

Hyperion Asset Management

Company Profile Roku, Inc. Class A

Main Business Activities

Roku was founded in 2002, is headquartered in San Jose, CA., and is one of the market leaders in the streaming TV industry, with 56.4 million active users today and more than 50 billion hours of content streamed on Roku devices so far in FY21.

Roku operates through two core segments, Player and Platform. The Player segment's revenue is derived primarily from the sale of physical hardware. The Platform segment generates revenue through the Roku operating system which includes advertising and content distribution fees.

Advertising revenue is further broken down into sub-segments and includes:

- 1) Video – largely programmatic or automated buying of ad-space;
- 2) Sponsorship – where a company sponsors a movie will place two to three commercials within the movie playtime;
- 3) Audience development tools – platform home-screen advertising placements;
- 4) Content distribution – largely button sales on the remote controls;
- 5) Transaction-Video-On-Demand (TVOD) - when a customer rents or buys a movie through the platform Roku earns a fee;
- 6) Subscription-Video-On-Demand (SVOD) – Revenue share when a customer subscribes for Netflix, Disney, or another video streaming service through the Roku platform; and
- 7) Advertising-Video-On-Demand – generated through advertising sales within the specific channel.

Key Value Proposition to Customers

Roku offers a strong value proposition to its three core customer bases through the provision of both high-quality hardware and an innovative software offering. The value proposition is outlined in detail below.

Consumer specific value proposition:

Roku offers the most advanced and easiest to use platform that enables users to aggregate and access the many and now growing streaming options available such as Netflix, Disney+, Hulu, Peacock, Amazon Prime, etc. The Roku platform has access to over 3,000 channels, providing the largest range in market. As Roku doesn't produce its own content, the larger content producers do not see it as a direct competitor and therefore customers are able to access largely all streaming services. Furthermore, Roku has its own Ad-based Video on Demand (AVOD). This channel is free to use and increasing in popularity driven somewhat by the rising costs that consumers' are facing from the many different Subscription Video on demand (SVOD) services.

TV Original Equipment Manufacturer (OEM) specific value proposition:

Roku is the most utilised operating system in the U.S and Canada and actually pays TV OEMs to deploy its operating systems on their smart TVs. This not only generates revenue for OEMs but also results in meaningful cost savings given it removes the need to develop or integrate software. Roku's operating system is designed to run-on low-cost hardware, a tight memory footprint, and a basic chip, which makes the operating system suitable for even entry level Smart TV's. A good example of the value proposition in action is Roku's relationship with TCL. In 2014 when the two companies partnered TCL was a relatively unknown brand in the U.S. market. Through the provision of high quality, low cost smart TVs utilising Roku's Operating System, TCL was able to grow its market share from sixth in 2016 to second in 2020. TCL were able to focus all efforts on manufacturing a great hardware at low costs, while Roku focused on providing superior software capabilities. As at 2021, Roku works with 17 OEMs.

Advertiser specific value proposition:

Due to the data that Roku collects from its platform, it can provide advertisers with the opportunity to run a significantly more

targeted campaign compared with linear TV advertising. Roku can target users based on location, age, sex, as well as what they are watching which drives higher return-on-advertising-spend as is typically seen with most digital advertising offerings. Furthermore, Roku has invested in advertising infrastructure through the acquisition of a demand-side platform (DSP) called Dataxu which has now been rebranded as OneView. The infrastructure provides a platform for companies to buy advertising time and makes it easier for small to mid- sized businesses to buy time on the Roku platform. OneView allows Roku to function as both a DSP and Supply-Side-Platform (SSP) for its own ad inventory as well as for others, and ultimately do more with its data, including automating the entire process. Roku offers advertisers - programmatic ads, direct insertion ads, click impression, action impression, adding third-party data to their campaign, guaranteed reach, frequency caps, real-time optimisation, sponsorship, buttons, home screen ads, buying proof points from Kroger data, and down funnel data.

Sustainable Competitive Advantages and Outlook

Roku's competitive advantage is largely derived from the data it collects. Roku acquires data from all three of its user types and is then able to charge a premium to advertisers for targeted advertising. The more active accounts Roku is able to aggregate the more advertisers will be attracted and the higher the premium Roku will command. Additionally, as the user base grows it becomes increasingly attractive to SVOD companies and content producers who are offered access to a large and engaged user base. This creates a network effect for Roku as more customers come onto its platform, more advertisers and SVOD providers are attracted and in turn, more customers are attracted as Roku has all the top apps. The platform already generates higher Cost-Per-Impressions compared with competitors and two to three times higher Cost-Per-Impressions than linear TV.

Overall Company Growth Options

Organic growth will be driven by increasing active accounts which have grown strongly over the last five years. Active account growth will be driven by international expansion, with Roku currently available in seven to ten countries; the structural shift to streaming away from linear consumption; new deals with TV Original-Equipment-Manufacturers; as well as the increased popularity of advertising-based video on demand (AVOD).

Roku's Average-Revenue-Per-User will increase as the mix shift to higher platform revenue, driven by increased advertising-based consumption, takes hold. We expect this to be driven by the continuation of brands and ad-buying teams migrating away from traditional TV spend to connected TV spend. Advertisers can better target their ideal customers through digital platforms, and we believe Roku's largest opportunity is in capturing the TV ad market. In the U.S. alone over \$70 billion is spent per annum on TV advertising whereas streaming-based advertising has only penetrated a low single-digit percentage of advertising budgets. Importantly, this penetration level is well behind the roughly 50% of TV users in the U.S. that stream their entertainment. As a result of the above, advertising revenue spend for U.S. connected TVs (CTVs) grew by 41% to \$9 billion in 2020 and is expected to grow to \$27.5 billion by 2025. Roku's monetized video ad impressions, which the company has said is the best proxy for its ad business, were growing at over 100% before the COVID-19 pandemic and only dropped to 50% growth at the start of the pandemic, compared with total industry ad spend which was flat.

Additionally, the Roku Channel, which is a free Advertising-Video-On-Demand application is not only driving engagement but also user growth. The Roku Channel more than doubled its reach in FY20 and also more than doubled its streaming hours year-over-year. It was the fastest-growing application of the top ten applications on the Roku Platform by streaming hour growth. Roku is able to better monetize this channel compared with non-company owned channels due to the more specific data it generates which in turn enables Roku to charge a premium.

The international expansion strategy is to build scale, drive engagement, and then monetise. Roku extended its TCL deal internationally and in 2020, Roku launched Roku TVs in Brazil and the U.K. The company has also been winning market share, with both Canada and U.K. being standout markets.

Transactional Video-On-Demand has seen strong growth during the COVID-19 pandemic. In general, if there is a transaction on the Roku platform, Roku will get some revenue share, even if it is within another Subscription-Video-On-Demand app. This should grow as studios release new content straight to their streaming platforms at the same time as in movie theatres. Warner Brothers have said they will begin releasing concurrently in cinemas and streaming at some point in 2021 through HBO Max.

It is likely that the CTV operating system (OS) industry will replicate what happened to the mobile phone operating system industry, where consolidation leads to one or two winners, Roku will be the likely benefactor.

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