Ad Market: Updating 2018 Forecast To +6.5% Underlying Growth

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BOTTOM LINE: We are refining expectations for US advertising growth. We now call for +6.5% underlying expansion this year vs. our previously published +4.8% forecast. Our new 2019 forecast now calls for +4.0% growth, higher vs. our prior expectation. While growth appears to be exceptionally strong this year, we note that it remains within one standard deviation from what our Personal Consumption Expenditure and Industrial Production-driven model predicts, indicating to us that most of the year's growth will be due to the current state of the economy. We remain doubtful that shifts of spending from non-media-related marketing budgets are a significant factor driving digital advertising growth in particular.

2018 is turning into another strong year for the overall advertising economy, lifted by what are positive current economic trends. Personal Consumption Expenditure growth rates are trending higher in 2018 relative to growth rates observed in 2017, with growth of +4.8% three quarters into this year vs. growth of +4.3% year-to-date at the same point in 2017. Industrial Production is also up by +4.1% through 3Q18, which compares with a similar year-to-date growth rate of +1.2% in 2017. These two economic factors are most tightly correlated with advertising growth, and so we are unsurprised if acceleration of these figures leads to acceleration in ad spending trends. After reviewing publicly media owner ad revenues through the end of 3Q18, we can see that the advertising market is also growing faster than previously expected.

Digital advertising is, of course, driving more than all of the growth. We think this trend is aided to only a small degree by large traditionally distributed brands shifting budget shares away from non-digital advertising. Instead, we think it is driven by ongoing shifts of spending into digital from small businesses, the growth of e-commerce, app developers and direct-to-consumer brands (including those owned by manufacturers of traditional brands). Through the first half of 2018, digital advertising in all of its forms grew by +23% to account for around 45% of all ad spending. Our preliminary estimate is that digital advertising grew at a slower pace in 3Q18 vs. the result recorded in the first half with Google holding relatively steady but with Amazon, Facebook and Oath decelerating among the largest media owners. Television probably grew around +10% including political advertising, or fell by around -1% excluding it, with national TV up slightly, probably similar to 2Q18's sub +1% growth rate. Over longer time horizons, we continue to anticipate an modest underlying rate of decline for national TV because the dominant advertisers on that medium are generally weak. Newer advertisers are not dependent enough on TV to make up the difference. Looking forward, we note that as traditional owners expand their digital advertising activities and as digital media owners push further into "traditional" media such as ad-supported premium TV, the distinctions between these media types will become increasingly blurry, impacting the utility of forecasts for specific media types based on historical definitions of a given medium.

As for other media, whose traditional formats now accounted for only 24% of the industry in 3Q18 (vs. 28% during 3Q17), print is likely continuing to decline by double digit rates. Different types of print media still serve as the primary source of growth for digital media when advertisers using the traditional medium shift budgets into digital. More than $35bn of spending remains on print media. While declines should continue from these levels, not all print budgets will shift to digital so long as related advertising brings some benefits to advertisers using those media. Among other media, radio was soft during the third quarter, with local radio down but national radio up. Local radio can remain a highly effective and heavily consumed medium for the foreseeable future, but unfortunately for its media owners, advertising budgets across all media have generally shifted towards national platforms rather than local ones, and because of that trend, the historical local skew of the industry's ad products cause radio to grow slower than it would have if the medium had evolved with a national orientation. Outdoor has similar issues, but the medium is generally faring better than radio at the present time.

Looking forward, we expect a general convergence of growth between reality and our model's forecast growth. To the extent that 2019 will prove to be a relatively slower growing economy than 2018 (as indicated by the latest consensus expectations from the Philadelphia Federal Reserve's Survey of Professional Forecasters), we would expect some deceleration for next year vs. this year's levels. Still, we think it appropriate to revise our 2019 forecast to +4.0%, better than our model's prior +3.5% expectation. Some of the factors which could cause differences to this forecast could include changes in expectations for overall economic growth, a change in the pace at which more digital ad-intensive direct-to-consumer brands emerge, the health of game developers (as advertisers) and the general pace of emergence of new brands.

Appendix: Important Disclosures

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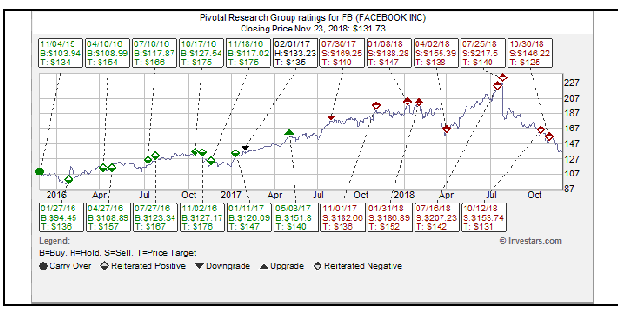
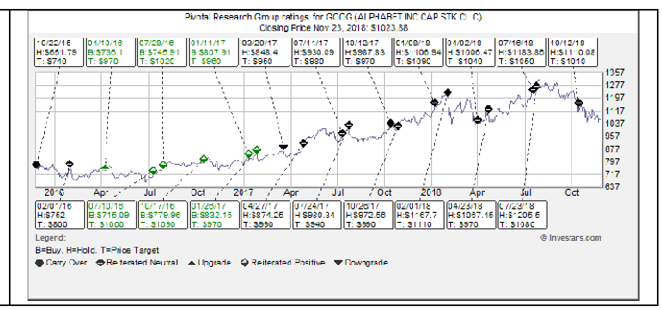
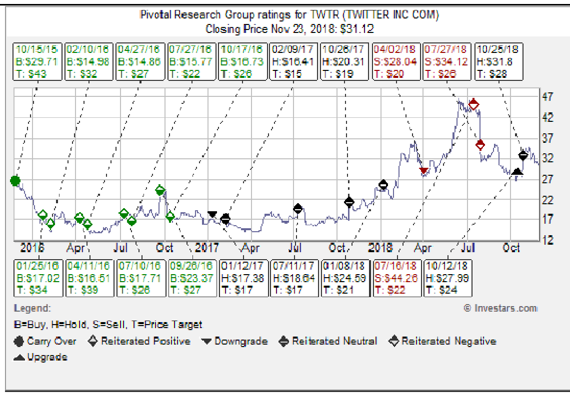
Price Chart and Target Price History






Pivotal Research Group ratings for TWTR (TWITTER INC COM)
Closing Price Nov 23, 2018: $31.12
Legend:
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Carry Over
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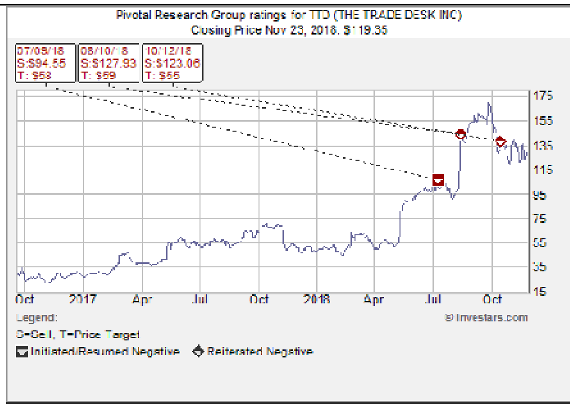
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Closing Price Nov 23, 2018: $119.35
Legend:
S=Sell, T=Price Target
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B=Buy, T=Price Target
Initiated/Resumed Positive
Reiterated Positive
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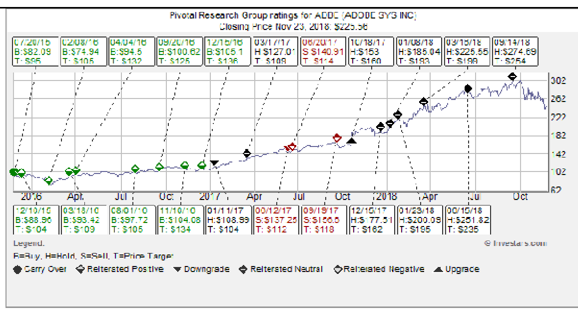
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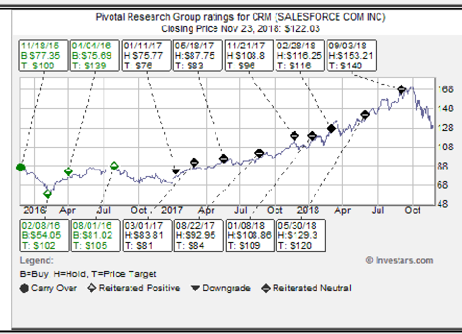
Pivotal Research Group ratings for CRM (SALESFORCE COM INC)
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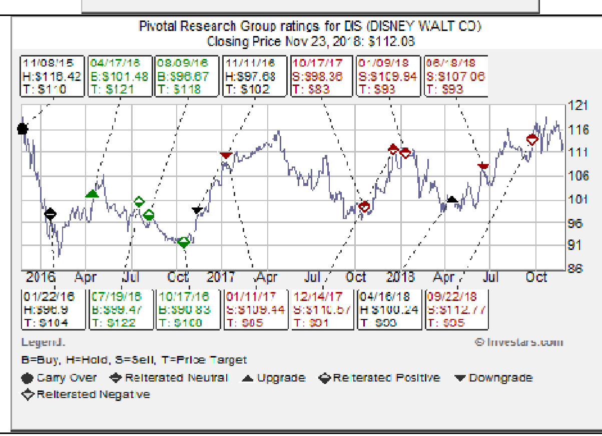
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Closing Price Nov 23, 2018: $112.03
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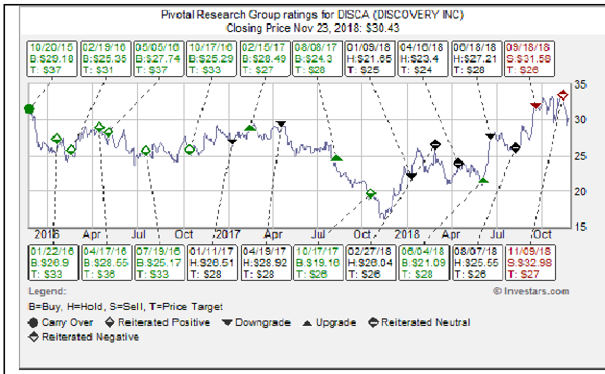

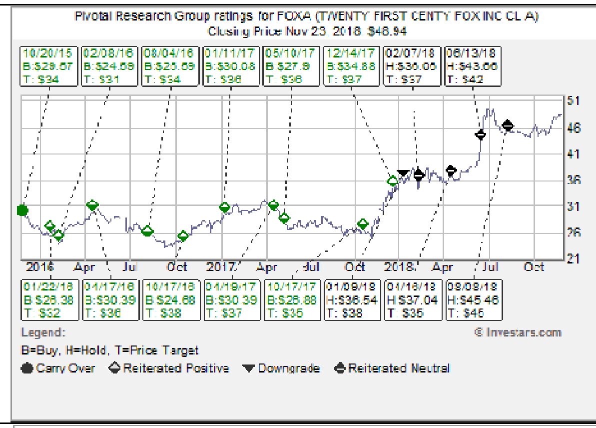

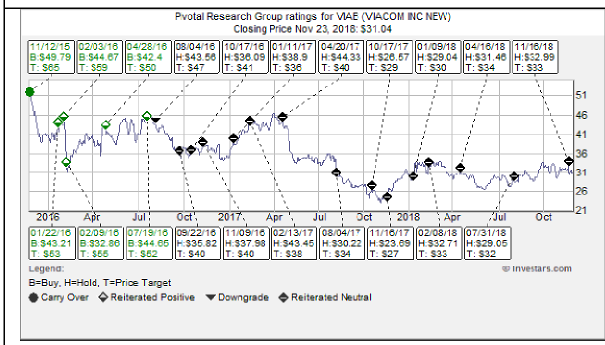

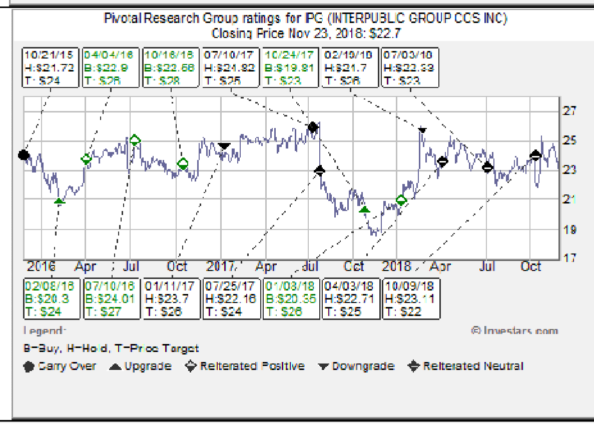

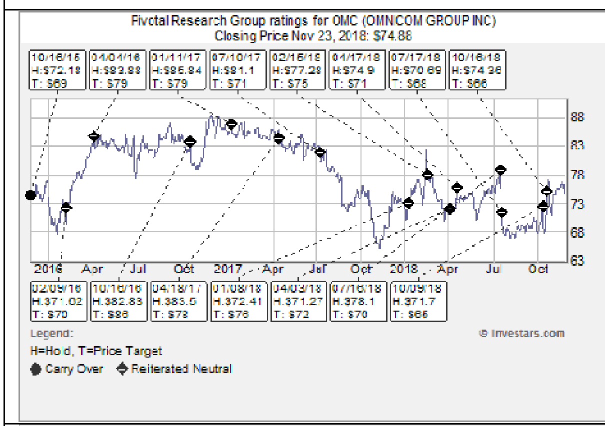

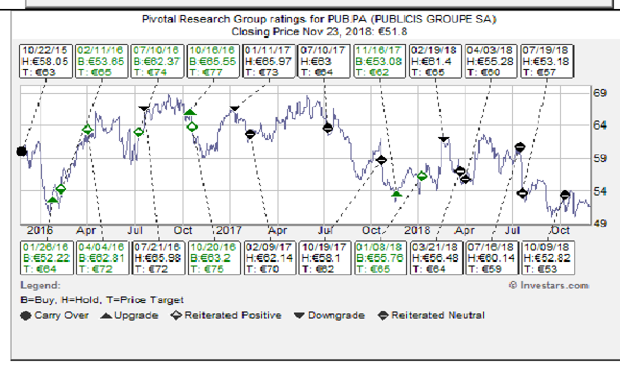

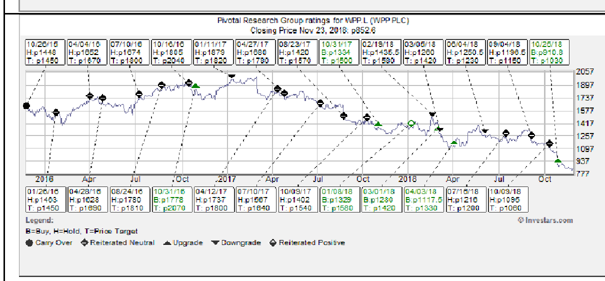

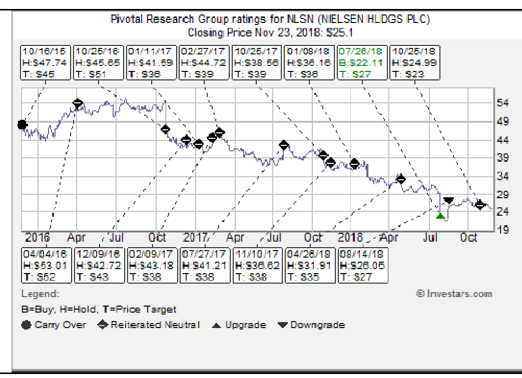

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