

Books, Music, and Movies

INDUSTRY OVERVIEW

Demand for physical books, CDs, and DVDs continues to wane. Retailers have anticipated the reduced demand and have adapted accordingly by managing inventory levels and investing in other categories. E-book sales continue to grow, albeit at a slower pace than historically. Consumers are moving away from dedicated e-readers and retailers have responded by adjusting their device portfolios. Digital album and track sales, once the bright spot of the music industry, are now declining thanks to the growing popularity of subscription streaming services, while digital movie revenue continues to grow.



TREND TRACKER

Three month NOLVs	Consistent
Sales Trends	Decreasing ↓
Gross Margin	Consistent
Discounting	Consistent

NOLVs: NOLVs have been flat for most companies, with NOLVs for certain textbook publishers increasing up to 2.0 percentage points.

Sales Trends: Sales of physical books are flat to slightly down, with physical CD and DVD sales continuing to plummet. E-book and digital movie sales remain on the upswing, while digital track and album sales are declining. College textbook sales continue to decline on a dollar basis, as rentals grow in popularity, while K-12 sales continue to rebound.

Gross Margin: Gross margin has been flat to slightly up for most companies. Retailers have been strategic in their promotions to drive sales and are closely managing inventory to avoid markdowns.

Discounting: Discounting has remained relatively consistent, with thoughtful, targeted promotions.

KEY INDUSTRY DRIVERS

- **Inventory management:** With physical product waning in popularity, retailers have been focused on identifying the hot titles and ensuring the correct depth of inventory and marketing support to maximize sales. Recent book sales have been driven by popular teen books such as *The Fault in our Stars*. Retailers also continue to expand other categories like toys and games. While CD sales declines are unlikely to turn around anytime soon, the fourth quarter of 2014 has a robust release schedule that includes albums from Taylor Swift, Jason Aldean, Lil Wayne, and One Direction. Taylor Swift is doing her part to promote physical album sales, as her album *1989* is said to include 13 Polaroid photos with each physical copy.
- **Devices:** Devices dedicated exclusively to reading e-books have declined in sales. Consumers now favor a tablet that can meet a variety of needs, rather than just reading. This device competition is reflected in Barnes & Noble's recent decision to outsource the manufacture of its NOOK tablet devices to Samsung. The company is shifting its focus away from hardware and toward its ability to offer compelling digital content. It also still has plans to separate its retail and struggling NOOK businesses, but no definitive decisions have been made.
- **E-book pricing:** Pricing remains a point of contention within the industry. Amazon.com is using its clout to negotiate better pricing from publishers, which has resulted in a dispute between Amazon and Hachette. Hachette will not give in to Amazon's pricing demands. As a result of the failed negotiations between the companies, Amazon delayed shipments, began recommending different books to consumers, and removed pre-order buttons for upcoming popular titles.
- **Subscription services:** Digital book subscriptions have been growing in popularity with companies like Oyster, Scribd, and HarperCollins offering subscription services to consumers. However, the biggest development to date is Amazon's introduction of Kindle Unlimited in July. This new service provides access to 600,000 titles for \$9.99 per month and is expected to solidify Amazon as the leading provider of e-books. Music streaming has grown significantly, with total music streams through outlets such as Rhapsody, Spotify, YouTube, and other means increasing 42% thus far in 2014 over the prior year according to *Billboard*.



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KEY INDUSTRY DRIVERS

- **Textbook rentals:** In the college segment, textbook rentals continue to grow, hurting total sales on a dollar basis. Competition for rentals is fierce, which has driven down rental prices and impacted margin. Given the stiff competition, many companies are focusing on the service side of the business, including tutoring, homework help, college selection tools, and access to scholarship information, all in an attempt to connect with students and build customer loyalty. Online rental company Chegg recently announced that it will slowly transition ownership of its physical textbooks to a third-party to focus on the service portion of its business.
- **Digital textbooks:** Students still prefer hard copies to digital, especially when rental prices are often cheaper than the price of digital versions. However, publishers are making efforts to enhance digital offerings to make them more appealing. Examples include NOOKStudy and Yuzu from Barnes & Noble and the Kno educational software.
- **DVDs:** The home entertainment sector has experienced mixed results recently. While Blu-ray DVD sales have been steady, increases have not been enough to offset declines in regular DVD sales. Even the release of Disney's *Frozen* DVD on March 18, which sold 3.2 million Blu-ray and DVD discs in its first day of release and is one of the bestselling kids movies of all time, wasn't enough to buoy the industry. Like books and CDs, consumer are showing their preference for digital, with both digital downloads and digital streaming revenues up significantly. During the first half of 2014, spending on digital movies exceeded that spent on physical discs.

SALES TRENDS

The following table illustrates comparable store sales trends for major public book retailers (Represents the most recent fiscal quarter sales reported):

	Most Recent Quarter	Prior Quarter	Two Quarters Ago	Three Quarters Ago
Barnes & Noble ¹	(0.4%)	(1.9%)	(0.5%)	(3.7%)
Books-A-Million	0.1%	(2.5%)	(1.8%)	(8.5%)

Note(s): Represents core comparable bookstore sales and excludes sales of NOOK products.
The most recent quarter for both companies ended August 2, 2014.

The following table illustrates physical CD album sales in units, per year, as well as the change versus the prior year, as reported by Nielsen SoundScan:

Year	CD Album Sales in Units (in 000s)	Change versus prior year
2008	360,617	(19.7%)
2009	294,924	(18.2%)
2010	236,956	(19.7%)
2011	223,507	(5.7%)
2012	193,378	(13.5%)
2013	165,407	(14.5%)
YTD October 5, 2014	94,076	(18.7%)



OUTLOOK

Retailers will continue to manage book, CD, and DVD inventory levels while also using other categories and in-store events to drive traffic. Sales of physical product will continue to decline and those retailers that stock the right depth of key titles will fare the best.