

December 18, 2006
Cable World magazine

XX on Demand

*Adult content and cable's on-demand service have been making sweet music together, with the niche raking in more than half of the **VOD** revenue pie. But VOD is also disrupting the relatively stable economics and content of the adult category.*

By Janet Stilson

Deep in the heart of Time Warner Cable's channel lineup in New York City lies hidden a very potent message: "Nothing but 100% Pure Sex. No story to get in the way of the lace and silk coating luscious female flesh."

That teasing message in the electronic program guide serves as a lure for a video-on-demand offering called "Clips by TEN," one of many erotic options offered on cable, which is cashing in on consumer cravings for adult content. Operators have long known of the genre's lucrative luster, but it's become more so recently. Last year Americans spent more on adult entertainment than they did to go out to the movies. In turn cable has stripped away its inhibitions and now offers much more explicit programming.

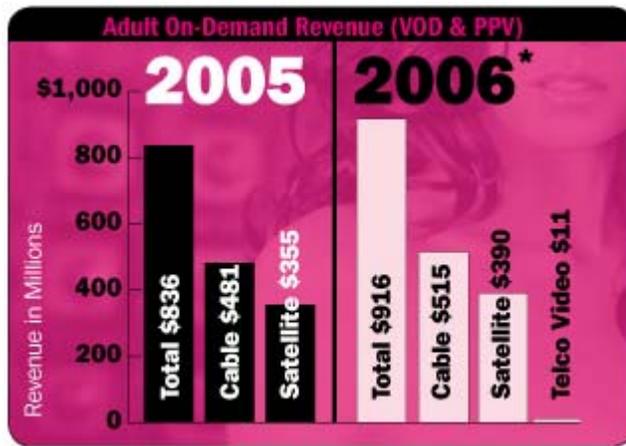


Jenna Jameson, star of Spice Digital Networks' on-demand channel clubjenna

That's rocked the worlds of adult content providers in profound ways. The gates are flooding open to a greater variety of programming from a larger number of suppliers. This is one reason why lust king, Playboy Enterprises, is at a pivotal juncture. The company's domestic TV business is foundering, and at least three top executives have been sent packing. Playboy is not alone in experiencing turmoil. Top execs at two other adult programmers — Trans Digital Media and Penthouse Media Group — got the boot as well in recent months.

None of those now missing in action was a slouch. TDM, home of Playgirl TV, dropped its president, Mark Graff, the well-known founder of the Spice Channel. Penthouse ousted Jim English, its president of entertainment, who has worked in the TV industry for some 30 years and was perhaps best known for his role as president of Playboy Entertainment Group.

Meanwhile, Playboy let go more than 30 staffers in recent months. Most prominent was Jim Griffiths, another longtime TV veteran who served as the senior EVP of Playboy Enterprises, as well as Ned Nalle, president of programming for Playboy Entertainment Group, in charge of original productions. Playboy also reportedly let go Craig Simon, SVP of sales and affiliate relations.



Source: Kagan Research. *Projections.

The loss of so many seasoned leaders within only a few months speaks to seismic changes in the adult category— and to how challenging business has become for some of those on the programming end.

"I don't think these people leaving has anything to do with a trend," says Paul Fishbein, president and owner of AVN Publications, whose magazines report on the adult industry. "It's just companies trying to get market share."

Marc Bell, CEO of Penthouse Media Group, tackles the issue somewhat obliquely when asked to comment on English's departure. "There is a paradigm shift in the adult marketplace," he says. "Consumers of adult entertainment desire content on their own personal schedules, not that of a broadcast programmer."

Geoff Lurie, CEO of Trans Digital Media, puts it slightly differently. "People who were stars 10 or 15 years ago don't necessarily function as efficiently in today's world. You have to be much more of a marketer, and have a key sensitivity as a leader to costs. Margins get squeezed, and it's a lot harder than...in the good old days."

Clearly, the rise of video on demand is changing the dynamics, with its added security features keeping provocative content from curious children. That's a big reason why most observers say there's little to fear from possible government intervention. VOD also is a significant hedge against DBS, which remains relegated to pay-per-view, further strengthening operators' hands.

What's more, economics have changed dramatically. In the past, buy rates were significantly higher — 8% to 12% for adult product. Now, with many more offerings on hand, it's typical for adult shows to attract only 2% or 3%, sources say. On the plus side, the more explicit the content gets, the more money operators can and do charge for on-demand adult fare, which usually ranges from \$10 to \$12 per program. But the revenue splits have been whittled to 10% for the programmers and 90% for the distribution platforms.

Playboy TV enjoys better splits than most of the VOD/PPV-oriented content providers. Playboy TV gets 15-20%, one analyst says. However, it's also cheaper. Four hours of Playboy VOD on Time Warner Cable in New York City is \$7.95, versus about \$10 to \$12 for about one and a half hours of other, more explicit adult fare.

Kagan Research reports that last year cable and satellite operators drew in \$836 million from adult content on pay-per-view and video on demand. This year, the firm projects the total for on-demand adult will rise to \$916 million (see chart).

LESS PLOT, MORE PORN

Adult programming shows a lot of luster when judged against other genres. An executive at a top MSO reports that adult represents 27% of all on-demand orders for his company — second only to new movie releases when judged by genre. But adult bests all categories in terms of revenue, with 53% of the on-demand pie.

Not only is it a cash cow, but it's a great way to satisfy a small but dedicated niche. "They're high-frequency users," says Larry Gerbrandt, SVP and general manager of Nielsen Analytics, speaking of adult content fans. "It used to be that there were essentially a couple of pay-per-view channels. With VOD you can offer as many hours of programming as an operator is willing to devote to the server." That also allows for a variety of content standards.

There is a paradigm shift in the adult marketplace. Consumers of adult entertainment desire content on their own personal schedules, not that of a broadcast programmer.

Indeed, Michael Weiner, CEO of New Frontier Media, noted in an August earnings call that Comcast was the last MSO to transition to the steamier XX version of adult fare on VOD.

"You don't see the 'cable version' — the really soft-core product — anymore," says Michael Klein, president of Hustler TV and its parent LFP Broadcasting.

As explicitness has become more prevalent, adult content sometimes dispenses with story lines. That's caused "a huge split in the industry over recent years," says a veteran script writer in Los Angeles who goes by the "nom de porn" Raven Touchstone. "The 'gonzo' movies — those with no script, no plot, done on a shoestring — are just nasty sex scenes tied together by a concept [like school girls or Asian girls]," she says.

The production community has also become unsettled. In the pay-per-view world, programmers could lock in an entire channel from operators. In the VOD universe,

"it's much more competitive," says media analyst Dennis McAlpine, managing director of McAlpine Associates. "Each program has to stand on its own economically."

DIRECTV PLAYS THE FIELD

Newer players are hoping to capitalize on the fractured competitive landscape. Among them are two services aimed at women, Inpulse TV and 2 Hearts Entertainment, along with stalwarts in the men's magazine business, Penthouse TV and Hustler TV.

The satellite sector also is contributing to the changing fortunes of adult programmers; you only had to listen to two recent quarterly earnings calls to understand why. On Nov. 7, New Frontier's Pay TV group reported a 14% gain in revenue during its second quarter ended Sept. 30, to \$12.2 million. In contrast, Playboy Enterprises' domestic TV revenue was down a whopping 19%, to \$20.5 million quarter to quarter, offset by stellar performances in overseas sales and online. Both companies attributed the reversal of fortune in the U.S. to DirecTV. Last April, Playboy lost its exclusive lock on the satellite platform. Before then, no other erotic channel was carried by DirecTV, which devoted five channels to programming from Playboy and its Spice Digital Networks. DirecTV has since cut Playboy back to two channels, and inked two-year affiliation agreements with New Frontier's TEN and TENClips channels.



Inpulse's Kimberly Wilson (l.) and Shirley Rohn-Saito.

Playboy decided to turn up the heat by revamping its Spice on-demand offerings, streamlining what had been nine channels into four distinct brands, including clubjenna, which showcases legendary adult star Jenna Jameson, whose company

Playboy purchased recently. The rebranding, in the works for a year, was one of the first big announcements from Bob Meyers, whose appointment to president of media at Playboy coincided with Griffiths' departure in September. (At a Credit Suisse media conference Dec. 7, Meyers said that Playboy still lacks buy-rate information from operators indicating how well the new strategy is working. That information is expected in early 2007.)

New Frontier spun the Playboy news as a sign of defeat in a press release it fired off on the day of Playboy's announcement, Oct. 11, declaring a "daylong celebration." Ken Boenish, president of New Frontier and The Erotic Networks, claims that by streamlining its stable of networks, Playboy actually is spurring more platforms to add TEN channels. "We think Playboy is really throwing in the towel," he says.

Playboy officials explain that none of the content from the nine original channels has been pushed aside; several of the channels were just devoted to differently edited versions of the same programming. The new foursome is much more "user friendly," according to Brian Postlethwait, SVP of adult programming at Playboy. "There's a stronger brand promise and upgraded editing standards," adds Gary Rosenson, Playboy's SVP of sales and affiliate marketing.



2 Hearts' Sandra Staggs (l.) and Anne Aaronson.

Playboy has also put together a new strategy for Playboy TV, and is urging operators to offer customers the linear channel in combination with subscription VOD.

Financial analysts are taking a wait-and-see attitude about both those moves. "The jury's out," says Matthew Harrigan, an analyst at Janco Partners. "It's not a layup in any sense."

PROGRAMMERS SEE THE NEXT WAVE: INTERNET TV

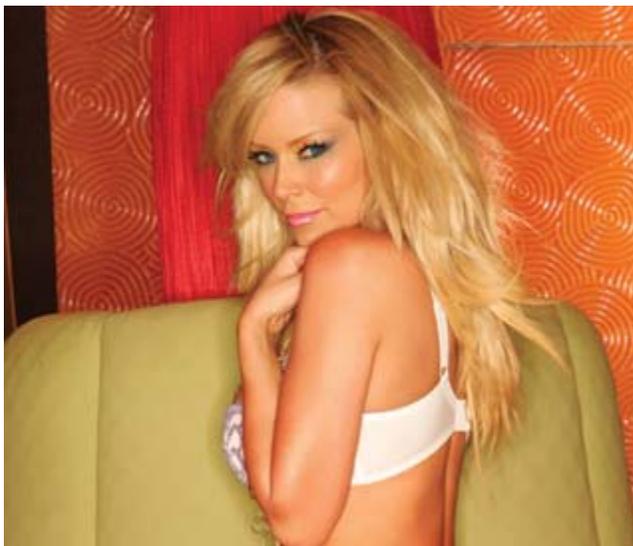
Like Playboy, most programmers in the adult space aren't counting on television alone to generate profits. Kimberly Wilson, founder and CEO of women-oriented Inpulse TV, says her company recently launched its seventh film in the DVD market. "Normally, with other distributors, the wholesalers only order the current release," she says. "But we're getting constant orders for all our movies every month." She takes that as a sign that Inpulse is filling a void for women's adult content.

Wilson's competitor, Sandra Staggs, founder/CEO of 2 Hearts, is eyeing broadband Internet content and a mobile content play. "We're in talks with international companies [about mobile], and looking into what's allowable in the U.S."

Adult mobile content will reap \$3.3 billion by 2011, Juniper Research estimates. However, concerns about adding age-verification features are holding up launches. Hustler's Klein believes it will only be just a few years before American carriers shed their inhibitions.

Just as cable's VOD platform and operators' openness to XX-rated content have tilted profits away from some programmers, mobile and broadband delivery will bring about another wave of change. "I believe in the next five or 10 years, there will be a complete shakeup in the adult business," opines TDM's Lurie. "Internet TV is becoming a reality." With broadband, there's no pesky middleman — and no 90-10 revenue split.

Whether broadband will increase programmers' clout remains to be seen. But it's clear the earnings from "lace and silk coating luscious female flesh" will continue to have a starring — if publicly downplayed — role on cable operators' balance sheets.



ADULT PROGRAMMERS ROUNDUP

HUSTLER TV

Launched: 2004

Ownership: LFP Broadcasting

Distribution: Available in 40 million households worldwide via VOD and PPV

Management: Michael Klein, president, Hustler TV and LFP Broadcasting

Programming: Targets men; available as individual titles as well as three and six-hour blocks

Level of explicitness: XX

IMPULSE TV

Launched: 2004

Ownership: Impulse Digital TV Group

Distribution: 5 million subscribers worldwide via on demand

Management: Shirley Rohn-Saito, chairman/CEO; Kimberly Wilson, founder/CEO

Programming: Targets women and couples; eight titles on offer now, with more to follow

Level of explicitness: Edited to fully explicit/hard core

PENTHOUSE TV

Launched: 2006

Ownership: Penthouse Media Group

Distribution: Pending, starting with VOD; also planning linear channel

Management: Marc Bell, CEO, Penthouse Media Group

Programming: Targets men with high-budget (\$100,000-plus) movies; has almost 600 titles in library

Level of explicitness: NC-17 to XXX

PLAYBOY TV

Launched: 1982

Ownership: Playboy Enterprises Inc.

Distribution: Available in 46 million households; linear premium channel, offered in combination with **SVOD**

Management: Christie Hefner, chairman/CEO, Playboy Enterprises Inc.; Bob Meyers, president, media, Playboy Enterprises Inc.

Programming: Targets men

Level of explicitness: NC-17

PLAYGIRL TV, WICKED TV, CHERIE TV

Launched: Playgirl TV in 2004, available in 17 households, targeting women and gays; Wicked TV in 2005, available in 17 million households, targeting men and couples; Cherie TV, launching soon, targeting men and couples with international content. All channels on demand.

Ownership: Trans Digital Media (Wicked TV is a joint venture with Wicked Pictures)

Management: Geoff Lurie, CEO, Trans Digital Media

Level of explicitness: Mostly XX

SPICE DIGITAL NETWORKS

Launched: 1988

Ownership: Playboy Enterprises Inc.

Distribution: Four on-demand channels available in 100 million households cumulatively

Management: Christie Hefner, chairman/CEO, Playboy Enterprises Inc.; Bob Meyers, president, media, Playboy Enterprises Inc.

Programming: Targets men; recently revamped nine channels, streamlining them to four

Level of explicitness: Various

TEN (THE EROTIC NETWORKS)

Launched: 1998

Ownership: New Frontier

Distribution: Seven on-demand channels available in over 125 million households cumulatively

Management: Ken Boenish, president, TEN and New Frontier Media; Michael Weiner, CEO, New Frontier

Programming: Targets men; 100 hours per channel per month

Level of explicitness: Various

2 HEARTS ENTERTAINMENT

Launched: VOD launch expected in 2007

Ownership: 2 Hearts Entertainment

Distribution: Expects to have 3.5 million U.S. subscribers by the end of the first quarter 2007

Management: Sandra Staggs, founder/CEO; Anne Aaronson, founder, COO

Programming: Targets women and couples; 10 hours refreshed every month

Level of explicitness: Ranges from X to unrated and uncensored