

Overlooked Opportunities in Digital Advertising

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In the new media ecosystem, it's unlikely that consumers will subscribe to 20 paid television services. So, the vast majority of content will still be ad supported. In our latest podcast, Weatherbie Senior Managing Director George Dai discusses the role of digital advertising in today's modern media landscape and the possible opportunities it may present to investors. Look at aerospace and defense, we see this market undergoing real change as the better companies bring new technologies to this industry.

ALEX BERNSTEIN: Hello. I'm Alex Bernstein and you're listening to the Alger Podcast: Investing in Growth and Change. We've been featuring a series of podcasts on Weatherbie Capital, a subsidiary of Alger that has been in the news several times recently for its style of investing, which focuses on searching for dominant, sustainable growth that can occur in unusual and often mundane places. One theme that Weatherbie believes investors have underappreciated is digital advertising—both in the new media ecosystem and elsewhere. Here with me to discuss that subject is George Dai, Senior Managing Director and Co-Chief Investment Officer at Weatherbie Capital. George, thanks so much for joining me this afternoon.

GEORGE DAI: Thanks, Alex.

ALEX: George, you've spent a tremendous amount of time researching the digital advertising space. What have you discovered?

GEORGE: While the overall global advertising market is growing at the rate of GDP plus, digital advertising is growing at a double-digit rate. Consumers are spending more and more time on the Internet and on mobile phones, and advertisers are following consumers.

ALEX: Investors have already seen a significant shift

from analogue to digital advertising. What other factors do you see driving this continuing shift?

GEORGE: There are several growth drivers within digital. Also, the way that digital advertising is purchased and sold is undergoing revolutionary changes. I'm going to briefly touch upon the three growth drivers within digital and then I'm going to shed some light on the new automated way to transact digital advertising.

There are three growth drivers within digital: one is mobile, one is social and finally, video.

U.S. mobile ad spend grew from 10% in 2012 to 65% percent in 2018 and it is expected to reach 75% by 2022. The reason that we've had such tremendous growth is the time used by consumers on their mobile phones. If you go riding in a subway, you'll see the vast majority of people, especially the younger people, have their eyes connected to the screens in their hands.

Part of the reason that the penetration was only 10% six years ago was because of the limitation of the hardware. Hardware used to entail much smaller screens and connection speed was a lot slower. Today screens are getting ever larger and 5G is going to communicate and transmit the signals of the contents much more readily. Mobile will continue to be a strong driver for digital advertising.

ALEX: Tell us about the trend in social.

GEORGE: Social is only possible with the advent of the internet. People like to see their friends, families and pets on their mobile phone and their desktop and so social has been growing strongly.

ALEX: And what about video?

GEORGE: The shift from traditional television to digital video has been slower than anticipated in the recent past. However, we believe that this trend has hit significant inflection points and the shift is accelerating today, possibly driven by the following two factors. TV is now 50% more expensive than five years ago compared to the 25% price inflation of digital video. In other words, if you were to advertise in the format of digital video, it would actually cost you significantly less.

The second part is viewership. We all know that many Millennials are cord cutting or may never have had a cord in the first place.

ALEX: And who stands to benefit most from this change?

GEORGE: I believe that perhaps a vast majority of the people in the value chain are going to benefit. For example, the consumers are going to benefit because digital advertising is much more targeted and if I have to see an ad, I had better see an ad that is relevant to me. The advertisers are going to benefit because digital advertising is much more effective in reaching the right audience.

Now, there is an old saying in the advertising market: advertisers used to say that 50% of their ad budgets is wasted. They don't reach the right audience and only the remaining 50% are really doing the job. The problem is it is hard to know which 50% is working. Digital advertising allows for much better targeting and data feedback loops than offline marketing. Digital advertising offers much, much better return on investment.

ALEX: George, on one of our recent podcasts, we talked about the new media ecosystem and how some major streaming platforms are foregoing advertising altogether. Do you see this making digital advertising less relevant?

GEORGE: If you look at the average American's budget, look at his wallet, he only has so much money to subscribe to a few of the most desirable streaming television services. But it's impossible for these people to subscribe to 20 paid television or content services.

What does that mean? It means the vast majority of the content will still be ad supported. And that's really good for the whole value chain from the advertisers to the end user and the players in the middle. So, I do not agree

that streaming television on a paid service is going to substantially negatively impact the advertising space at all.

ALEX: Do you think this is solely a Millennial shift?

GEORGE: I think Millennials are definitely leading the trend because they are still up and coming and they're working with a bit more limited budgets. Also, because they're more technology familiar and friendly, they seem to lead the mass market.

ALEX: What kind of company in the digital advertising space excites you the most?

GEORGE: One company that we have studied intensely is one of the few players in the space that we believe is revolutionizing digital advertising transactions. More specifically, it is automating the whole process with the assistance of additional technology as well as data, the tremendous power of data.

Traditionally, if you look at how advertising was transacted, you and I have a telephone call and we say, Hey, you want to place an ad? It will cost you one million dollars, Sunday edition and for one weekend. Two weekends. Then the faxes come into play, then emails. The vast majority of this transaction is manual and does not respond to supply and demand because the data is so slow-moving and the advertisers and the publishers don't know exactly what the market looks like at any given time.

Now, here comes this company. It serves as the demand side's platform. In other words, it is used by companies, advertisers or major ad agencies. The ad agencies serve the function of gatekeeper and demand side aggregators for a lot of these advertisers. These guys are the experts. That's all they do. This demand side platform, abbreviated as DSP, is used by these buy-side people.

They can look at the inventories in the marketplace, for example, on the digital television side or the display side or audio or mobile. They can then, at any second, look at five to ten million potential inventory spots that can be used to insert into their customers' impressions. Then based on sophisticated algorithms, they can pick the right inventory, meaning the spot on the publisher's website, to insert the right impression so that the audience, like you and me, will see that impression.

Let's say I'm trying to buy a set of golf clubs and then when I hit these certain websites, these ad impressions just come to me. This kind of automated way really benefits from Internet-based technology, as well as data, the tremendous amount of data that has been collected over the years, both first party and the third party.

Technology and the Internet have made it possible to collect and rapidly process massive amounts of user data in real time. Integrations of the big data sources together with real-time feedback about consumer reactions increases the ROI for all parties, including advertisers, publishers and consumers. Having the ability to collect data and analyze data and use data to guide which inventory to pick, which price to pay is hugely powerful. That can only be realized in the Internet age.

This whole automated transaction of advertising—buy and sells—is called real-time bidding, or RTB, or sometimes the name of programmatic advertising transactions.

ALEX: When you found this company, did you find it because you were exploring the digital advertising space in general? Or were you more focused on tracking this one company?

GEORGE: We've actually spent quite a bit of time looking at the advertising technology space in the last ten, twenty years. We have historically mainly shorted a few of these companies that had the promise of big potential or that the street believed had the greatest potential, but upon further research, we believed the potential wouldn't be realized. We have had a lot of institutional experience dealing with the companies and technologies in this space. Now, when the company that we currently owned in our portfolio became public, we were there.

ALEX: You'd been tracking it.

GEORGE: Yes. We'd been tracking it, we'd been following it since the IPO and then a few months into it after doing enough work together with the assistance of our past knowledge, we believed that this company was substantially differentiated.

ALEX: George, you mentioned to me that you believe data privacy, which is a concern for investors and consumers, may actually change this media ecosystem in a significant way. Can you elaborate on that?

GEORGE: Recently, at the federal level the Department of Justice and the Federal Trade Commissions have begun launching investigations into four tech giants. They are actively investigating whether these companies have stifled competition and hurt consumers. Not only the U.S. government is jumping into action, but also the European regulatory agencies.

ALEX: In fact, Europe has actually been leading the U.S. in terms of putting in place the proper regulations?

GEORGE: Yes. This GDPR, which stands for General Data Protection Regulation, went into effect in May 2018. It is a far-reaching law intended to give consumers increased control of the use of their own data by the commercial entities. And the GDPR lays out strict guidance for the proper handling of consumers' personal information and levies substantial penalties for failure to meet the standards. The GDPR applies to all EU citizens' personal data, no matter where in the world it is used or stored.

One of the law's key components is the requirement that companies ask users, directly and explicitly, for permission before using their data. Subsequently, the California Consumer Privacy Act of 2018, which was passed on June 2018 and will become effective January 2020, is going to follow the spirit of the GDPR, requiring companies to provide consumers with information about the law, and why and how and with whom the data is going to be used and offer the opt outs for data collection.

What does this all mean? We all know that data without proper regulation is dangerous. Just on the economic side, regulations are going to create many more opportunities and level the playing field for smaller entrepreneurial companies to deliver better solutions and better services to their constituents. The regulations will also make the whole advertising space much more vibrant, much more targeted and allow it to offer even better ROIs for the whole value chain.

I support the proper regulation of the digital advertising space and I believe it's really good for the ecosystem.

ALEX: George, you and the Weatherbie team are working with a focused strategy, so there's ultimately only a limited number of names you can choose for your portfolio. How do you think this theme fits with the Weatherbie philosophy?

GEORGE: Yes, I would say that this really exemplifies the Weatherbie way of thinking, that is flexibility and our willingness and ability to explore areas that are not treaded by our peers or are feared by our peers. This is just one example. We are diligent, we are thorough and we are early; therefore we believe a combination of these factors help us strive for excellent performance.

ALEX: George, thanks so much for speaking with us this afternoon.

GEORGE: Thanks, Alex, for the great opportunity.

ALEX: And thank you for listening. For more information on Weatherbie and the [Weatherbie Specialized Growth Strategy](#), please visit www.alger.com.

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