FORSYTH BARR

FOCUS

SPECIAL REPORT

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Accelerating the digital revolution

Lockdown measures around the world have forced many people and businesses to change how they communicate, how they buy and sell goods and services, and how they spend leisure time. While we expect most will largely return to previous ways of living and working once restrictions are lifted, we do expect some lasting changes.

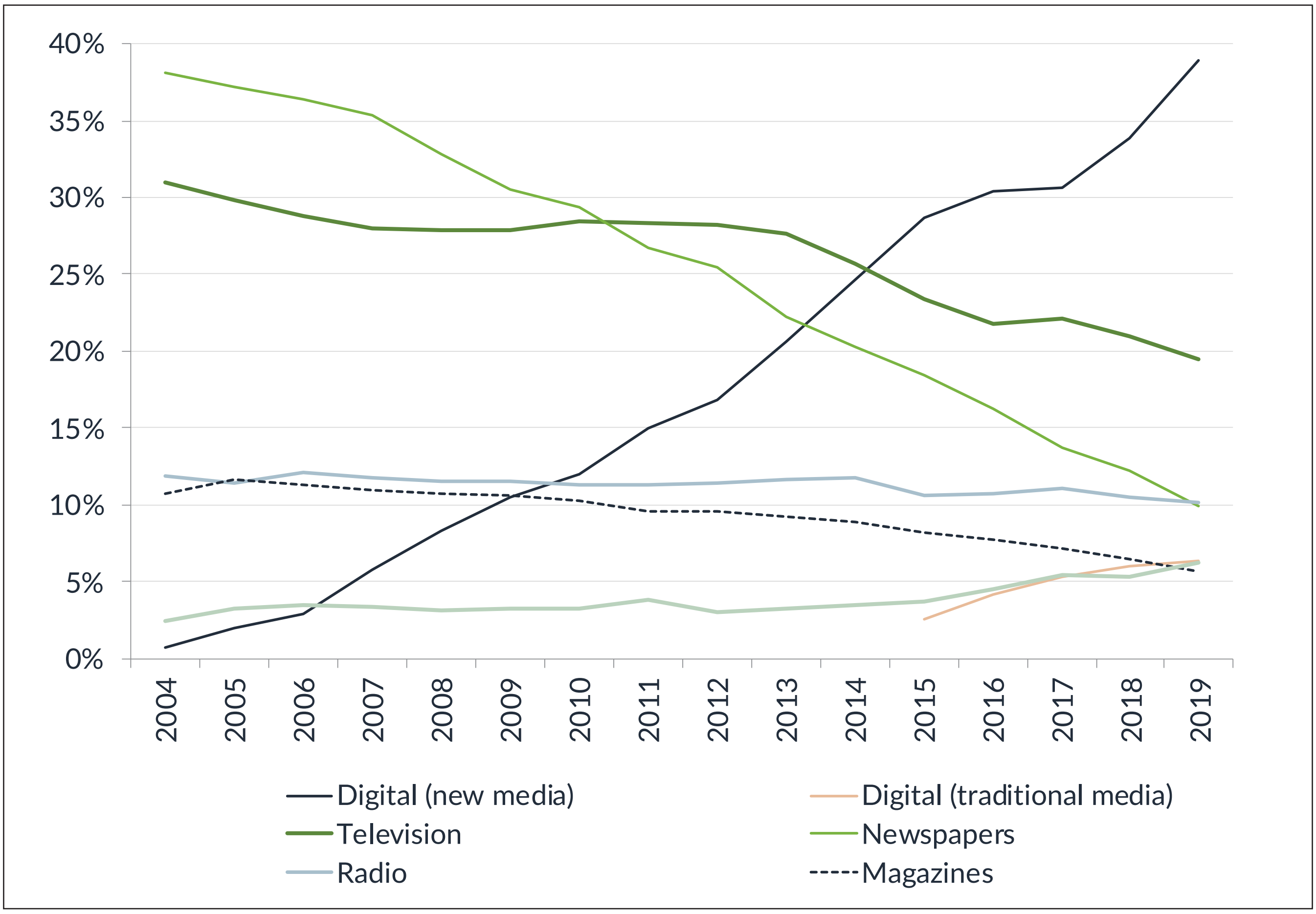
The shift to digital is clearly not a new trend. Technology has been the clear sector winner over the past decade. But the current crisis has only accentuated that trend. Microsoft CEO Satya Nadella summed it up: "We have seen two years' worth of digital transformation in two months".

Restrictions on travel and social interaction have forced pretty much everyone — governments, companies, schools, and individuals — to embrace digital. Many changes have delivered productivity benefits and will prove enduring. Companies are now more likely to move their information technology to the cloud, and have staff working from home. Households are more likely to consume digital content and shop online.

Old versus new media

One surprise through the lockdown has been the resilience of digital advertising revenue. Advertising is the principal form of revenue for tech giants Alphabet (Google) and Facebook. Digital has been steadily, but rapidly taking market share from traditional channels. In New Zealand it became the largest form of advertising in 2015, surpassing television. Globally, this happened slightly later in 2017, but by 2019 it was larger than all traditional advertising combined (including TV, print, radio).

Share of New Zealand advertising revenue



Source: Thompson Reuters, Forsyth Barr Analysis

Not surprisingly, during lockdown with many businesses shut, overall advertising plunged. There's little point of a business advertising if it's not open to service customers. In New Zealand, providers of traditional advertising suggested revenue was down around 50% over the Level 4 lockdown.

The global tech giants, however, saw nothing like this sort of pullback. While many companies pulled or reduced their advertising, many also shifted more to digital. It obviously helped that people stuck at home were spending more time online. Digital also benefited from its relatively lower pricing, actionable ads (e.g. click to buy), and digital's better ability to measure the customer response (i.e. how many clicked on an ad or made a purchase).

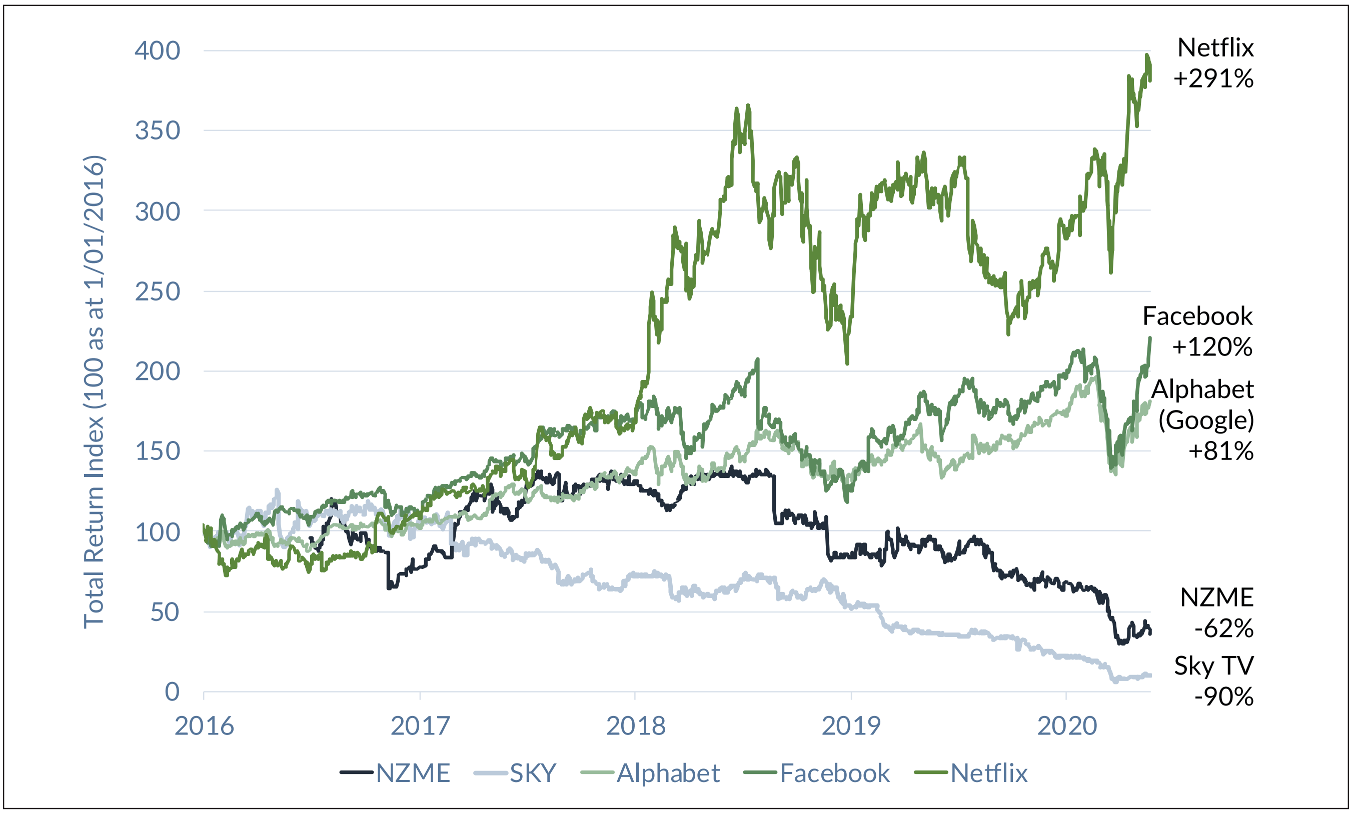
The cost of big tech

Big tech's global scale and dominance of the global advertising market benefits consumers with low prices or, in many cases, no cost. Products like Google, Facebook, and YouTube are free to use.

These benefits, however, do come at a cost. News journalism has historically relied on advertising to pay the bills. As more and more of the advertising pie is captured by tech giants, traditional media are grappling to find a sustainable business model. Not all are succeeding. In the United States, over 20% of newspapers have shut since 2000. The issue is not that people aren't reading the news. The issue is they're doing so online and not paying for it. And the advertising revenue that is able to be generated online is a fraction of what used to be earned from print.

New Zealand's traditional media is not immune. Profits have been falling for years. It's been well publicised that the owners of MediaWorks television business and Stuff, two of New Zealand's larger media businesses, have been looking to exit without success. Pressures have only been exacerbated by the COVID-19 crisis. We've seen job losses and calls for government assistance.

New versus old media: Total share price returns since 2016



Source: Thompson Reuters, Forsyth Barr Analysis

Two important messages

1. We shouldn't take our media for granted

Media's role is to inform and entertain. A healthy and independent media is central to democracies. It keeps people informed and fosters constructive debate. A local presence is important for ensuring local news and issues get coverage. Studies in the United States show that when local newspapers are closed, people become less engaged in their community and voter turnout declines in local elections.

New Zealand is a small market. Much of the revenue that supported our media in the past is now being channelled offshore. We are not alone in wrestling with how to ensure our media industry remains viable. But don't take it for granted that it will be. It's doubtful we'll be just able to rely on the free market to provide a healthy media like we've done in the past.

2. Keeping abreast of changing technologies is critical to investing

Media is a case study in how industries can change rapidly. As legendary investor Warren Buffett, once a big fan and owner of newspapers, said "the world has changed hugely". Newspapers have gone "from monopoly to franchise to competitive to … toast".

The defensive moats of these once strong businesses have been steadily eroded away. Consumers can now instantly access news and other content over the internet from anywhere in the world, and often for free. And global tech giants are gobbling up the lion's share of advertising revenue.

Technology will continue to reshape industries. And COVID-19 will accelerate some of these changes. The attrition rate of retailers who fail to transition to a digital world will likely rise. Increased working-from-home may reduce the need for office space. Will there be greater e-learning or telemedicine? And what about business travel? Will the savings in time, cost, and carbon emissions outweigh meeting in person?

Tracking and understanding technology trends is critical to Forsyth Barr's investment research process to identify both future winners, and today's leaders whose positions may be threatened in the future.

When it comes to investment advice, Forsyth Barr is committed to providing New Zealanders with personal service, supported by technology where appropriate. Your Forsyth Barr investment adviser can be contacted at any time to provide the advice you need, when required.

Matt Henry
Head of Wealth Management Research

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