FINANCE FOCUSED

Equity Research Report

NETFLIX

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Tech & Entertainment	
NFLX – NASDAQ	August 14, 2020
Stock Rating	**BUY**
Implied Share Price	**$578.03**
Upside (%)	**+13.38%**
Share Price (07/08/2020)	$509.8
52-Week Range	$254.9 – $548.73
Shares O/S	441,000,000

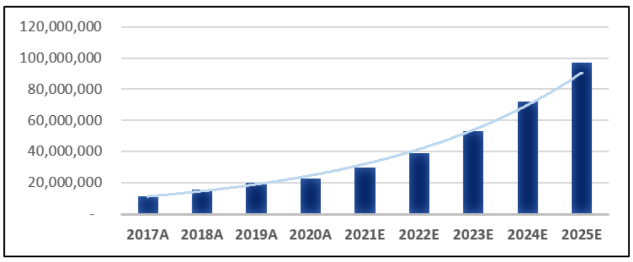
Share Price

Key Statistics & Valuation	
Terminal Growth	1.75%
WACC (%)	7.64%

DCF Analysis	
Enterprise Value	292,570,296,000
Less: Net Debt	(10,339,685,000)
Equity Value	282,230,611,000
Implied Share Price	**$653.67**

Comparable Companies Analysis	
EV/EBITDA Multiple	17.89x
Netflix EBITDA (LTM)	12,956,293,000
Enterprise Value	231,796,483,000
Less: Net Debt	(10,339,685,000)
Equity Value	221,550,798,000
Implied Share Price	**$502.38**

Revenue Projections



Netflix, Inc.

BUY

As Coronavirus Affects Everyday Activities, People's Love For Streaming Has Not Changed

Overview

Netflix is a sector leading, and an early pioneer of its kind, subscription video on demand (SVOD) company with 182m subscribers in over 190 countries. Netflix's revenue is purely a function of the number of subscribers that join and pay a membership fee, starting at £5.99 in the UK, and constantly renewing their membership every month instead of churning away.

In an industry where SVOD is largely homogenous, with little room for differentiation in content streaming, and a high churn rate of subscribers, Netflix ensures that subscribers remain loyal by delivering popular exclusive content like 'Orange is the New Black' and 'Stranger Things'.

In the company's 23-year history (founded in 1997), its CEO and co-founder, Reed Hastings, oversaw the dramatic surge in popularity and success of the company. Netflix, who originally started as an online DVD rental site, gained its first 1m subscribers in 2003, before it became the online streaming site in 2007. Throughout the years, Netflix captured strong partnerships to widen its user accessibility from partnering with XBOX and Blu-ray disk players, to becoming available on Apple iPad and iPhone. Before you know it, in 2018 it had already expanded to 130 countries and premiered "Stranger Things", which soon became an award-winning phenomenon. In the same year, Netflix became the most nominated service at the Primetime and Creative Arts Emmy awards with 112 nominations. This just goes to show the quick and rapid success of Netflix.

Strategic Analysis

Netflix has a flat unitary organisational structure. with the main business executives reporting directly to the CEO, which reduces excessive management levels and allows it to make swift decisions – a key trait in an industry of fluctuating consumer trends and taste.

Below is a detailed SWOT analysis carried out to assess Netflix's market position and to understand what gives them a competitive advantage.

Strengths

Branding – Netflix has a high likeability among consumers due to its affordable price and place in mainstream culture. Further evidence can be seen of this through the recent decision to cancel thousands of accounts that have been inactive for a long period of time, and although this may reduce revenue, it increases rapport among customers.

Rapid Revenue Growth **–** Annual revenue grew by 27.62% in FY19. This level of growth has been sustained throughout the years. The impact of COVID-19 may result in a larger growth rate in revenue, with 15.8m new subscribers in Q1, beating previous expectations of a mere 7m.

New Original Content **–** In 2019, Netflix produced 802 hours' worth of new content. The majority of Netflix originals have been successful, with several films being nominated for the Oscars. By producing their own content, it reduces reliance on external content.

Weaknesses

Original Content Spending – While Netflix's original content has been a success, the spending levels have been growing rapidly since original content is more expensive than licensing. Netflix, in FY19, spent the 3rd most on original content within the industry at $15.3 billion. This is one of the leading factors underlying Netflix's negative free cash flow.

Limited Rights in Other Content **–** Reliance on non-Netflix content is still an issue, with many users still predominantly using the service for this. TV shows such as the 'Office' and 'Friends' are popular but will expire at some point due to the licensing agreement. Subscribers may then leave Netflix for this content.

Pricing Increases – Netflix has been under $10 a month with different packages being SD and HD. In FY19, prices increased in the majority of countries, with the USA price increasing by $2. Part of Netflix's appeal is in the affordability, and should this rise too much, people will cut the service or use an alternative.

Opportunities

Strategic Alliances – The ability to strike localised partnerships, will help expand Netflix's authenticity in a country. This helps them gain access to native-language content that has already succeeded. Netflix has already seen strong results of this in Europe, by partnering with BBC and Canal Plus.

China – With a population of 1.4bn, entering China could lead to great expansion. Currently, Netflix has not been successful due to strict censorship policies. In 2017, Netflix had partnered with Chinese streaming giant iQiyi, giving them license to a number of Netflix original content, however, this has since ended.

New Technology – Since 2007, Netflix has stayed ahead of the curve. They are already succeeding from the rising internet coverage across the globe, exposing them to new customers. By utilising new technologies, such as VR and 8K, they will be able to offer a better quality streaming service.

Threats

Competition **–** Netflix can be replicated easily, with companies being able to use their existing content or invest in new content. Companies such as Disney, Amazon and HBO have become established streaming sites, while others are also looking to venture into the paid streaming industry. Consumers now have a larger choice in streaming services.

Digital Piracy **–** The streaming industry is at risk with people torrenting Netflix's content. This reduces incentive to pay for the service when it can be obtained for free. Additionally, users which mooch off others' paid accounts, result in loss of potential revenue. TechCrunch (2019) reported that an estimated 24m users do not pay for their own account.

Data Protection **–** Netflix has over 167.1m subscribers and must ensure that their data is not being harvested. This is vital to retain customers' trust.

The brief PESTLE analysis below highlights Netflix's strategy in the wider context of key external factors.

POLITICAL	ECONOMIC
• Netflix must be aware different laws and policies in other countries • Need to review their content for each particular country, to ensure compliance and avoid a negative reputation	• Strong global activity; unaffected by COVID, so far • Due to COVID-19, unemployment is rising, and this can impact subscriber base, in long run • Future recessions will reduce subscribers straight away due to the leisure nature of the service
SOCIAL	**TECHNOLOGICAL**
• Strong staff satisfaction and general perception • Representation through creating diverse content while actively engaging with communities	• From a polished interface to algorithms in favourable content, subscribers receive a personalised high-quality product • Algorithms aim to show subscribers similar content they enjoy reducing subscriber churn
LEGAL	**ENVIRONMENTAL**
• Following external content contracts, through restricting access from other countries, where users had been using VPNs to access content • Less exposure to product safety due to being an online service → less chance to cause harm • High safety standard; e.g., child mode, which restricts over age movies	• Online business, hence, no large direct impact on environment, in terms of natural resources • Does produce large carbon emissions to power their data serves, however, 50% of this now comes from renewable sources • Netflix is striving to reduce its carbon footprint

Risk Analysis

Competition

Netflix is now in a competitive industry, and hence needs to spend for top resources, such as content producers, actors, production houses, and creating top original content. This leads to the price of the content rising. If Netflix is unable to win new subscriptions, while maintaining its current base, it will lead to ballooning debt and increased risk. Currently, Netflix holds a weak cash position.

There is risk of consumers switching to competitors, if they offer lower subscriptions or have better original content, such as Disney. However, Disney is heavily reliant on originals and has a huge brand name, rather than producing new content, which will lose values once watched. Amazon prime subscriptions have additional benefits such as grocery shopping/ next day delivery, so it has stronger member retention. These competitors can form alliances to strengthen their competitive positions. Furthermore, competition from people opting to adopt piracy-based video offerings is another risk to the industry as a whole.

Coronavirus

Last quarter Netflix showed a huge increase in subscriptions, fuelled by the pandemic with more people staying at home. However, a deceleration in membership growth is expected. Delays in filming due to COVID-19 may lead to un-subscriptions, due to lack of new original content. Although the COVID-19 situation is improving, there is still uncertainty in the future. This may determine whether users stay subscribed or switch. If the virus halts, users may opt for other forms of entertainment, such as going out, hence there may be a decline in users. Overall, COVID-19 is more likely benefitting rather than harming the company.

Marketing & Other Risks

An excellent marketing tool is the Netflix home screen – leading to hits on new content which battles the risk from having too much content and thus hard discovery. Netflix also has expansive reach due to being a well-known, reliable company with a global presence. Its operating flexibility tailors well to other countries. However, the long term and fixed cost nature of content may limit this flexibility. Netflix must also keep up with technological advances and is prone to third party risks, due to reliance.
Finally, Netflix is open to market risks, such as interest rate fluctuations, which affects their debt value and foreign currency risks, which cannot be reliably forecasted.

Financial Analysis

Revenue

Netflix, as of FY19, recorded annual revenues of $20,156m (+27.6%), representing fast consistent growth. The company has fast-growing revenues due to the expanding streaming industry and being a top player. Netflix still runs the service of renting DVDs in the USA; however, this service is being transitioned out completely. Total DVD revenues are declining, due to existing subscribers now transitioning to online streaming services.
Netflix's online streaming services offers different plans to cater to different types of subscribers, allowing them to maximise their revenue. The plans consist of Basic, Standard and Premium, all at different prices

with different features. Netflix appeals to a large demographic of the population, which has been a leading factor in their success.

Online streaming service is available worldwide. Predominantly, Canada and the USA contribute the most to online streaming revenues, accounting for 50.6% in FY19. EMEA, Latin America, and APAC contributed 27.9%, 14.1% and 7.4% in FY19, respectively. Throughout all regions, positive growth occurred from FY18- FY19, with APAC region growing the fastest at 55%. Canada and America grew at the lowest rate, signalling the increased saturation in these areas, with companies such as Walt Disney entering the market. Overall, there has been a slowdown in growth across all regions in FY18-FY19 compared to FY17-FY18, however, this can be explained by the global economic slowdown.

Expenses

The majority of the cost of revenues comes from the amortisation of streaming content assets, but there are also streaming delivery costs, expenses from the acquisition, licensing, and production of content.

The $1,684m increase in content amortisation related to existing and new streaming content with more exclusive and original programming. Other costs rose by $789m, mainly due to increases in expenses associated with the acquisition, licensing and production of streaming content and increased payment processing fees due to increased members.
The interest income earned on cash balances coupled with foreign exchange gains, driven by remeasurement of Senior Notes dominated in euros, resulted in an increase of $30m.

Ratios	2017	2018	2019
Gross Profit Margin	7.2%	10.2%	12.9%
Net Profit Margin	4.8%	7.7%	9.3%
Return on Equity	15.6%	23.1%	24.6%

The increase in Gross Profit Margin (GPM), shown in the table above, shows that a greater share of revenues has been converted into operating profits, indicating that the cost of revenues has reduced relative to revenues. This increases by roughly the same amount each year.

Similarly, Net Profit Margin (NPM) measures the company's profitability but accounts for the company's total expenses and hence is a much more definitive metric. The NPM also increases year on year, indicating an increasing amount of revenue from sales has been translated to profit, as a percentage. Again, this increases by almost the same amount each year. This high ratio displays efficient cost management, low costs, and strong pricing strategies from Netflix.

Return on Equity (ROE) compares profits to equity investments. The higher, the better and it shows the efficiency of the company in generating profits from equity financing. The ROE has increased over the years, with a very small increase from FY18 -FY19.

Overall, all these ratios are increasing and have an upward trend.

Balance Sheet Analysis

Netflix's Strategy is to increase subscriber base, which has been initiated through producing more original content. This can be seen year to year with the increases in total assets and liabilities. From FY18-FY19, total assets have increased by 30.8%. The predominant reason for the increase in assets has been the increase in non-current content assets from $14,951,141 to $24,504,567 in FY19. Part of the reason for this has been the reclassification of current content assets to non-current content assets. This reclassification does not change the total assets, due to being under the same category. What has led to the change is the increased streaming content available on Netflix, as they generate revenue from subscriptions as opposed to specific title successes. Original Content assets have increased by 62.7% in the time period. In FY20, the impact of COVID-19 has meant that production has been paused for the majority of future content. This may mean that the increase in new content slows down. In the current assets, cash & cash equivalents, have increased 32.2%, and a large part of this increase has been through borrowing.

Total Liabilities have increased by 27.3% in FY19. The predominant reason for the large increase in the long-term debt increase to finance the streaming content, due to having negative cash flows from operating activities. Long term debt rose 42% from FY18-FY19, which represents Netflix's desire to investing in more original content.

Debt-to-Equity Ratio	2017	2018	2019
Netflix	1.81	1.98	1.95
Walt Disney Co.	0.61	0.43	0.53
Charter Communications	1.8	2.01	2.51
Comcast Corp.	0.94	1.56	1.24

The Debt-to-Equity ratio measures a company's financial leverage, displaying the breakdown of how a company is financing operations through debt and equity. High leverage ratios indicate more risk, due to financing growth through borrowing, which the company could default on these debt repayments. Netflix has increased its debt-to-equity ratio over the 3 years, from a ratio of 1.81 to 1.95. The production of their original content has been the predominant reason for this increase in debt, moving away from just licensing external content, which can be cheaper. Compared to competitors, Netflix has one of the largest debt-to-equity ratios, which could be explained by the need for cash to catch up in size to competitors. Disney, on the other hand, has a low debt-to-equity ratio, financing the company through shareholder equity as they are already established, and have a decreased need for rapid expansion.

Current Ratio	2017	2018	2019
Netflix	1.4	1.49	0.9
Walt Disney Co.	0.81	0.94	0.9
Charter Communications	0.23	0.23	0.52
Comcast Corp.	0.74	0.79	0.84

Overall, Netflix's current ratio has remained above 1, until FY19 where it decreased to 0.9. This would signify that they would not be able to cover their current liabilities in the short run. The sudden drop can be explained by the change in assets, as cash & cash equivalents increased, but current content assets have been reclassified in FY19 and are now listed under non-current content assets. A current ratio lower than 1 can be deemed acceptable as the company receives monthly instalments from subscribers that should ensure financial liquidity. Netflix, compared to competitors, has a healthier current ratio.

Industry Analysis

Market Overview

The streaming video on demand market (SVOD) consists of usual cable & satellite TV companies, as well as strictly SVOD companies. The market is valued through revenue from the subscription model, of subscribers paying a fee to consume the content and generating revenues from advertising. The SVOD global market size was valued at $42.6bn in 2019 increasing by 18.1% relative to 2018. High growth has been common in this industry due to the growing popularity, with subscribers moving away from traditional TV.
Subscription models have proven dominant so far, as they account for 43% of the revenue in 2019. These have been more effective due to predominately providing a wide variety of original content. On the other hand, advertising models account for a smaller proportion of revenue and consumers are less inclined to watch adverts and have a preference for just paying a fee to avoid them.

North America is the largest market for streaming, being responsible for 39% of the revenue share. This growth can be down to the advancement of technology, making the service more attractive. The cloud, for example, has made it possible for more content to be available. Growth is likely to cool off in the future due to increased saturation from new players getting involved.
The Asian-Pacific region has the highest growth in the market. This is due to the nature of accessibility to streaming in the region. Countries such as Indonesia, Philippines and Vietnam saw a 5-7% increase in smartphone owners. This has also been tied in with the advancement of internet speeds and access, which has made the ability to consume streaming services easier.

The market is expected to register a compound annual growth rate (CAGR) of 20.4% between 2020-2027, with the expected global market size in 2027 being $184.27bn. The impacts of COVID-19 is likely to give the market a short-term boost to the market, due to the lockdown.

Porter's 5 Forces Analysis

The analysis below provides a deeper understanding of how the SVOD industry is structured and its economic attractiveness. It looks at the rivalry, threats of substitution, new entrants, and buyer & supplier power.

Competition in the industry → Strong

There are many firms with high aggressiveness, displayed by their mass media marketing strategies, leading to a strong force here. However, moderate differentiation exists due to the wide range and diversity of audience, favouring different content. Competition makes companies in this industry strive to provide affordable prices to retain customers and there is high competition for acquiring rights to display content. In addition, larger companies can acquire smaller ones. In 2019, Walt Disney completed its acquisition of 21st Century Fox and also acquired a 1/3 stake in Hulu, cementing its competitive position in the streaming industry.

Exit barriers are low because external suppliers tend to be used for making content and many film sets are one off costs and can be sold. For customers, the switching costs between companies are low, which also influences rivalry.

Potential of new entrants into the industry → Moderate

New entrants are able to thrive due to the fragmented market and wide audience if the company has niche offerings. Netflix has the advantage of having a mixture of top budget films and niche offerings, as well as producing its own lower budget films and series which have blown up.
Evolving technology increases the threat of new entrants. Netflix has the edge; due to the range of content it offers and its convenience. It would be difficult for a new entrant to gain a competitive advantage due to the high cost of requiring capital investment, supplier contracts and networking in the industry. On the other hand, there is low switching cost between companies and customers can cancel their Netflix subscription at any time.
The threat of new entrants may vary internationally. For example, in Europe, US and Brazil, US films and content are highly popular, whereas in Japan, Japanese content is more popular. A new entrant could have an advantage if it engaged in international collaboration.

At current, the COVID-19 pandemic has restrained any entry to the market.

Power of suppliers → Strong

Suppliers include film and production companies. High overall supply means that companies cannot easily affect the market, especially as there are a lot of other competitors that can support the suppliers. Suppliers have an edge as they can negotiate the pricing of giving a license to acquire and distribute their content. Netflix is highly influenced by suppliers compared to Disney Plus which uses its own content and not external suppliers. Netflix has lowered its profits in order to maintain contracts with its suppliers in order to establish a customer base, highlighting the power of the suppliers.
Switching costs are high during production and suppliers also have higher power when it comes to creating or obtaining content of higher quality.

Due to COVID-19, film suppliers may have lower power due to the closing of cinemas which are their main source of revenue, so instead they would be releasing high quality films to Netflix for lower prices in order to earn revenue.

Power of customers → Strong

Netflix is unable to charge high prices due to the low switching costs between different companies. This means that brand loyalty is weak. Buyers are also likely to switch between companies that provide films that have been successful at the box office or hit TV series.
The fact that Netflix is a producer of content as well as a distributor weakens the power of customers as they would pay a higher price for Netflix's exclusive content.

Threat of substitute products → Moderate

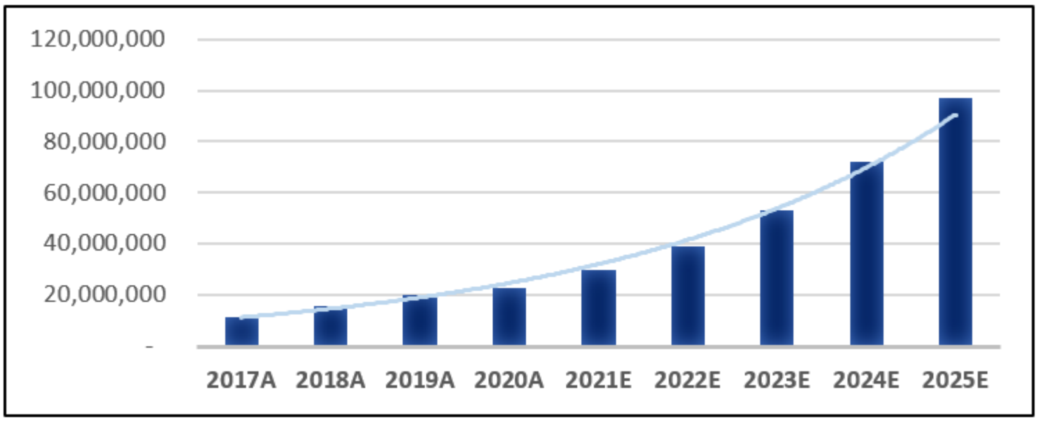
There are other entertainment activities that customers may choose instead of online streaming, i.e. theatres. However, these can share the same audiences. Another substitute is illegal piracy, which is often of poorer quality. Strategies such as high quality and performance must be applied to attract customers away from substitutes.
Additionally, Netflix must continuously update its content library with content that is in demand by the customers. Marketing is also essential to maintain the customer base and increase profitability.

Outlook

Revenue Growth

A base case scenario for Netflix will most likely be one of flat year-on-year growth, with a tendency to decrease year-on-year at least marginally. Factors contributing to this are related to the increasing saturation of the SVOD industry coupled with the continued rise of pirating. Given that content providers, such as HBO, are starting to reject renewals of rights and licenses, and also developing their own in-house streaming models, adding competition to Netflix, as well as a potential supply shock towards Netflix's content pipeline. However, Netflix still has the lowest user churn rate amongst its rivals, and comparatively, Netflix has a greater approachability to local markets, such as India and other APAC regions, which have undergone rapid growth in streaming. Given that China is an untapped market for Netflix, and given the escalated conditions with US-China, a potential democratic sweep in the white house in November may provide some relief, and potentially allow Netflix to access the Chinese market. With the rollout of 5G imminently soon, advances in tech and user reachability will be a positive factor. In the near term, the downside risks are mainly lower consumer incomes as well as halted production of Netflix originals, both as a result of COVID-19.

Revenue Projections



Cost of Revenues

With advancing technology, streaming delivery costs are likely to increase due to increasing cloud computing costs. Payment processing fees in the operation costs will also increase if there is a growing customer base. With Netflix having to keep up with customer satisfaction and the saturating industry, they are required to continuously update their content and remove unsuccessful content. Thus, increasing streaming content assets, increases the cost of revenues due to amortisation. Amortisation also increases with Netflix producing more original content in addition to licensing content from production companies.

Over the past 3 years, cost of revenues has increased by 24-25% annually. The increase over the past year was primarily due to the increase in content amortisation relating to new and existing streaming content. As Netflix has continuously improved and grown with these increases in cost of revenues, it is likely that these costs will increase at a similar amount as previous years.

Marketing

With the current market saturation in North America, larger spending on marketing may improve product differentiation, in order to stand out from competitors and therefore win a larger market share. However, it is unlikely Netflix will make drastic changes to spending on marketing in the near future. In the past 3 years marketing has been at 12-15% as a percentage of revenues, maintaining general continuity on spending patterns. As a result, we have assumed that marketing will maintain a similar ratio to revenue and the expenses will be at 13% of revenues year on year.

Technology and development

In order to maintain the quality of the streaming service, Netflix must utilise the latest technology. Through continually improving the service, current subscribers will stay subscribed, while Netflix will be able to continually attract new subscribers. With Netflix's current trend in spending, it is unlikely to increase differently than its past performance. Spending on technology and development has increased 26-28% annually in the past 3 years and maintained the percentage of revenues at 8% yearly. During this time period, Netflix has been producing improvements every year, highlighting why there is no sudden need for an increase above average on spending. As a result, we have assumed technology spending will represent 8% of revenues year on year.

General and Administrative

Netflix's general and administrative costs as a percentage of revenue range between 4-7% since 2015, with last year's costs being primarily attributed to increased compensation for existing employees and headcount growth. This figure is likely to stay in line with the upper end of the range in the near term due to increased costs of licensing, contracts and rights ownership, increasing production costs of original content to offset the likely reducing externally sourced content pipeline, and increasing headcount to support production.

Other factors such as one-off consultation costs and streaming service improvements, especially given the roll out of 5G and next gen consoles, will likely add to this cost. Hence, whilst Netflix shifts to developing internal content rather than purchasing fixed term contracts, resulting in increased headcount and service development, this will push costs to the upper range.

Valuations

Comparable Companies Analysis ('Trading Comps')

Our comparables list consists of Walt Disney, Amazon, and Comcast. Due to there being no direct comparables to Netflix listed on the stock exchange, in regard to solely offering online streaming services, we have had to use the closest competitors that all offer streaming services, among various other activities. Hence, the relative valuation may be distorted and should be looked at with scepticism.

Comparable Companies	Share Price	Equity Value	Enterprize Value (EV)	Adjusted EBITDA	EV/EBITDA Multiple
Walt Disney	$ 144.73	$ 261,421,023	$ 304,322,023	22,962,000	13.25
Amazon	$ 3,051.88	$ 1,577,821,960	$ 1,613,913,960	48,583,000	33.22
Comcast	$ 38.98	$ 179,580,860	$ 261,997,860	36,394,000	7.20
Average					**17.89**

In our analysis, we made use of the EV/EBITDA multiple, where EV is derived by deducting net debt from the Market Capitalization. The EV is then divided by EBITDA, which is fairly straightforward to calculate from the comps' financial statements, and a multiple is obtained. In our case, the average EV/EBITDA multiple amounted to 17.89x. This multiple is then applied to Netflix's EBITDA, to arrive at the company's EV. The EV minus Net Debt equals Equity Value, and this divided by the number of shares outstanding, results in the implied share price of $502.38. Further breakdowns and details are provided in the tables.

Netflix EBITDA (LTM)	**12,956,293**
EV/EBITDA multiple	17.89
Enterprise Value (EV)	**231,796,483**
Enterprise value (EV)	231,796,483
Plus: cash and cash equivalents	7,167,438
Less: pension benefits; net of tax	47,000
Less: Debt	- 17,460,123
Equity Value	**221,550,798**
Shares O/S	441,000
Implied Share Price	**$ 502.38**

Discounted Cash flow Analysis ('DCF Analysis')

The DCF valuation method is predicated on deriving the Present Value (PV) of future Free Cash Flows (FCF), discounted at an appropriate WACC rate. The outlook section helped derive our projections for forecasting the cash flows used in our DCF model. The calculation of the WACC rate and a more detailed breakdown of the DCF analysis process is provided in the subsequent sections below.

Weighted Average Cost of Capital (WACC) Calculation

WACC is the cost of capital to the firm, indicating the rate at which the company pays its security holders. In order to calculate the return on equity for shareholders the Capital Asset Pricing Model (CAPM) is used to estimate an expected return. The risk-free rate represents the 10-year US Treasury Bond yield, and the figure used is a 5-year average. The market risk premium is the difference between the returns on the market (S&P

500) and the risk-free rate. The Beta is a measure of Netflix's volatility in relation to the market, and as the figure is under 1, Netflix is considered to be less volatile than the market. The cost of debt is calculated by using the interest incurred/total debt. As interest is a taxable deduction, the cost of debt is reduced due to the tax shield. In order to calculate the WACC, the two figures of Cost of Equity and Cost of Debt are apportioned in relation to the breakdown of the total capital. The table below shows how the WACC was calculated in the case of Netflix.

WACC Calculation	
Risk-free rate	2.14%
Market risk premium	6.13%
Beta	0.9408
Cost of Equity	7.90%
Cost of Debt	4.24%
Effective tax rate	11%
Cost of Debt (after-tax)	3.79%
Shares O/S	439,961
Share price (£)	484.48
Market Capitalization	**213,152,305.28**
Net Debt	14,759,260.00
Total Financing	227,911,565.28
Proportion of Equity	93.52%
Proportion of Debt	6.48%
WACC	**7.64%**

Free Cash Flow (FCF) Calculations & Projections

From the forecasted revenues (discussed in the outlook section), we deduct the projected cost of revenues and other expenses, to arrive at the Earnings Before Interest and Tax (EBIT). Thereafter, Net Operating Profit After Tax (NOPAT) is calculated by EBIT * (1 – t), where t is the marginal tax rate and is 11% for Netflix. Since it is cash flow we are interested in, rather than income, we need to make a few adjustments for non-cash items, such as Depreciation & Amortization, Changes in Working Capital, Stock-based compensation. Additionally, Capex must be deducted here since it is a cash expense but not recorded as an expense on the Income Statement. Through all these adjustments, we obtain the firm's future FCFs, which must now be discounted using the WACC rate of 7.64%.

In addition, since companies are treated as a going concern, we assume that Netflix will operate and grow at a certain rate, indefinitely. To account for this in our valuations, we set a Terminal Growth rate, which In order to be realistic is set between the historical inflation rate and average GDP growth rate, and consequently we decided on 1.75%. The PV of all future FCFs beyond the projection period is calculated as the Terminal Value (TV) and this accounts for the majority of the company's valuation. The relevant calculations and adjustments is provided in the table below.

	2018A	2019A	2020A	2021E	2022E	2023E	2024E	2025E	2026E - TV
EBIT	**1,646,951**	**2,688,254**	**3,704,823**	**2,663,786**	**4,320,945**	**5,325,799**	**7,952,461**	**10,697,613**	**10,884,822**
Marginal Tax Rate (%)	*1.0%*	*9.0%*	*22.0%*	*11%*	*11%*	*11%*	*11%*	*11%*	*11%*
NOPAT	**1,630,482**	**2,446,311**	**2,891,208**	**2,379,996**	**3,860,606**	**4,758,407**	**7,105,234**	**9,557,926**	**9,687,491.30**
Add back: D&A	7,615,245	9,319,826	10,059,890	14,284,489	18,958,060	25,703,521	34,891,267	46,935,567	47,756,939
Add back: Stock based compensation	401,557	401,557	401,557	401,557	401,557	401,557	401,557	401,557	401,557
Less: CAPEX (PPE + Streaming content)	(13,382,557)	(14,303,747)	(13,896,120)	(15,625,404)	(17,569,887)	(19,756,349)	(22,214,901)	(24,979,406)	(28,087,935)
Less: Changes in NWC	(300,266)	(224,776)	230,435	(791,711)	(566,217)	(857,345)	(1,133,816)	(1,519,108)	(103,597)
Unlevered free cash flow	**(4,035,539)**	**(2,360,829)**	**(313,030)**	**648,927**	**5,084,119**	**10,249,791**	**19,049,340**	**30,396,536**	**29,654,456**
Discount Rate (Wacc)				**7.64%**	**7.64%**	**7.64%**	**7.64%**	**7.64%**	**7.64%**
Discounted Free Cash Flows				483,453	3,518,961	6,591,033	11,380,416	16,871,047	259,763,345
Sum of PV FCFs	**298,608,255**								

The summation of all discounted future FCFs gives us Netflix's Enterprise Value (EV). As mentioned under the comparables section, deducting Net Debt from EV, gives us Equity Value and dividing this by the number of shares outstanding will provide us the with implied share price through DCF analysis, which is $653.67 according our calculations.

Enterprise Value	**298,608,255**
Plus: cash and cash equivalents	7,167,438
Less: pension benefits; net of tax	- 47,000
Less: Debt	- 17,460,123
Equity Value	**288,268,570**
Shares O/S	**441,000**
Implied Share Price	**653.67**

Valuation Discussion & Recommendation

We have derived our final implied share price by combining the results from the DCF analysis and the Trading Comps, equally weighted. Both methods mentioned above have issues associated with them and must be looked at with precaution. The DCF analysis is based on Free Cash Flows (FCF), which is derived after accounting for Capex, which creates an issue where the more investments you carry out for innovative purposes, the less FCF you will have. A negative FCF is not necessarily bad since it indicates high Capex which is good for growth (i.e. Tech and Start-up firms), although other reasons may exist.

Similarly, relative valuations have their own issues. For one, it assumes that the comparable companies are fairly priced by the market, however then, why is the target firm also not considered to be fairly priced? Companies also tend to have different accounting methods, measures of profitability and are not always exactly the same, as we see in the case of Netflix, which lacks many direct competitors that solely focus on streaming.

Implied Share Price		Weighting
Comps	$502.38	50%
DCF	$653.67	50%
Final Share Price		**$ 578.03**

Based on all our calculations, the intrinsic share price arrived at is $578.03 (breakdown is shown in the table above). This represents an upside of **+13.38%** and hence a **BUY** rating is recommended.

(**Disclaimer**: This report is for informational purposes only and is not financial advice)