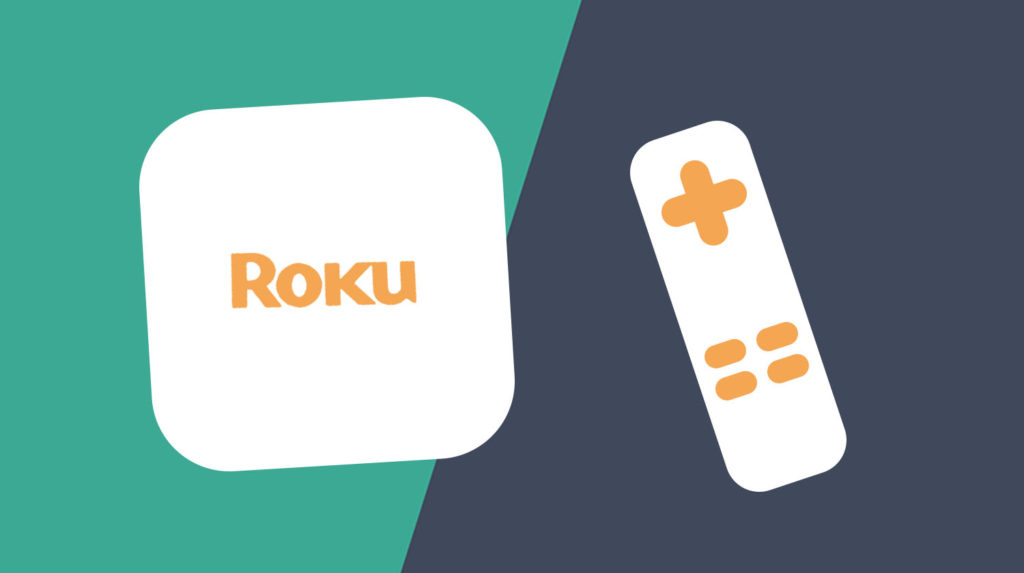
Is Roku’s business model ideal in the next era of streaming wars?

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One of the most rapidly growing trends across today’s consumer landscape is the growth of streaming video, and the Roku business model might be uniquely positioned to continue to take advantage of this trend.

The number of people ditching traditional cable and other Pay TV services for streaming services is at all-time highs and compounding. A report on the cord cutting trend released in February of this year noted that the number of Pay TV subscribers dropped 4.1% in the calendar year 2018, its highest rate of decline since 2010.

Companies in the streaming industry are luring in customers with an experience characterized by an easy to navigate platform at a significantly lower price than Pay TV providers. But how do all of these companies make money? Three ways typically: SVOD, TVOD, and AVOD.

Subscription Video-On-Demand (VOD) is a service in which consumers pay a recurring set amount and watch an unlimited amount of content. Think [Netflix](https://nextlevel.finance/streaming-trend/). Transactional VOD is a one-time payment service, much like buying a DVD to own. Advertising VOD is a service that is free (or perhaps a reduced fee) to consumers, but includes advertisements. To many industry analysts, AVOD is one of the hottest business models in the streaming space (more on that later).

As this industry continues to grow, there are companies that are better positioned than others to capitalize on this shift in consumer culture.

Streaming giants like Netflix, Amazon Prime Video, and Hulu (now owned by Disney) are significant players in the space. But one of the most unique companies in streaming media, and perhaps the company with the most upside potential, is Roku, Inc (ROKU). And it all comes down to the Roku business model.

For starters, Roku isn’t primarily a “streaming service” like a Netflix or a Hulu. Instead, you can stream Netflix or Hulu from the Roku platform. Roku’s main objective is to provide an easy-to-use platform from which you can stream your favorite videos, TV shows, and media. In fact, if you asked Roku why you should be a customer, their answer would be: “Roku devices are simple to set-up and easy-to-use”. Roku is the platform that connects the “ecosystem” of streaming media.

In the past, Roku emphasized hardware. The company sells a variety of products that connect directly to your TV via HDMI. Their products range in capabilities even including component capabilities for older TVs. Roku also sells a competitor to the Amazon Fire Stick: The Roku Streaming Stick. All but one of Roku’s hardware products and accessories can be purchased for under $60 (Roku Ultra).

Many televisions now don’t even require the additional hardware and have Roku’s system built in to the television. During the most recent conference call (2019 Q1), management reported that in the first quarter, one in every three smart TV’s sold in the US was a RokuTV, up from one in every four TV’s sold all of last year. This stat makes Roku the #1 Smart TV OS in the United States. Roku player units as a whole were up 21% year-over-year (yoy).

Not only has Roku created a platform from which you can access all of your favorite streaming media services, they have their own. On The Roku Channel, you can watch hundreds of free movies and shows. You also have the option to pay for premium subscriptions to streamers like Starz, HBO, or Showtime on top of that. The Roku Channel itself is also a thriving part of Roku’s business as management reported in the 2019 Q1 conference call that The Roku Channel is a “top five channel in terms of reach.”

Roku’s not alone in de-emphasizing the low margin hardware business and focusing on attracting as many users as possible to the platform and monetizing the engagement instead. Apple’s made very similar moves with its Apple TV initiative. For the first time, Apple is aiming to open up its platform (very similar to Roku) in that you no longer need an actual Apple TV device. The goal is simple: to get users.

Roku’s unique position

The thing that makes the Roku business model especially unique in the streaming space is their ability to profit from all advances in streaming media. Roku is strategically positioned to make partners out of companies that, at first, look like competitors.

When asked if whether or not big name players like Disney entering the streaming space made management nervous about potential partnerships, CEO Anthony Wood reiterated that any player in the streaming space is “absolutely not a competitor.” Wood added, “They are direct-to-consumer services, but they need a platform like Roku to reach consumers in the living room on TVs.” Roku reported 29.1 million subscribers total for 2019 Q1. Streaming media companies are embracing the opportunity to put their services in front of potential new customers.

The area of Roku’s business perhaps gaining the most interest from the analyst community is the AVOD piece. After mentioning that monetized ad impressions doubled again in this most recent quarter, management listed monetized ad impressions as not only the biggest driver of the platform segment, but overall as the biggest revenue opportunity for the company.

Roku generates revenue through advertisements in unique ways. For ad-supported streaming services that run on Roku, the ads may be sold by Roku or the company that owns the streaming service (e.g. Crackle). When a user watches Crackle through Roku, Roku doesn’t get a cut of the ad revenue if Crackle sold the ads. Management mentioned that this is “very hard to police and enforce.” Rather, Roku gets access to a percentage of the ad inventory on Crackle to sell themselves. When combined with the increasing usage of The Roku Channel, Roku is building a very powerful advertising channel. As ad impressions continue to increase, Roku is heavily investing in its advertising tools and technology to attract more and more advertising money away from linear television.

It’s worth noting that two of the largest streaming services that Roku users likely spend a good chunk of time watching are Netflix and Hulu. Netflix doesn’t do advertising, and Hulu is big enough to where they have told Roku that they will not get access to any inventory. So, for now, Roku’s advertising sales apply to its own channel and the smaller ad-supported streaming services.

One particular tool that the company has just announced is called the “Activation Insights” tool. This new ad tool informs advertisers about ads that are being viewed on Roku that aren’t being viewed on linear TV. This ad tool was designed to show advertisers the advantage and exposure of not only Roku, but the OTT space in general. This will be an important tool as management continues to lure in the $70 billion of traditional TV budgets that the company expects to eventually move into the streaming space.

Roku’s own streaming channel, The Roku Channel, allows Roku users to freely access a library of movies and shows with advertisements sprinkled in. This channel is important strategically not just due to the increasing revenue contribution it adds to the company, but because of the data Roku will be able to gain about its users and integrate into its advertising targeting technology. The better the targeting gets on Roku, the higher the ad rates Roku can command.

Can Roku benefit from increased competition?

Roku isn’t attempting to be one of the two or three or five or ten paid streaming services left standing after the streaming wars shake out. Rather, Roku is simply attempting to help users connect to these streaming services. As new entrants join the battle (e.g. WarnerMedia, NBCUniversal and more), these services will compete hard with respect to user acquisition. Roku stands to benefit from this battle. Not only can Roku sell premium space on the Roku platform “home page” to emphasize a particular service, it can even sell buttons on its remote. Think about the Netflix or Hulu button on the remote.



While Roku can benefit by increased competition among streaming services, the question remains about Roku’s long-term strategic positioning. Roku’s platform isn’t overly unique when compared to what Amazon provides and what Apple’s TV offering is evolving toward. Essentially, all three aim to provide a slick, user-friendly interface in which you can access any and all streaming services plus perhaps some original content only available to that particular platform.

It’s worth noting that Apple and Amazon have different business models, however. At the end of the day, Apple is ramping up its services business and revenue, but it’s still primarily a hardware company attempting to keep users within the iOS ecosystem. Similarly, Amazon’s goal is to bring individuals into the larger Prime universe of buying products and uses its streaming video piece to help attract users. So, while Amazon and Apple are more ubiquitous brands compared to Roku, Roku has the advantage of being more singularly focused on the streaming space. It also has the advantage (at least over Apple) of having years of a first mover advantage attempting to get the Roku platform in the hands of more people.

Perhaps Roku’s biggest advantage might be its growing advertising platform. If Roku can continue to develop best in class tools for brands to advertise into streaming video, this business could prove quite lucrative. We’ve already seen how big advertising businesses can get in the cases of Google and Facebook, so Roku management is wise to be giving this area the proper attention and investment. As linear television usage continues its decline, the leader in monetizing AVOD services could stand to become very valuable in the years ahead. Assuming Netflix remains off-limits for ads, if Roku’s capabilities and market position for advertising spend increase dramatically, you might even see Hulu open up some inventory to Roku.

Is Roku a buyout target?

With Roku’s strong strategic position in the space, it would make sense to consider Roku to be a buyout target for a larger company. Over the last year, many have speculated the possibility of a Roku buyout and there have been many different companies named in the M&A speculation. Companies often associated with the talks of a Roku buyout are Walmart (WMT), AT&T (T), and Alphabet (GOOGL).

One could make a good case for each of these companies’ interest in Roku. For Walmart, the biggest reason to acquire Roku is their competition with Amazon. Walmart has taken necessary steps to keep up with Amazon particularly in the e-commerce space. However, with the acquisitions made in the last year including Bare Necessities, Cornershop ($225 million), and Flipkart ($16 billion), it’s hard to see the company spending another estimated $10 billion for Roku.

From a strategic standpoint, it would make a lot of sense for AT&T to pull the trigger on Roku. HBO and DirecTV would benefit from being front and center on the Roku platform. The blinding issue with AT&T is the debt load north of $190 billion that AT&T has committed to reducing. At this juncture, I don’t believe AT&T is a buyer.

Finally, Google Alphabet has been mentioned. Strategically, AT&T makes the most sense. But if one of these companies were to buy Roku, it might be Google. Google is sitting on a significant pile of cash ($113 billion) so Roku is affordable. One reason Google may be interested in buying Roku is to boost the reach of YouTube, particularly YouTube TV. Roku would give good exposure to those services and make up for Google’s lack of significant presence in the video streaming space.

If any company were to consider buying Roku, they may want to act quickly as Roku’s price tag continues to grow. As of writing, the stock has nearly tripled year-to-date in 2019.

Whether Roku gets bought out or not, the company is certainly in a position to reap massive benefits from the cultural shift into the streaming media age through the success of its platform, streaming service, and hardware.

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