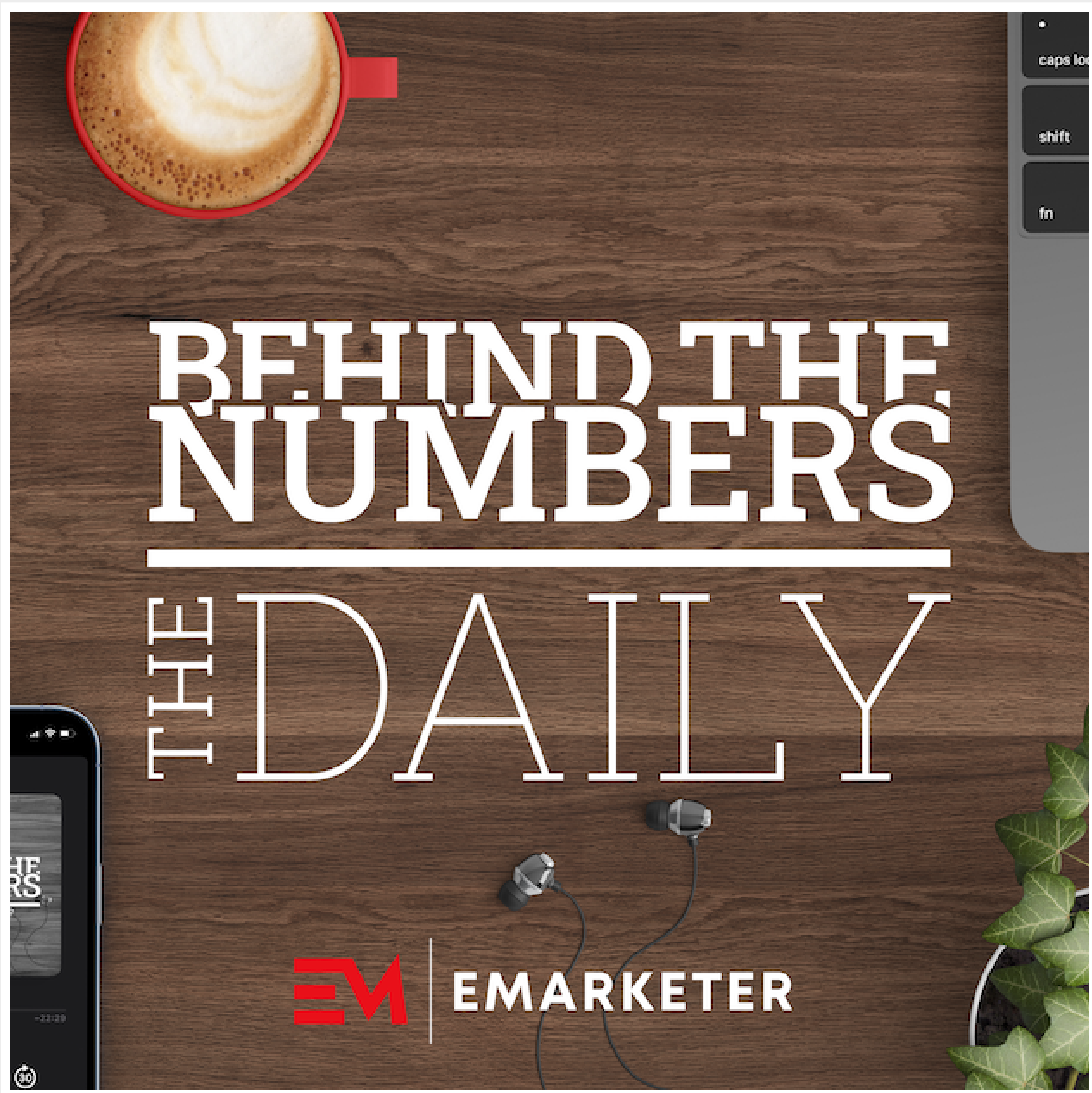
Daniel Konstantinovic

The Daily: How Netflix surprised folks, how much advertising will move the needle, and what its "Next Act" will be

Audio

On today's podcast episode, we discuss why more people just signed up to Netflix than expected, how much of their revenue will come from ads, and what its "Next Act" will be. Tune in to the discussion with our analyst Daniel Konstantinovic.

Subscribe to the "Behind the Numbers" podcast on Apple Podcasts, Spotify, Pandora, Stitcher, YouTube, Podbean or wherever you listen to podcasts. Follow us on Instagram



Episode Transcript:

Marcus Johnson:

This episode is made possible by Walmart Connect. If you expect your media investment to deliver clear, measurable results, Walmart Connect's got you, with powerful analytics and the reach of America's number one retailer. Their closed-loop measurement uses Walmart's proprietary customer buying data to track the impact of your campaign on sales, not only on Walmart's site and app, but in-store as well. For some campaigns they can even offer rest of market data that tracks the impact on sales at other retailers. Check out walmartconnect.com when you get a moment and see how they can help make your media spend meaningful. Walmart Connect, more than media, meaningful connections.

Daniel Konstantinovic:

You could view a lot of these subscribers as previous or existing Netflix subscribers who have resigned through another channel or for just as part of their regular churn. So this could be a sign that they expect the really big growth surge from password sharing to start to die down a little bit.

Marcus Johnson:

Hey, gang, it's Thursday, April 25th. Danny and listeners, welcome to the Behind the Numbers Daily, an eMarketer podcast made possible by Walmart Connect. I'm Marcus. Today I'm joined by one of our analysts who writes for our marketing and advertising briefing. He's based in New York?

Daniel Konstantinovic:

In New York, yeah.

Marcus Johnson:

Okay.

Daniel Konstantinovic:

Hopefully will still be soon because I'm looking for an apartment.

Marcus Johnson:

He's based somewhere on the eastern seaboard. It's Daniel Konstantinovic.

Daniel Konstantinovic:

Hello. It's good to be here.

Marcus Johnson:

Hey, fella. Next time I introduce you, I'm going to have to say based outside, because there's he doesn't have a place anymore. Today we're talking all about Netflix, but we start with today's fact.

Danny, I was stunned by this, but maybe this is a common knowledge in the States. There is one US state where you're not legally required to wear your seatbelt. Oh my goodness.

Daniel Konstantinovic:

Can I guess which one it is?

Marcus Johnson:

What are we doing? I know what you're going to guess as well.

Daniel Konstantinovic:

Is it Missouri?

Marcus Johnson:

Oh, I did not know you were going to guess that. What makes you say that?

Daniel Konstantinovic:

I mean, I used to live there and there were all kinds of weird laws. I think at the time that I lived there texting and driving was technically not illegal. So it's in that vein. It checks out.

Marcus Johnson:

Yeah. No offense, Missouri. You're the worst drivers. I've driven all over the country. You get to Missouri, it's like you're part of a NASCAR race. It's disaster. There's cars flying all over the place. But it's not Missouri. I still love you Missouri, but you're just bad drivers. No, it's not Missouri. Its', V, do you want to take a guess? You want to take a stab?

Victoria Grace:

Oklahoma?

Marcus Johnson:

No. Why Oklahoma?

Victoria Grace:

I don't know. I know somebody that lived in Oklahoma for a short while and just based off of his-

Marcus Johnson:

Bad driver.

Victoria Grace:

Well, just based off of some of the stories he told me, I was like, it's kind of like the wild West out there. I don't know.

Marcus Johnson:

Okay. No, it's not Oklahoma. So yeah, the first federal law requiring all vehicles to have seatbelts came into effect in 1968, but it wasn't until 1984 when New York became the first state to make wearing your seatbelt as an adult the law. Most other states followed, except for New Hampshire.

Daniel Konstantinovic:

Really? I never would've guessed New Hampshire.

Marcus Johnson:

New Hampshire, yeah.

Victoria Grace:

Live Free or Die.

Marcus Johnson:

That's so random. There we go. Yeah, that's it.

Daniel Konstantinovic:

Is that the state slogan? Live Free or Die?

Marcus Johnson:

That's their slogan.

Daniel Konstantinovic:

Live Free or Die. Shout out to my college roommate, Kayla.

Marcus Johnson:

Kayla. What the hell was going on up there? While the state requires that drivers and passengers under 18 wear seatbelts, a law for adults never made it through the legislature. According to a New Hampshire public radio article, the national average for folks buckling up is 90% in terms of those who do it. It's the law everywhere else. In New Hampshire, it's just 70.

Daniel Konstantinovic:

Damn. Or well, dang, excuse me.

Marcus Johnson:

What's going on? However, beautiful state in the fall. So they have that going for them.

Daniel Konstantinovic:

That's true, and you can drive as fast as you want to see all of it. It looks even more beautiful when it's all just one blur.

Marcus Johnson:

At speed? Yeah.

Daniel Konstantinovic:

Yeah.

Marcus Johnson:

Anyway, today's real topic, checking in on Netflix's start of the year performance.

In today's episode, first on the lead we'll cover how Netflix is getting on. No in other news today. So Daniel, we're talking all about Netflix again. It's that time. They just reported on how they did in January, February, and March. And so we'll look at how many people are still subscribing to Netflix, how much money they're making, how that's going, and what the next act might be. And then we'll throw a grade on their Q1 performance at the end of the show.

But we start with the users. And in Q1, Netflix added over 9 million subscribers worldwide reaching the 270, 2-7-0, million mark. And that was up. Yeah, Q1 of last year they added nearly 2 million and then they added six and then nine, and then the end of last year, Q4, they added 13. And then this Q1 down to 9 million. But we're going to play slice of pie. How was Netflix able to nearly double expectations, growing subscribers by over 9 million versus the 5 million that was projected?

Daniel Konstantinovic:

I think it was three main things. I think we're still seeing a big runway for password sharing changes. I think that it's definitely driven subscriptions for Netflix for a longer period of time than we maybe imagined. Although it's been less than a year, so in retrospect, expecting that all of that would be condensed into two quarters was maybe a little unrealistic.

Marcus Johnson:

No, but to your point though, Dan Gallagher of The Wall Street Journal was pointing out, Netflix has added over 31 million subscribers over the past three quarters since the program began. That's more than double what it added the three quarters prior.

Daniel Konstantinovic:

So it added more this quarter than during the first quarter of password sharing changes. Yeah, I mean I say password sharing, but there's a lot of stuff that goes into that slice of the pie, like the ad supported offering. It's now the cheapest way to subscribe to Netflix. There's been really strong growth for the ad supported tier since the password sharing changes started. I think the most recent number they rolled out, at least before these earnings, was 15 million subscribers total, which is a really big jump from what it was at the same time last year. So it's driving a lot of growth for Netflix. So I would attribute the largest share of the pie, let's say like 60%, to password sharing. I think it's turned out to be a really, really big growth generator for them and it probably will be similarly for Disney and Max and the other services that are planning to do that starting this year.

Marcus Johnson:

Yeah, the ad tier giving Netflix a boost. Had a 65% rise in quarter on quarter adoption. Nearly four in 10 signups in markets offering ads were for an ad supported subscription as well. They were noting, "We expect Netflix's US ad supported viewers to double this year to nearly 14 million." That's faster growth than any other platform and then reach 20 million next year, that would be good enough for 6% of the population, which is pretty decent. All right, what's your second slice?

Daniel Konstantinovic:

I'm going to go with live events. Netflix has been doing a lot of live broadcasts or this quarter we really got to see one of their first major self-branded live events. There was the Netflix Slam, which was a big exhibition tennis match between Nadal, and my gosh, the Spanish player whose name-

Marcus Johnson:

Alcaraz.

Daniel Konstantinovic:

Yes, Alcaraz, that's right. So that was a big testing ground for Netflix's live capabilities. So was the Formula One and golf tournament event that they did last year. But the most notable event in the quarter I would say, and I wouldn't be surprised if it drove people to sign up specifically for watching. We just wrote a story in the marketing and advertising briefing the other day about how streaming subscribers tend to subscribe and cancel very liberally to watch specific things. So it's possible that this event drove a lot of subscriptions and they have others coming up. They have Netflix is a Joke fest, like their stand-up comedy event. There is a live event that John Mulaney is going to be hosting later this quarter. There's also going to be a boxing match between Jake Paul and Mike Tyson.

Marcus Johnson:

Yep.

Daniel Konstantinovic:

So they're really going in on these live events and events and I'm sure that that's generating some attention

Marcus Johnson:

It seems. I mean it's got attention from some other competitors because it seems like as a piece in the New York Times, "FIFA said to be close to a TV deal with Apple for the a tournament." So it seems like maybe some other streaming services are saying, "Hey, why can't we also create an event around sports and use that as a hook to pull people into our streaming platform?"

Daniel Konstantinovic:

Yeah, I mean Netflix notably until recently lacked a major sports rights deal. And we sort of covered these live events as their way of tapping into the really big digital live sports audience by creating its own branded events. And I'm sure that them doing that caused Apple and others to say, "Hey, why can't we do the same thing? It gives us more leverage because we're not having to negotiate for the rights to broadcast elite. We can kind of dictate the terms a little bit more strongly."

But I would still say that this probably drove some subscriber growth, but it wasn't the biggest driver. Maybe I'd give it a 10% of the pie.

Marcus Johnson:

Okay.

Daniel Konstantinovic:

But the last one that I would say was likely a very big driver of growth was its deal with the WWE.

Marcus Johnson:

Oh.

Daniel Konstantinovic:

We're talking about sports rights deals. They during this last quarter announced a deal with the WWE where they are going to have the broadcasting rights or the streaming rights to WrestleMania for at least five years. They have the option of extending it for another five after the first five years, starting in 2025. In fact, WrestleMania just wrapped and had its highest ever viewership ahead of the next WrestleMania, which will be under Netflix. So it's possible that there are a lot of wrestling fans who are signing up for the service in advance of the broadcast next year.

And in the meantime, Netflix still has a humongous library and a lot of big popular shows that Ted Sarandos has talked up in earnings, new seasons of things like Emily in Paris, Bridgerton. We had a story on this in the marketing and advertising briefing as well. So I would say that the upcoming WWE deal and general original content offerings, I'm going to wrap up into one slice of the pie, which is the remaining 30%.

Marcus Johnson:

So, yeah, I mean some of its rivals are licensing content to Netflix again because they need the cash.

Daniel Konstantinovic:

Yeah.

Marcus Johnson:

And so they are benefiting from that. So just to recap the pie, I've got 60% to password sharing, 30% to the WWE TV rights deal and general original content offerings, and 10% for live events.

I mean that's what was been driving subscriber growth 9 million in the quarter to reach that 270 million mark worldwide that I mentioned up top. But Daniel, it seems as though that's going to go away. Not the number of people who are subscribed, but the reporting of those subscriber numbers. And so Netflix saying they're going to stop reporting quarterly subscriber numbers starting in 2025 as they shift their focus to revenue and engagement metrics. That's the party line. But what's your take on Netflix not reporting quarterly subscriber numbers from next year?

Daniel Konstantinovic:

I think it's really interesting. I think this is a direction that Netflix and other streaming services have been moving in for a while. I mean the launch of ad-supported tiers was very much about average revenue per user and not so much about subscriptions. And we've seen that investors are really pressuring these companies to increase ARPUs and that they don't care so much about the subscription numbers, especially as companies like Netflix start to circle a saturation point.

There has been really strong growth for subscribers. So people might be like, "Well, if the subscriber numbers are looking so good, why would they close off access to that number?" I think reasons why they would do that are password sharing means that the new subscribers to Netflix, it doesn't necessarily reflect that there are new audiences coming to Netflix. A lot of these are people who were sharing passwords or had access or have signed up for cheaper tiers or are coming back to the service. You could view a lot of these subscribers as previous or existing Netflix subscribers who have resigned through another channel or for just as part of their regular churn. So this could be a sign that they expect the really big growth surge from password sharing to start to die down a little bit over the next couple of quarters.

And if you think back to when Netflix had first announced the ad supported tier, which is when it had its first ever loss of subscriptions, that was a huge deal for the company that really affected it, the stock market and really caused this crisis of identity. And if they veil that number or hold it a little bit closer to the chest, then they can avoid a similar scare.

Marcus Johnson:

Yeah.

Daniel Konstantinovic:

And it really seems like their priority is on live events, the ad supported tier, things that will increase the average revenue that one subscriber brings into Netflix.

Marcus Johnson:

Right.

Daniel Konstantinovic:

So it makes sense that they would do this. They've been going this way for a while

Marcus Johnson:

And just because they've been doing well subscriber growth wise in the last couple of quarters, I mean the last three quarters they've recorded double-digit subscriber growth worldwide, but the previous nine quarters before that, it was single digits.

Daniel Konstantinovic:

Yeah.

Marcus Johnson:

And that's worldwide, it was single digits. And that's not great. If you look at the US and Canada from Q4 of 2020 to the start of 2023 pretty much, they didn't grow users at all in the US and so things haven't been going well for quite a while. And so I think they're trying to just get ahead of this, knowing that at some point subscriber growth is going to tail off and they don't want to have to be answering those questions to the street, to reporters, when that time comes.

They also, Danny, they already said this, apparently at the end of 2022, Netflix said it would no longer provide quarterly subscriber projections in part because those projections fell short of Wall Street's expectations every quarter but one, according to FactSet Data. So they have said this before, it's just coming into effect now, but we've mentioned the money side of things. They made 9 billion in Q1. That was a hair above Wall Street's expectations. 9 billion, good enough for 15% growth year on year. What do you make of how Netflix has started off the year revenue wise?

Daniel Konstantinovic:

I mean, I would say that they've done pretty well. Revenues were up almost 15% year over year for the quarter. They did just come above expectations, but I think that they're in the green, it's showing that the ad-supported tier is growing and it's driving significant revenues for the company. They're likely to keep investing in that going forward. I think that's just going to be the real big focus for Netflix is getting as many users as they can to sign up for the ad supported tier, whether that's by increasing the gap between ad free and ad-supported video to get people to opt for the cheaper tier or doing things like password sharing to get them to sign up.

Marcus Johnson:

Yeah.

Daniel Konstantinovic:

If growth for the ad-supported tier does start to taper off later in the year, the question is going to be how can they increase the average revenues per user without an influx of new people?

Marcus Johnson:

Right, right.

Daniel Konstantinovic:

What levers can they turn? And I think that's a tougher question for them to figure out.

Marcus Johnson:

Yeah, I mean ad revenue is heading in the right direction, but it's not giving them a boost just yet. Visible Alpha expects Netflix to make 1.5 billion from ads this year. That'll be about 4% of total revenue. Next year estimates it will make 7% of its money from ads. So they're starting to turn that dial up as we move forward. But, Danny, yeah, I mean it could expect a boost from another price increase as well because they announced in February they were going to be bumping prices up again after raising them towards the end of last year. So that will help.

Dan Gallagher of The Journal, Danny, was writing, "Netflix dealt with the freeloaders. It's next act will be tougher." What is Netflix's next act in your opinion?

Daniel Konstantinovic:

I think for them really it's going to be sports. I think they are trying to make a name with this self-branded stuff like we talked about, like the tennis tournament and this boxing match. I think they're going to see how those perform and see if they can keep investing in those. And the WWE deal that starts off next year I think will be a really big boost to Netflix's ad revenues, to subscribers. I suspect it's going to perform very well for them and open up a lot of options for additional revenues. So prepping for that to be as seamless as possible and really trying to get those viewers to sign up for Netflix to access this content is going to be very important for them.

But if you had asked me a couple of months ago before this WWE deal was announced, what's the next act, I would've been very uncertain. I would've said, "I'm not sure. And it's concerning because they are doing these live sports events, which is something, but it's not on the level of a major sports league." But now they've struck this deal and I think it's going to be a really big anchor point for them for the next five or possibly even 10 years.

Marcus Johnson:

Yeah.

Daniel Konstantinovic:

They're spending a lot for it though. It's a 5 billion, I believe, dollar deal.

Marcus Johnson:

Yes.

Daniel Konstantinovic:

The WWE.

Marcus Johnson:

Yep, that's right. They better figure something out for the next act because they've got very aggressive goals. They gave their first ever annual revenue forecast projecting growth of 13 to 15% for the year, in line with what analysts are hoping for. This is pretty ambitious because you have to go back to 2021, so three years ago to find full year double-digit revenue growth for the video streaming giants. Daniel, let's end with a grade for Netflix's Q1 performance.

Daniel Konstantinovic:

I'm going to give them a good grade. I think I would give them an A for this quarter. I think they did very well. They had really strong revenue growth. Password sharing continues to do really well for them. And they're not just resting on those laurels. With the WWE deal and these live events events we're seeing them set up the next tent poles for growth and subscriptions. They've got a lot of very popular shows that viewers consistently rank Netflix among as having some of the best originals. So there's a lot of interest in whatever original content that they're putting out. I think this was a good quarter for them.

Marcus Johnson:

You Americans are too nice and you guys are such nice graders. I need to give this to a Brit. They'd be like a D, max, and they should be grateful. But no, they did do very well. They'd beat expectations on users. Adding 9 million is pretty impressive. That's the most they've added aside from Q4 of last year, since 2020. So that is impressive. And then they met expectations on the revenue front as well. And their password sharing crackdown and ad supported tier have been doing really well as well. So I think it's fair.

If you want to subscribe to the marketing and advertising briefing that Danny writes for and I read literally every day, click the link in the show notes for that. But that's all we have time for this episode. Thank you so much to Danny for hanging out with me today.

Daniel Konstantinovic:

Yeah, it's always a good time.

Marcus Johnson:

Yes, sir. Thank you to Victoria who edits the show, Stuart who runs the team and Sophie does our social media. Thanks to everyone for listening in. We hope to see you tomorrow for the Behind the Numbers Weekly Listen. It's an eMarketer video podcast made possible by Walmart Connect.