LINDSELL TRAIN

Something For Nothing

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I recently returned from a revealing trip to San Francisco, home to Morgan Stanley's annual TMT conference and presentations from 200 of America's top technology companies. The mood was one of optimism and the consensus the same throughout: innovation is alive and well, with mobile and social still the trends to watch. As one of Morgan Stanley's analysts summed up "these themes are no longer just buzzwords, they are driving real growth". Apple has just celebrated its 25 billionth app download and Facebook has now signed-up half of the population of North America, the vast majority of whom log on at least once a day.

However, despite the Silicon Valley setting, the conference was also packed with traditional media companies, cable stations and production studios. This is unsurprising; the media industry has always had a symbiotic attachment to technology. Entertainment providers thrive off efficient distribution and in turn, many tech developers would be rendered obsolete without worthwhile content to distribute.

In recent years though, the relationship appears to have soured. With the internet, distribution seems to have become too efficient, too easy and this has diminished consumer perception of the content's value. Most people are comfortable with the idea of buying a CD or a DVD, something physical that can be taken home and that has obviously taken money and resources to create. But digital content that can be duplicated and distributed en masse for next to nothing? Surely this should be free?

This is a concept the media industry has struggled with for the last decade and music, the first on the block thanks to small file sizes, has set a terrible precedent. In the 10 years following Napster's 1999 founding (when movies were still watched on VHS and YouTube was another 6 years away) US music sales more than halved. Now, the same thing appears to be threatening video, with Netflix, Love Film and many other streaming services allowing their subscribers to legally access thousands of hours of video content for a few meagre dollars a month. Is video done for as well?

Well perhaps the situation needn't look so bleak. Increasingly consumers seem happy to pay good money for online media. The most extreme example of this may be the inexplicable popularity of 'digital-only goods' in internet gaming. Nexon, a recently floated Asian online games company, makes 87 billion yen in annual revenues selling entirely virtual goods (weapons and power-ups for example) to its online community. Gamers even pay to upgrade their character's clothes or haircut. This may sound slightly niche, but its recent hit 'KartRider' has now been played by a third of the population of South Korea. Zynga follows a similar model in the US charging players real dollars to buy virtual farm equipment for its Facebook games. Zynga has over 200 million monthly active users, took a billion dollars of revenues last year and is valued by the market at 10 times that amount.

So what impact will Netflix have on video? Well, assuming people really are coming round to the idea of paying for digital content, online streaming services might not be such a bad thing after all. $8 a month for access to a 20,000 hour library of movies and TV shows may not sound much, but this has helped legitimise online video and created incremental revenue streams for media owners. It allows them to monetise old content and even unlocks value from episodic content, traditionally difficult to sell to viewers who've missed the first in the series.

In January, Netflix claimed that its 20 million members had consumed a total of 2 billion hours of video over the preceding quarter. That's an average of 100 hours of online TV streaming per subscriber. In an attempt to satisfy this ravenous audience Netflix has in the last six months cut big money deals with Fox, DreamWorks, CW (CBS and Time Warner's joint venture channel) and several other studios. Great content is the only way Netflix can differentiate itself amongst a sea of competitors and so far it's shown that it's more than happy to pay for it. The Wall Street Journal reported the CW deal alone to be worth over a billion dollars despite being non-exclusive and only containing TV reruns. Likewise, US cable distributor Comcast has just inked a 10 year deal with one of the company holdings in our global equity portfolios, Disney. Having failed to buy it outright in 2004, Comcast is desperate to stock the libraries of its own on-demand TV service with Disney-owned ESPN's genuinely 'musthave' sports content.

Several of the companies we hold are owners of such incredible content that it's hard to see them not benefiting from these increasing monetisation opportunities. ESPN is so popular that Disney is already able to charge its TV viewers 5 times higher subscription fees than any other cable channel. WWE's weekly wrestling show is the longest running and highest rated program on all of US television, pulling in more viewers than baseball, hockey, and basketball combined. International Speedway operates the tracks for NASCAR, giving it 65% of the media rights for America's 2nd most popular sport (behind only the NFL), boasting over 70 million viewers per season.

Certainly there remain issues for media producers to overcome. As customers tire of recycled old episodes they may demand access to newer content online which will eat into DVD or cinema revenues. Serious companies are also starting to get involved and Google, Amazon and Apple all now offer some form of online video service. Each has a large customer base and a history of disrupting complacent business models. If any one of them is able to establish a dominant distribution platform (be it an Android tablet, the Kindle Fire or the iPad) and use this to negotiate cut-price 'broadcast' rights, then this could be a threat to content owners.

Back in August 2010, US pay TV saw its first ever drop in subscribers. This capped a decade of suspicion over the internet from broadcasters, and editorials around the world hailed online streaming as the death of TV. Now however, the mood within the media industry appears to be changing. Rather than devaluing content, tech companies are finally helping producers to realise the opportunities originally promised by online distribution. Last year the total revenue derived from smartphone app sales was estimated at $8 billion. This indicates a growing appetite for new forms of chargeable content with customers paying an average of $3 per app for material that is often freely available elsewhere. Facebook's 800 million subscribers represent a massive base of registered users equipped with well defined preferences, eager to consume and 'like' even more media. Facebook have already begun streaming movies on their web platform.

During last year's Grammys, a million people 'Tweeted' or 'Facebooked' about the show whilst watching it, this year that social audience grew 13-fold. Advertisers noted the engagement and ad slots for next year will be easier to sell than ever. Leslie Moonves, the CEO of CBS (Grammys broadcaster and owners of one of the world's largest TV content libraries) presented at the Morgan Stanley conference and was just as bullish about his company's prospects as any young tech executive. New technologies have boosted revenues, increased the appeal for advertisers and all for the same cost of programming as before. As Moonves says, now is a great time to be a content owner: "content is forever and it will always be possible to make big money from it".

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