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FAANGs looking long in the tooth

Exclusive

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When Netflix told investors last week that subscriber numbers in the US market had fallen in the June quarter, chief financial officer Spencer Neumann told investors that it was no big deal.

Investors didn't buy it. The Netflix share price slumped, falling 13 per cent from when the company's operational update was released on Wednesday to close of trade on Friday.

Neumann had told investors that the subscriber fall-off was just temporary. "There'll be some quarter-by-quarter choppiness along the way, based on things like seasonality and content slate and so forth," he argued.

Aoris Investment Management's chief investment officer, Stephen Arnold, didn't buy it, either.

The subscriber numbers, he says, are representative of a bigger shift than mere choppiness: the longer-term decline in the US technology companies known as FAANGs – Facebook, Amazon, Apple, Netflix and Google.

"The likelihood that people will be disappointed with the next five years is pretty high," Arnold says.

Netflix was the first to release its results, but over the next two weeks the remainder of the FAANGs will also reveal their numbers. With growth waning in product areas such as iPhone for Apple and ad revenues for Facebook and Google, Arnold is expecting further evidence of a decline for the technology stocks.

A primary issue for the companies is that the core businesses of FAANGs are in markets that have matured, which means the incredible growth of previous years has run its course.

For Facebook and Google, the primary revenue source has been advertising and Arnold says that is showing signs of a pull-back.

"The online advertising market is slowing and I think those numbers might take people by surprise – that the growth rate for that market has slowed for five consecutive years, and this year will grow at the slowest rate for almost 20 years."

And, like subscription numbers for Netflix, Apple's iPhone sales have been struggling.

For most of the FAANGs, their dominant market position has allowed them to effectively monopolise the market and protect their position. This has been consolidated by control of data, particularly the lucrative business of user information and behaviour.

"The prevailing view is these are the winner-takes-all markets. And the winner has already been decided and the barriers to entry are phenomenal. Now the barriers might be high, but they're not insurmountable," Arnold says.

"I think that's particularly the case with Amazon. Not every retail bricks and mortar retailer has gone bust, and those that haven't gone bust are by implication stronger than those that disappeared. In Australia you're also seeing the traditional retailers put up a big fight."

To replicate their past successes, FAANGs would need to execute on their new blue-sky projects, such as Facebook's foray into the payments market and Alphabet's entry into driverless cars.

But Arnold says the companies will face big challenges in those new areas.

"I think that they're all trying to create disruptive products on the scale that they've enjoyed in the last couple of decades, but I think the likelihood of doing that is very low.

"They're tackling wide applications a long way from their core competency."

Google's entry into driverless cars might allow the company to leverage its artificial intelligence expertise, but beyond that Google is a long way from its core business of internet search, according to Arnold.

Facebook's Libra payments business is another example. "They talk about Libra being a cryptocurrency but I think the currency that really matters here is trust. And they have very little of it."

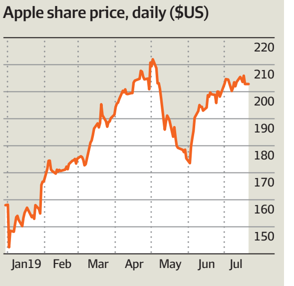
Second, while FAANGs have all demonstrated an ability to dominate a market in an emerging technology-driven area, executing on new, novel ventures will be harder because these companies are no longer the agile, lean start-ups they once were.

The size of these companies and the profitability imperatives that come with maturity have created another problem.

"You've seen now that there's a clash between the commercial imperatives in these organisations and the kind of Californian-leftist ideals on which they were founded.

"I think the idea was 'let's create something fun', and the money making comes later. Well now the money making is dominating the thinking and the foundational principles, idealistic principles on which they were created is clashing internally."

Long tooth



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Aoris Investment Management's Stephen Arnold says FAANGs growth projects are unlikely to deliver. *James Brickwood*