Investing in the Fragmented Entertainment Industry: Is Safe Better than Sexy?

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If you want to strike it rich in the entertainment business in 2007 and you don't want to take huge risks doing so, you are better off investing in a predictable and perhaps humdrum company that distributes a lot of movies rather than in an edgy upstart that hopes to release one or two blockbuster films, according to a panel of investment experts.

"It's hard to outperform" when you are investing with the belief that your new idea or technology is better than anyone else's, said Howard Lipson, who works with the legendary MTV founder Bob Pittman and is a member of the Pilot Group, a media-oriented private equity firm.

Lipson was one of the panelists in a discussion group -- part of the recent 2007 Wharton Economic Summit -- titled "Hollywood Meets Wall Street: Investing in Media and Entertainment Ventures," where participants discussed, among other topics, the anxiety that some businessmen and investors are feeling in the unpredictable, fast-changing era of iPods and YouTube.com.

Lipson's Pilot Group has, over the past few years, been following a strategy of making relatively safe bets in a media world that has been turned upside down by the Internet and other new technologies, and by the reconfiguration of some longstanding distribution channels.

The company's investments include the Barrington Broadcast Group LLC, a 2003 startup that now operates 21 television stations in 15 economically stable small-market cities; and Double O Radio, a radio broadcaster with a similar philosophy. The company also has a stake in Daily Candy, an online newsletter covering fashion and lifestyle trends in various cities.

Lipson and Pittman met during the 1990s when both men were involved in operating Six Flags Theme Parks, which Lipson held up at the Wharton event as the model of a solid entertainment investment. "The last time I looked, you can't go to a theme park over the Internet," said Lipson, explaining a preference for entertainment investments that aren't so threatened by new and disruptive technologies. "You also have movie theatres, because people still want that out-of-the-home experience."

Another panelist -- William Egan, founder and general partner of Alta Communications, which finances media and other types of growth companies -- was one of several who expressed nostalgia for the older days of entertainment, when a few companies with a lot of capital could control the distribution of movies, TV shows or pop-music records. "A distribution system was just like being a toll collector," Egan said, recalling a time when just three national television networks controlled some 90% of all the TV ad revenue. "I'm for monopolies and oligarchies when I'm investing," he joked. "Now, there are more and more ideas, and more and more places to invest your capital. You need to be smarter and smarter, but you also need to be luckier and luckier."

The age of network dominance was before the Internet and digital technology arrived in the 1990s, which eventually opened up the media to just about anyone with a good digital camera and a YouTube account. The impact of the digital boom may be strongest in the area of music, the panelists said, where fans who once paid $10.99 to purchase a compact disc can now pay 99 cents to buy one favorite song off iTunes. Sales of compact discs -- once a predictable and steady revenue stream -- have plunged. Enders Analysis, a media research company, recently suggested that overall music sales by 2009 will be half their level at the peak of the CD boom.

As for the entertainment business, several panelists agreed thatthe impact of digital technology has been highly uneven. The film industry has still managed to perform well in an era of disruptive technology, although a great deal of the recent growth in revenues has been overseas. Still, with advertising on video already a $2.3 billion market and growing, and with players from Apple to Amazon investing in downloadable movies and related video, Egan and other panel members said thatthe landscape for investors is highly uncertain.

Predicting the Next Hit

The somewhat downbeat tone for the Wharton panel had been established in an earlier session keynoted by Hollywood power broker Jeffrey Berg, chairman and CEO of International Creative Management, or ICM, which represents many of the biggest stars in film and in television.

"It's an industry in severe transition to alternative technologies and delivery systems which are altering the ways in which consumers access programming and content," Berg noted in an interview after his address. He added, however, that "ultimately, our business is driven by the quality of ideas, and it favors those with a high level of artistic expression."

Indeed, that seemed to sum up the dilemma that Wall Street equity investors currently face. According to the panelists, trying to predict the next hit -- whether it's an independent horror film, a new recording group or a popular video game -- entails a high amount of risk in a fragmented marketplace, more risk than many investors seeking a guaranteed return on investment are willing to take.

For that reason, the discussion kept returning to a similar theme: The most successful equity players in Hollywood tend to look for broad-based venues -- a large and comprehensive film library, for example, as opposed to one director's avant-garde film -- as investment vehicles.

Panelist Arthur Bilger is the managing member in Shelter Capital Partners, which invests in new media ventures such as the Ruckus Network, a college-only multimedia service, and Veoh, a fast-growing Internet video service. He said that the breakdown in traditional media distribution channels has also created new opportunities for investment. "In the past, limited distribution meant that a small group of parties caused you to watch what they wanted you to watch. Today, the key is navigation: How does anyone find anything?"

But that's not the only economic issue currently facing the entertainment world. Marc Utay -- a managing partner at Clarion Capital Partners, which invests in the IMAX chain of cinemas, among other media properties -- touched on another when he mentioned the difficulty artists have maintaining control of their work in the Internet age. "A big issue is exclusivity -- the value of assets and whether the producers of content will be adequately compensated," Utay said.

Buying a la Carte

In citing other problems created by the rise of digital entertainment, Lipson noted that, in the past, shifts in technology tended to create enormous economic opportunities because consumers were willing to spend a lot on that new technology -- replacing older albums or cassettes with CDs by the same artists, for example. "In going from CDs to music on your computer, there's no actual replacement," he said. "People can buy *a la carte*, when we had been forcing them to buy a *prix fix* meal."

Another recurring topic among the panelists was the difficulty in investing early in the creative process -- "cherry picking," Utay called it -- for a motion picture or a new idea for a video game, for example. "You don't really know what a movie has until you see it."

Panelist Clark Callander -- a managing director at Savvian LLC, which invests in media ventures as well as in health care and technology -- said investors in the movie business are seeking larger slates of films or film libraries in order to guarantee a more predictable, yet healthy return. Recently, Savvian played a key role in raising the money to launch Legendary Pictures, a joint venture with Warner Brothers that seeks to produce about five or six films a year and has already been responsible for blockbusters like the recent *300* as well as *Batman Begins* and *Spiderman Returns*.

The proliferation of channels on cable TV, Egan noted, has placed a premium on the ability to supply a large amount of content. Indeed, Bilger said he had worked with Turner Broadcasting in the 1980s when the company experienced dramatic growth due to its strategy of buying the rights to a number of classic films that are shown repeatedly.

Today, the vast array of content has made the field much more difficult to navigate. According to Callander, the*New York Times* recently reported that film school in this decade was becoming as popular as business school had been during the Wall Street boom of the 1990s, and that digital technology and the Internet are allowing many to market and promote their wares outside the established networks. "We are entering the world of unlimited content," he noted. "You can have a voice today on the Internet by the time [you are] 18....The democratization of the media has empowered people more than ever."