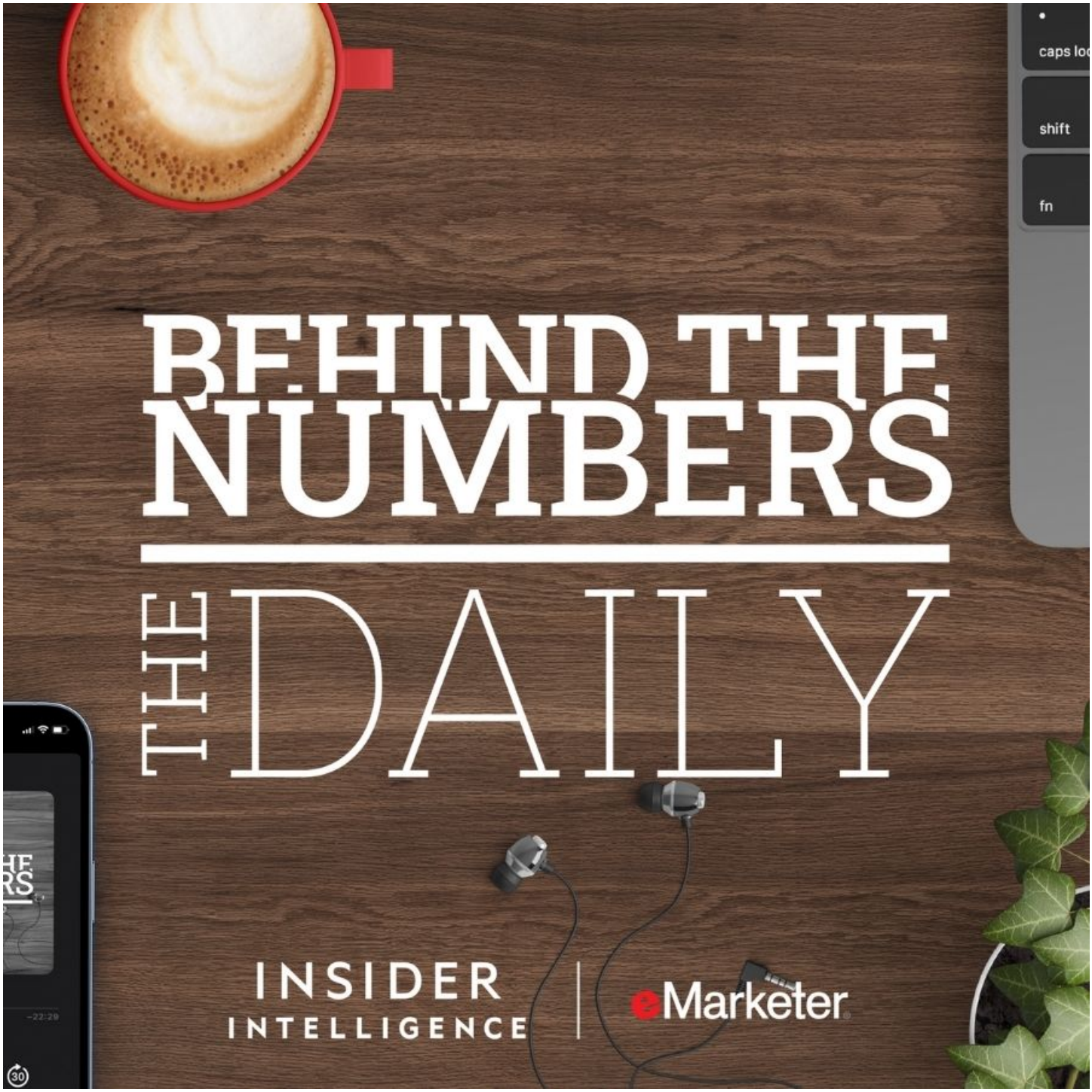
Paul Verna

# The Daily: Why Disney+ is struggling, feelings about enhanced CTV ads, and a new type of in-stream video

Audio

On today's episode, we discuss why Disney+ lost around 3 million subscribers, how much its new ad-supported tier can move the needle, and whether The Walt Disney Co. is more likely to buy the rest of—or sell—Hulu. "In Other News," we talk about how connected TV (CTV) viewers feel about "enhanced" ad formats and what a new category of video called "accompanying in-stream" is all about. Tune in to the discussion with our analyst Paul Verna.



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Episode Transcript:

Marcus Johnson:

Hey gang, it's Thursday, March 2nd. Paul and listeners, welcome to the Behind the Numbers Daily an e-marketer podcast made possible by Meltwater. I'm Marcus. Today I'm joined by our principal analyst who heads up our digital advertising and media practice based out of New York. It's Paul Verna.

Paul Verna:

Great to be here.

Marcus Johnson:

Hello. Today's fact, so it's actually related to Disney. I didn't mean to do this. This is actually completely coincidental.

Paul Verna:

World's collide.

Marcus Johnson:

But Walt Disney's first cartoon character tanked. As Reader's Digest explains Mickey Mouse and Walt Disney, which go together like macaroni and cheese, but before Mickey, Disney had another character. Do you know what this was, Paul?

Paul Verna:

I'm guessing it was probably something that just didn't resonate with people like an aardvark or a slug, I don't know.

Marcus Johnson:

A rabbit.

Paul Verna:

A rabbit, that should have caught on.

Marcus Johnson:

I know. Bugs did pretty well. Oswald the Lucky Rabbit. Universal hired Walt Disney Studios to make 26 shorts starring Oswald. Universal and the cartoon's distributor, Charles Mintz, forced Walt out and took over the rights to the Rabbit series. According to the BBC, Disney's next creation involved no middleman and the mouse as Mickey's popularity ensued. Oswald couldn't keep up, even though the rabbit wasn't successful. Walt Disney and his other creations obviously are.

Paul Verna:

Oswalt Disney.

Marcus Johnson:

It's a terrifying illustration. If you look at what it looks.

Paul Verna:

I'm looking at it now. I could see why between the character and the name. Just not so good.

Marcus Johnson:

Oswald the entirely too intense rabbit. Anyway, today's real topic, Disney.

In today's episode, we'll first cover Disney in the lead, and then in other news, we'll discuss how viewers feel about enhanced CTV ads and a new type of in-stream video ad. But we start with Disney. Paul, Disney+ subscribers fell for the first time ever. For the first time ever, its subscribers fell for Disney+ from 164 million to 161 million quarter on quarter. ESPN+ and Hulu subscriptions did increase, however by 600 and 800,000 respectively. 600,000 for ESPN+ Hulu grew 800,000. However, going back to Disney+ for a second, Paul, why did they lose around 3 million subscribers quarter on quarter, and how concerning is this?

Paul Verna:

Mostly the laws came from the Hotstar service in India, which the company actually recently started breaking out separately from the Disney+ branded service. And the reason they lost customers in India had a lot to do with the fact that Disney was outbid for rights to the IPL, which is the Indian Premier League for cricket. That was what drove down a big part of the decrease. As far as the rest of Disney+, it had very, very slight growth in the quarter, which really amounted to a letdown because the previous quarter they blew past expectations on subscriber growth and Disney+ had that very small increase, partly because it had a price increase during the quarter. There are some dynamics that I think make this somewhat more palatable for Disney than it sounds like. When you say they lost 3 million subscribers and it's the first ever subscriber lost, those things are factually true, but there's definitely a little bit more nuance to this.

Marcus Johnson:

As you mentioned, India, Disney+ Hotstar is the service there. They lost 6% of its subscribers last quarter. Bright spot is average revenue per user, it did increase slightly in the region, so that's a positive. But your points were taken, one of your points, which is that last quarter before this one we're talking about, things were so good that it makes this quarter look really bad. Disney+ adding 12 million subscribers, that's up 40% year-on-year. This is the past quarter, the previous quarter than the one we're talking about. That's six times more than Netflix's quarterly edition. They had such a good quarter before that this one doesn't look so good in context. But Paul, how concerning is this?

Paul Verna:

It's certainly not good that their subscribers fell. They had already lowered their guidance last year. Originally they were saying 230 million to 260 million subscribers, and then they lowered that by about 50 million. It's a tough economic climate, so that doesn't help. Competition is fierce and getting even more intense. And also Disney, like Netflix has said that it's more focused on making its service profitable than on growing subscribers. I think it's concerning in the sense that Disney doesn't want this to happen obviously on an ongoing basis. But if the factors that drove the decreases and the underlying economic conditions and all the other dynamics that are at play resulted in an anomaly, like an outlier for this past quarter and they get back on track, then I don't think it's a huge deal.

It's worth noting that Disney's stock did okay after this earnings report. They over-delivered a bit on revenue. That certainly helped on revenue and profit. Really what it's going to come

down to is the next few quarters are going to be critical. This one was already in the crosshairs of investors because it was the first one since Bob Iger returned and it followed a quarter when the revenue losses were pretty alarming. I guess we can say that Disney pretty much acquitted itself in this past quarter, but we really won't know how sustainable their position is until we see at least another couple of quarters of data.

Marcus Johnson:

Not great that they were struggling in India in large part because India is just such a huge country. It's actually about to become the most populated country on the planet taking China's long-held crown.

Paul Verna:

And they get about 80 million of their subscribers from India.

Marcus Johnson:

Wow.

Paul Verna:

It's a very substantial portion of the subscriber base for Disney+.

Marcus Johnson:

Okay. Wow. Home to 18% of the planet's population. It's a big deal. To Paul's point, they do draw a lot of their subscribers from that particular region. In the US and Canada though, Paul, Disney+ did add 200,000 subscribers to reach over 46 million. That is up slightly. You mentioned the price increases at the end of last year, its monthly subscription went up three bucks from eight to 11. Its yearly plan therefore went up $30 from 80 to 110. How much of an impact do you think that had on subscriber growth and how do you see that affecting things going forward?

Paul Verna:

I think by now price increases have become so normal for people that I don't know if they really inhibit growth that much. It's very hard to make that determination in isolation because you have to look at it in context of every other service, which has also raise prices. But in some cases, prices were already much higher. Disney, and we've talked about this on the show,

Disney started out with a pretty low price point for all of its services for Disney+, for ESPN. That gave it a little bit more runway to raise prices. The other calculus here is that they launched this ad supported plan, which brings in more subscribers at a lower rate. The average revenue per sub subscriber is likely going to drop somewhat as they bring in presumably more customers to the ad tier.

And the other thing that's important is that, again, there's a parallel with Netflix, but up until now Disney has guided on subscribers. They've talked about every quarter they say, "This is where we're at, this is where we think we're going in X amount of time." They have now said that they're going to stop doing that. Again, they're more focused on profitability than on growing their subscriber base. We're not going to get as much color into what happens on a quarter to quarter basis.

Marcus Johnson:

Let's zoom in on the ad part of this for a second, because Insider Intelligence's Briefings writer Daniel Konstantinovic, was noting that Disney+'s new ad supported tier, which they launched at the end of last year, I think it was November time, similar timeframe to Netflix ad supported tier as well. And we have some new forecasts actually that break out how much we're expecting Netflix and Disney to make from their respective ad supported tier. Check them out for your pro subscriber. But he was noting that Disney+'s new ad supported tier failed to drive meaningful subscription or revenue growth. Paul, is this lack of growth so far at least because it's only been a couple of months something or nothing?

Paul Verna:

If you're giving Disney the benefit of the doubt, you could say that the ad product only just launched and it needs time to ramp up. But on the flip side, you could also say that Disney, unlike Netflix, has a lot of experience in the ad business, both on the TV and on the digital side. The bar is higher for them to hit the ground running with an ad business that scales more quickly. Now, Variety surveyed consumers including Disney+ non-subscribers on whether they plan to buy into or downgrade to the ad tier. And the responses were not very encouraging. I think it's fair to say that it hasn't gone very well in the early going, but like I said earlier, with regard to the bigger picture in terms of subscribers, we're just going to need to see how this plays out over the next few months. It is definitely a slow burn. I think Netflix got a little bit ahead of that perception by saying right off the bat that it's going to take a while for that business to scale. Disney didn't exactly do that.

Marcus Johnson:

Finally, Paul on Disney, Robbie Whelan and Joe Flint, at the Wall Street Journal remind us that Hulu is two thirds owned by Disney and one third owned by Comcast Corp. Under an agreement reached in 2019, Disney has the right to buy out Comcast stake at a fair market value, stake in its one third stake in Hulu, starting in early 2024, which is somehow a year away, just a year away. And Comcast also has the right to force a sale of its stake. Disney's boss, Bob Iger, who we have been talking about, surprised folks recently, some at least by saying the company isn't committed to pursuing full ownership of Hulu and that everything is on the table, including a potential sale of its two third stake in Hulu. Paul, I want to ask you why Disney should sell its stake in Hulu and why it shouldn't. Let's start with the why it should.

Paul Verna:

I think why it should is that they are carrying quite a bit of debt and Disney is such a strong brand on its own that they could potentially, that they don't really need Hulu to carry them as a streaming brand. If Disney by the end of this year is in a position where that debt load is really weighing on them and they need to unload an asset, that would definitely be one of them. They'd already pretty much ruled out selling ESPN after the activist investor, Dan Loeb, lobbied for that sometime late last year. That would be one argument toward selling Hulu.

Marcus Johnson:

And why shouldn't Disney sell Hulu?

Paul Verna:

Interestingly, before Bob Iger made those comments that you cited where he basically said everything's on the table, he made a pretty strong pitch on the earnings call for why Hulu is important to Disney. And he talked about the show Abbott Elementary, and he was saying that on ABC TV, the show's audience averages close to 60 years of age, which is pretty much in line with where linear TV is these days, while on Hulu it's closer to 30. I think the suggestion was that the show is catering to a very wide audience, and the audiences on both ABC TV and Hulu are quite complimentary. In other words, Hulu is reaching an audience that Disney on its own or through at least on its linear platforms, doesn't reach. There's also the aspect of the live TV service, which I know probably is not profitable, but it does bring in, it will bring in this year over 4 billion in revenue in the US.

I think there are a lot of reasons why in the same way that ESPN is part of that Disney flywheel that Hulu is doing the same. They also by now have amassed a pretty decent library of content on the TV side and on the movie side. That's something that Disney can leverage. They've always been very good at leveraging those content franchises. I could definitely see some arguments where they get to the end of the year and they say, "You know what? We want this as part of our portfolio," but it would come at a cost.

And I know that speaking of activist investors, there was another effort more recently that was really aimed at cost-cutting in general and was very critical of Disney's acquisition of Fox. Now undoing that was probably not realistic, but clearly that's part of the debt load they're carrying, and I don't think Disney is eager to go into 2024 with even more debt on its balance sheet, which would happen if they buy Hulu. I think there are strong arguments to make in either case. It's probably going to come down to how Disney is performing in the next couple of quarters and what the investor sentiment is toward making another big purchase or just wanting to get rid of it.

Marcus Johnson:

A few reasons why they shouldn't sell, why they should keep it, first of all, in the US, Hulu is the third-largest streaming service. It's got 130 million viewers. That's 40 million behind Netflix, 30 behind Prime Video, and 10 million more than Disney+ according to our forecast crew. Second point here from Daniel Konstantinovic, one of our writers, saying that they could bundle Hulu and Disney+ into a super video streaming app. And then the third point here just goes back to the size of their viewer portfolio or viewer audience, Paul, Variety article, by Todd Spangler, pointing out that if you add up all of Disney's streaming properties, so Disney+, 160 million, plus Hulu, 50 million, plus ESPN 25, gives you 235 million global subscribers. You would match the same number of global subscribers for Netflix and they launched Disney+ just over three years ago.

That is all of Disney's properties wrapped up in that number I just mentioned. They're 235 million for all of Disney's, which includes Disney plus, Hulu and ESPN, but still is it ESPN+? But still, that's remarkable to have all those properties and be able to stack those up against Netflix, which has a similar number. Bob Iger expects Disney+ to be profitable by the end of next year. That's 2024. Other parts of the business, the parts of the business grew revenue over 20% to 9 billion and they had strong box office and Disney+ results as well for Black Panther: Wakanda Forever, which helped Disney through the holiday season as well. Paul,

that's all we've got time for the lead, time for the halftime report. Quick takeaway from you, Paul, from the first half.

Paul Verna:

I think the point you were making about profitability by 2024, that's another big consideration with Hulu because if Hulu interferes with that plan, then it's a broken promise. Nobody wants that to happen. Again, I think it's going to come down to performance and where Disney is at later in this year.

Marcus Johnson:

All right, that's all we've got time for the first half. Time for the second today. In other news, how does CTV viewers feel about enhanced ad formats and what's going on with instream and outstream video definitions?

Story one, CTV viewers feel positive about enhanced ad formats rights. Insider Intelligence Briefings analyst, Daniel Konstantinovic, he notes that fraud concerns and frequency capping issues aside, folks quite like the CTV ad experience, half of Americans are likely to engage with enhanced CTV ads, think QR codes or information like location data to recommend nearby stores according to an LG ad solution study. Daniel notes, almost all the folks in the study said they feel the same or more favorable about brands that use QR codes or store locations in enhanced ads. But Paul, the most interesting sentence in this article is what and why?

Paul Verna:

I think the interesting part is that the survey, or at least the part that Daniel highlighted, is about the enhanced part of the ads, like the QR codes. I think people generally think that that is a value add when it's executed well. But the part that I think is glossed over is the repetitive ads. And I think if you really drill down with people and ask them how they feel about connected TV advertising, considering the repetition, I think that's a real annoyance. And I'd love to see a survey that's a little more holistic and frankly one that's not coming from an interested party, LG being in the CTV ad business. I'd like to see more data. I think it's interesting, but I really think that the repetitiveness is a big problem.

Marcus Johnson:

Story two, what's going on with instream and outstream video definitions. Instream video ads are accompanied by editorial video contents. Outstream ones are unattached to editorial

video, but back in August, the IAB Tech Lab was thinking about redefining these terms to help with visibility, writes Mark Stenberg of Adweek. But definitions matter. You can't just change them on a whim, especially since instream ads can be 15 to 20% more expensive, says ad tech expert Scott Messer. Now the IAB might add a third type of video ad called accompanying instream. You'd have primary instream, their viewer initiated with sound is about five to 10% share of video ads you'd have accompanying instream. Primary instream, then you'd have accompanying instream, autoplay without sound. That's about 40% and outstream absent of any editorial video content that's about 50%. Those three one more time, primary instream accompanying instream and outstream. But Paul the most interesting sentence from this article that being the Adweek piece from Mark Stenberg is what and why?

Paul Verna:

It's when he says in the article that marketers thought they were buying a polished video package, but in reality, we're often buying sticky, autoplay slideshow. That gets at the heart of why this has become a problem. Up until now, there's been this sort of binary approach to it's either instream or outstream, but really there are so many different ways that instream ads exist. I think having a little more nuance into how you define them is important. But it's also worth noting that parsing of the definition is more favorable to the buyer than to the seller. If you're a publisher selling instream ads, really what this does is it takes some of the inventory and puts it into a different category that's less profitable to you or less lucrative. There's going to be more to talk about, but I think overall just having a conversation about how to characterize the different flavors of instream is a step in the right direction.

Marcus Johnson:

And that is all we have time for. Paul, thank you so much as always for hanging out today.

Paul Verna:

Thank you as always.

Marcus Johnson:

And thank you to Victoria who edits the show, James, who copy edits it, and Stuart who runs the team. Thanks to everyone for listening to this very episode. We'll hopefully see you tomorrow for the Behind the Numbers Weekly Listen, this e-marketer podcast made possible by Meltwater.