Daniel Konstantinovic

The Daily: How Netflix's password-sharing crackdown is going and why Disney might be bailing on TV

Audio

On today's episode, we discuss whether Netflix's password-sharing crackdown is actually working out, why the company got rid of its basic ad-free plan, and whether sticking to sports-adjacent programming is the right move. "In Other News," we talk about whether The Walt Disney Co. might be bailing on TV too soon. Tune in to the discussion with our analyst Daniel Konstantinovic.

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Episode Transcript:

Marcus Johnson:

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Daniel Konstantinovic:

A lot of people did not cancel subscriptions to streaming services during the pandemic, even though it was a really tough financial time. Just shows that people are going to pay more for it and not really think too much of it, because even in really tough times we've seen that people are not willing to sacrifice on entertainment.

Marcus Johnson:

Hey gang, it's Tuesday, August 1st, Danny and listeners, welcome to the Behind the Numbers Daily, an eMarketer podcast made possible by Awin. I'm Marcus, and today I'm joined by one of our analysts who writes our marketing and advertising briefing based out of New York. It's Daniel Konstantinovic.

Daniel Konstantinovic:

Hey, thanks for having me. It's really hot today.

Marcus Johnson:

Every day from now on, forever.

Daniel Konstantinovic:

Forever.

Marcus Johnson:

So today's facts. How far does the average person walk during their lifetime? Any guesses Danny?

Daniel Konstantinovic:

Oh my gosh. No, I had a conversation with someone recently about running shoes.

Marcus Johnson:

About this. Oh, okay.

Daniel Konstantinovic:

Well, no, it was adjacent, where apparently you're supposed to get new running shoes every 250 miles, and that sounds like a lot, but that's not that much, right?

Marcus Johnson:

That's not the most, no.

Daniel Konstantinovic:

Yeah, so I don't know. I would say, I'm going to go, I'm going to shoot high. I'm going to go 300,000. That was maybe too high.

Marcus Johnson:

Steps? Miles?

Daniel Konstantinovic:

Miles was that the question? Miles?

Marcus Johnson:

Oh yeah, miles. It's not terrible. It's not close, but it's not terrible. So, a post from Alliance Work partners notes that the average, moderately active person takes around seven and a half thousand steps a day, and if you maintain that daily average and live until 80 years of age, then you all have walked over 200 million steps in your lifetime. Flip that into miles and you're looking at about 110,000 miles.

Daniel Konstantinovic:

Oh, all right.

Marcus Johnson:

Put another way.

Daniel Konstantinovic:

I overshot.

Marcus Johnson:

Yes. I would've had no idea what to say. But put another way, that would be walking across America once, walking across once, let's say right to left 37 times, or walking around the earth more than four times in your life around the earth, more than four times. Well, I won't.

Daniel Konstantinovic:

I won't either. I was going to ask how many trips back and forth from the fridge to my bed is that. It's got to be a lot. It's got to be like a million.

Marcus Johnson:

At least. Today's real topic though, Netflix's Surprise tailwind.

So in today's episode, first in the lead, we'll cover Netflix. Then for another news, I'll talk to Danny about why Disney might be bailing on TV. We start, of course, with the lead. We're talking about how Netflix has been doing performance-wise lately. We'll talk a bit about them canceling, axing their basic ad-free plan, and then what their plans are for sports going forwards. We start with how they've done recently in terms of subscribers. Well, Netflix now has 238 million paid subscribers, that's up 6 million in Q2. That's three times as many people that they added in Q1. Subscribers in the US and Canada, that was worldwide, subscribers in the US and Canada, which account for about 32%. So about third of Netflix's total subscribers coming from that region added more than a million. That region is approaching 76 million total. But Danny, what's your takeaway? After the streaming giant added 6 million new users worldwide and over a million in the US and Canada.

Daniel Konstantinovic:

Yeah, I think the really strong user growth figures, this is one of Netflix's highest quarter for new subscriptions in a while just shows that their password sharing change was a really big success. I think there was a lot of fear around it or anxiety around it, because consumers were not going to be happy about it. There was a lot of discourse of Netflix turning its back on things that has long encouraged like it used to advertise that we don't care if you share an account, you can go ahead and do it. And then they turned on that and they didn't just make it so that people who are using someone else's account have to pay for their own. But they also made it so that if you have an account and you want to keep someone on there in a different household watching on your account, you can only do that for one person. So if you have two kids who don't live at home and they're both on your Netflix account-

Marcus Johnson:

Pick your favorite.

Daniel Konstantinovic:

Yeah, pick your favorite child.

Marcus Johnson:

Easy.

Daniel Konstantinovic:

But yeah, it was a huge success. I was surprised with how quickly it created a turnaround for Netflix. I thought it was going to be a much slower burn, but it seems like people were really quick to not want to lose access to it.

Marcus Johnson:

It speaks to the staying power of it, doesn't it? And some numbers to support that. So Antenna reporting immediately after the crackdown, password sharing crackdown, Netflix had the four largest days of US user acquisition since it began tracking subscriber numbers 3.5 million signups in June alone. Morgan Stanley analyst, Ben Swinburne thinks Netflix is on track to reach nearly 25 million net new subscribers from the page sharing program in 2023. And then Third Bridge analyst, Jamie Lumley thinks about 50% of the reported 100 million households, that was the headline figure that kept going around, a 100 million households were not paying for Netflix, was sharing passwords. This analyst, Jamie Lumley thinks about 50%, about half of those 100 million households sharing passwords could end up creating their own Netflix account, according to an article from our senior director of briefings, Jeremy Goldman. Danny, do you think that's the case? Do you think this tailwind continues into Q3, Q4 and beyond?

Daniel Konstantinovic:

Yeah, I think it will continue for at least a little while. And I don't know if they're going to see a hundred million new users because of this, but I think it's safe to say that at least next quarter we'll probably also have some pretty strong user growth. But it looks like that's not enough to really carry the company. They, despite the really strong growth and success password sharing and other things that we'll talk about, the market response to the earnings was pretty bad and Netflix missed some revenue targets and the stock went down pretty significantly. So even though it seems like it was a strong quarter, I think that reflects that there's some anxiety about long-term growth.

Marcus Johnson:

Yeah. Let's talk about their revenue, because as you mentioned subscribing numbers are pretty good, which isn't normal, at least it hasn't been normal for a long time. Q2 isn't normally a bountiful quarter for Netflix, subscriber wise. The company hasn't seen this kind of worldwide growth in a Q2 since a flood of signups back in Q2 2020, when the pandemic kept everyone inside. And in North America, adding over a million subscribers is not normal either. At least as of late in the US, Netflix has only added over a million users one time in the last 12 quarters, last Q2, in fact, it was busy losing a million subscribers. So quite the turnaround.

And then on top of that, Danny, maybe this is some of the reason for less optimism on the revenue side, is because when you zoom out, Netflix isn't really growing specifically in the US and Canada, because it's been stuck around 74 to 75 million users since the end of 2020. And even though they added a million this quarter, that's been up and down, and up and down, and ultimately it's really stuck at that 74, 75 million users figure in North America. Netflix, total revenue grew 3% money from US and Canada was up to. What should we make of their low single digit revenue growth?

Daniel Konstantinovic:

Yeah, I think something Netflix is really struggling with is growth in its biggest markets, which makes sense when you have so many subscribers in North America and it's the main subscription base, it's going to be hard eventually to keep growing that, which is why the company's making a lot of investments in Asia and places like South Korea to try and build out new subscriber bases there. But I think it makes sense that Netflix would struggle with revenues like this, because the only ways that they get revenue until a quarter or two ago was through subscriptions. And they have this merchandise business, but I don't think that's adding meaningfully to the spreadsheet. The ad supported tier is another big boost to that, but it's still really new. And even though there appears to have been strong signups for it, Netflix itself hasn't said how many subscribers there are to the ad supported tier, but you'd have to imagine that now with the password sharing change, a lot of those people who were booted off sharing probably signed up for the ad supported tier because it's the cheapest one.

Marcus Johnson:

It's closest in terms of price. We haven't got any official official numbers, but a lot of the estimates saying that it's still a tiny share of Netflix is total. And we think Netflix will make about $200 million from ads this year, over 700 million next year. And so to your point, maybe that is some of the reservation that the markets have is that, look, you've got advertising now, but that's not really going to see any real gains, reap any rewards for at least a couple of years.

Daniel Konstantinovic:

They have invested a lot of money into video games and acquiring video game studios and building two of their own video game studios, and it's still basically widely inaccessible to the majority of Netflix subscribers who can only play these games on your phone. They're not yet on TVs or on the Netflix app and there is no bundled service. There's no pay an extra $1 a month or $2 a month on your Netflix subscription and get access to this games' library. It's just sitting there without anything happening.

Marcus Johnson:

A bit of a sunk cost at this point, because they've not been able to get any kind of return on investment as of yet. But yeah, that's a really good point. Something that is easy to forget that they made those investments in games so recently. Yeah, revenue wise, so worldwide revenue growth has been stuck kind. It's been 4% or below for each of the last three quarters, so that's been stuck for a little while now, going on nearly a year. US and Canada growth struggling, a 6% growth was the low point for Netflix back in Q1 2022. This quarters 2% makes that 6% look pretty amazing. So yeah, particularly concerning in the US and Canada just 2% and supposed to be one of its more lucrative markets.

Daniel, we've mentioned the ad supported tier, which was a lower cost option for folks, Netflix, that some of the recent news as well is that Netflix just removed its cheapest ad free tier called Basic, which was $10 a month. So now that's gone. The offerings are Netflix standard. With ads it's seven standard, without ads is 15 and then premium is $20. What are your thoughts on Netflix axing, their basic ad-free plan for $10 a month?

Daniel Konstantinovic:

So I have two thoughts about this. My analyst brain says that this is a smart thing for them to do. Of course, that they would do this. Why would I have this middle of the road tier that a ton of Netflix subscribers are on when I can get rid of that and divert them to a tier where they're either spending $2 more a month and that bumps up revenues really significantly, or I could divert them to the ad supported tier where maybe they're paying less but there's a longer runway and will sustain itself. You'll get more viewers, more advertisers will come in, revenues will go up and the cycle will repeat.

Marcus Johnson:

And they've said that those users have been more lucrative, the ads supported ones.

Daniel Konstantinovic:

For sure. So from a financial point, it makes a lot of sense and I think it's a smart move for the company. From a consumer point, it sucks to have lost access to the cheapest tier of Netflix without ads shortly after a lot of consumers had to probably boot their kids off of the Netflix subscription or their friends off the Netflix subscription. It is never fun to lose a cheaper option, but I think the fact that so many people signed up after the password sharing changes the fact that a lot of people did not cancel subscriptions to streaming services during the pandemic, even though it was a really tough financial time, just shows that people are going to pay more for it and not really think too much of it. Because even in really tough times, I think we've seen that people are not willing to sacrifice on entertainment like that.

Marcus Johnson:

Clever to have done this by saying, "Well look, if you want a cheaper option, we do have one. It's with ads. People are used to watching things with ads, but if you don't want them, then pay it a bit more and you can keep the same experience." And it speaks to the staying power, I think, of Netflix. I've always thought that they could raise their prices to 40 bucks a month and see very little churn to be perfectly honest. It is a service that people almost need to have. It's become a staple once you cut the cord, that's the thing people get first and then go from there. And you can really tell that in terms of some really meaningful metrics like time spent.

And there was a recent NextTV article from Dave Frankel, noting that Netflix was still watched more than twice as much versus any other SVOD in the US during Q2, only YouTube, excluding YouTube TV beat Netflix in US streaming minutes during Q2, and that was only slightly. The Disney bundle, Disney+, Hulu, ESPN+, if you added all of those up, they're the next closest to

Netflix in terms of usage. But this just 70% of the minutes that Netflix gets. Amazon in third, if you get rid of a YouTube, Amazon was just 40% of Netflix in terms of minute stream. So I think Netflix knows that it can do this and people aren't going to love it, but there are alternatives, cheaper alternatives for them to move to. So I don't think they're going to jump ship as much as they would if they didn't have those alternatives to downgrade to.

Let's close the lead out by talking about what Netflix plans to do with sports. So Netflix recently said that they will stick to sports adjacent programming, think documentaries and TV shows like Drive to Survive, the series on Formula 1 racing and Quarterback. Netflix said it thinks it can have a really strong offering for sports fans on Netflix without having to be part of the difficulty of the economic model of live sports licensing. Danny, is sticking to sports adjacent programming the right move for Netflix?

Daniel Konstantinovic:

It's complicated to say. I think right now if I were Netflix, I would not be looking to spend several billion dollars on acquiring sports rights. Also, there are very few options left for things to acquire just because everything's been snapped up. Even pickleball rights are, I think Peacock-

Marcus Johnson:

Thank goodness.

Daniel Konstantinovic:

... got those or someone got those.

Marcus Johnson:

Finally.

Daniel Konstantinovic:

Finally, it's about time. So there's first of all not a lot of options for them to spend on. Ever since that quarter last year where they lost subscribers for the first time, they have had this really intense magnifying glass on them about spending. Even the streamers that have spent a ton of money on sports rights like YouTube on Sunday Ticket or Amazon on Thursday Night Football are under a lot of pressure to really quickly show that they can turn this into a revenue stream. Netflix is struggling to turn what it already has into a meaningful revenue stream. So I think it would just be maybe too many things to juggle, but also on a technical level, they have really struggled with live-streaming. Their first attempts to do live-streaming events great have been basically a disaster. And I'm sure that a sports league is not really thrilled about the idea of selling to someone who can't figure out live-streaming.

Marcus Johnson:

That's true. Would they sell to them in the first place, let alone would they want to buy from them?

Daniel Konstantinovic:

Yeah. So I think right now they have to do this, whether it's the right move or not, I don't think they have much of a choice. Their sports adjacent programming is really popular. It's funny you mentioned Drive to Survive, how this is such a popular thing on Netflix and drove up the value of Formula 1 rights and advertising so significantly and then Netflix couldn't even reap the benefit of that. They just had to watch as-

Marcus Johnson:

Vicious irony.

Daniel Konstantinovic:

They just had to watch wistfully through the window and be like, "Oh my child," or whatever.

Marcus Johnson:

We'll see you in 10 years, when it's time when those rights are up for renewal. To your point, they've tried some live stuff. One went well, one really did not go well, but it doesn't seem like they're completely out on live sports. Their first foray into live sports, this is, it's not just live things, live sports. It will be a celebrity golf tournament in November. So Danny, they said they were out on advertising, they said we'll never do it. They did it eventually when the market made them. And so you could see them keeping an eye on sports and if the right type of sports comes about, the right package for them, then maybe they go for it. That's what we've got time for the lead. Time, of course, for the halftime report. So Danny, what do you think is the one thing that's most worth repeating from the first half?

Daniel Konstantinovic:

I think Netflix just is really struggling to diversify its revenues. They have a lot of projects in the works that will have a really long lead time, and I think they're hurting because of that. They are squeezing that little bit of extra juice out of the North American market, but it's not enough to really satisfy investors or really hit the targets of it seems like Netflix wants to hit. So the question now that they've gotten some of their footing back is what's next? And I'm sure Netflix is asking itself that, but also the idea of what's next is something that Netflix has struggled with and struggled to execute on a lot in the past.

Marcus Johnson:

Well, that's it for the lead time for the second half. Today in other news, just one story, why Disney might be bailing on TV.

Audio:

Power back one.

Marcus Johnson:

Story, one of one. Daniel, you recently wrote that Disney CEO, Bob Iger suggested the company might be considering selling off its linear TV assets, think ABC, which he said may not be core to the entertainment giant. This statement excludes owned property, ESPN, which they said they are seeking strategic partners for. But Danny, the most important sentence in your article about Disney maybe bailing on linear TV is what and why?

Daniel Konstantinovic:

I think it's that both viewers and advertisers will follow if Disney cuts the cord. I think it makes a lot of sense. Everybody knows that TV is on the way out, even if it's a very long decline and that streaming or digital video is replacing it. That's why NBC, Paramount, Max, all these companies are really investing so heavily in streaming, because it really is a get there now or get left behind down the road gambit. So if you're Disney, which still makes billions of dollars on linear TV and linear TV even though it's on a decline, will actually increase in spending, in ad spending next year, because of things like the US election. But if you're Disney and you see that really long decline, is it maybe a smart decision to divest entirely from TV now so that you don't have this depreciating asset at the same time that you're trying to build out a really expensive streaming business?

And maybe the answer is yes, that seems to be what Disney is hinting at, or at least they're starting to toy with the idea. It's interesting that they've been talking so publicly about this idea and about plans with ESPN that makes it seem like it's a little bit more of a real thing than just some frivolous statement. It clearly got a lot of attention and I think the success of Disney+ on a pretty quick turnaround shows that viewers will follow and advertisers will follow. There was a lot of advertiser demand for a ad supported tier in Disney+.

Marcus Johnson:

I understand where they're coming from. It did seem like maybe it was a bit too soon to be at least putting this out there publicly, because you made the points in your piece, which you just mentioned just now, advertisers spending $61 billion on US linear TV this year. You said major events are going to give it a bump briefly next year to 62 billion. And if you fast-forward four years into the future, we have our forecast that say $57 billion will still be spent on linear TV by 2027. And so it seems like a lot of money to leave on the table, even if you are nervous that those assets are going to depreciate. So I guess it's finding the right time to jump ship and I'm not sure when that is, but that seems like maybe it's a bit early with so much money, especially considering CTV hasn't got to that level and exceeded it yet, and still there's so many dollars still to be made.

That's what we've got time for this episode. Danny, thank you so much for hanging out today, mate.

Daniel Konstantinovic:

Yeah, no problem. Thanks for having me.

Marcus Johnson:

Yes sir. Thank you to Victoria who edits the show. James, who copy edits it, Stewart who runs the team, Sophie who helps with social media stuff, thank you to her. Thanks to everyone listening in to the Behind the Numbers Daily, an eMarketer podcast made possible by Awin. You can tune in tomorrow to hang out with the re-imagining retail crew. Sarah Libo will be speaking to principal analyst Jasmine Enberg and senior analyst Sky Canaves all about TikTok and shopping.