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Subject: Board Meeting Jan 2010 (AR) (2).docx
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Leslie: Here are my prepared "remarks" in case you want to read them over. I'm practicing for George Thursday morning.

If you have other suggestions, just let me know.

Carolyn

2010 – THE REVOLUTION HAS FINALLY ARRIVED

For at least ten years people in publishing have been making predictions about when electronic books would replace the physical editions that we have, for decades, been selling through retail outlets. A number of obstacles have held the market back—a lack of consumer-friendly eReaders, difficulty in purchasing the books consumers want to read, and suspicion on the part of authors about the new format. But I think that 2010 represents a real tipping point in the digital revolution in publishing, and that the revolution has finally arrived.

I'd like to quickly review how we got to this point.

Electronic publishing actually began around 1998, when the Rocket eBook and the Softbook were introduced into the market. They were clunky, heavy, and never caught on with readers. Like later eReaders, you pushed buttons to turn the pages, the screen was about the size of a printed book's page, and you could change the type size. But neither device got wide distribution and because Amazon and Barnes & Noble.com didn't sell eBooks, it was difficult for consumers to find books to buy for the devices. Significantly, this is when publishers began to make sure that when we acquired a

book, eBook rights were included as part of the contract. But at this stage, publishers were selective about which books they published electronically because of conversion costs and what were still miniscule sales. So there was limited content available and it was difficult to find.

But the Technology companies were enthusiastic. Microsoft, Palm, Yahoo all entered the market, Palm most successfully. Simon & Schuster worked with Stephen King to publish the first original and exclusive eBook, RIDING THE BULLET, in March of 2000 which, because it was by Stephen King, got immense publicity. We priced the story at \$2.50 and we had 600,000 downloads in two days—and would have had more if demand hadn't crashed several servers, including Amazon's, for a brief time.

But RIDING THE BULLET was the high water mark for quite a few years. We don't believe any single item since has generated that kind of demand and in the years since then publishers began facing all the complexities of the new digital world, establishing a common format (known as ePub) across the industry, digitizing their

backlists, and figuring out how to integrate digital processes throughout their publishing processes for physical books.

So we were better prepared when the Sony Reader was introduced in 2006. Although this was the first major consumer electronics manufacturer to introduce an eReader, it had little impact on sales because it was under-marketed, and there was little outreach to publishers to encourage them to help build the eBook market.

The real growth began in 2007 when Amazon introduced the Kindle. This was the first time consumers could buy eBooks where they were used to buying books—at the Amazon store—rather than at a specialized site like the Sony store.

In addition, publishers were making more titles available—as the creation of eBooks was integrated into the production process, costs declined and every new book was simultaneously published as an eBook at very little additional cost. We also began to clear rights in the backlist, and although there are still discussions about the

proper royalty rate on old contracts, more and more titles have been added to the eBook stores.

Third, the Kindle was wireless, with Amazon paying for the connection, so ordering books became incredibly easy for the consumer.

And last but not least, Amazon down-priced eBooks significantly. It decided that NY Times bestsellers would be priced at \$9.99, even though this meant that it was losing money on each eBook it sold, because publishers were selling the eBooks to Amazon at approximately 50% of the suggested list price (which was usually higher than \$20.)

The Kindle was also the first closed system to be introduced into the eBook market. You could only buy books for the Kindle from the Amazon Kindle store—unlike other eReaders. Amazon was effectively wedding its customers to it by making it impossible for them to purchase eBooks for Kindle elsewhere.

The real jump in eBook sales came last year with the introduction of the Kindle 2, which was faster, thinner, and easier to use than the first Kindle. Amazon took prices down even further, and by now a vast majority of hardcovers are priced at \$9.99 within three weeks of publication. They have been heavily promoting the Kindle on the site, and elsewhere and now claim it is their #1 selling item.

You are probably asking why we have objected to the \$9.99 price if we are not losing money on the sales, and that's because we feel it will ultimately be destructive to our industry. We believe it is destructive to retailers – both the retailer of our physical books, because it creates such a large disparity between the pricing of physical and electronic books, and the eRetailer, because in order to compete any seller must also lose money on sales. We believe it is destructive to authors because it devalues intellectual property, assumes all books are "worth" the same amount, and doesn't differentiate between author, subject, content or timing. And we believe it is destructive to publishers because at the end of the day it takes control of our business away from us and creates the danger of disintermediation as authors, in order to preserve their income, decide they don't need publishers.

Right now the eBook market is completely dominated by Amazon. According to a recent industry survey 48% of eBook buyers have purchased from Amazon.

At S&S, Amazon represent 86% of our total eBook sales.

In 2009 Simon & Schuster's eBook sales with Amazon crossed the \$18 million mark –an increase of 620% in dollars and over 450% in units over the prior year.

Since 2002, when the industry began to track them, eBook sales have grown from \$2.1 million to close to \$150 million – and that is just though just October of last year.) That is growth from less than point o five percent to over 3%. Our growth has been similar: in 2009, eBook sales represented 4% of Simon & Schuster's net sales.

We expect to see growth at least that explosive, if not even greater, in 2010. There are several strong reasons. First of all, we will see

the introduction into the market of real competition for the Kindle – the device – and for Amazon – the retail store. As you heard earlier this week, Apple will be entering the eBook market at the end of March when it launches its Tablet, which has an incredible eReader as part of its software and will begin to sell books in the iTunes store. I have long felt that eBooks would truly take off when consumers had a piece of hardware that they loved for another reason – because it played movies or games or was a wonderful telephone—that also ordered and read books easily. And I believe that day has come. In addition, Barnes & Noble has introduced the Nook, another wireless eReader that in some ways improves on the Kindle—with a second small color touch screen that is easier to navigate than the Kindle – and has redesigned its eBook store. Sony has also introduced a new and improved model, also with some touch screen capabilities, which you will be receiving here. And Google will be introducing Google Edition, which will sell books through its site as well as make it possible for any bookstore to have its own eBook storefront powered by Google. We expect that Google, too, will before too long introduce a device, using its new Android software, to compete with Apple’s Tablet.

So for the first time, eBooks will be widely available from a variety of strong and significant retail outlets across the internet. At the recent Consumer Electronics Show, 23 new eReaders were introduced—many of which we don't expect to survive. Some were dedicated to reading books and newspapers or magazines; some were flexible; some were quite large and others were small; the price points were also all over the place. Just two days ago we even heard about one priced as low as \$99 that is going to be introduced mid-year.

2010 will see a proliferation of eReaders—and a significant increase in the number of popular sites where consumers can easily purchase eBooks. As a result, we expect sales to soar.

We'll also see new and different ways of selling eBooks. S&S, for instance, has created what we call the Author widget, which allows authors to list their books and place them on any website—their own, a site related to their books by subject—and connect them to a retail outlet to sell the titles. For the first time we have the capability to literally take books to wherever the consumer lives.

In addition to expanding the market, Apple's entry into the market will enable publishers to take back control of their eBooks. As I briefly mentioned, in the past we sold eBooks to accounts on the same kind of resale discounts we use with physical books. We will now move to what we call an Agency model, where we are the seller and control the price, giving the retailer a fee to fulfill the sale for us on the terms we set, with no right to discount the prices. Our eBook prices will be rising— we are planning, for instance, to sell NY Times bestsellers for \$12.99 at all outlets.

We think eBooks present a lot of exciting opportunities. They are always available to the consumer and never have to go out of print. Particularly with wireless connectivity, the ease of purchase really enables impulse buying. We can get books to market much more quickly because we don't have to wait to print or ship the book – in fact in the last year we've created two eBook originals for this very reason, followed a month later with physical editions. There is less waste—no returns, little bad debt. And we can form a direct relationship with the consumer, instead of relying entirely on the retailer for that relationship.

And, of course, there are risks. Even with the increase to \$12.99, there is downward pressure on pricing, and our margins actually do not improve under the new models. We always thought with no returns, no shipping and no warehousing we would see more profit from eBook sales, but even though we have a more efficient business, we do not yet have a more profitable one.

Copyright infringement and other misappropriation of our content is one of the major hazards of the digital world. We've seen it with the introduction by the Kindle of text to speech capability—the device “reads” the text to the consumer—which can undermine the author's audio rights. Should the consumer be able to cut and paste sections of the book? And of course there is the danger of electronic versions being copied and distributed across the internet—which is the reason why all eBooks currently have DRM and are not lendable or shareable—which frustrates consumers, but until we can figure out the piracy question, will not change.

But for me the biggest danger from the digital world is the threat of disintermediation. When we published RIDING THE BULLET, Matt Lauer on the Today Show asked me—what does Stephen King need S&S for? Couldn't he have published this electronically all by

himself? Well, the answer back then was “yes, he could, if he wanted to bother.” And that’s true today, too. So more than ever we need to prove our value to our authors on a continual basis. And we need to be alert to retailers who try and get between us and our authors – as it sometimes seems they are trying to do.

And I’d be remiss if I didn’t mention that today still 95% of our business is in printed books and even if this quickly goes down to 75%, which I believe it will, p-books will still be a majority of our sales. So we are still running two businesses simultaneously and we have to make sure both are profitable, both stay at the forefront of what consumers want and how they want it. Not always easy to do. There is inevitable disruption of sales between accounts; difficulties in coming to agreement on splits of digital income with authors, challenges to what format various books should take.

But there are also opportunities for new business models and formats. The Apple Tablet and other new players in the market will make children’s picture books possible. There will be enhanced eBooks—we are talking with CBS News, for instance, about doing an enhanced eBook of Laura Bush’s autobiography, with news footage connected to key moments in the text. As I mentioned, we have

already published instant books—one on the financial crisis, the other on Israel and Iran—and I believe the eBook is the perfect format for a new shorter form of book to flourish. We have published a VOOK, which combines alternating video and text, and I think there will be e other hybrid formats and even new forms of the book that grow out of the new medium. We are already selling chapters on DR. Oz’s new site, askdoctoroz.com—we were the first publisher to do that.

We’re talking about a lot of other possibilities. Will we sell subscriptions to our catalog? Will books become ad supported? Will consumers prefer to rent books to read, rather than own them? And in each of these cases, what happens to our economics?

I believe that the publishing market is on its way to balancing between the physical and the electronic – it wouldn’t surprise me to find eBooks comprising 30% of our sales within five years and there are days when I believe that number could be 50%. Frankly, I believe the number will be determined by the price and expansion of the technology.

That makes this a critical moment for publishing. We’re making sure that we are building our companies so that we have the skills

to navigate the new world, that we are making the alliances that put us at the forefront of new developments, but have to keep in mind that at the end of the day it's the content that matters, and helping our authors get the widest possible audience, in the most profitable way, that is still the ultimate goal.