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Finding value in turbulence and rapid change

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In a whitepaper on the digital music sector that Near Earth recently added to its online library (<http://www.nearearthllc.com/analysis/Whitepapers.asp>), we argued that in this sector characterized by high fragmentation, volatility, and perpetual change, there is value to be found in “optionality”. By this we meant that as fragmentation facilitates the entry opportunity for new competition (in contrast to an environment dominated by a few well entrenched participants), volatility can enhance the value opportunity for such new entrants (and incumbent operators alike). With a nod to the commonly used Black-Scholes formula, in which option value increases in direct proportion to the volatility of an underlying asset, we suggested that the greater the swings in potential results, the greater the opportunity for industry competitors (in this case, in digital music) to come back from behind, or to be lifted by a rising wave. Which said, we presented our case that the competitors most likely to succeed in such an environment will be those demonstrating, among a number of characteristics, the greatest strategic and operating flexibility to change with changing circumstance, and the greatest potential to participate in eventual consolidation. While our case was made specifically with the digital music sector in mind, it seems that many of the same notions could as easily apply to other “new media” segments in the current investment environment. Below are two additional examples from among many, selected on the basis of recent experience and familiarity by Near Earth:

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- Digital signage. (Please also refer to a prior overview article on digital signage in this newsletter (<http://www.nearearthllc.com/analysis/articles.asp>.) Perhaps even more than digital music, which does include a few well capitalized and publicly held companies in addition to numerous smaller competitors, the digital signage industry is fragmented in every direction. Not only are there hundreds of operators, who for the most part remain focused on isolated market verticals (e.g., elevators, supermarkets, taxicabs, etc.), but dozens of varying business models. While some companies are owner/operators of networks and try to sell advertising inventory to third parties, others instead act as network managers on behalf of network owners, while others still focus on individual aspects of the business (such as content creation, technical support, etc.). There are, in addition, a number of new technology providers and enablers that are enriching the consumer experience and business opportunity through new applications such as blue-tooth enabled impulse purchasing, music downloading, and similar features. Within this rapidly evolving and highly fragmented universe, revenue models are still being defined and the long term economics remain unclear. What seems to us certain, however, is that digital signs will in the years to come increasingly displace old-



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fashioned paper billboards, while outdoor advertising as a whole will probably not diminish. With this in mind, identifying platforms that are well positioned to participate in the sector's evolution and eventual consolidation, and buying in at valuations reflecting such "optionality", seems a reasonable idea.

- Wireless broadband. (Please also refer to another recent whitepaper by Near Earth, on wireless broadband, available in our online library (<http://www.nearearthllc.com/analysis/Whitepapers.asp>).) Driven by many of the same forces behind digital music, digital signage, and other "new media", the wireless broadband segment is rapidly emerging as a result of technological advancement and growing consumer sophistication, both of which are paving the way for new and improved content delivery platforms. While individual business plans vary in their approach – some more reliant than others on spectrum ownership, capital investment, technical innovation, or for that matter consumer market penetration – it is not difficult to imagine a time when wireless (as opposed to wireline) broadband delivery will be the standard form of content distribution. With advantages including speed, mobility, and even cost, the only disadvantage of wireless broadband networks may be their relative upstart status, but communications history has shown that incumbency can sometimes be a fragile advantage. And even though a particular business model or even technical standard may be difficult to pin down at this stage (the emergence of WiMax notwithstanding), there should be high option value in this fragmented arena that is clearly on the rise.

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As previously stated, the selected sectors are not the only "new media" or emerging communications fields in which investment opportunities based on "optionality" may be identified. While digital music, digital signage, and wireless broadband, are each forms of content distribution among many, it seems that the content side itself should be rich with opportunity. (Consider, for example, the rapid trajectory of Facebook as a source of inspiration.) Moreover, the case could perhaps even be made that traditional media also may be a breeding ground for such opportunities. As valuations in the traditional media sector continue to decline (see Near Earth's market indices and corresponding data in this newsletter), reflecting some of the uncertainties and competitive factors described herein, certain assets may reach a valuation point where the concept of option value may not be inappropriate. At some price level, for example, newspapers may be attractive Internet investment candidates, and let's not forget the enormous amount of wireless spectrum (and related tower infrastructure) owned by radio operators in perpetuity.

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