The Frontlines of the Streaming Wars

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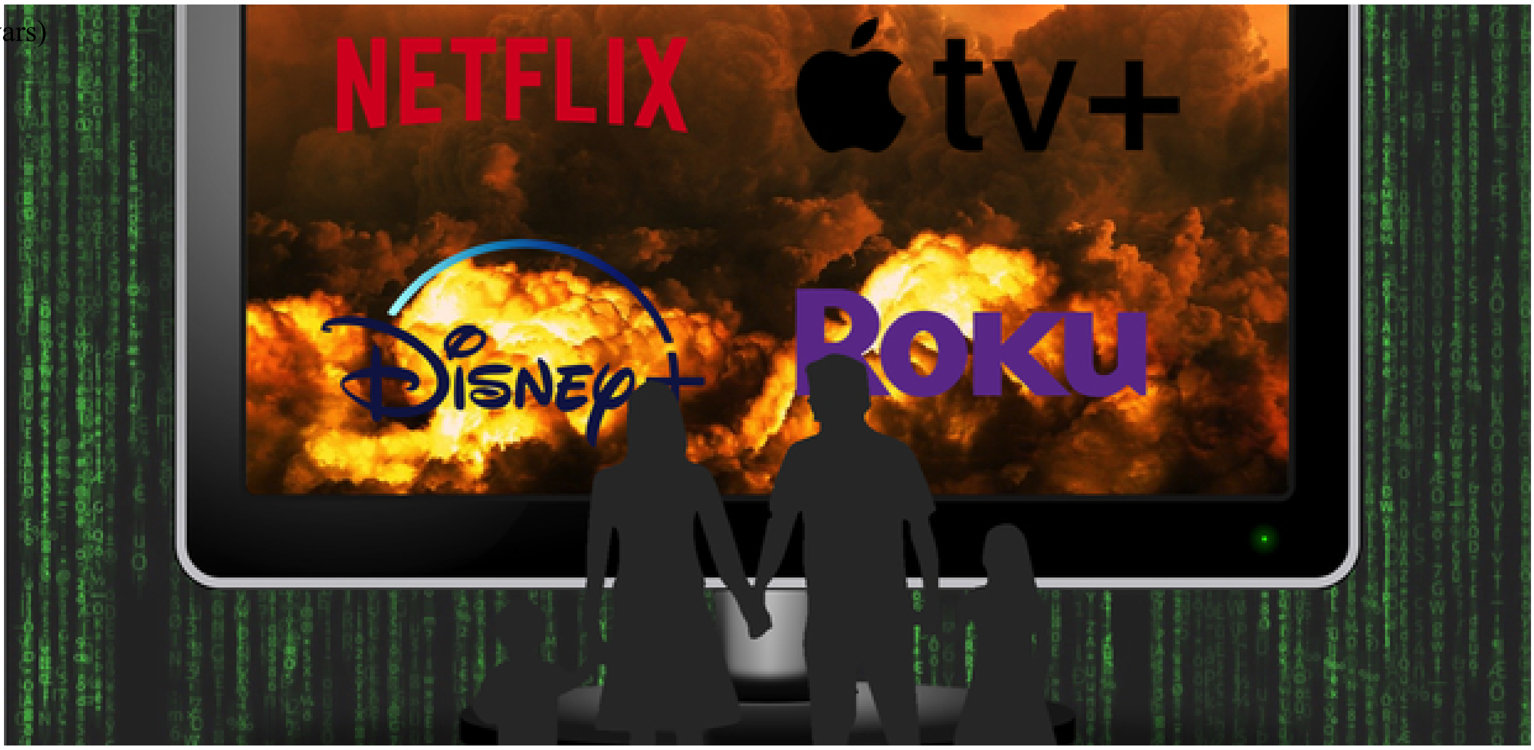

With Disney and Apple entering the arena, we reviewed some of the ideas posited by SumZero contributors to examine how these two giants are shaping the competition for subscription-based video and how companies like Apple and Netflix – the 6th and 7th most-searched for companies on SumZero – are being affected.

Disney Plus: Not Just For Kids

Disney's (DIS) acquisition of Marvel Entertainment and Lucasfilm (and thus, the Star Wars franchises) in 2009 and 2012 respectively, expanded its reach as an entertainment company. As New Constructs LLC's David Trainer, a SumZero top contributor, notes:

> **"Disney-owned films now account for 10 of the top 15 global box offices of all-time. The company has achieved a level of box office dominance that is unprecedented in the modern era. This dominance is bad news, not just for its fellow movie studios, but for all other content producers out there, especially Netflix."**

The November 12th launch of Disney Plus, a streaming service that augments its massive catalog with exclusive programming like The Mandalorian, has already positioned it as a major player in the streaming wars: its stock price jumped after their announcement of 10 million sign-ups the day after launch, closing up 7.3%[1]. As a subscription model, those numbers form the bottom line for the service and Disney estimates 60 to 90 million sign-ups by 2024. Beyond the array of exclusive programming and its coveted Marvel titles, Disney Plus is priced to lure and keep consumers: at $6.99 a month, it's already $2.00 cheaper than Netflix's lowest option and can be bundled with ESPN+ and Hulu (which Disney owns) for $12.99: the price of Netflix's second-tier option. Moreover, Verizon customers will get the service free for a year: certainly long enough to whet their appetite and becoming paying subscribers.

Disney's biggest bullish proponent is Rosenblatt Securities analyst Bernie McTernan, whose $175 price target exceeds any on Wall Street[2]. McTernan's estimates for sign-ups are equally optimistic: he foresees 35 million subscribers by the end of 2020 and Disney’s 60 - 90 million estimates to be reached by 2022: a full two years earlier than the company’s current guidance. Timelines aside, CEO Bob Iger is counting on success. “We’re making a huge statement about the future of media and entertainment and our continued ability to thrive in this new era,” he said on their last earnings call [3].

That’s not just talk: entering the streaming game comes at a cost, which includes $150M stemming from the loss of the third-party licensing revenue and another $3.9B in operating losses from ESPN+ and HULU for 2019, which are expected to rise to nearly $5B in 2020[4]. Disney Plus’ original content budget for 2020 is estimated to be $1B: a far cry from the $17.8B BMO Capital Markets analyst Daniel Salmon anticipates Netflix will spend on original content during the same year [5]. That said, it’s worth remembering that Disney has proven itself on the big screen: as of September of this year, Disney – driven largely by the success of Avengers: Endgame and Captain Marvel – commanded 34.1% of domestic box office sales, with Star Wars: The Rise of Skywalker likely to drive that number skyward [6].

With Disney's stock up over 30% YTD, their entry into over-the-top content could push their revenue to new heights.

Netflix: Could This Giant-Killer Go the Way of Blockbuster Video?

With 23 ideas written about it on SumZero, Netflix's (NFLX) influence cannot be overstated.

Rather than triumphantly standing on the bones of vanquished video stores as it once did, Netflix now operates in a competitive environment crowded with studios and platforms that have become increasingly territorial about their content. With Disney Plus taking back all of their Marvel and Star Wars offerings and Netflix's apparent inability to match the success it earned with House of Cards before the series was deflated by scandal, many investors are openly questioning the company's viability, particularly as expenditures on content continue to rise. Among those bearish on Netflix is David Trainer. Citing the end of its licensing agreement with Disney and the threat posed reliance on outside content like Friends and The Office for success, Trainer also notes that the company isn't seeing enough subscriber growth to justify its spending on content[7], which hit $12.8B in 2018 and was expected to reach $15B in 2019 [8].

"Since 2011, revenue has increased by $12.6 billion, which is half the total increase in expenditures over the same time," Trainer writes in his analysis, which is SumZero's fifth-most-viewed idea YTD.

> **"The difference in revenue and expenditures means Netflix has burned through nearly $13 billion since 2011. For the Netflix business model to work, subscriber revenue growth has to cover the cost of increased expenditures. To date, the model is not working – not even close."**

SumZero contributor Dmitijs Soha agrees. "The company has to run faster each year just to stay on pace with competition and hence cannot stop increasing its content investments," Soha wrote in a widely-read short position on SumZero, further noting that Netflix "cannot become cash flow positive without significantly growing its revenues and raising prices, which in turn is virtually impossible given existing market penetration, significant competition, and growing content costs.[9]"

Roku: A Fading Star?

Unlike the other players mentioned here, Roku (ROKU) is not a streaming platform, but rather a maker of TV streaming devices: online media players that connect you to subscription video on demand (SVOD) "channels" like Amazon Prime Video, Disney +, and Netflix, essentially removing cable companies (most of whom have wisely gone on to become Internet Service Providers) from that side of the equation. Leichtman Research Group found[10] that 74% of U.S. households have at least one SVOD service, with 69% of those households having more than one. Roku's market share is huge, accounting for approximately one-third of devices in use. Nevertheless, the Wall Street Journal reports that the company's stock dropped 16% the day after its Q3 earnings report earlier this month after disappointing analyst expectations for new active accounts and a revenue forecast of + 39% for Q4, despite showing a 50% YoY increase in revenue in Q3[11]. Roku saw similar declines in September first with Apple's announcement of its streaming service and then with Comcast's announcement that they'd be offering their own streaming device to their subscribers for free. Despite an early lead, Roku's biggest obstacles may yet lie ahead as they struggle to compete with Amazon's Fire TV, Apple TV, and Chromecast.

The Comcast announcement underscored a weakness identified by Dmitrijs Soha in his widely-read examination of the company. "The company operates in an extremely competitive space saturated with large players with vast financial resources," Soha writes, "and we believe its main revenue stream, the Roku platform, lacks a sustainable competitive advantage, as its service is simple and easily replicable.[12]"

Whither Apple TV +?

Aggressively priced at $4.99 a month – and free for a year for buyers of new Apple devices – Apple (AAPL) TV + is an audacious move on the part of Tim Cook. The company is making some big bets on original content, including See, a post-apocalyptic drama featuring Jason Momoa (Aquaman) and The Morning Show, a drama starring Reese Witherspoon and Jennifer Aniston, and apparently costing $15M per episode – the same as Disney's The Mandalorian [13] – largely due to the salaries commanded by its stars. The company plans to spend $6B on original programming in 2020[14]. Apple's strategy, however, seems to be less about competing for eyeballs with programming – it launched on November 1st with only eight shows and a documentary – than it is about changing the way people watch TV: in essence, becoming a one-stop shop for audiences.

A CNET analysis of Apple TV+ described the situation. "If Apple can provide a unifying interface, billing structure and a way to access a ton of content across phone, tablet, computer and TV, then it will have something worth consumers' time and money. To pull that off, Apple's new Apple TV app will try to 'do the whole banana,'

as Steve Jobs famously said about the company's vertical integration strategy -- its preference to control the entire user experience so it can smooth out the rough edges [15]. While that's an admirable strategy, it hasn't been well communicated to consumers confronted with a wave of programming and franchises that they're already familiar with on platforms that they've already integrated into their viewing habits.

For Whom the (Closing) Bell Tolls:

As the competition for audience attention spans heats up, companies are still struggling to find the balance between spending and pricing to engage – and keep – the direct-to-consumer base that has emerged in a post-cable entertainment environment. While Apple and Roku are hoping to leverage their existing technological market penetration, they're finding more critics than supporters, either by being outmaneuvered, as with Roku, or by simply missing the mark in original content, as in the case of Apple. Studios like Netflix are spending huge sums to make big bets based on trying to predict what will be The Next Big Thing, while Disney's game of taking all of its toys (and comics and princesses and so on) home may prove to be the wisest play yet. Content is still king, however, and audiences will follow their tastes to the ends of the Earth. Those lacking a finger on the pulse on what people actually want – and are willing to pay for – will be left haplessly flipping channels, desperately trying to find something before they realize that their show is over.

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