. This fast increase in penetration can primarily be attributed to the construction of an extensive 4G network and heavy promotions of 4G-compatible handsets. In 2017, it was estimated that 73% of mobile subscribers were on a 4G network and China's smartphone penetration was 71% of all phone users in 2016. This latter figure is expected to grow to 74% by 2020. With widely available 4G and smartphone devices, all three major mobile operators in China have built their own online video & entertainment platforms to capitalize on the digital lifestyle of Chinese consumers but take up of these services has been limited.

China's fixed broadband growth has been driven by a national strategic initiative known as "Broadband China" which has set a 2020 target for fixed broadband to reach 70% of households with broadband speeds in cities and rural area of 50 megabits ("Mbps") and 12Mbps respectively. China's fixed broadband subscriber numbers experienced annual growth of 9% between 2013 and 2016, growing from 185 million subscribers to 241 million. By the end of 2018, fixed broadband subscriber numbers are forecast to reach 268 million, representing an annual growth rate of 6% from 2016.

4. China's Online Video Landscape

China's online video market size by number of active users was estimated to be 596 million at the end of June 2017. This represented roughly 76% of the online population, highlighting that online video viewing is one the most common online activities in China. Revenues for the online video sector have grown by a factor of five over the last three years, from RMB 10 billion in June 2014 to an estimated RMB 50 billion in June 2017.

The evolution of China's online video market has seen it transition from services with links to piracy, to legitimate services driven by advertising and, more recently, to subscription driven services. At the end of 2017, there were an estimated 74 million paying video users, up from only 8 million in 2014. The 2017 figure represents approximately 12% of the entire online video user base, up from 2% in 2014. A one-month subscription to an online service in China ranges between RMB 20 to RMB 40 depending on the platform and type of package selected.

While the online video space is made up of more than 200 players, the premium long-form content space is dominated by just three players: iQiyi, Youku and Tencent Video. These players are owned by the three largest internet companies in China, Baidu, Alibaba and Tencent respectively (commonly referred to as B.A.T.), who aggressively compete head-to-head across a range of digital businesses. Other established online video platforms in China include both native online players and the online platforms

Daily time spent watching live streaming video in China, Aug 2016

Legend:
- 20+ Min
- 16-20 Min
- 11-15 Min
- 6-10 Min
- 2-5 Min

37%
23%
19%
12%
9%
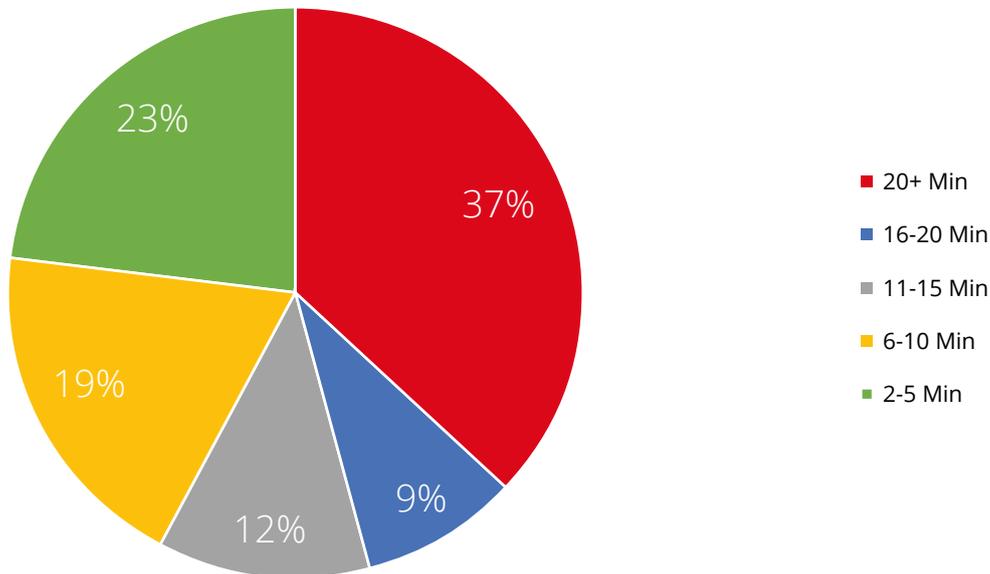
Source: China Internet Network Information Centre (CNNIC)

of traditional FTA broadcasters. Rounding out the Top 10 premium long-form content video platforms in terms of monthly active users (MAUs) are MangoTV, LeTV, Bilibili, Sohu, PPTV, Hanju TV, and Migu TV.

## 5. New Developments in China's Online Video Industry

Three emerging developments in the online video industry are live streaming, eSports and short video. The live streaming user base in China grew 60% from 194 million in 2015 to 310 million in 2016. However, growth forecasts for the next three years have dropped to 12% largely due to stricter regulatory enforcements which have

severely reduced the amount of live streaming content that is considered too risqué.

The phenomenon of eSports has also seen tremendous growth in China since 2015, with the number of eSports viewers and gamers growing 81% year on year from 87 million to 285 million by 2017. By 2019, it is estimated that number will reach 351 million. Industry revenues have also expanded quickly, increasing 198% per annum from RMB 5.2 billion in 2015 to RMB 46.2 billion in 2017.

Short videos as a genre are becoming increasingly popular in China driven by the number of viewers watching content on their mobile phones while out-of-home. The number of viewers watching

Usage & preference of video content by source – pirated sources are marked w/ red Violator

| | | | Unauthorised sources | | Past 6 Months | | Daily |
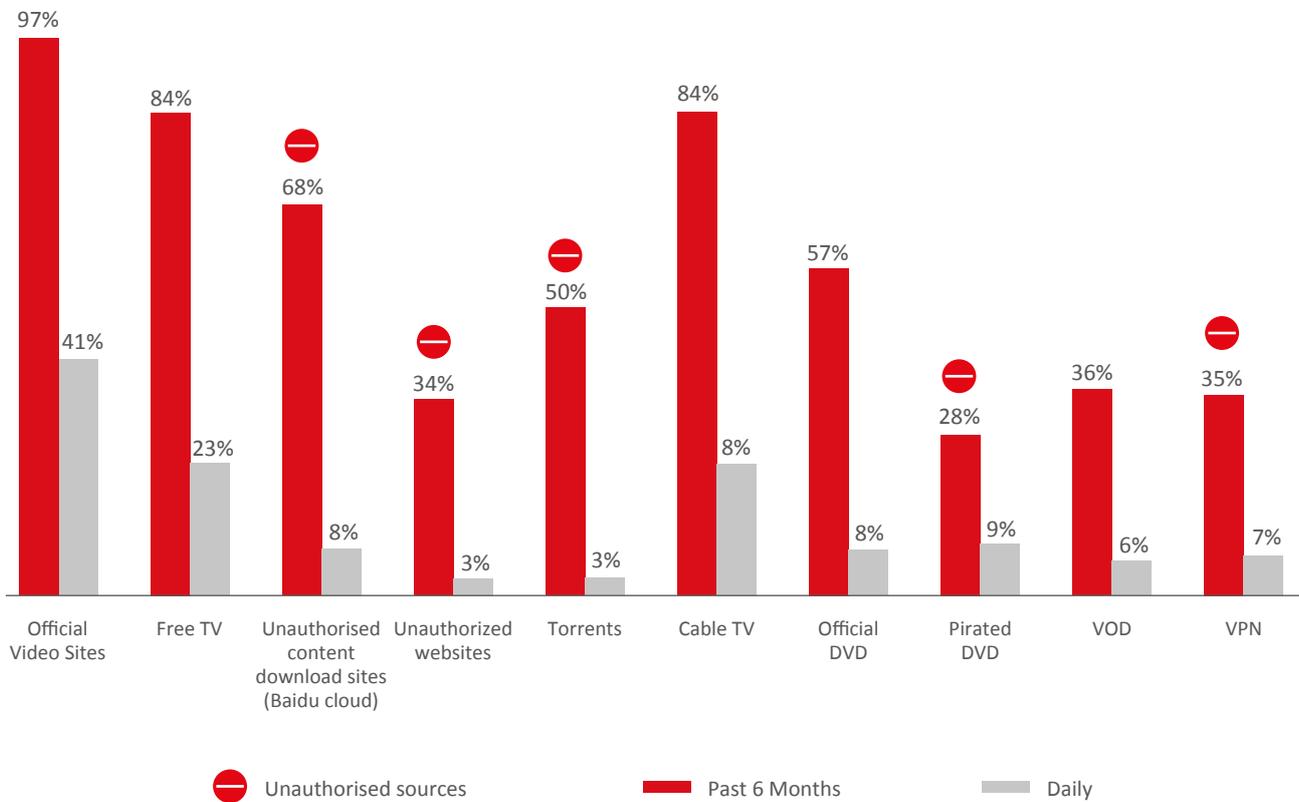
Source: Pioneer Consulting Asia

video on dedicated short video platforms was expected to reach 242 million at the end of 2017, up from 151 million in 2016, and forecast to grow to 352 million by the end of 2018. A key success driver for platforms offering short-form content is the algorithms they use to serve the right content to each individual user in order to keep them engaged for longer periods of time. On average, online video users click on short video platforms five to six times daily, spending an average of 44 minutes per day watching short videos.

6. Video Content Piracy in China

According to one estimate, revenue losses in China due to video piracy will increase from US$5.5 billion in 2016 to US$9.8 billion in 2022. (Figures only take into account TV episodes and films and do not include sports). This accounts for roughly 17% and 19% respectively of the estimated global cost of piracy in those years. Based on our research it was reported that the most frequently used sources of pirated content in order of usage are cloud site downloads, unauthorized streaming sites and torrents. While

these pirated sources were used in the past six months by 50%–68% of total survey respondents, Free Official Websites (iQiyi, Tencent, Youku) were the most cited source for video usage on a daily basis at 41% of respondents.

Given the size of the piracy issue in China, regulators have started to take a more active approach to enforcement. In 2009, the regulator released a provision that requires operators to enhance their processes for protecting copyrights and to take appropriate measures to protect the rights and interest of copyright holders. In November 2016, an anti-piracy campaign known as the Jianwang Operation resulted in a seizure of 1.5 million pirated publications, the shutdown of 1,655 websites containing pirated content and the removal of 274,800 pirated links. In May 2017, the Beijing court awarded one of the highest fines ever issued (US$1 million) for a case of copyright infringement against an online platform.

Below is a summary of the findings on piracy from our research:

- 68% of respondents said they used cloud downloads to access pirated content in the last six months, making this the most commonly used source of piracy in China
- The highest proportion of respondents using pirated sources on a daily basis drops to 9% for pirated DVDs, followed by 8% of respondents for cloud downloads, indicating that most viewers are not visiting pirated sources on a daily basis

- Based on our interviews, respondents aged 18-24 were more likely to watch pirated content than other age segments, reporting incidences of 2-3 times per week
- While both males and females reported using pirated sources, males reported higher incidences overall across age groups
- The primary reasons given for watching pirated content were:
  - It was difficult to find legitimate versions of western shows and movies
  - Pirated content was easy to use and find online as it is very prominent in search listings
  - Pirated content is free
- In terms of respondents' views on piracy, our respondents who watched pirated content fell into two camps:
  - The first camp expressed support for copyright laws saying they should be observed but said pirated sources were the only way to obtain a lot of content that they could not find on legitimate websites
  - The second camp expressed the sentiment that everyone watches pirated content and that they do not really care if it is illegal and therefore were not concerned whether the content was available legally or not

7. Regulatory Environment

Our overview of the regulatory environment in China related to digital content focuses on four areas:

1. Key stakeholders in Chinese TV regulation
2. Licensing requirements for online platforms
3. Regulations on foreign content
4. Live streaming regulations

Below we have provided a summary of each of these areas:

1. Key Stakeholders in Chinese TV Regulation

There are four key government organizations that oversee broadcast content in China:

i. State Council
ii. Ministry of Culture
iii. State Administration of Press, Publication, Radio, Film and Television ("SAPPRFT")
iv. Cyberspace Administration of China

Content censorship in China has historically been primarily overseen by SAPPRFT. Oversight of TV content in particular, is viewed as vital to the government's efforts to communicate key messages and influence public opinion as TV's reach spans the entire nation and is hence tightly regulated. As a relatively new medium, professionally produced online content has had less comprehensive censorship guidelines applied to it with lax enforcement in the past, but the government has undertaken a number of enforcement campaigns over the last two years. This more active approach to enforcement is likely to continue as online video viewing becomes more pervasive in the country making it a greater threat to the country's social fabric in the government's eyes.

In another move widely seen as further tightening the government's control over the media sector, it was announced in March 2018 that SAPPRFT would be abolished and replaced by three new bodies that would report directly to the State Council:

1. The State Administration of Radio and Television ("SART")
2. The State Bureau of Film (Film Bureau)
3. The State Administration of Press and Publication ("SAPP")

2. Licensing requirements for Online platforms

In December 2007, SAPPRFT issued the Administrative Provision of the Internet Audio-Video Program service or the Audio-Video Program Provision, which came into effect in January 2008 and was later amended in August 2015. The Audio-Video Program Provision defines "internet audio-video program services" as the producing, editing and integrating of audio-video programs, supplying audio-video programs to the public via the internet, and providing audio-video programs uploading and transmission services to a third party. Providers of internet audio-visual program services must obtain an Internet Audio-Video Program Transmission License to provide their services.

There are two types of Audio-Video Program Transmission Licenses that internet audio-video program services can apply for as highlighted below:

I. Integrated license
- Integrated licenses are needed for content providers to load their video applications on IPTV/streaming boxes
- There are seven integrated licenses – three were awarded in 2010 and four more in 2015

II. Internet Audio Video Program Transmission License
- All online platforms that distribute content online are required to possess an Internet Audio Video Program Transmission License

As a result of the stringent criteria for an Internet Audio-Visual Programming License, many platforms are either forming partnerships with existing licensees or acquiring companies who have the license.

3. Regulations on foreign content

Another key regulation affecting online platforms in China is the restriction on foreign content which requires operators of online video platforms to obtain permits for all foreign and TV dramas per title before they are transmitted via internet. To obtain approval for a serialized show, applicants must submit the full season to the regulator for review. The impact of this is that the release date of legitimate content significantly lags the release date in the country of origin which inevitably leads to a higher incidence of piracy. In addition, online video platforms must import foreign films and television dramas for use on their own websites and not exclusively

to resell to others. Finally, the annual import quantity of foreign films and television dramas may not exceed 30% of the total hours of content an online video platform purchased in the previous year.

4. Live Streaming Regulations

In a bid to regulate the live streaming industry, SAPPRFT issued the notice on Strengthening the Management of Live Services of Internet Audio-Visual Program Services in September 2016. This ultimately resulted in 19 articles specifying the regulations and codes of conduct for operating a live streaming platform in China which were designed to restrict popular live streaming content that was seen as not promoting desired social values.

In May 2017, the Ministry of Culture launched inspections of live streaming sites that were operating without a license or allowing restricted content to be streamed on their platforms. This enforcement campaign resulted in ten live streaming platforms being closed. In addition, 48 live streaming operators were subject to administrative punishments.

The following month, in June 2017, the Ministry of Culture reviewed 10,562 mobile live broadcast applications and required another 12 of them to be closed down.

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About the Asia Video Industry Association

The Asia Video Industry Association (AVIA) is the trade association for the video industry and ecosystem in Asia Pacific. It serves to make the video industry stronger and healthier through promoting the common interests of its members. AVIA is the interlocutor for the industry with governments across the region, leads the fight against video piracy and provides insight into the video industry through reports and conferences aimed to support a vibrant video industry. AVIA evolved from Casbaa in 2018.

Hong Kong Executive Office
20/F Leighton Centre
77 Leighton Road
Causeway Bay, Hong Kong
Tel +852 2854 9913
avia@asiavia.org
www.asiavia.org

pioneer
consulting asia

About Pioneer Consulting Asia

Pioneer Consulting Asia is an international management consultancy and research firm, focused on media, telecoms and digital. It has worked with a wide range of clients to develop growth strategies, manage risks and develop organizations for a digital world. It undertakes primary market research across Asia and also provides training and coaching services for executives and their teams.

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