

# Research<sup>2.0</sup>

*Technology Analysis for Business & Investment*

## Brightcove: Internet Video Infrastructure

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Brightcove has developed an online video content platform for organizing, publishing, monetizing and monitoring performance across all types of use cases on different devices, networks and software environments.

The recent introduction of the Apple iPad with no support for Adobe Flash has made the difficulties of simply delivering video content very apparent — never mind the fact that content owners require a host of management features, special branding, and support for myriad business models to be included with the content they distribute.

Brightcove as a company was launched in 2005 and thanks to raising capital of \$90M from both venture and strategic investors they have been able to build themselves into a market leading position. Their large customer base includes household names in media and entertainment, broadcasting, and large corporations.

Brightcove was founded and is managed very much as a technology company with an on-demand and usage based business model. Their model is a combination of Salesforce.com and Akamai with probably higher touch and more services than either one of those companies.

Although the company doesn't disclose any revenue information, it's possible to gather enough information upon which to generate an intrinsic value which we currently place at \$644M for 2010 and this value should grow rapidly with the company to reach \$990M by the end of 2011.

## INTRODUCTION

Video has emerged as the next major wave of Internet content. Cisco has been focused on video for some time and just announced a new video-focused product. The proliferation of video-capable devices on the network like smartphones and Internet-connected TV sets has been underway for over a year now. Video is much harder to manage than the text, image and programmatic content that has dominated the Internet so far. There are myriad formats and it's hard to operate on digital video assets when compared to something like formatted text. Adobe made this clear when they spent \$1.8M to purchase Omniture to bring online analytics capabilities to their own popular Flash technology, which is widely used for video.

Although even casual users of video are already aware of the many incompatible formats and challenges in supporting wide variations in network bandwidth and device types, the real challenge is turning video from something simply viewable into something that is interactive and related to other online content. Video content needs to be clickable and trackable the same way that other types of digital content are today.

Compounding the pain the industry has in managing video content, the feud between Apple and Adobe over Flash versus HTML 5 has created another compelling reason to use a provider of video services like Brightcove to handle these issues for content.

Brightcove is the dominant player in this space today after \$90M in cumulative funding, a large roster of top-tier customers, and the earlier acquisition and execution of their top competitor at the time, Maven Networks, by Yahoo in 2008 for \$160M. Brightcove has faced down some serious competitive issues over the last few years (described in greater detail below) and from our perspective is now in a position where the contest of the video platform providers is "theirs to lose."

This report follows our standard approach to company analysis, beginning with the market opportunity and continuing through company background, management, positioning, business model, competition, opportunities and threats and finally, valuation.

## MARKET OPPORTUNITY

Although precise estimates for the current size and growth rate of the online video market may be hard to come by, the overall figures follow a path already worn by the shift from print to online media. A decade ago, the \$140 billion/year print advertising business, including classified advertisements and the yellow pages, started moving content online in earnest. The same is happening today with video and this is becoming increasingly clear to the broadcast and cable TV industries.

Third party forecasts have been all over the map the past few years as they have grappled with the timing of the shift to more digital video-based advertising. Most agree on the size of the US TV advertising market being in the range of \$70B per year. Because the online market is still nascent and highly fragmented, getting exact figures isn't easy; however, we are reasonably sure that Google has recently crossed the \$1B annual revenue level and that they probably have a share in the US of between 40% and 60% of all video content viewed online depending on what metrics are used. Google is still over 10 times the size of the next largest online video content provider (Hulu). So the

current market is about \$2B per year in the US and may be approximately twice that figure on a global basis.

Most of the market research firms we looked at estimated the size of the market in 2012 to be closing in on \$8B. This suggests 40% growth, which is consistent with the 50% level of growth we have seen from leading market players.

As an online video platform, Brightcove is not directly concerned with the business model that the content owner plans to use, so the size of the online video advertising market is only an approximate way of looking at the market opportunity for Brightcove.

Many Brightcove customers are more interested in using video as a tool for driving business directly or wanting to brand their video content. These are much different applications than putting advertisements in videos. In fact, the migration of content from analog and digital TV formats to Internet-based video will push adoption of online management platforms irrespective of how the content will be used.

In this way the video platform management space should develop similarly to others like data management, document management and more general content management tools. One aspect that is different is that with video there is a larger run-time component.

As a rule-of-thumb we allocate 10% of the market for technology services like those provided by a video platform provider. So using the figures above we'd put the market size today in the \$400M range and expect it to grow for quite some time in the range of 40-50% per year. This means that sometime in 2012 the market will reach the \$1B/year level and IP video will represent about 15% of video content.

## **SUMMARY COMPANY INFORMATION**

Brightcove was founded in 2004 and has grown to around 220 employees across its 8 offices in North America, Europe and Asia. Brightcove has raised approximately \$90 million from both traditional venture-backed funds like Accel and General Catalyst and powerful strategic partners like AOL, IAC/InterActiveCorp and Allen & Company LLC.

Brightcove has followed a partnering approach and integrates their services with those of adjacent technology product and service providers. It has built partnerships with popular website content management systems like Drupal, publishing tool builders like Adobe, online analytics tool providers like Google AdSense, advertising serving networks and online branding and advertising agencies.

From a product standpoint the company has been viewed as a quality provider throughout their history but there were many complaints of too-high pricing. In late 2009 the company addressed these loud criticisms with a lower end "Express" offering that does indeed meet the needs of most smaller organizations with a much friendlier \$99/month pricing level.

So far the company has not been very acquisitive and has grown organically. They did make one acquisition back in 2006 of a company called MetaStories, which was a small 10-employee firm with some publishing technologies for combining video with other elements to create a full content experience. The acquisition was early in the evolution of online content but was done on favorable

terms from what we can tell. It's unclear how acquisitive Brightcove might be as the market growth accelerates.

Brightcove continues to explore newer markets. It has been pushing "TV Anywhere", something that the industry has been moving towards with smartphones and Internet-connected TV sets.

**History:** There's some interesting history behind the founding of the company. Jeremy Allaire had built a major success from the ground up with his brother with Allaire Corporation, which developed a leading web-based development tool called ColdFusion and was acquired by Macromedia (now part of Adobe) back in 2001. Allaire joined venture capital firm General Catalyst and appears to have formed his ideas for starting Brightcove while working with and serving on the board of Maven Networks, another video-technology-focused start-up in the Boston area. Allaire left to form Brightcove in 2004.

Brightcove received its first funding of around \$5.5 million through Accel Partners and General Catalyst Partners. Subsequent rounds of funding have yielded a net of approximately \$90 million, the last round of funding occurring in mid-2008. The company has used some of that capital to develop the product, but also to expand globally and build the sort of technology and company platform that important corporate players require when signing six-figure contracts.

Brightcove certainly has had a major advantage due to the role some of their strategic investors played in adding to their marketing and sales reach.

**Product:** Brightcove is known for their high-end solution which is targeted toward professional media organizations and enterprises. These companies spend millions on their production capabilities and have extremely demanding requirements. Customers of this caliber typically spend low to mid-six figures for an online video platform solution like Brightcove. The feature set of a high-end online video platform is fairly daunting and covers all aspects of the video lifecycle from uploading to encoding, adding player templates, handling different types of streaming, providing analytics, integrating with different advertising technologies and platforms, supporting delivery networks and special devices like the iPhone, allowing secure management, scheduling, and very granular control based on many factors — all this with 24/7 support.

As we alluded to earlier, this positioning made Brightcove a very expensive vendor and precluded smaller companies and most startups from adopting their technology. The situation persisted for some time and we know that it cost Brightcove some customers (although perhaps not a great deal of revenue.) Late in 2009 the company introduced their "Express" line that is targeted to small companies with 50 to 500 videos and a few solo users with budgets in the \$99 to \$499/month range.

Brightcove is a software-as-a-service company and their pricing is usage-based. So it's possible that bandwidth usage could add materially to monthly costs, even when on their low-end plan. It will always be important to make sure that a video business model is consistent with costs that are incurred from popularity. Without a business model a video that "goes viral" can be costly without an embedded business model like "click-to-buy" in the video. For example, music companies can reap millions in high-profit back catalog sales if a song in a viral video (like "Forever" recently) can be purchased with a click from iTunes or Amazon.com.

The screen shot below provides a rough visual idea of the three main elements of solution coverage: uploading and organizing video content, publishing the content, and finally tracking and measuring video effectiveness after deployment.

The Brightcove product is positioned as the most functional and well-integrated solution and now is seen as a fairly cost effective and easy-to-adopt platform. There are some competitive solutions out there which are covered in the section on competitors below.

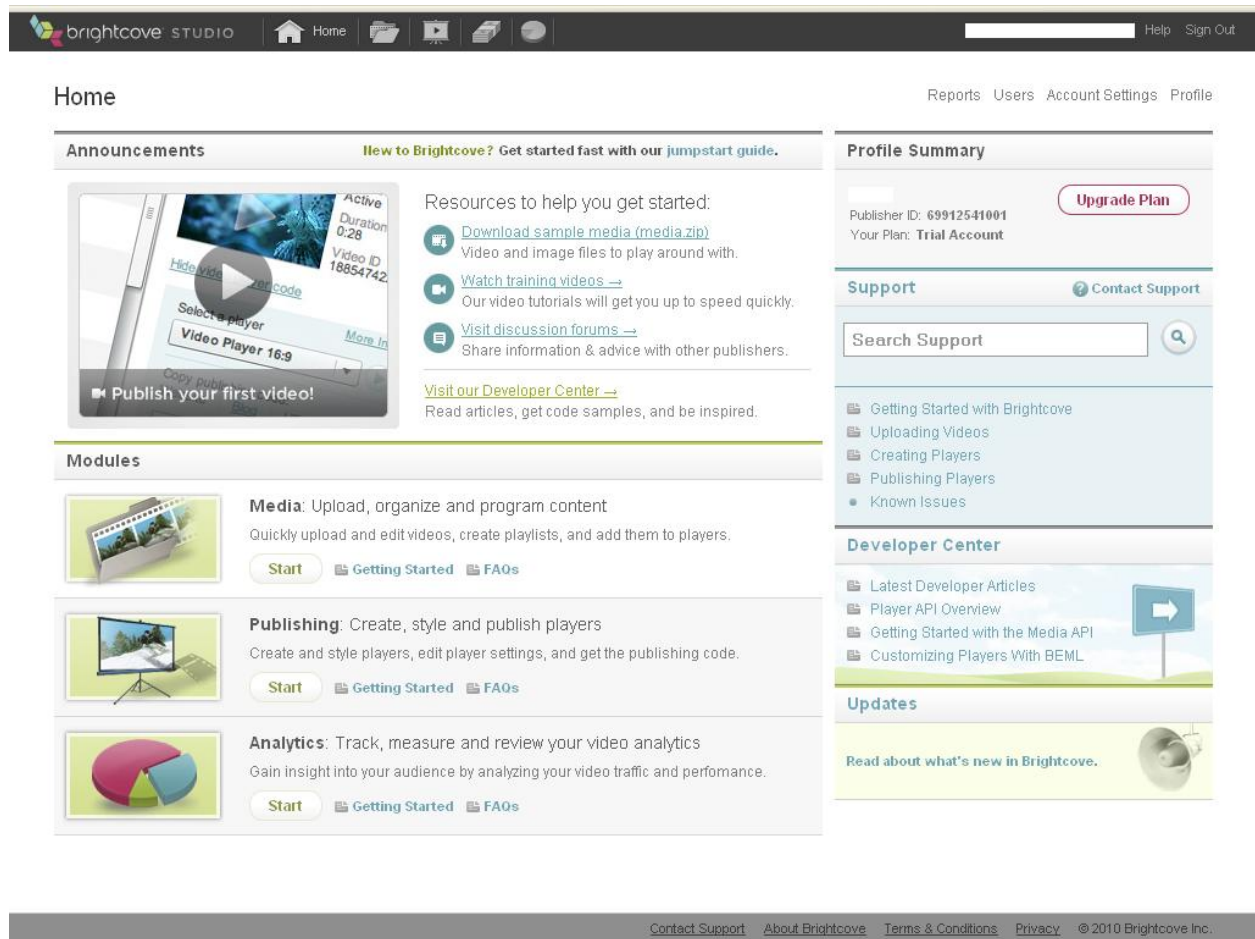


Fig 1: Brightcove Studio Screenshot after signing into trial account

**Business Model and Margins:** Brightcove can be thought of as an enterprise scale SaaS provider from a model standpoint. We'd describe their model as a combination of Salesforce.com plus Akamai since they do get paid by the user-month and also based on usage. Because of their customer set and relatively high-end solution, Brightcove needs to have a fairly high-touch model that demands investments in sales, support and marketing both locally and with physical offices around the world.

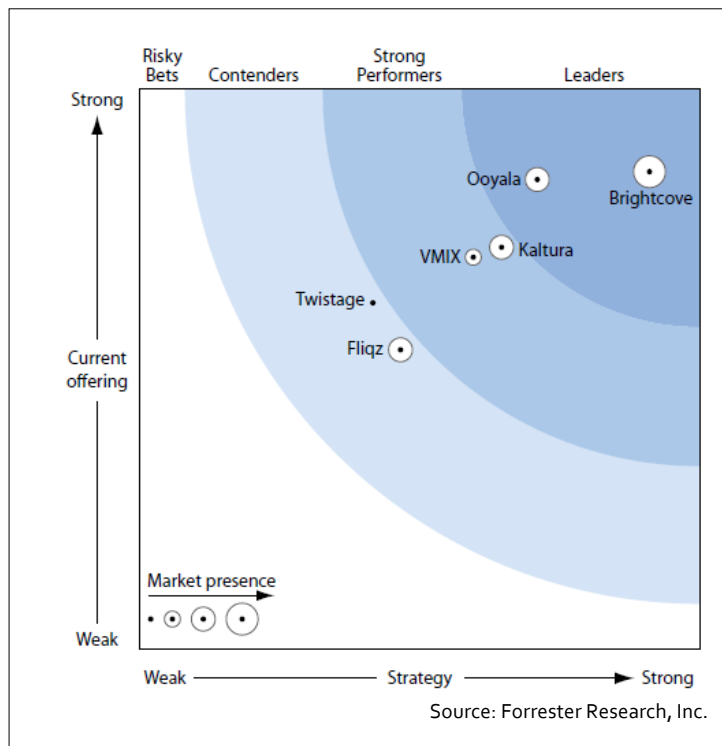
The Express offering, however, is likely to be a more efficient way to convert new customers due to low entry cost, simple signup procedure and the availability of a free trial. All of these aspects tend to lower the per-revenue-dollar costs of sales and marketing.

**Management and Culture:** Brightcove was founded by and is still largely run by software technology types. In addition to Jeremy Allaire, the senior management backgrounds are mostly from companies like Macromedia, Art Technology Group, Lycos and Adobe, although there are also some from major media firms.

A scan of current employment opportunities makes it clear that the company is moving aggressively to build deep technology that works across many platforms and has as a foundation very strongly architected and implemented technology. Brightcove is in the media technology space but it is at the extreme technology rather than the media end from a management and culture standpoint.

**Partners, Suppliers and Alliances:** In line with its mission to be publisher of choice for online video content providers, Brightcove has continuously strengthened its offering through partnerships and alliances. As a company that helps video content providers publish, manage, brand, monetize and measure content effectiveness, Brightcove has put in place partnerships with both established players as well as startups with newer technologies. It has built partnerships with popular website content management systems like Drupal, publishing tool builders like Adobe, online analytics tool providers like Google AdSense and Omniture, advertising serving networks and online branding and advertising agencies such as Ogilvy Interactive. Brightcove also supports almost any platform that can be used to deliver video, including devices like the iPhone and social networking services like Facebook. Brightcove continues to invest in strengthening its partnerships both on the technology and solution side of its business. It encourages developers and solution providers to exploit their platform and invests energy and resources in helping them be successful.

**Competition:** Being in the broad-based online video content publishing business, Brightcove has competition from two fronts. The first is video hosting sites that provide everything in exchange for controlling the advertising revenue and paying out a portion of that. Google's YouTube is a perfect example of this model but there are many others including sites like Vimeo and Dailymotion.



However, these sites mostly cater to casual user-created content. Although there are a few YouTube users reportedly making \$1M per year in advertising revenue, it's mostly fun and games.

More serious competition exists in the form of other online video platform providers like Ooyala which has a positioning and a strategy very similar to that of Brightcove's. There are a half dozen credible technology players in this space including Kit Digital (NASDAQ: KITD - \$13), Kaltura, VMIX, Fliqz, and Twistage just to pick out some names from the industry view by Forrester Research.

Currently, the pricing of Ooyala starts at \$500/month which is a higher bar to

start with than Brightcove Express. Some vendors like Kaltura play the open source card and offer self-hosted solutions.

From a revenue growth and margin perspective we believe that Brightcove is in the best position, but one or more of these competitors could be problematic if they decide to introduce powerful features and slash their prices.

## **OPPORTUNITIES AND THREATS**

+ Online advertising will continue to expand and video, along with mobile, is the next major area of interest and growth. Video content owners are eagerly looking for ways to transition their content to generate online revenues as non-IP video viewing declines and jeopardizes \$70B in advertising revenues alone.

+ Businesses are beginning to see video as an important element of their online content strategy and all require online platforms to achieve their objectives.

+ As business models and device types for video multiply, it puts complex demands on distribution which only a high end service like Brightcove can effectively deliver against.

+ As a market leader with substantial momentum and a strong balance sheet Brightcove is in a position to make acquisitions that can consolidate related technologies and services to add to their growth.

- Dominating Internet properties like Google (YouTube) have the reach and financial power to quickly disrupt lucrative markets in their favor.

- Text-based advertising is still perceived at the most effective means of advertising with new avenues being opened up by social media and location based services.

- Although Brightcove is a leader, many of their competitors have very solid offerings and they could emerge with capabilities, pricing and/or partners that could alter Brightcove's revenue growth and/or margins.

- Even though Brightcove has introduced the Express line they still have a "high cost" image that precludes some potential customers from looking at them again.

## **VALUATION**

Our current estimate for Brightcove intrinsic (IV) valuation is \$644M in 2010. Because the company is growing rapidly and will have substantial margin expansion the IV increases sharply to \$990M in 2011.

Brightcove doesn't disclose revenues or shares outstanding but we are able to piece together enough information to do a full intrinsic valuation for the company. Here are the steps we followed to generate our IV estimate:

- Using public information about customers and pricing we estimate that 2009 revenues were between \$35M and \$75M and have chosen \$50M as our starting point for 2009.

- Our market growth estimate of 40-50% is our base of overall revenue growth and we expect Brightcove to grow slightly faster than the market.
- We selected an analysis set of existing public companies to use to create a long-term model for the company. These companies are: Akamai, Kit Digital, Limelight Networks, OpenTable, RealNetworks and Salesforce.com. The most important insights needed are gross margins and operating costs by type as well as a range of trading multiples.
- Lastly we used 100 million as a sharecount because it makes it easy for investors who have the actual sharecount number to do the math and compute a per-share IV value.

At this point we don't distinguish between taxed earnings and cash flow but it's possible that this may be worth doing at a later stage of company development if investors agree that one is a more effective measure of company valuation than the other.

## CONCLUSION

Brightcove is best placed to service the professional and enterprise segment of the online video market rather than the small independent and amateur content producers. Its success in this market in the past 2-3 years has been noteworthy and their new Express product line is accelerating their customer acquisition.

The launch of the Flash-less Apple iPad, increasing penetration of video-capable phones, and the emergence of Internet TV will make 2010 another very busy year for Brightcove. It already appears that the company is hiring aggressively for jobs in development and services.

We see Brightcove as benefiting from several of our key research themes including mobile Internet, RealVR (especially Internet TV) and cloud computing.

We believe that investors should expect the company valuation to reach \$644M by the end of 2010 and further increase to \$990M at the end of 2011 if the market and Brightcove continue their present trajectory.