

From Digital to Physical: The Growing Demand for Tangible Media Products

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Despite the rampant advancement of digital technologies, we are witnessing a resurgence in demand for physical products and analog goods in the US and the UK. We note this trend in three product segments:

- 1) **Vinyl records:** In recent years, sales have surged and a variety of retailers have again started to sell vinyl records and turntables to capitalize on consumer demand. In the US, however, vinyl sales started to decline in 2016.
- 2) **Stationery:** Some consumers are opting to buy premium stationery because they actively want to own these products rather than because they need to use them. This is boosting sales at premium retailers such as Paperchase and brands such as Moleskine.
- 3) **Books:** Sales of printed books are experiencing a revival, while sales of e-books are declining.

However, these trends must be kept in perspective: the return to vinyl or the renewed appreciation of stationery are likely to remain relatively niche, and the strength of demand could wane. Meanwhile, online retailers and digital media providers such as Amazon will continue to grow.

Introduction

Despite the rampant advancement of digital technologies, we are witnessing a resurgence of demand for physical products and analog goods. In particular, digitally-exposed consumers have regained an interest in tangible products in three media and entertainment goods segments: vinyl records, stationery and books. This report will focus on these three types of products in the US and the UK.

Tangible goods still provide consumers with aesthetic pleasure, a feature that cannot be achieved by a digital screen. As a result, even as music moves to the cloud, vinyl record sales have surged to a 25-year high in the UK. Meanwhile, there has been a reversal of the declining sales trend for printed book sales in the US and the UK, and ebook sales have stagnated.

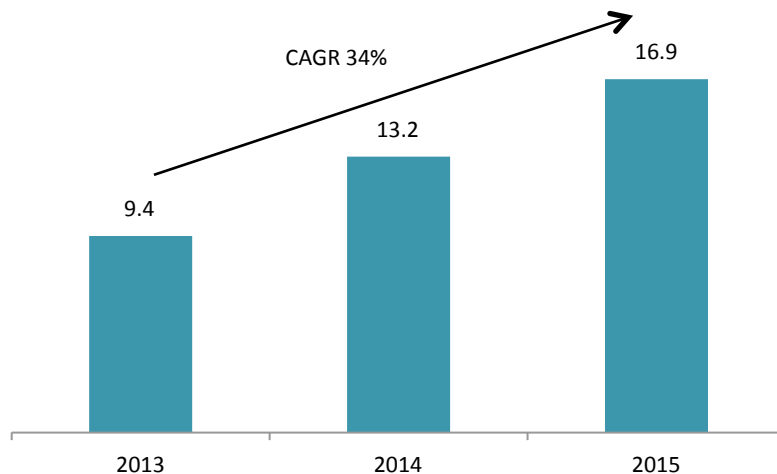
1. Vinyl Resurgence

In the US and the UK, sales of vinyl records have surged. This trend constitutes perhaps the most substantial and high-profile element of the shift back to physical media.

US: US vinyl album sales grew by 32% year over year in 2015 to US\$416 million, according to the Recording Industry Association of America, marking the highest level since 1988. Furthermore, as depicted in the chart below, the number of vinyl albums sold in the US increased by a compound annual growth rate of 34% between 2013 and 2015.

In the first half of 2016, however, vinyl album sales were down 6% by value and 9% by volume, year over year, according to the Recording Industry Association of America. Vinyl single sales were down 24% by value and 28% by volume. These figures suggest that US demand could have peaked.

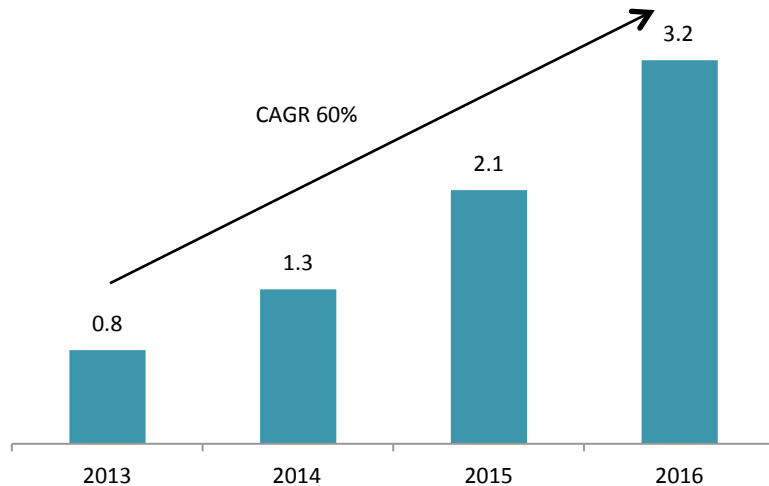
Figure 1. Number of US Vinyl Album Sales (Volume Units, Mil.)



Source: Recording Industry Association of America

UK: Likewise, vinyl sales reached a 25-year peak in the UK in 2016, after increasing over the past eight years. The format faced extinction in 2007, when only 200,000 LPs were purchased. According to music industry body the British Phonographic Industry (BPI), vinyl sales increased 53% year over year to 3.2 million records in 2016, comparable to 1991 levels. Over the past three years, UK vinyl sales have increased by a CAGR of 60%, as depicted by the graph below.

Figure 2. Number of UK Vinyl Album Sales (Volume Units, Mil.)



Source: BPI

Furthermore, UK vinyl sales in value terms outperformed digital album downloads for the first time ever, in week 48 of 2016, according to the Entertainment Retailers Association.

A variety of retailers have started to sell vinyl records again to capitalize on the demand resurgence.

- **Barnes & Noble, Urban Outfitters:** US-based book and gift seller Barnes & Noble, and specialty-apparel chain Urban Outfitters sell a variety of vinyl records and turntables.
- **Amazon:** Online retailer Amazon offers over 87,000 LP titles for sale.
- **Mainstream UK grocers Sainsbury's and Tesco:** Sainsbury's reported in December 2016 that its sales of vinyl records totaled £2 million since it re-introduced the category in March 2016. Sainsbury's says it accounts for 80% of total vinyl sales by UK grocery retailers, and holds an 8% share of the UK vinyl market.
- **HMV:** HMV is the UK's largest retailer of physical music, including vinyl and CDs. According to the company, it expected to sell 1.5 million vinyl albums in 2016, the highest level of sales since 1997.
- **Tiger:** Danish affordable variety-goods retailer Tiger offers one turntable model and a small variety of vinyl records.

The resurgence in vinyl can be attributed to several factors, such as mainstream retailers, including Tesco and Sainsbury's, re-introducing the category, as well as events such as Record Store Day and Black Friday. Many people prefer vinyl records because sound quality is perceived to be better than on other mediums. The vintage collectability aspect of vinyl records has also contributed to the rise in sales.

Despite the resurgence, turntables and vinyl players are likely to remain niche products. Vinyl records account for only 2% of the UK's recorded music market, according to the BPI.

2. A Love of Stationery

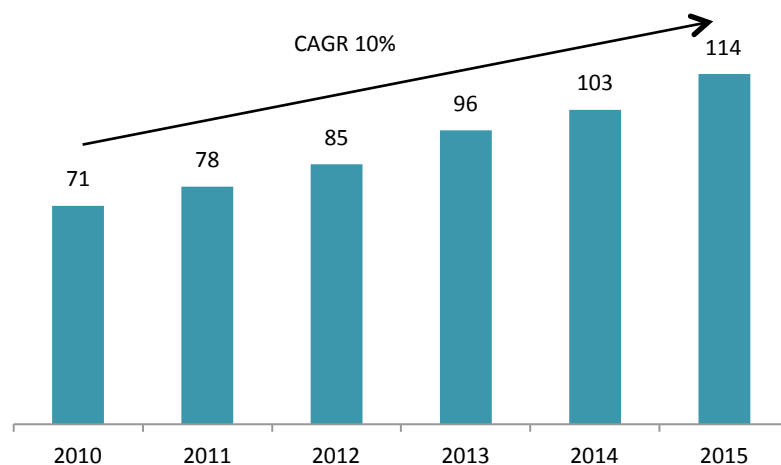
British consumers are showing increased interest in stationery items such as notebooks, scrapbooks and arts and crafts supplies, according to market-research firm Verdict Retail. Drawing instruments and accessories are the fastest-growing categories, and will continue to dominate in the next five years. The sector is also seeing new stationery retailers, such as Australian Smiggle and Typo, enter the UK market.

Growth at retailers such as Paperchase and brands such as Moleskine reflect that the growth opportunities in categories such as stationery have shifted from everyday essentials to desirable, relatively affordable "luxuries." Consumers are choosing to buy premium stationery because they actively want to own these products.

The CEO of UK-based stationery, card and gift retailer Paperchase stated in November 2016 that the greeting card industry was in robust health, and despite the rampant growth of technology, there is considerable consumer interest in traditional items such as scrap books and greeting cards.

Paperchase increased UK sales by 11% to £114 million in 2015, and the brand opened 14 stores in the UK in 2016.

Figure 3. Paperchase UK Revenues (GBP Mil.)

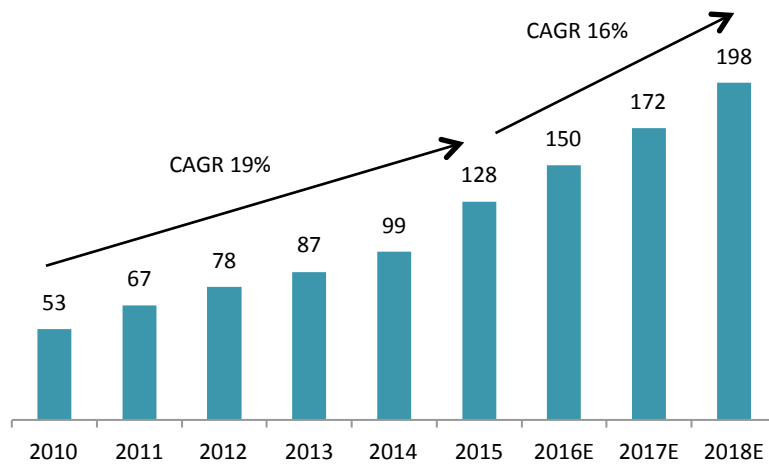


Source: Company reports

Italy-based retailer of premium notebooks, leather goods and stationery Moleskine was launched in the 1990s and has successfully grown through vintage product brand positioning to reach annual sales of over €100 million. Despite leading digital lives, Moleskine leather notebooks and organizers are frequently used by executives and creative types.

Moleskine sells approximately 20 million notebooks annually and grew 2015 fiscal year sales by 30% year over year.

Figure 4. Moleskine Annual Revenues (GBP Mil.)



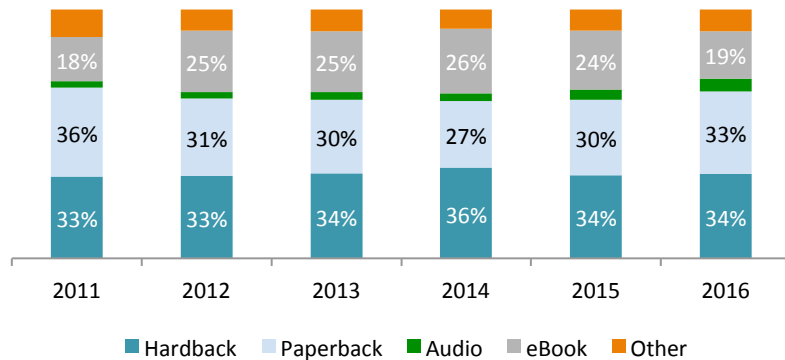
Source: Company reports/S&P Capital IQ

3. Printed Books Come Back to Life

Despite the exponential rise of Amazon, some independent bookstores still flourish, and sales of printed books are also experiencing a revival, while sales of ebooks have started to fall.

- The number of bookstores in the US increased by 40% from 1,651 in 2010 to 2,311 in 2016, according to the American Booksellers Association. Even Amazon has opened three physical book stores in the US, with plans to open two more this year.
- Sales of printed paperbacks and hardbacks have made a comeback in the US market. According to the Association of American Publishers, in the first half of 2016, paperback book sales increased 8.8% year over year to US\$1 billion, and the format regained 6% of market share of book format sales in the past two years.

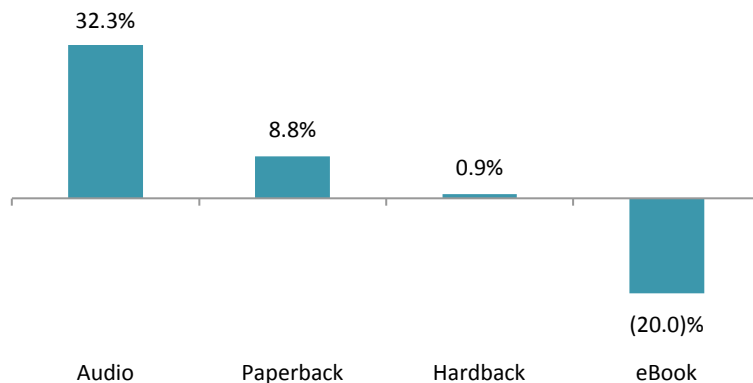
Figure 5. US Book Sales by Format (%)



Source: Association of American Publishers

- US ebook sales saw a declining trend. US book retailer chain Barnes & Noble reported that 2Q17 Nook device and content sales declined 19.4% year over year. In the first half of 2016, US ebook sales fell 20% year over year to US\$580 million, as depicted by the graph below.

Figure 6. 1H16: US Book Sales Year over Year Growth, by Format (%)



Source: Association of American Publishers

- UK printed book and ebook sales show similar trends to the US market. According to the Publishers Association, UK sales of printed books increased 0.4% to £2.8 billion in 2015 (latest), marking the first year in four years that UK physical book sales increased. The recovery in printed book sales was spurred by the popularity of adult coloring books. Six of the top seven non-fiction paperbacks in 2015 were coloring books.
- UK ebook sales decreased by 1.6% year over year to £554 million in 2015, marking the first annual decline in seven years since the industry body started monitoring the digital book market. Furthermore, the UK’s largest book retailer chain Waterstones discontinued selling Amazon’s Kindle e-reader last year.



Key Takeaways

Despite the emergence of new digital technologies, tangible goods still provide consumers with aesthetic pleasure, a feature that cannot be achieved by digital screens.

In particular, we have witnessed surging vinyl record sales, appreciation of premium stationery and a switch back from ebooks to printed books.

However, these trends must be kept in perspective: the return to vinyl or the renewed appreciation of premium stationery are likely to remain relatively niche, and demand could well ease again. It seems undeniable that online retailers and digital media providers such as Amazon will continue to grow and ultimately secure a major foothold in our highly digitized world.



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