



Case Study: New Release DVD

*How one DVDNow Kiosks customer
seized opportunities, spurred
organizational growth
and realized the potential of a
movie rental kiosk business*



Overview: 400% growth in 20 months

New Release DVD is one of the most successful customers of DVDNow Kiosks, which provides movie rental machines as a business opportunity to entrepreneurs for less than \$25,000.

Operating since 2006, New Release DVD has expanded nearly 400 percent in the last 20 months, from 18 kiosks in spring 2011 to 74 kiosks as of December 2012. Preceding this rapid expansion, the business experienced steady growth over four years starting from three kiosks in 2007 and reaching 18 kiosks as of January 2011.

The company provides self-serve movie and video game rentals from kiosks to consumers primarily at independently owned supermarkets in Pennsylvania, with a few kiosk locations in the adjacent states of Maryland and Delaware.

The DVDNow Kiosks Business Opportunity

Independents thrive in fast-growing industry led by Redbox



New Release DVD owners Debbie and Troy Smith are part of a growing league of independent operators supplied by DVDNow Kiosks who are proving there is room in the market for an alternative to Redbox machines.

DVDNow hosts the largest independently operated DVD rental kiosk network in the world, with operations in over 16 countries.

New Release DVD is an independent business capitalizing on the same industry that landed Redbox parent company Coinstar (CSTR) at number 15 on this year's *Fortune* Magazine's 100 Fastest-Growing Companies List. The movie rental business has also been the driving force of Coinstar's profitability, with Redbox revenue surging 18 percent to \$460 million in the third quarter of 2012.

This case study examines the factors behind the success of New Release DVD during three phases of their business:

- Initial start-up phase from 2006 to 2007
- Steady growth phase from 2007 to 2011
- Exponential growth from spring 2011 to present.

This report will explore their strategies for success and the challenges they faced, as well as providing a snapshot of the industry and current trends.

TIMELINE

Jan 2007 – 3 kiosks launch

Dec 2007 – Total 6 kiosks

Three Phases of Success

Phase 1: Start-up 2006 to 2007

New Release DVD officially launched three DVDNow movie rental kiosks in 2007 within a 10-mile radius of the Smith family home in Chester County, Pennsylvania.

At the time, the dominant business in the industry, Redbox, was not in the area. The Smiths were faced with the challenge of overcoming customer trepidation about using credit cards to rent movies from the kiosks. Most of their customers had never seen a DVD rental kiosk before and needed some encouragement.

»»» Test the market

They tested three different kiosk locations:

- A fitness center
- An apartment complex
- A convenience store.



»»» React quickly

The fitness center location failed to perform. The Smiths reacted quickly to establish a new location at a supermarket and were able to move the machine within a couple of weeks, minimizing their losses in those very early days.

People began to gain trust in the machines. The low movie rental price of \$1.49 per night proved to be a convincing factor.

“Our first supermarket location was an instant success.”
– Debbie Smith

»»» Duplicate success

The supermarket kiosk far outperformed the other two locations, and the Smiths immediately focused their business on duplicating that success.

»»» Heavily promote new locations

New kiosk locations were promoted heavily with signs above the store entrance, banners at the edge of the road outside the store, and large signs in the storefront windows. They learned that locating kiosks at the front of supermarkets was crucial.

»»» Re-invest in the business

During the start-up phase, they re-invested everything back into the business by buying additional kiosks and expanding their movie selection.

Strategies for success

Phase 2: Steady growth from 2007 to 2011

In 2007, Redbox began expanding its business in Pennsylvania, a development that proved beneficial for the Smiths.

“When they brought Redbox to Pennsylvania, it really helped our business because people began to trust the machines more.”
– Debbie Smith

By the end of 2007, the Smiths had doubled their total kiosk count to six.

»»» Stock the most profitable movie selection

New releases proved to be a key incentive for consumers to rent movies. One of the first lessons that proved crucial to their business was the importance of stocking the right movies – the ones that customers wanted to watch.



»»» Plan the month as a whole

The Smiths planned each month as a whole to capitalize on the best new releases coming out each month. They developed a system to select movies using box office results and reviews from sites like www.rottentomatoes.com, a tactic that served them well.

“We look at how well the movie did at the box office – that’s probably the biggest factor.”
– Debbie Smith

»»» Capitalize on the 28-day advantage

They capitalized on their biggest advantage over Redbox – the 28-day delay. Independents aren’t bound by the movie distribution contracts of Redbox and Netflix and can offer Fox, Warner Bros. and Universal films up to 28 days earlier.

»»» Reinvest gross profit

When the Smiths launch a kiosk, they re-invest 50 percent of the machine’s gross profit into new movies until the machines earn more than \$1,000 a month. For machines earning \$1,500 to \$4,000 a month, they spend \$600 to \$700 a month.

Phase 2 continued...

The recession

The recession that began with the stock market crash in October 2008 proved to be an asset to their business. Fewer people were taking their families to the movies, and more were turning to the low-overhead option of movie rental kiosks.

“The recession actually helped us. No matter what, we got stronger.”
– Debbie Smith

Business growth: the DVDNow kiosk evolves

In 2009, DVDNow Kiosks released the improved, larger capacity red 250 machine to replace the silver 110 machine. This kiosk holds 250 discs and could carry Blu-rays and video games, offer variable pricing, and was intuitive to operate with a touchscreen interface.

Jan 2009 – 5 new kiosks, total 11

In 2009, the Smiths acquired five 250 machines, bringing their total machine count to 11 kiosks in York, Lancaster, Chester, and North Cumberland counties.

Dec 2009 – total 13 kiosks

They began a process of putting the larger machines into their most successful locations, and moving the smaller 110 machines to new locations.

Jan 2011 – 18 kiosks

“The 250 machine created an instant 25% revenue growth for our business because there were less restrictions on availability of movie titles.”
– Debbie Smith

The Smiths were able to leave their day jobs behind to focus on their movie rental kiosk business. By the end of 2009 they had acquired another two machines, bringing their total to 13. In the spring of 2010, they acquired three more. By attending trade shows, they had become so well known in the industry they were actively being approached by supermarkets who wanted to host kiosks in their stores.

At the start of 2010, six of their top performing locations were taken over by Blockbuster Express, which forced them to scramble for new locations with strong profit potential. By the following year, they had expanded further afield into the adjacent state of Maryland.

»»» Forge partnership with distribution center

They began working with a grocery store distribution center to place their machines. And the big push to grow their business began in earnest.

Exponential growth

Phase 3: Seize the opportunity, 2010 to 2012

PART 1: State of the market

While the Smiths were steadily growing their business, Redbox machines were proliferating madly throughout the U.S., at Walmart, 7-Eleven and other major chains. The number of machines grew from 1,900+ in 2006 to 19,000+ as of 2009. From 2009 to present, Redbox kiosk locations more than doubled to the current count of 42,400+. However, independent supermarkets often failed to meet the criteria for hosting a Redbox.

Redbox grows from 19,000+ kiosks as of 2009 to 42,400 kiosks

Consolidated revenue up 600% from 2007 to 2011

Video stores close due to Redbox \$1 movies, Video-on-Demand options and video-streaming



Netflix and video-streaming

Video streaming didn't bring same quality people had come to expect from Blu-ray and DVD rentals. Like Redbox, Netflix was limited in its capacity to offer new releases on the release date due to contracts negotiated with the major studios.

In 2011, Netflix, the industry leader, was widely acknowledged to have made some poorly received business decisions – for example a price hike and a plan to split video streaming and by-mail DVDs into two operations. This led to a loss of 800,000 subscribers – 23.79 million subscribers down from 24.59 million in the last quarter.

“People want to take maximum advantage of their Blu-ray players and large LCD or plasma TVs. Video-streaming doesn't offer the same quality viewing experience.”

-Scott McInnes, CEO and Founder, DVDNow Kiosks

Phase 3 continued...

The ongoing popularity of the disc

Disc rentals continue to be the most popular way to rent movies in America as customers tend to rely on video streaming for television shows and older movies.

»»» 31% of online consumers rented discs in the last 30 days

A study released October 18, 2012 by research company the Mintel Group found that traditional DVD rentals remain the most popular way to rent movies, with 32 percent of online consumers renting discs via this method in the past 30 days. A quarter of people surveyed said they used online streaming in the past 30 days and 22 percent of people used pay TV to watch movies.

»»» 81% of consumer spending on filmed entertainment comes from disc sales and rentals

Discs still dominate when it comes to retail. Physical discs created the majority of revenue with 81 percent of consumer spending on filmed entertainment coming from physical disc sales and rentals, according to the *D2 Report: Discs and Digital – The Business of Home Entertainment Retailing*, released September 12 by the Entertainment Merchants Association.

»»» Spending on Blu-ray discs up 23% in first quarter 2012

The report also found that consumer spending on Blu-ray discs increased 23 percent in the first quarter of 2012. When they asked people to choose between a physical and digital video game, 75 percent of people surveyed said they would choose the physical version.

»»» DVD and Blu-ray rentals made up 62% of movie rental orders in first half of the year

Research shows Americans still prefer watching movies on discs. DVD and Blu-ray rentals accounted for 62 percent of movie rental orders in the first six months of 2012, while video streaming made up 38 percent, according to the NPD Group's VideoWatch VOD report, released August 2012.

“Blu-ray and DVD provide access to the latest titles, which are not available through streaming sites.”

– Andy Parsons, SVP of corporate communications for Pioneer Electronics and chair of the Blu-ray Disc Association Promotion Committee, as quoted in *HomeMedia Magazine*

Phase 3 continued...

PART 2: Exponential Expansion: 400% growth

New Release DVD's business grew 400 percent in 20 months from April 2011 to December 2012.

All the above market factors gelled together to create an enormous expansion opportunity for independent operators like New Release DVD.

Along with the closure of the video stores, came the demise of Blockbuster Express.

The assets of NCR Corporation were acquired by Coinstar in a deal that closed in June 2012, but in the meantime, Blockbuster Express vacated many locations, and some would never meet the criteria for Redbox kiosks.

»»» Embrace opportunity

New Release DVD was able to step in when Blockbuster Express stepped out, creating an expansion opportunity that the Smiths embraced to the fullest potential.

The Blockbuster Express locations had an avid clientele who had become customized to picking up a disc during the weekly trip to the supermarket.

“With a brand new location, you have to train people. With a mature location, you rise to profitability very quickly.”

– Debbie Smith

“One of the first locations we took over was an instant success that made us want to try to do more. Many store owners said the reason their Blockbuster Express kiosks were pulled was because they never worked – not because no one used them,” said Debbie.

They continued to focus on supermarket locations. By September 2011, they had grown to 28 kiosks. By the end of the year, they had 45 machines, mainly in eastern and central Pennsylvania.

In 2012, they recovered the six high-performing locations they lost to Blockbuster Express in 2010.

Movie rental kiosks had become the latest must-have accessory for grocery stores. In spring 2012, they had more than 180 stores approaching them for kiosks, most of which they had to turn down. The Walmarts of the world had Redbox. In order to compete, smaller independent grocery stores needed to offer an equivalent service to their customers.

This also gave New Release DVD the opportunity to expand into Delaware.

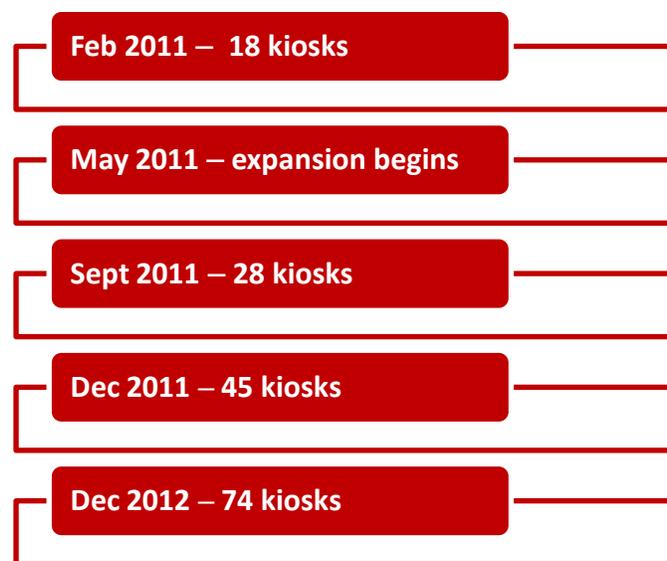
Phase 3 continued...

»»» Create a private membership club

The instituted a membership plan so customers could have the option of joining and pay a monthly fee for unlimited rentals.

By December 2012, they had expanded to over 74 kiosks, and received their largest shipment of movies ever, 800 movie cases.

They see more room for expansion, planning to grow their business to 100 kiosks, while keeping it local to Pennsylvania, Maryland and Delaware.



CONCLUSION

A number of external factors assisted in the success of New Release DVD, but ultimately their success was fueled by their strong business rationale.

From the very early days, they applied systemic decision-making to crucial business processes. They put in the effort required to get consumers used to the kiosks, and actively promoted their new locations. When faced with problems like underperforming kiosk locations, they were flexible and able to react quickly to overcome issues.

When strategies proved successful, they duplicated them, and reinvested profits into their business. They devoted energy to determining how to best serve their customers by choosing the most ideal movie selection. Meanwhile, they built relationships in their industry, making them the go-to people in Pennsylvania for movie rental kiosks.

Ultimately, their business operates like a finely tuned machine, just like the DVDNow Kiosks themselves.



About DVDNow

DVDNow launched in June of 2006 and quickly became the leading provider of independently operated DVD rental kiosks. Today, with operations in over 16 countries, DVDNow has the largest independently operated DVD rental kiosk network in the world.

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Appendix

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