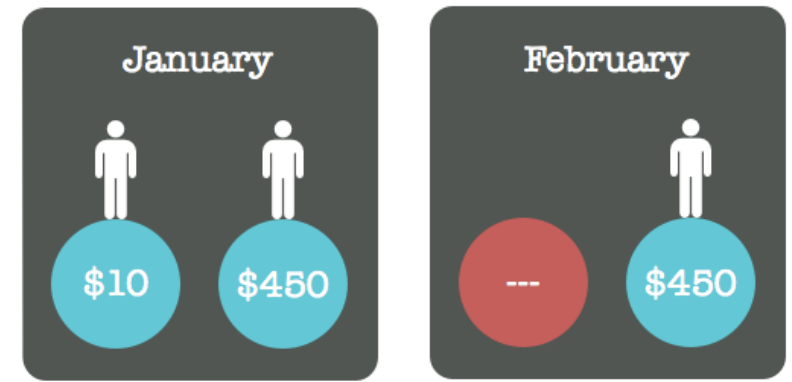


How Do You Project Revenue for a Subscription (SaaS) Business?

What's Your Churn Rate?



Customer Churn Rate: 50%

Revenue Churn Rate: 2%

This Lesson: From an Upcoming Case Study

*I'm currently working on a **Netflix** case study where you analyze the company and recommend **debt vs. equity vs. convertibles** for its funding needs.*

*We're going to look at a **small part** of that in this lesson.*

This Lesson: Our Plan

- **Part 1:** Key Drivers of a Subscription Revenue Business
- **Part 2:** Where to Find the Required Information
- **Part 3:** How to Put It Together in Excel + Add Scenarios



What Drives Subscription Revenue?

1. **Existing Subscribers and the Renewal Rate** – MOST revenue will depend on this, unless the business is growing like a beast



2. **New Subscribers and Their Renewal Rates** – As a % of existing subscribers, how many is the company adding each year?



3. **Monthly Fees and Pricing Increases** – Would you pay \$12/month? \$15? At what point do you cancel your subscription?



More on the Key Drivers...

- **Different Renewal Rates** for Existing vs. New Subscribers in many cases – new people tend to cancel more quickly
- **But...** after the first year, the New Subscriber Rate will approach or equal the Existing Subscriber Rate
- **Subscriber Adds** – You should generally project these as a % of total existing subscribers to avoid nonsensical growth rates
- **Scenarios** – You almost always want to look at different outcomes; higher growth rates, renewal rates, and fee growth, and then lower figures for all of those



Finding the Information

- **Netflix** famously **does NOT disclose** its Churn Rate or Renewal Rate – shareholders once sued them for this lack of disclosure!
- **Disclosures:** Revenue, “Net Additions,” and “Members at End of Period”
- **Intuition:** Churn Rate can’t possibly be *that* high because Net Additions were 17 – 25% of Subscribers historically...
- If the company *lost*, say, 30% of its subscribers each year, they’d have to keep increasing *new* subscribers by ~50% per year
- **Not plausible** for a saturated market like U.S. streaming



50%

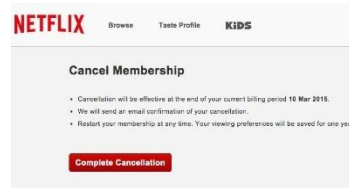


Finding the Information (cont'd)

- **Industry Sources:** Parks' Associates → Tracks churn rates for video streaming services like Hulu, Netflix, etc.



- **Netflix:** Fairly low cancellation rate of ~9%, far lower than Hulu's 50% rate (!!!!) → Don't know the new vs. existing breakout



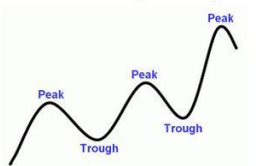
- **Base Scenario:** Will start at a 94% renewal rate for existing subscribers and 88% for new ones (91% is in the middle)
- **Others:** 2% higher in the Upside Case, 2% lower in the Downside Case, and 2% lower than that in the “Extreme Downside” Case

Finding the Information (cont'd)

- **Subscriber Adds:** This % will be *above* the historical Net Addition %'s; it will also decline over time
- **Monthly Fees:** Upside Case will be closer to the historical high and the Downside Cases will be closer to the historical lows
- **Reality:** Netflix will not increase its fees by exactly 3.5% per year... they'll jump up discretely in certain years, but this is a “model”



Peak & Through Analysis



Putting It Together in Excel

- **Step 1:** Set up the Renewal Rate schedule for New vs. Existing
- **Step 2:** Multiply the Existing Subscribers by the Renewal Rate each year
- **Step 3:** Factor in New Additions each year as a % of Base Subscribers
- **Step 4:** Apply the New or Existing Renewal Rate each year
- **Step 5:** Sum the Total Subscribers and take the yearly average
- **Step 6:** Grow the Monthly Fees and multiply to get Total Revenue

What Next?

- **Check and refine** your numbers – Do all the scenarios make sense? What about the capitalized annual growth rates (CAGR)?



- **Consult other sources** – What is equity research saying? How do your estimates compare with the consensus views?



- **Finish the rest of the model** – You still have to factor in the expenses, working capital, CapEx, etc. to build a full model



Recap and Summary

- **Part 1:** Key Drivers of a Subscription Revenue Business
- **Part 2:** Where to Find the Required Information
- **Part 3:** How to Put It Together in Excel + Add Scenarios

