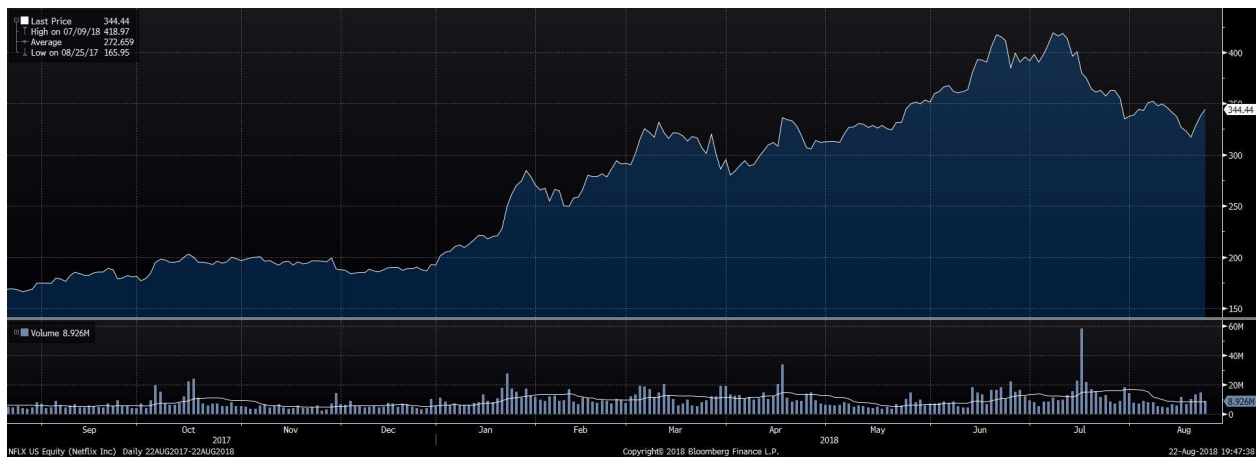
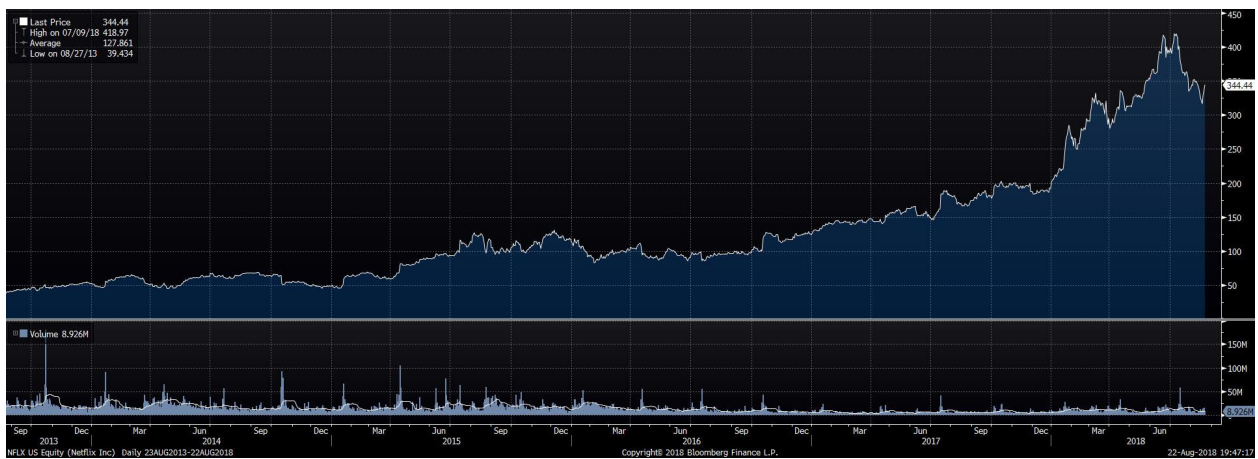


# NETFLIX

1-Year Chart:



5-Year Chart:



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## **Executive Summary**

I'm currently recommending Netflix as a hold. Despite a large inflow of negative sentiment since the missed subscription mark by almost 50%. They're moving towards making a large database of future content, which will allow them to lower the price of production per show. This will allow them to be slightly more profitable, which will allow them to get a larger profit margin per subscriber. I do believe that Netflix will miss their subscription benchmark again, but this will make for a great opportunity to buy the stock at a discount.

## **Recommendation**

Ticker: NFLX

Price \$370.43

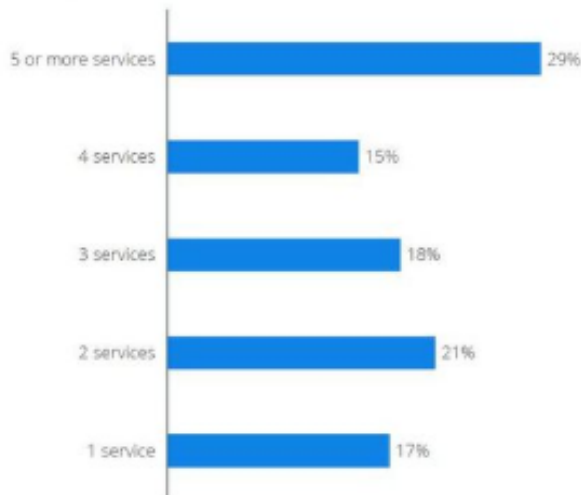
Rating: Hold

Target Price (1yr): \$440/share

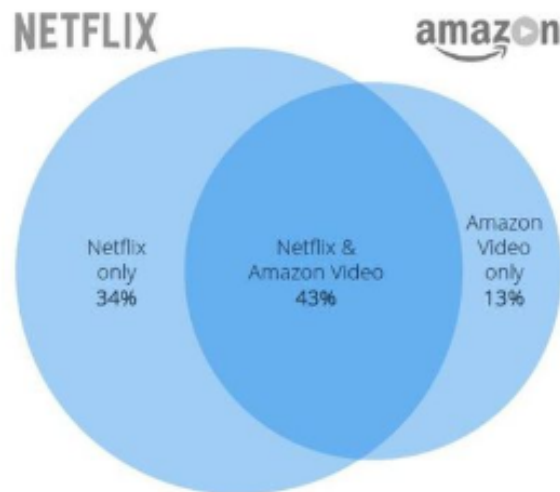
## Industry Analysis

The streaming industry has been reshaped over the past few years. A lot of large players were able to gain significant traction. However, this doesn't mean pre-existing giants like Netflix are losing market share. There is a significant amount of overlap in this industry, which is great for a subscription based business model like Netflix and its competitors have. The diagram below shows the overlap within the industry:

Number of services used in the past 12 months among U.S. VoD users



Overlap between U.S. users of Netflix and Amazon



Since overlap is such a common occurrence in this industry the players within it have to just provide what their subscribers want and keep them from leaving the service for another option. This can be easily done by adding content for all consumer demographics. The real opportunity for growth comes from new international subscribers because the market is seemingly untapped. Out of all of the streaming services available Netflix is leading the pack in international subscribers and should continue to do so since they've released plans to shoot their Netflix original content in a multitude of different languages.

Piggybacking off of the above there is also a chance that this can be marketed to certain audiences who are trying to learn a new language as a way to do so. There are countless articles and forums online that state that consumers are using the subtitles on Netflix content to learn different languages. Thinking of this more thoroughly this could be a huge driver for international growth within the industry.

There's a huge increase in concentration in the movie industry as a whole. This means that the top ten box office movies currently take up 34% of revenue for the year compared to only 26% for the past five to six years. This shows that when people go to the movies they're only going to the big blockbusters, which shows that the consumer is moving towards "stay at home options" like Netflix or other streaming services. There is also a huge increase in quality TV series, in 2009 there were only 200 series being produced per year. Now there are over 500 of these premium TV shows being produced a year.

This promotes a much more competitive landscape for big streaming players and the entertainment industry. This is leading the consumer to be much more selective due to the large selection they have and the growing amount of online movie/TV show critique that's available. Many people share their opinions about movies and TV series on social media, which may deter or promote others to watching a certain series. This landscape brings significant risk to the industry, but also a huge upside.

## **Company Background**

The good is easily seen – Netflix is able to produce content for the majority of their specified market. Netflix just turned 21 years old, which has allowed them to pioneer the streaming industry. Netflix has become so big because they introduced a platform where you can binge watch a series without clicking a button (their auto play feature is a huge driver in why users find Netflix appealing; 43.4% of users, surveyed). This gives the user added gratification because they're able to watch a whole series through rather than watching one episode per week on normal cable television. This on top of Netflix becoming a verb with the saying "Netflix and Chill" gives the streaming service a solid foundation within the industry and provides a great marketing strategy with no cost.

One of the main drivers that has pioneered their success in this space was "The Office". The series has been a huge hit ever since its first season was released in 2005. This has been a staple show for the streaming service and is a huge reason a lot of Gen Xers use this service. Alongside Netflix's staple series' they have been spending insane amounts of money to build up a database of "Netflix Originals". This will be used for years to come and will allow them to just sit back and relax as their subscription model allows them to generate substantial free cash flow on a monthly basis. One of the largest reasons as to why Netflix is loved so much is because individuals in each household are able to create their own accounts.

The bad is just as easily seen compared to the good. First off, Netflix has been rumored to take down a staple series from their available content, "The Office". This has a lot of younger people who adored the show, very upset with the streaming provider. Personally, a lot of my friends have been making the switch to Hulu. This could be detrimental for Netflix because they have allotted a certain amount of capital to create their database of content, which has been modelled off of their current number of subscribers.

Hulu is also a huge risk to Netflix. On July 30<sup>th</sup> Disney's proposed merger with 21<sup>st</sup> Century Fox was approved. If this merger comes to fruition Disney would hold majority share in Hulu, which would be a huge distribution point for their Intellectual Property. This will give Hulu a huge marketing standpoint to Generation X, Millennials and the earlier half of Generation Z. As Generation X and Millennial's start to have children they will want to raise their children on the content they grew up watching, which was mostly comprised of Disney related content. A lot of families in these age brackets will consist of two working parents. This will be partially related to the rise in education for both females and males. This means a lot of new parents will be looking for their parents to watch their children. This will allow Hulu to push two to three subscriptions per family. Netflix falls short in this category because the consumer is able to use their parents account even if they aren't in the same household. This feature of having your own account within a subscription is also a huge reason as to why users pick Netflix over the competition.

## **Investment Thesis**

Netflix has had a difficult time dealing with investor sentiment regarding the subscriber benchmark that they missed. However, I still view this as a positive because they are still gaining subscribers. This will allow them to tap into that cash flow after they're done burning cash on this database of content that they're creating. Netflix's largest driver of growth will be through international growth because they've been in the states for 21 years, which is fairly mature in my eyes. A large risk that Netflix does face is the Disney-Fox merger, which would take over the middle age and younger demographics due to Disney's intellectual property.

## Valuation

Company Name	Market Data			Financial Data				Valuation				
	Price (\$/share)	Market Cap (\$M)	EV (\$M)	Sales (\$M)	EBITDA (\$M)	EBIT (\$M)	Earnings (\$M)	EV/Sales x	EV/EBITDA x	EV/EBIT x	P/E x	Sales Growth %
Netflix Inc	370.98	161,550	165,980	13,878.7	1,478	1,402	1,027.5	8.9924	61.3533	71.8937	84.24	36.20
Walt Disney Co	111.92	166,450	190,920	57,906.0	17,214	14,289	10,078.0	3.1686	10.5597	12.433	15.05	4.30
21st Century Fox	44.73	83,480	97,380	30,400.0	7,588	6,935	3,468.2	3.0048	12.7851	13.7464	20.82	6.70
CBS Corp	53.01	19,940	29,540	14,319.0	3,145	2,921	1,776.0	1.9244	8.5175	9.044	9.346	8.50
Discovery Inc	28.18	19,120	39,160	8,667.0	3,087	2,314	900.6	3.5075	8.8004	12.588	9.549	31.60
<b>Average</b>	121.76	90,108.00	104,596	25,034	6,502.40	5,572	3,450.06	4.12	20.40	23.94	27.80	17.46
<b>Median</b>	53.01	83,480.00	97,380	14,319	3,145.00	2,921	1,776.00	3.17	10.56	12.59	15.05	8.50

Netflix is in a very strong position compared to its peers. Netflix being compared to its competitors seems to be fairly overpriced due to their extremely high P/E ratio, EV/EBITDA and EV/EBIT. However, I believe in the short-term this will see some correction when Disney and Fox merge (merger was approved July 30th). Alongside this, Netflix has the largest sales growth compared to its peers, which will allow the company to generate enormous amounts of free cash flow once their stockpile of content is complete.

### Catalysts:

- Certain trailers and teasers are released that feature future Netflix Original content.
- Black Panther to be released on September 4<sup>th</sup> for those who missed it in the box office.
- Continue bringing large blockbusters onto the streaming service after they have left the theatres.
- Adding content in different languages to help expand internationally.
- If Netflix is able to bypass Apple and Google payment systems, which eat away at their margins.
- Pushing Netflix Original content into movie theatres to add additional revenue and diversify their business model.

### Risks:

- Analysts have predicted that Netflix's EPS will rise 62-100% in the coming year, which is a high benchmark to beat, especially considering their large cash burn.
- Netflix's growth in the states continues to plateau, which could lead to more missed subscription marks.
- Disney starts pushing its intellectual property through Hulu.
- Netflix's stockpile of content isn't as fulfilling for consumers as they have made it out to be.
- An increase in subscription cost may deter some existing and future users from using the service.