

[Rich Greenfield of Palicapital](#) had another great research note about the economics of video downloads , in particular how they apply to Unbox, [Amazon.coms new video download program](#).

Here is his email summary of his research note, below it are my comments explaining why the studios and anyone who sells to retail is in no rush for video downloads, particularly of movies, to succeed.

## Maybe the Studios Do Not Want Legal Internet Downloading to be Successful Right Now?

Richard Greenfield [rgreenfield@palicapital.com](mailto:rgreenfield@palicapital.com)

Mark D. Smaldon [msmaldon@palicapital.com](mailto:msmaldon@palicapital.com)

Yesterday evening, Amazon launched its new movie and television download to own/rent service called Unbox ([www.amazon.com/unbox](http://www.amazon.com/unbox)).

The rules and pricing scheme of Unbox, **make us believe that movie studios do not want legal movie downloading to be terribly successful in the near-intermediate term.**

Exhibit A illustrates the Unbox download-to-own pricing (\$19.64) for a recently released movie, *Family Stone*.

■ **\$4.65 premium (31%) to the cost of the same physical DVD available on Amazon** as shown in Exhibit B (albeit you do have to buy at least two DVDs to qualify for free shipping from Amazon, with no sales tax on the download or physical DVD).

■ Unbox Internet download-to-own allows you to playback the movie on two computers and two portable devices, but **you cannot burn the DVD for playback on a standard DVD player**. Consumers need to connect their computer to their TV.

○ What makes no sense to us about the inability to burn a DVD, as well as limiting to two PCs/devices, is that the studios are competing against increasingly easy to obtain, albeit illegal, ripped DVD versions that have no restrictions on PCs/devices that can be burned for playback on any DVD player.

○ Exhibit C illustrates an illegally ripped version of *Family Stone*. The "torrent" file was found by simply entering the words "family.stone torrent" into a Google search window (bittorrent client application must also be installed once). The illegal version has no cost, no restrictions on use/playback, and can be downloaded far faster than the Amazon version as it utilizes BitTorrent peering technology to accelerate the download (relative to the 1 hour 50 minute download time stated by Amazon for a 2-hour movie file on a 3 Mbps connection).

§ The fact that Amazon is not using P2P technology to accelerate downloads also means that they are bearing all the bandwidth costs to transmit the files, versus leveraging their users' bandwidth to offload a significant portion of those costs.

■ Unbox Download-to-Rent – why bother? Amazon's unbox rental service is constrained by the studio's pre-existing subscription deals with HBO, Showtime and Starz Encore. The reason why Unbox rentals expire 24 hours after you begin watching (although you do have 30 days to start your 24 hour viewing period), is that anything over a 24 hour rental is a violation of the pay cable subscription window output deals. This has been the underlying problem affecting previous online rental services such as Movielink and Cinemanow.

○ Given that pay TV output deals are critical to movie industry economic health, not to mention that the majority of these pay TV output deals last until 2010-2012, it is unlikely that online download-to-rent terms of service will improve in the near-future.

○ The \$3.99 rental price (see Exhibit D), is the same as renting a physical DVD from a video store (such as Blockbuster), and again you cannot burn the file to a DVD to watch on an existing in-home DVD player, users must watch on their PC, a portable device or connect their PC to a television screen.

**Restrictions on use should drive a cheaper price to the consumer, not the same or higher pricing**, especially because the studios' cost to produce and distribute is lower in an online world. In turn, the rules/pricing of online downloads-to-own/rent appears to be intended to ensure that they have no meaningful impact on the movie/television studios existing (and highly profitable and important) physical DVD business. While this will surely change in the future, the goal today appears to be to protect incumbent physical DVD distributors such as Wal-Mart.

■ At a premium price point we also question who is the target market? Illegal movie downloaders are unlikely to be attracted at these prices and physical DVD purchases are unlikely to be interested in dealing with primarily PC-based nature of the downloadable files (with heavy movie renters far better off with Netflix or Blockbuster than Amazon Unbox).

We are quite interested to see how Apple's new movie store changes the game next week (September 12<sup>th</sup> launch). Speculation is building that the service will go beyond simply allowing full-length movie downloads to an improved video iPod; with some form of hardware/software solution to enable (ease the process for) viewing of downloaded movies on home televisions (home theatres).

■ We hope the Apple service is significantly more innovative than **the Amazon service, as the studios need to accelerate the attractiveness of digital delivery to prevent illegal P2P from capturing too much market share** (particularly as cable system/RBOCs are continuing to increase bandwidth provided to consumers as competition to control the broadband IP-pipe into the home continues to heat up).

First of all, i dont agree that the illegal P2P market will capture any more market share than it has now. As I have said many times, its too much hassle for anyone other than those who have lots of time on their hands, and those people will borrow DVDs from their friends before they would buy the movie.

However, his google search for a movie torrent does raise the question of why the studios and MPAA dont go right to Google and ask them to use all that amazing search technology they have to block illegal torrent sites the MPAA provides them. Its not like the MPAA cant put in the same search terms and then provide a list of sites.

But lets get back to why Studios are smart in not pushing Internet Downloads of ANY products they sell in packaged goods to retail. The simple answer is that download sites pay a license per download while retailers buy inventory.

The complete uncertainty of how many licenses/downloads may occur vs the far greater certainty of product that has been shipped selling one way or another with an expected return percentage makes downloads not very desirable to big media companies.

Its one thing to allow downloads of yesterdays TV show and create a market and revenue that didnt exist last year. Its another thing to mess with your biggest revenue stream.

What makes downloading even less desirable is that the sites offering the downloads don't believe in their ability to sell enough to pre buy a given number of licenses. IN other words, I can't go (so far anyway) to CinemaNow or MovieLink and say "we need you to place an order for at least 10k licenses in order to get the same price as 10k DVDs shipped to a retailer". They won't do it.

I will give you the gist of an exchange i had with a torrent site that promotes that it reaches 70mm unique users and growing. They wanted us to offer our content for sale through their site. I told them I would be happy to if they placed an order for a number of units that made it worth our while to encode the content, deal with the management of the content and working with their systems. All that is overhead to me, and I was absorbing the risk. So if they placed an order like a retailer or rental outlet would, i would be happy to work with them. They wouldnt put up a nickel. They wanted us to absorb all the risk . Which in turn tells me they dont trust their platform.

Compare this to Netflix. This is one of the reasons Netflix has been so successful compared to any and all download sites. They believe enough in their product and systems to know and trust what they will rent and how many turns it will generate. Which in turn allows them to offer guarantees and minimums on products they want to offer.

So the choice for studios comes down to simple economics. Make a real sale, and get the revenue minus a historical rate of product returns or hand over an encoded file and hope it sells with no assurances of ever making a nickel or covering your administrative and management costs.

And as far as the perspective of giving users what they want and they want downloads. If we dont offer them downloads, they will find downloads on their own , jus

t as we saw in the music business... Nope. This aint the music business. This aint 3 minute songs that download in under a minute and allow users the option of getting the 1 song they like instead of a package of 10. IF movies were sold in prepackaged albums of 10 movies. Maybe. If movies were 3 minutes in length. Maybe. If watching on a computer or on an Ipod was as good an experience and often better than watching on the smallest TV in the house, maybe. But its not.

Watching video on a computer or on a PDA/Ipod is a 2nd class experience. It works amazingly well as a time killer on a bus, plane, lunchroom. It works good enough in a dorm room or your apartment bedroom, but its not going to replace watching on a real tv. It will always be a niche market in every manner.

and for all you "but i can and do download everything " types. Good for you. Get up and away from your computer and go see how the rest of the country lives. And when you hit 27, get a real job or move out of your parents house, whichever comes first, tell me if you are still downloading 10 movies and burning them for your friends and creating 10 playlists for Itunes every week like you did in college or when you first graduated. At some point you realize the time you spend downloading and burning to a DVD is worth more than the 10 bucks to go to a movie or 20 bucks or less to buy the movie. When that happens you will have figured out that all that time you spend burning DVDs and trying to manage space on your hard drive wasnt worth it