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Special Report

Broadband Billions

These Three Powerhouses Are Here to Say

by Ari Charney and the team of analysts at Investing Daily

There's so much technology-driven disruption underway in the world of media and telecom that sometimes it feels nearly impossible to wrap our heads around it.

Of course, the same could be said about any number of industries. It's now been more than 20 years since the Internet went mainstream and nearly a decade since the adoption of smartphones became de rigueur.

Networked computing coupled with the tiny, but powerful computers that we carry around in our pockets has upended industries, markets and even entire societies.

But the media and telecom arena is generally where the tech sector's creations strike first and hardest. While some companies have been shrewdly adapting to this changing landscape, others are still playing catch-up.

At its core, this competition is all about attracting eyeballs, as well as winning and retaining subscribers.

In some ways, that's become far more difficult than in the days when there were just three television networks, and Ma Bell ruled the wires. We're no longer tethered to any one device or service for our news, entertainment, and communication with others.

Although from a user standpoint, our media consumption has become more diverse and decentralized; a tiny handful of players control the means of distribution.

So even as Internet behemoths such as Google and Amazon enter the fray, the powerful incumbents that own the wires and the spectrum still have an edge on their would-be usurpers.

After all, these are the crucial avenues through which the Internet giants (and everyone else) reach consumers. This edge is so powerful that the federal government has even laid the groundwork to regulate Internet providers like utilities.

Nevertheless, telecom and cable giants such as AT&T, Verizon, and Comcast are hardly resting easy. They've aggressively pushed into areas far beyond their legacy businesses, and all three will soon be involved in providing their customers with access to the Internet, landline and wireless phone service, and video on demand.

But wait … there's more! In their bid for vertical integration, all three companies are starting to create their own content as well. And if they don't have the resources to create their own content in-house or tailor the ads that help them get paid for such content, they'll go out and buy the companies that do.

Consequently, we expect there to be further consolidation across the media and telecom industry, particularly when it comes to content.

That's because high-quality content is a key differentiator: It helps compel consumers to subscribe to all these services and keeps them coming back for more. Equally important, strong content also drives data usage on mobile devices, which helps telecoms rack up fees and pad their margins.

Meanwhile, successful web and video content can also help these companies earn a piece of the lucrative mobile advertising market, an area that's been almost entirely ceded to Google and Facebook.

Future Shock

Of course, when it comes to creative endeavors such as content, it's exceedingly difficult to anticipate what will prevail in the marketplace. Indeed, some movie studios go through a full boom-and-bust cycle every two years.

And it's also almost impossible to know how technology will change consumers' habits over time.

For instance, I recall reading back in 2004 that text messaging was a big deal overseas and that it was expected to take off stateside as well. At the time, I couldn't understand why people would resort to low-tech texting when they could simply give someone a call or send them an email.

These days, however, I immediately get annoyed when friends or family call to coordinate over the phone or, even worse, leave a long, detailed voicemail when it would have been far more convenient if they had just sent a text. In fact, I rarely use my iPhone to make actual phone calls anymore.

I'm what the consultancy Deloitte has dubbed a "data exclusive"—someone who uses their phone almost exclusively for data.

But even tapping out a text can be fairly laborious compared to more image-oriented modes of communication, including emojis, photos and short video clips.

So if I had to predict what's in store for us, I would guess that image- and video-based messaging come to dominate interpersonal communication, while binge-watching immersive, top-shelf content on demand continues to dominate our leisure time.

And that means more fees for access, data, and advertising for our favorite telecoms.

The Telco Triple Play

Powerhouse #1: Verizon Communications Inc. (NYSE: VZ)
Growth Portfolio Core Holding Verizon is hoping to make hay from companies perceived by most consumers as Internet also-rans.

Last year, the telecom giant acquired AOL, a company that had been a punchline for more than a decade, for $4.5 billion. During that time, however, AOL developed two assets that Verizon coveted: exclusive short-form video content that's perfect for smartphone users and a program that automatically targets ads to those watching mobile video.

In a corresponding move, Verizon announced the purchase of Yahoo's core operations and land holdings in a $4.8 billion deal. Like AOL, Yahoo was, for a time, one of the dominant Internet portals of the 1990s, but lost the crown to Google and has long since been a punch line too.
But also like AOL, Yahoo has developed original content and ad technology that Verizon covets and intends to combine with similar assets it acquired from AOL.

Although this latest deal will double Verizon's digital ad sales, the telecom will still have just a 4.4% share of the $187 billion market, ranking it a distant third behind Facebook, which has a 17.2% market share, and Google, which boasts a 35.7% market share.

It's also worth noting that both AOL and Yahoo came with built-in audiences. AOL had about 190 million average unique monthly users prior to Verizon's acquisition, while Yahoo has more than 1 billion monthly active visitors.

Meanwhile, as the No. 1 wireless company in the U.S., Verizon has nearly 113 million customers. And management believes that the insights the company has into these customers' habits and locations at any given moment can help deliver the sort of closely targeted advertising that will help it win a greater share of the mobile ad space.

In the near term, neither of these deals will do much to move the profit needle at this $229 billion company. But over the medium to long term, they could pay off. And even if they don't, Verizon is big enough that it can afford to make mistakes of this size.

Powerhouse #2: AT&T (NYSE: T)
Verizon's fellow telecom giant and Growth Portfolio Core Holding AT&T also reportedly made a bid for Yahoo, though it clearly fell short. Even so, AT&T already made its big convergence play with its $49 billion acquisition of DirecTV, a transaction that made the telecom by far the largest pay-TV provider in the U.S.

The fundamentally transformative deal more than doubled the revenue for the telecom's Entertainment Group segment, which now accounts for nearly a third of total sales. And it also gives AT&T the clout to negotiate content deals that will serve its move into mobile video.

More recently, AT&T acquired Quickplay Media, a firm that provides one of the leading platforms for mobile video, for an undisclosed amount.

The two companies had previously partnered on AT&T's U-Verse "TV Anywhere" service, so this latest move simply gives AT&T greater control over integrating Quickplay's platform with its current and future offerings.

Upon the deal's announcement, AT&T CEO John Stankey remarked, "Our strategy is to deliver video content however, whenever and wherever."

Powerhouse #3: Comcast Corporation (NSDQ: CMCSA

With its deal to stream Netflix's video content on its X1 platform, Growth Portfolio Core Holding Comcast showed yet again why it's one of the shrewdest players in the pay-TV space.

The X1 platform is Comcast's effort to give television viewers a seamless way to experience the same flexibility that they already enjoy online. Clearly, adding Netflix to its offerings goes a long way toward achieving that. The service is expected to debut later this year.

In a sense, Comcast wrote the playbook for telecom and cable's push into creating content with its acquisition of NBCUniversal back in 2013.

That deal gave the cable giant one of Hollywood's Big Six studios, one of the three major television networks, and a dozen national cable networks, among other assets. The division now accounts for about 30% of Comcast's operating profits.

Comcast also moved to expand its content portfolio with a $3.8 billion all-cash bid to acquire DreamWorks Animation SKG Inc.

With NBCUniversal, Comcast already owns key children's film franchises such as "Minions" and "Despicable Me." My wee one goes wobbly for "Minions," in particular.

This latest deal adds DreamWorks staples such as "Shrek" and "Kung Fu Panda."

Comcast also gave another sign that it's getting more serious about launching a wireless service, which would give it the highly coveted quad-play. The firm recently appointed one of its top sales executives to head its nascent mobile division.

Previously, Comcast had given Verizon notice of its intent to piggyback on the firm's network. And it could also bid on this summer's FCC auction of wireless spectrum.

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