

## Case study: Netflix

## Enders Analysis

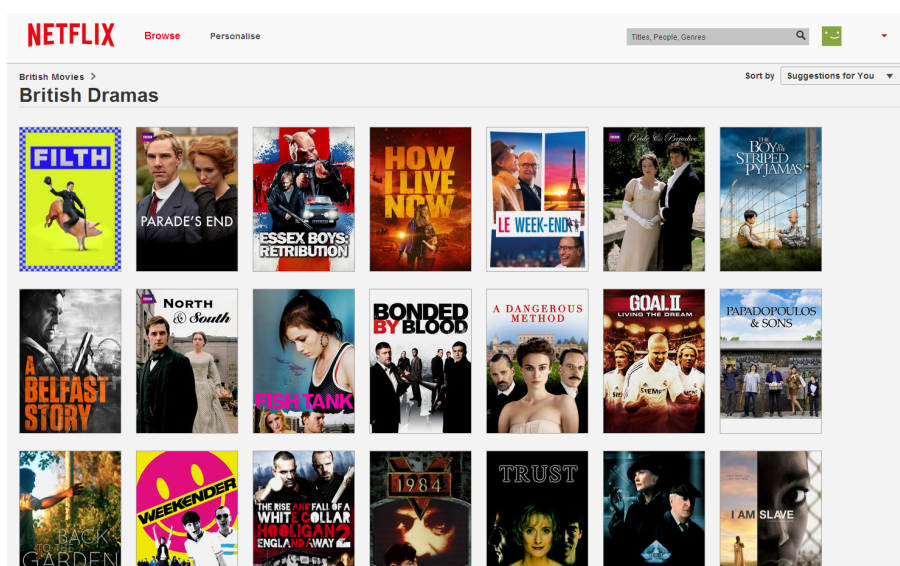
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## Overview

Netflix is an internet-based subscription video-on-demand (SVOD) service, enabling advertising-free viewing of popular TV shows and feature films. Starting out as a US mail order DVD business, it has become the world's largest streaming video service with over 50 million subscribers in more than 40 countries. Since its UK launch in 2012, Netflix has grown rapidly and we estimate that it now has more than three million subscribers. Subscribers can watch Netflix online, on mobile devices and on the TV set through game consoles and set-top boxes. Initially, providing access to older, mainly US, TV series and feature films, Netflix's offering has expanded to include original series, such as *House of Cards* and *Orange is the New Black*, helping to differentiate it from its competitors. Netflix particularly appeals to young adults, with around half of its UK audience aged 18-34.

## Netflix UK website homepage



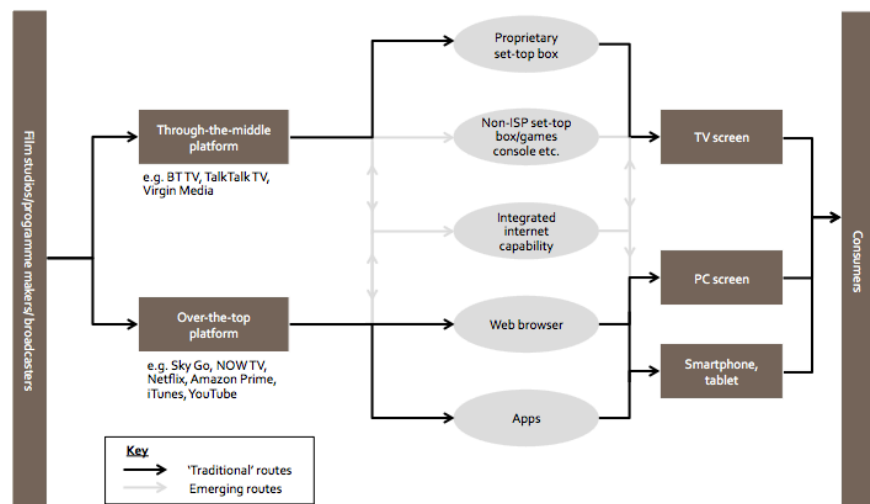
[Source: Netflix]

Key to Netflix's strategy is its original programming – full-length, broadcast-quality television series such as *House of Cards*, in stark contrast to the short, relatively low-budget videos usually associated with online media. In a competitive industry, where content owners can increase the cost of licensing shows more or less in direct response to profitability, original content is a natural way to guarantee a VOD service having the sort of exclusive offering which differentiates it. To this end, the largest players in this space, Netflix and Amazon Instant Video, are both producing such content. Netflix is also developing original content for specific markets: *Marseille* and *The Crown* are original dramas reportedly in the works, set in France and the UK respectively. This is a clear attempt to gain traction in markets where Netflix is not as well established as in the US, and suggests a new approach where content for a global audience is produced with a national focus, rather than one where domestic programming is exported to a variably receptive audience abroad.

## Background and context

Consumer appetite for over-the-top (OTT) video is expanding rapidly, supported by increasing access to high-speed broadband and rising adoption of tablets, smartphones and connected TV sets. In the UK, we estimate that video consumption to devices other than the TV set now accounts for 10% of total viewing of TV and other video content, and continues to grow in absolute terms as the range and quality of content improves. Amongst younger people, it already represents over a quarter of all consumption.<sup>1</sup> Over-the-top video services include a broad selection of paying and free options, from subscription-based services such as Netflix, video stores like iTunes, broadcasters' internet video offerings such as BBC iPlayer and Sky Go, and pure-play online video aggregators including YouTube.

### Distribution channels for internet video



[Source: Enders Analysis]

## Content strategy

At its simplest, Netflix enables subscribers to watch films and TV shows at a time and place and on a device of their choosing. The vast majority of content is older catalogue content licensed from broadcasters and film studios, though since debuting their re-make of *House of Cards* in February 2013, greater emphasis has been placed on Netflix's own original programming. Content availability varies from territory to territory; in the UK Netflix's content strengths lie in archive TV shows, largely thanks to content deals with the public service broadcasters. These deals help the service fulfil a number of PSOs, particularly PSO1, PSO5 and PSO6. The service is available across a wide range of connected devices, including Virgin Media TiVo boxes, smart TVs, tablets and smartphones.

The service is unique because of its distribution method and the added functionality that comes with it. Netflix is delivered entirely over IP (at least outside the US). Its utilisation of IP as a delivery method means it can go beyond the constraints of traditional broadcast:

- It eschews the linear schedule, making shows available to watch at any time

<sup>1</sup> Enders Analysis, based on BARB/InfoSys+ and other sources

- Any internet-connected screen can receive Netflix content
- Personalised home screens recommend content tailored to the viewer's tastes
- Effective utilisation of algorithms influences content commissioning
- Innovative search and navigation tools aid content discovery

Another area of innovation is its subscription model, where Netflix offers a one-month rolling contract that allows subscribers to cancel at any time. Finally, as Netflix does not carry advertising, it has no need to provide consumption data; beyond total subscriber numbers usage data is unavailable.

In its Long Term View manifesto<sup>2</sup>, Netflix sets out its ideas and goals. The company argues that the linear TV channel model is broken and ready to be replaced and foresees a future where all TV viewing becomes 'Internet TV', with Netflix the market leader. CEO Reed Hastings constantly uses American cable channel HBO as a benchmark, both in terms of subscriptions and programming; Netflix US subscriber numbers passed HBO in October 2013 and subscription revenue in August 2014. Content acquisition decisions are made based on improving user engagement, boosting subscriptions and reducing churn. Analysis of terabytes of consumption data, backed up by A/B testing, affects acquisitions.

Public audience engagement is mainly limited to social media and other promotions designed to drive viewing to Netflix. YouTube, Twitter and Facebook pages are all active and have sizeable audiences: 156k Twitter followers in the UK, 8.5m global likes on Facebook, 167k global subscribers on YouTube, with 76m views spread over 426 videos<sup>3</sup>.

In spite of its innovative delivery mechanisms and customer proposition, the content available on Netflix – both catalogue *and* originated – is traditional in style and feel. Catalogue content is licensed from broadcasters and film studios and therefore fits into the mould of "typical" films and TV shows, i.e. professionally shot, TV shows are 30 minutes/1 hour long etc. To date, Netflix's original shows have stuck to traditional TV formula but their Long Term View points out that they are not bound by this in the same way as traditional players:

*"We are able to provide a platform for more creative storytelling – varying run times per episode based on storyline, no need for week to week recaps, no fixed notion of what constitutes a 'season'"*

Netflix's focus is on entertainment, which is reflected on the content on offer, content that largely fits into PSO1, and there is also a large number of documentaries and children's programmes. Netflix have not indicated any plans to expand into other areas of 'broadcasting' and it seems unlikely that they will offer news, sports and content with a short shelf life. They are also clear that they are not just a generic "video" company, rather a film and TV series network.

## Contribution to Public Service Objectives

### PSO1 – Cultural activity

A large number of Netflix titles fall into PSO1 thanks to its catalogue content deals with British broadcasters. Examples:

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<sup>2</sup> <http://ir.netflix.com/long-term-view.cfm>

<sup>3</sup> Correct as at 15/08/14

**Drama:** *Parade's End*, a BBC adaptation of the WW1 Ford Maddox Ford novels about the relationship between a British aristocrat, his wife and a suffragette, and *Snatch*, a crime comedy film set in London's criminal underworld.

**Comedy:** *Black Books*, a Channel 4 comedy starring Dylan Moran as an incompetent bookshop owner, and *Michael McIntyre: Showtime*, a stand-up set from one of Britain's top comedians.

## PSO5 – Factual

Netflix produces, acquires and hosts a number of documentaries that deal with a number of the issues highlighted in the 2003 Communications Act. Examples:

**Science:** *Blue Planet*, the BBC documentary series focusing on life in the Earth's oceans, narrated by David Attenborough, and *The Inexplicable Universe with Neil deGrasse Tyson*, a lecture-style series exploring the cutting edge technology enabling modern scientists to explore the universe.

**Matters of international significance:** *The Square*, an Oscar-nominated Netflix original documentary exploring the Arab Spring with a particular focus on young people in Cairo, and *Dirty Wars*, an Oscar-nominated documentary examining America's undercover operations around the world

## PSO7 – Children and young people

As well as having children's content available across the site, Netflix has a dedicated 'Kids' section featuring a wide range of videos. Examples:

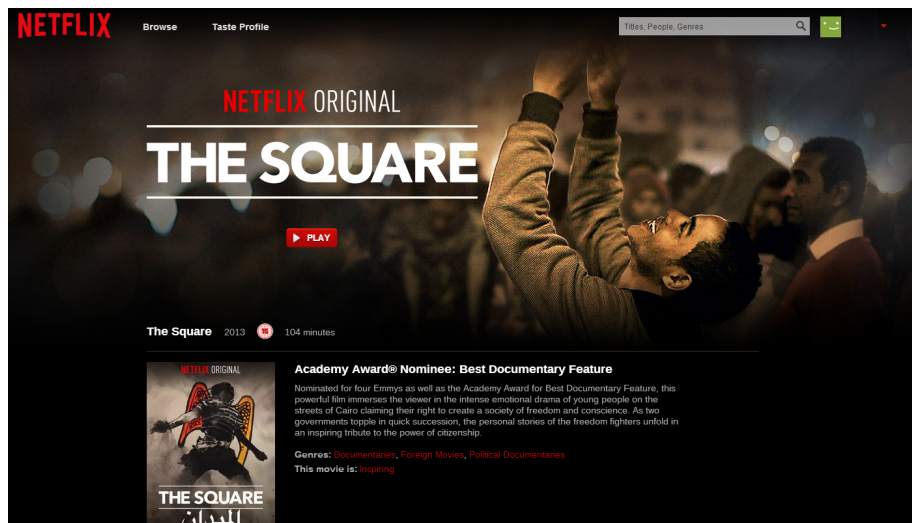
**Pre-school:** *Yo Gabba Gabba!*, a high-energy Nickelodeon show with a host of colourful characters, and *Thomas & Friends*, an animated series about the mischievous trains on the Island of Sodor.

**Primary school:** *Madagascar*, an animated series based on the hit film featuring animals who escape from the zoo and head to Madagascar, and *A Bug's Life*, an animated Disney/Pixar film featuring an ant who corrals a troupe of warrior bugs to defend themselves from grasshoppers.

## Sample content

*The Square* is an Oscar-nominated documentary centred on the 2011 and 2013 Egyptian revolutions. Filmed over the course of two and a half years, *The Square* marks the start of Netflix's Original Documentary Initiative. After winning critical acclaim at the 2013 Sundance and Toronto Film Festivals, Netflix acquired the international SVOD rights to the documentary in November 2013 before making the film available to all global streaming subscribers in January the following year. The 104-minute professional documentary is a particularly good example of Netflix fulfilling PSO5, material dealing with matters of international significance.

## The Square

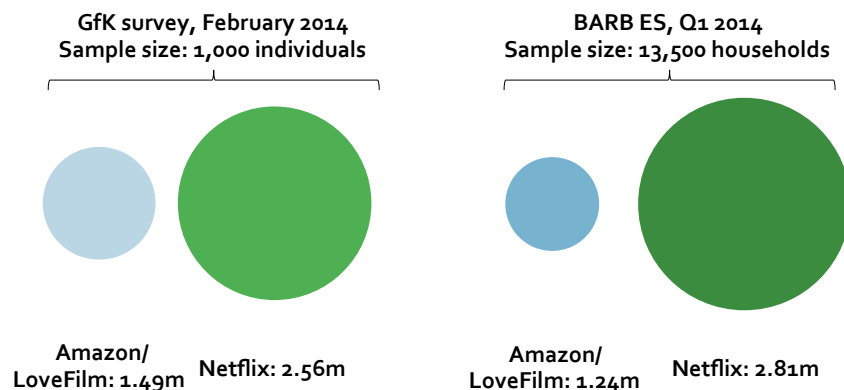


[Source: Netflix]

## Subscribers and audience profile

Netflix has not disclosed the size of its UK customer base, a number of surveys have been published which provide some estimates. Earlier this year, GfK conducted a short telephone omnibus study on a base of 1,000 adults aged 16+. This suggested Netflix had 2.56 million paying and 0.33 million non-paying subscribers in the UK. In Q1 2014, BARB, the Broadcasters' Audience Research Board, which compiles UK audience measurement and television ratings, used its questionnaire-based Establishment Survey (ES), based on a sample of 13,500 households, to estimate that 2.8 million homes used Netflix at that time. Allowing for growth would suggest that Netflix now has more than three million UK subscribers.

### UK customer base: Netflix vs. Amazon/LoveFilm



[Source: Enders Analysis, GfK, BARB]

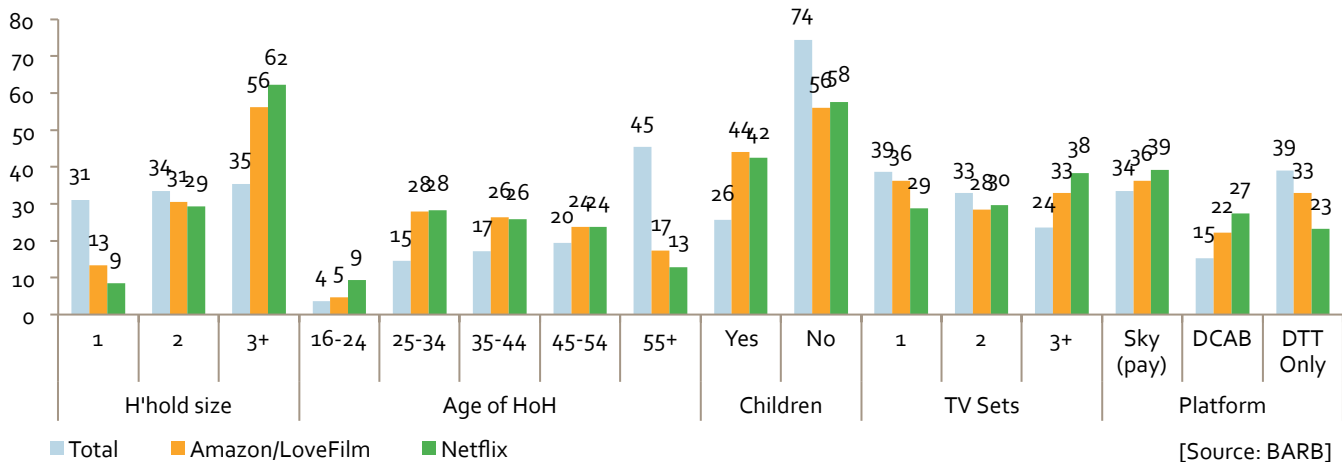
Other data from the BARB ES survey suggests that:

- Netflix has a very heavy skew towards younger households, especially ones headed by the under-24s

- Netflix is very popular in households with children, and by the same token households with 3+ persons
- Netflix is more likely to be taken by pay-TV households, especially Virgin Media where it has a ‘through-the-middle’ (delivered through Virgin’s dedicated TV cables – see chart above) deal with TiVo. Although Netflix has no such deal with Sky, it still has above average take-up in Sky homes, especially the ones taking Sky Sports and/or Sky Movies.
- Netflix has a notably higher take-up in ABC1 homes, and at the same time homes with three or more TV sets, HD reception and one or more 40+” screens

In comparison to Amazon/LoveFilm, Netflix emerges as the clear winner in pay-TV households boasting more TVs, larger screens and HD. The biggest difference is in the age of head of household profile, where Netflix has double the proportion of the 16-24s – clearly the extra “cool” factor. This ties in with the GfK data.

## SVOD service profiles (%)



## Business model and revenue

Since the US launch of its streaming video service in 2007, it has expanded into Canada in September 2010, before launching in Latin America a year later and the UK & Ireland in January 2012. Since 2012 it has launched in the Nordics, and the Netherlands and launched in France and Germany in September 2014.

Netflix is a B2C subscription business and does not carry any advertising. New subscribers in the UK are offered a one-month free trial before signing up to one of three packages:

1. £5.99 – allows the customer to watch on one screen at a time in SD
2. £6.99 – allows the customer to watch on two separate screens at a time and in HD where available
3. £8.99 – allows the customer to watch on four separate screens at a time and in HD and Ultra HD where available

All three packages allow the account holder to register up to six devices per account.

Netflix has been a publicly traded company since May 2002 and its current market capitalisation is \$27.6 billion<sup>4</sup>. In 2013, revenue totalled \$4.4 billion, up 21% year-

<sup>4</sup> Correct as at 15/08/2014

on-year. The company is based in Los Gatos, California and employs just over 2,000 people globally.

Netflix does not break out its content spend at a regional level, instead giving a global figure of \$3 billion in 2014, of which less than 10% is on originated content.

## Summary

Netflix is a video-on-demand service that offers unlimited viewing of video over the internet for a monthly fee. It is a new breed of player in the audiovisual sector: primarily offering a novel mode of distribution, it has moved into the content-creation business, at least partly due to business pressures to control the entire content vertical, from production to delivery. It is also undermining traditional television release schedules: by releasing seasons of its original shows all at once it is responding to the data it has on how people generally consume on its platform. It is easy to see how a shift in the mode of consumption could affect content decisions. Netflix is reportedly producing a drama set in the UK, which would fulfil the public service requirement to provide original UK drama. At any rate, it is likely to continue to expand its original programming, and a comparable service from Amazon is doing the same.

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