EMARKETER

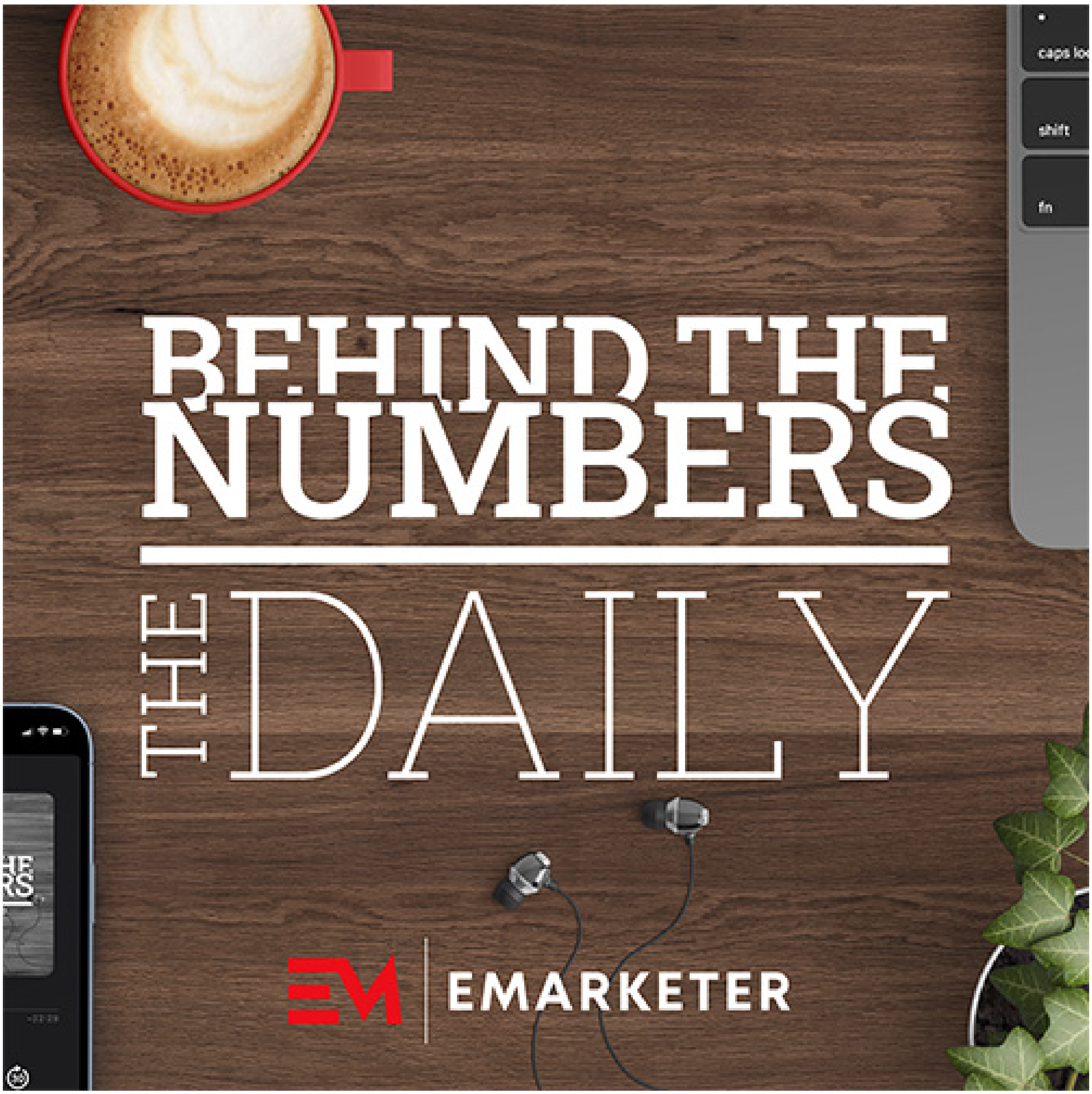
Daniel Konstantinovic

The Daily: How Netflix is holding on to its streaming crown, the biggest question for its ads business, and more

Audio

On today's podcast episode, we discuss why Netflix was able to grow subscribers and revenue by such an unexpected amount, the biggest question surrounding its ads business, and the most significant threat facing Netflix at the moment. Tune in to the discussion with host Marcus Johnson and 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 (00:00):

EMARKETER is your trusted partner for actionable data and insights on everything. Not everything, but marketing, advertising, commerce, and more. So maybe everything.

(00:10):

But did you know EMARKETER also has a division focused on B2B media solutions? You could partner with EMARKETER today and connect your brand messaging with our powerful audiences. If you want to learn more, you can head to emarketer.com/advertise.

Daniel Konstantinovic (00:28):

Those ad supporter viewers are still paying a monthly subscription fee, even if it's less than what the premium or ad-free people are paying. So I think that they're seeing a revenue boost from that, even if it's not contributing to advertising revenues as much as they would like for it to.

Marcus Johnson (00:49):

Hey gang, it's Thursday, July 25th. Daniel and listeners, welcome to the Behind the Numbers Daily, an EMARKETER podcast. I'm Marcus. Today I'm joined by one of our analysts who writes about marketing and advertising briefing. He's based in New York City. He is Daniel Konstantinovic.

Daniel Konstantinovic (01:05):

Hello. Happy to be here.

Marcus Johnson (01:06):

Hey, fella. Thanks for hanging out today. Today's fact is where we begin. Before we talk Netflix, what are the chances of scoring a goal from a corner in soccer?

Daniel Konstantinovic (01:17):

Oh, that's a good question. I'm going to guess it's fairly high. Do I need to be exact here? I'm going to go with like-

Marcus Johnson (01:23):

Yes.

Daniel Konstantinovic (01:24):

Oh shoot. Okay. Maybe like 43%. Just throwing out a random prime number in there.

Marcus Johnson (01:30):

Wow. Why that high?

Daniel Konstantinovic (01:31):

Well, I just remember when I played soccer, setting up a goal opportunity off a corner was a really big deal or setting up the proper defense, a very tense situation. So my guess is the tension is because they could score.

Marcus Johnson (01:46):

Exactly right. That's why I thought it would be higher. So with the Euro Cup just ending, Goddamn England and Copa America also finishing, I've been watching a lot more soccer than I normally would, even though I'm English, and I was wondering how often players score from a corner. Because when a corner is won, to Danny's point, everyone gets crazy excited and very expective. But it always felt anticlimactic because I can't remember many goals ever being scored from them, probably because I'm watching England play. But it appears as though lots of teams have trouble scoring from a corner.

(02:19):

So estimates vary somewhat, but one analysis I found from Sports Stack Exchange found that the average English Premier League, EPL, team, professional football top league in England, the average team scores one goal from a corner about every 10 games.

Daniel Konstantinovic (02:36):

Whoa, my gosh.

Marcus Johnson (02:37):

Yes. Which put another way, Michael Kelly of The Washington Post analyzed nearly 13,000 corners taken in the EPL between 2011 and 2013 and found only 17% produced what he calls a legitimate shot attempt. Of those shot attempts, 370 were scores. So the chance that a goal will be scored off a corner kick appears to be around 3%.

Daniel Konstantinovic (03:06):

3%. Oh my God. That's so low.

Marcus Johnson (03:08):

Every time there's a corner one now I'm like, that's when I go and get a drink. That's the perfect time to get a refreshment because nothing's going to happen. There's a 97% chance nothing's going to happen. Anyway. Today's real topic, how Netflix is holding on to its streaming crown.

(03:30):

In today's episode, we'll cover Netflix. No In Other News today. So Danny, let's talk about Netflix people, subscribers. How are they doing? 278 million people around the world now call themselves Netflix subscribers as the streaming giant added 8 million new subscribers in Q2. That would be a growth of 16, 16% year-on-year in Q2 for subscribers. Netflix grew subscribers that fast in Q1 of this year as well. So 16% Q1 growth, 16% Q2. But before that, Danny, you have to go back, so over three and a half years ago, before you can find quarterly growth that is in that range. It's been a lot lower for most of that time.

(04:14):

We're playing slice of pie for this first question. That's why Danny's going to create a pie chart as to the reasons, three max, why Netflix was able to grow subscribers 16%, an impressive 16% in Q2, adding 8 million folks.

Daniel Konstantinovic (04:29):

Yeah, I mean the 8 million was also notable because it was almost double the expectation. People thought that there would be around-

Marcus Johnson (04:35):

Oh interesting-

Daniel Konstantinovic (04:36):

... four-point-something million subscription editions, but they added 8 million. And I think one of the biggest reasons and why, and one of the biggest shares of the pie is the password sharing crackdown. And it's a little hard to say exactly how much of a percentage I should allocate to that because it kind of plays into other things the company is doing to drive subscription growth. But let's just say that, let's bundle it all under the category of the ad supported tier.

(05:05):

So the idea is Netflix now has this new cheaper subscription offering where you can watch Netflix with advertisements, and the way that they have gotten people to sign up for that is through bundles. It's through password sharing crackdowns so that people who were not paying for Netflix now no longer have access to the service and want the cheapest access possible. So they go for the ad supported tier.

(05:27):

Those cheaper subscription offerings are where a huge portion of the subscription growth in the last couple of quarters is coming from. I think they said that it accounted for the majority of subscription signups in markets where it was available this quarter, and 45% of new subscribers do ad supported viewing.

Marcus Johnson (05:47):

Yes, exactly right. Exactly right. And they were saying in May the with ads tier had 40, 40 million worldwide monthly active users up from 5 million a year ago. It's impressive.

Daniel Konstantinovic (05:59):

Yeah, it's grown really fast. And I think the password sharing crackdown that they've been doing has had much longer legs than anyone thought. I thought it would just be a couple of quarters that they would see strong growth from all these people who are booted off the service want to sign back up, but it's still going on. So the question is how much longer will it continue because it can't go on forever.

Marcus Johnson (06:25):

So how much is all of that in terms of the reason why they grew 16%?

Daniel Konstantinovic (06:30):

I'm going to give it 66%, like two thirds of the pie. I know that's kind of a boring number for a pie chart, but ...

Marcus Johnson (06:38):

It does well. So what's the rest?

Daniel Konstantinovic (06:38):

It feels logical. Yeah. I'm going to go with just the existing brand power and size of the catalog. Netflix is still the leader in subscription streaming. It has the most subscribers of any of these top streaming services. It has a lot of shows that people sign up for the service to watch, including the new season of Stranger Things. There's been already a big marketing push surrounding that, so that has a lot of brand pull and when people are ...

Marcus Johnson (07:05):

New Bridgerton, I think.

Daniel Konstantinovic (07:06):

Yeah, Bridgerton was a big one this year. And when people are making a decision about what entertainment service to sign up for, Netflix is just one that pops up immediately because it already has such a well established presence.

(07:17):

And another thing is the size of the catalog. Netflix has a really, really enormous library and they're very good at getting people to continue watching through recommendations or what have you. And that is something that consumers value really highly in deciding whether to sign up for or stay subscribed to a streaming service.

(07:37):

In September, Ernst Young did a survey where they found that access to specific content was the main motivator other than cheap cost for signing up for staying subscribed to a subscription service. And right underneath it was an extensive content library. And Netflix absolutely has both of those things. So I think just being early onto the scene is still benefiting.

Marcus Johnson (07:58):

Yeah. It's not until you use other services and you start scrolling through the titles and then it very quickly runs out of content, you're like, "Oh." You're not used to that type of experience from a Netflix. So that's definitely a really important point.

(08:11):

Two things jumped out to me. I mean, one, it's more subscribers than they added last Q2. When you look at Q2 versus Q2, 8 million, this Q2 compared to 6 million last Q2, so the comps there. And then two, the share of North American paid subscribers, the number of folks who subscribe from the North American region continues to tick down. From the start of the pandemic to today North America's share of paid subscribers has gone from 40% to 30%. They're still adding folks, but more internationally. And so that share is going down.

(08:43):

Also interestingly, Danny, they said Netflix announcing that early next year plans to stop providing investors quarterly membership numbers. So we won't be able to see these kind of figures, these subscriber figures as of next year.

Daniel Konstantinovic (08:54):

Yeah, that's a really interesting change. You would assume that they would only release those subscriber numbers in the future when they hit some big milestone, right?

Marcus Johnson (08:55):

Mm-hmm.

Daniel Konstantinovic (09:04):

And yeah, it's going to just make it a little bit more difficult to track who among these top streaming services is doing the best. And I think Netflix is hoping that they can focus less on the subscription number and more on the revenue number. But as I'm sure we'll talk about that might be a little more complicated than they would hope as well.

Marcus Johnson (09:23):

We've seen this from other tech players as well. Meta, Facebook saying that they're not going to give out those subscriber numbers, those user numbers anymore as they try to shift the conversation away from growth of users and more towards, as Daniel was mentioning, the revenue picture.

(09:37):

Danny, you mentioned the advertising piece of this and the password crackdown and how that pushed people onto Netflix is cheaper ads here. What to you is the biggest question surrounding Netflix's ads business?

Daniel Konstantinovic (09:47):

I think the biggest question is how they're going to scale it and what they're going to do to entice advertisers to spend on the platform. Because all of the reporting out there and stuff that we've been writing as well shows that Netflix is having trouble attracting advertisers, that advertisers are not impressed with the ease of buying inventory on Netflix, with the available inventory, with its ability to reach consumers at scale, especially when compared to things like Amazon or Disney and Hulu.

(10:15):

So Netflix has had kind of a slow role despite there being a really high demand for them to launch an advertising tier in the first place. There are big things on the horizon for Netflix that could change that and could be a big boost to their ad business. This year they're planning to launch Netflix ad inventory on programmatic channels, which basically just means it will be much easier for advertisers to buy ad space on Netflix through channels that they already purchase other ad inventory through. So there is less of a barrier to entry there. That's something that advertisers have been asking for for a while and it's set to come this year.

(10:54):

Another is that Netflix has a really big sports deal that is going to kick into effect next year with the WWE that will give it potentially some ad space alongside live sports. And we've seen that be a big driver of revenues and spending for Amazon and for YouTube. So it's not the NFL, but WWE is still really large, and I'm sure that there will be people who are looking to advertise alongside that.

Marcus Johnson (11:18):

Yeah. That's a great point. This is all still so new as well. It feels maybe a bit unfair to Netflix that folks are expecting it to generate trillions of dollars in revenue from something that they only just recently rolled out as Netflix saying they're trying to taper expectations. They're saying don't expect advertising to be a primary driver of revenue growth this year or next year.

(11:38):

And we tend to agree. Our forecasting team expects the company to make close to a billion dollars this year from ads growing to 1.5 billion by 2026. That's similar to what we expect Disney+ to make from ads and Visible Alpha, they estimate Netflix generated close to $800 million in ad supported revenue in the first half of this year. It's about 4% of the company's total. Next year they expect Netflix to make closer to 10% of its revenue from ads. So I feel like we've got to give this a bit of time to be fair to Netflix.

Daniel Konstantinovic (12:08):

Yeah. I mean there's definitely a bit of a danger in putting a huge amount of stock, no pun intended, into quarterly earnings because it can get a little bit horse racey, right?

Marcus Johnson (12:18):

[inaudible 00:12:18].

Daniel Konstantinovic (12:18):

And yeah, thank you, thank you.

[NEW_PARAGRAPH]And Netflix did spin this up relatively recently. They are already an enormous service with 200 something million subscribers. How much more could it possibly grow? But that's what the market and investors are demanding, is growth, and that's why companies are launching all of these ad supported tiers.

(12:38):

And to push back a little bit on what you said, I think part of the reason people are being so harsh on Netflix for not growing its ad business fast enough is because Amazon launched its video ad business earlier this year and just flipped the switch and made ad supportive viewing the default for Prime Video viewers, and now it's among the leaders in the industry for ad revenue.

(13:03):

I think if Netflix were launching its ad supported tier this year, it would probably do the same thing, but they came to the market with an ad supported tier before that was really on the table, so they're kind of stuck on their current trajectory.

Marcus Johnson (13:16):

Yeah, that's a good point, mate.

(13:17):

Speaking of growth and investors and expectations, the dollar side of things looks pretty healthy. Netflix made just shy of 10 billion, 9.6 in Q2 in revenue. That's 17% growth year-on-year. Q1 they grew 15%. Q2, that's 17 I mentioned. But the company, Danny, hasn't seen revenue growth like this since late 2021, so this is a bit of a surprise as well to a certain extent. Slice of pie, again. Danny's going to create a pie chart as to the reasons, three max, why Netflix was able to grow revenue 17% in Q2.

Daniel Konstantinovic (13:50):

I think there are some similar reasons to our first slice of pie. New subscriptions is a really big one, and people are subscribing to Netflix because of that cheaper access that we were talking about earlier.

(14:04):

We talk a lot about Netflix's ad supported revenues, but it's also worth noting that those ad supported viewers are still paying a monthly subscription fee, even if it's less than what the premium or ad-free people are paying. So I think that they're seeing a revenue boost from that, even if it's not contributing to advertising revenues as much as they would like for it to.

(14:25):

I think another reason is that they have increased the gap between ad supported and ad-free viewing. So Netflix has gotten rid of its cheapest ad-free tier in a lot of markets, which means that you either have to pay for cheap access with ads, which gives the company more revenues, or you pay twice as much or three times as much as you would be paying for the ad supported tier for ad-free viewing. So for those viewers who don't want to go to the ad supported tier because they're used to watching Netflix without ads or they hate ads or whatever, they are paying a lot more to stay at that high level.

(15:02):

So they're squeezing more out of every user. The ones who are signed up for the cheaper tier are generating more revenues per user, and the ones who are staying ad-free are chipping in more than they ever have.

Marcus Johnson (15:16):

17% growth is really impressive because last Q2, they grew 3% versus this quarter, this Q2 is 17%, so that's really impressive. And then by region jumped out to be North America revenue outpacing total revenue, growing at 19% in the quarter. And North America still accounts for 45% of the money that Netflix makes, has for a number of years now.

(15:39):

Danny, let's end with this. What to you is the biggest threat that Netflix faces at this moment?

Daniel Konstantinovic (15:46):

This was a tough one. I think a big threat that they're facing is just the prominence of these other streaming players who have a much more built out advertising business than Netflix does.

(15:59):

Disney and Hulu launched around the same time that Netflix did, launched their ad supported time around the same time that Netflix did and appear to be generating much more ad revenues. I mean, Hulu maybe tips the balance a little bit unfairly in Disney's favor because it's had ads for a very long time and got recently folded into Disney's portfolio completely. But Amazon is another big player that's really casting a shadow.

(16:24):

And I think the threat for Netflix is that if they are too slow to build up their advertising business and advertising capabilities that they could struggle to make those early relationships with advertisers that are really going to matter-

Marcus Johnson (16:40):

Good point-

Daniel Konstantinovic (16:40):

... as ad supported digital video becomes the norm in the years to come.

Marcus Johnson (16:45):

Yeah.

Daniel Konstantinovic (16:46):

It's hard to say that it's an existential threat though, because Netflix has such an enormous subscriber base and has such big intellectual properties. I think there will always be brand interest in the audience size and the properties that Netflix has, but they want to be, I'm sure, the dominant video advertising player among all these streaming services, but the longer this disparity goes on, the lower the chances of that happening are.

Marcus Johnson (17:13):

Yeah. Yeah. I was trying to think of the answer to this. Big is probably not the best question to my answer. Probably more the most interesting threat potentially. But my question was can it pivot to live? Because they recently inked this three year deal. I mean. You mentioned the WWE. They recently inked a three-year deal with the NFL to stream games on Christmas Day. I think it's going to be quite interesting to see how that performs since Christmas Day already has five NBA games that play at different times throughout the entire day. So can it steal audience away from that to make a splash?

(17:45):

And Ted Sarandos, who's the co-chief executive recently said, "It's very difficult to have big league sports and profit when you offer them in entire seasons, but when you offer them in this event model that we are building on, we're really excited about our opportunity to do that without the risk."

(18:04):

But I'm wondering, does that just annoy viewers because it's already frustrating to sports viewers who have to sign up to multiple packages to watch their team play all the games that they need to throughout the season, thinking about I need Netflix for this one game of the year when 50 ... A lot of people have Netflix, but not everyone. 52% of people in America have Netflix according to us, so 48% don't. I'm wondering whether they can actually win big with this event model approach to live.

Daniel Konstantinovic (18:31):

Yeah, I think pivoting to live I think is something that they are working really hard on. They've done a number of live streams in the last year or so. They're building out some of their own big marquee sports events like boxing matches or tennis matches.

Marcus Johnson (18:45):

Golf.

Daniel Konstantinovic (18:45):

Yeah, golf as well. Those could all offer opportunities for them to have a consistent live offering outside of paying a licensing fee to the NFL or what have you.

(18:55):

So I don't know. I mean, I wonder what their approach with the WWE is going to be. My guess is that's all going to be live, and that'll be a real test of their live capabilities and advertising capabilities. And that's pretty soon. I mean, that starts next year, so they've got to build that out pretty fast.

Marcus Johnson (19:12):

Somehow five months away.

[NEW_PARAGRAPH]All right, Danny, to close out the lead, if you could give me a grade for how you think Netflix performed in Q2.

Daniel Konstantinovic (19:22):

So I would give Netflix a B for Q2. I think that they did very well with subscription gains and revenue gains, but they had to lower their forecast for the next quarter. I think we're about to see subscription growth taper off and the news that they don't expect their advertising tier to meaningfully contribute to revenues possibly through the end of next year is a really big blow.

Marcus Johnson (19:45):

Looking ahead to Q3 subscriber growth might not look that stellar. Likely worse than last year because of the tough comps, when the password sharing crack down had that big boost on subscriber growth numbers. We'll only be getting these numbers, these subscriber numbers for another couple of quarters anyway. That's what we've got time for this episode. Danny, thank you so much for hanging out with me today.

Daniel Konstantinovic (20:06):

Thanks for having me. Always a pleasure.

Marcus Johnson (20:07):

Yes indeed. Thank you of course to Victoria who edits the show. Stuart runs the team and Sophie does our social media. Thank you to everyone of course, for taking time to hang out with us and listen in. We hope to see you tomorrow for the Behind the Numbers Weekly Listen, an EMARKETER video podcast.