Privcap/ Report

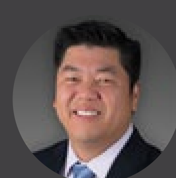
DEALMAKER ROUNDUP

Investing Behind the 'Democratization of Media'

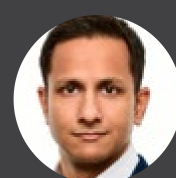
EXPERT DISCUSSION

- Why content catalogs are hot
- The expanding use of music
- Video games at the center of convergence
- Enabling e-commerce

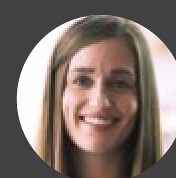
FEATURED EXPERTS:



Victor Kao,
RSM US LLP



Ripan Kadakia,
Partner, ZMC



Julie Kelly,
RSM US LLP

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> "There's certainly a lot more science and rigor around how you predict the value of music IP."
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> –RIPAN KADAKIA, ZMC

Privcap: In the media business, there historically has been a classic tug-of-war between distribution and content. How has that evolved in recent decades?

Ripan Kadakia, ZMC: One of the media mega trends is the fragmentation of the distribution landscape. Over the last 30 years, we've moved from a world where you have a handful of national broadcasters and national radio stations to the current time where you basically have, to quote the Springsteen song, 57 Channels and Nothing On. It's thousands of channels between VOD, cable, etc. As a consumer, you've got a lot of choice and that fragmentation has led to content creators and distribution networks differentiating by the content they have.

We're seeing a boom in content spending as each one of these end points tries to have unique, special content to draw audiences. So, you see Netflix making headlines, spending something like $120-plus billion on content just this year alone to stem that increase in fragmentation.

For us at ZMC, we've played this by an investment in a business called 9 Story Media, which is a play on kids' content. As the world gets more fragmented, kids' content—which tends to be more evergreen and durable—is something all these distribution end points are going to seek out.

You see HBO buying "Sesame Street," you see Disney+ quickly becoming a top streaming platform, you see Netflix continue to license and produce their own kids' content.

Privcap: Julie, you have seen an uptick in interest in the rights to songs, movies, TV shows, right?

Julie Kelly, RSM US LLP: Content is being created all the time and posted instantaneously through all these distribution channels, whether it be through Spotify or Apple music. So, we are seeing a huge uptick in song catalogs being attractive. Two huge majors have purchased Paul Simon's catalog, Bob Dylan's catalog. You're seeing other private equity firms get involved as well by buying masters. There is a guaranteed return on already-established content and as such existing franchises are going up for bid.

Privcap: The traditional barriers for getting content from the creator to the consumer are falling down. Does that give greater economics to those who own content and those who create content?

Kadakia: Yes. The trend that Julia was speaking to is an example of the desire to own proprietary and unique content and have an engine to continuously produce it. We're seeing that in video, certainly with the "streaming wars." You're seeing that in audio with Spotify, in the investments they're making in podcasting and the eye-popping deals they've been signing. For sure, the value is

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being shifted more toward the content owner. The adage that “content is king” is truer now than ever. Certainly, you can see that through the investment activity and the amount of money being spent on it.

Privcap: Are these catalogs viewed as collections of IP or as operating businesses that can be optimized?

Kadakia: 9 Story Media, our kids' platform, is a combination of a studio that's producing content and also production on an outsource basis for other content creators. From that perspective, it's a hybrid business. It's not a pure IP business. It was a business primarily focused on the Canadian marke. We've now extended that business globally. They're now supplying the Netflix and the Disney. We definitely view it as an operating company. One of the handful of advantages they have is some proprietary IP and that's how we've played it. We've seen our peers look at content in a purer form and raise specific funds that focus on that asset class. As opposed to buying operating companies, they're buying IP rights and creating a portfolio of those, whether they be audio or video. We've seen more interest in that. We've also seen many businesses like Hypnosis and Downtown effectively act like large holding companies. So, you're seeing a blend between investing in pure operating companies and investing in pure IP.

Kelly: In some cases, entities purchase content and enhance it. They're taking a catalog that perhaps didn't perform well, but then remastering it so they can monetize that further than what the original artist or content producer may have experienced initially.

Privcap: Is it becoming clearer how to monetize portfolios of IP? Obviously, at the height of the Napster era, there was a question of, would people ever pay for music again, to use music as an example. Are the paths to monetization clear enough that a private investor can underwrite and predict the future cash flows of a content catalog?

Kelly: It is becoming clearer. There still is some uncertainty, but the valuation of catalogs is becoming more systematic. It is more of a predictable model.

Victor Kao, RSM US LLP: There are a lot of different ways to monetizing now because media has evolved into so many different mediums. Think about music, for example, music—those YouTube stars are playing background music on their YouTube channel, and people are wanting to know, what's that song you're playing in the background? People are not necessarily listening to music as much as they used to, but music is being played in the form of video now. When you think about all the different collaborations happening and entertainment converging, you can monetize content in different ways than you were able to ten to fifteen years ago.

Kadakia: We see a similar trend that Julie alluded to. There's certainly a lot more science and rigor around how you predict the value of music IP. Whether you're a publishing house or a private equity firm, there are more tried and true valuation methods. The part that becomes trickier has been the idea that you can buy this catalog and it's under-utilized and you can embed it in more video content, you can embed it in video games, etc. That's a tougher thing to quantify, but not impossible. As a result, with the values that a lot of these catalogs are trading at, we haven't been able to find assets that generate the kinds of returns we typically target.
So, our approach has been to look for derivative plays that benefit from the value of IP and streaming and try to invest in those. As an example, we've been looking at technology to help make the royalty collection process more efficient. In general, the typical musician is paid inaccurately and slowly because of the way the royalty ecosystem works. But there increasingly is a technology ecosystem emerging to help alleviate that. We've been looking at and making investments in those types of businesses that benefit from the overall demand in streaming and hopefully generate slightly better returns. We'll see if we're successful in doing that. We're very much in hunting mode at the moment.

Privcap: Let's talk about another type of convergence taking place, which is the blurring of lines between media and what can broadly be defined as software. Victor, walk us through how many people who perhaps invested in media companies as defined 20 years ago are now essentially investing in businesses that provide software, but act like media assets.

Kao: Video gaming is becoming a huge element of the media and entertainment ecosystem. Video gaming has a software component in the sense that

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these companies need to think about developing this software, producing the game and distributing it through the ecosystem.

Kadakia: ZMC is unique in the private equity world in that, in addition to our fund that we manage, we also manage a public company, Take-Two Interactive, a large global gaming publisher known for Grand Theft Auto and NBA 2K. That's something we've been managing for the last 14 years. My partners have deep knowledge in gaming and the intersection of gaming and media. Not only is the content valuable, but it's creating sports leagues, betting environments and adjacent media content around it. Through Take-Two, we were investors in Twitch in the early days. It's been interesting to watch that ecosystem evolve.

Privcap: A lot of people assume that this gaming is the realm of venture capital. But are there opportunities for private equity firms focused on more mature businesses to get involved?

Kadakia: One of the challenges we found is that the publishers themselves control a lot of the rights and the rules of the game. So, it's tough for us to get involved, unless those publishers are looking to take on private investment. But that dynamic may change.

Kao: Private equity firms probably do want to take a hard look at gaming, given the increased monetization. The culture of younger generations is surrounded by video gaming. Look at the increase of users who are now watching Twitch—during the pandemic, it doubled from 3 billion to 6 billion hours. For a platform like Roblox, which is targeted to 10- to 16-year-olds, there's 9 billion hours consumed on a quarterly basis. Video gaming and e-sports is becoming a culture—it's more and more important to understand how to monetize it. It's even bigger than just seed, angel or VC money. There certainly is a lot of monetization that's about to happen in the space.

Kelly: Fortnite is now doing a concert series. They have artists come in, and they're in the Fortnite world. They have their avatar and it's like you're at a concert. There are so many different avenues for monetization within gaming.

Privcap: Ripan, you have used the term, the "democratization of media." What does it mean?

Kadakia: The cost to create and distribute content is going down as technology continues to improve. We're living in a world where anyone can be a professional creator. You don't have to work for The New York Times to have a platform. You don't need a record deal to distribute your music. You don't need a radio platform to speak. All you need today is internet access, a digital device and the willingness to do it. The term "creator economy" is used to describe this phenomenon, but there's this entire ecosystem of people who have personal passions who can now turn those into

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careers. You've seen companies like Patreon and Substack and WordPress become fairly large technology platforms to enable these creators.

So, what are the opportunities now available to people that weren't available 10 or even five years ago? We've played this a couple of different ways. One is we have an investment in a company called AdThrive, which is a monetization platform for bloggers. So, if you're passionate, if you're a gamer and you create content around gaming—10 years ago, that generally fell on deaf ears or at least it wasn't something you could do for a living. Now, our platform allows these creators to create written content hosted on their website. Then, we monetize it for them by helping them navigate what's now a very complicated digital ad ecosystem to a huge market. There are millions of bloggers globally and growing every day. Our platform has now allowed them to turn that into a real career.

We have a similar investment—a business that allows small retailers to live stream and sell goods through video, like a next-generation QVC. The barriers to either commerce or advertising have really fallen, and we've been trying to play it through some of these types of investments.

Kao: Private equity firms certainly are familiar with valuations of software, and they understand that software is highly scalable. Video gaming is no different. It's a highly scalable platform, but then you merge that with media and entertainment. Those two in combination create a massive opportunity. It is easy to dismiss video gaming – initially, we did. But now we're the only firm who has a specific sub-sector on video gaming and e-sports.

Kadakia: We've been trying to invest behind the theme of "commerce enablement." We always viewed media and commerce as intricately involved with each other and, as one moves online, so does the other. Commerce is still early days in online penetration. The pandemic, for better or worse, has accelerated adoption and certainly shown a light on commerce and that ecosystem. Setting up an online store is easier than it was 10 years ago. But successfully operating one is very challenging. There can only be so many direct-to-consumer t-shirt companies out there. Differentiating your platform, figuring out what tools to use, how to take payments, and what platforms you want to utilize are all complicated. So, we've been focused on that ecosystem. We have one investment in that space and are looking to make others. That's a big trend that we think is going to be around for the next 10-plus years.

This report is based on a recent Privcap webinar. View the program here