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Netflix: See What's Next
Buy Debtflix and Chill

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Abstract

This report aims to provide an actual price for Netflix's stock in 2020 and estimate the gain or loss coming from an investment in the stock for the timeframe of one year until the end of 2021. It provides a forecast for the timeframe 2020-2029. Moreover, to evaluate the company discounted cash flow model combined with a multiples valuation was used considering an extended forecasted period until 2039, Covid-19 impact on 2020 results, and sensitivity and scenario analyses. At the end, it makes a final recommendation for the stock as of 31.12.2020 analyzing risks and accounting for stock criticisms.

Keywords: Forecast, Valuation, DCF, Multiples

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This report is part of the Report – Part 2 *Netflix: See What's Next* and should be read has an integral part of it.

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Forecast

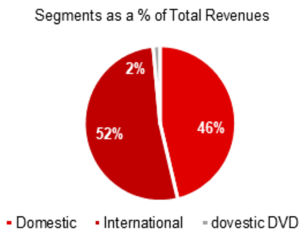


Figure 32: Segments as a % of total revenues 2019
Source: Annual Report 2019

To evaluate Netflix, a forecast for the timeframe 2020-2029 was estimated without taking into consideration any anomalies from the Covid-19 pandemic. The main captures of income statement and balance sheet were forecasted using revenue as primary value driver. In addition, content assets and liabilities were analyzed to assess the development of total streaming content and its impact on the company's revenue.

Revenue Forecast

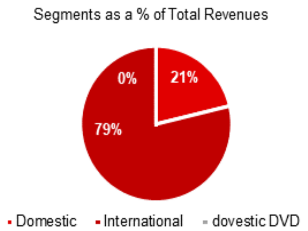


Figure 33: Segments as a % of total revenues 2029 forecast

Netflix revenues can be segmented in domestic streaming, international streaming, and domestic DVDs. International streaming represents the main source of revenue at the end of 2019 accounting for 52% of total revenue compared to 46% of domestic streaming and 2% domestic DVDs. The company derives revenues from monthly membership fees for the offered services associated to streaming content and DVDs rentals. Thus, the number of paid memberships and the related price changes play a crucial role in the estimation of the revenue for the next ten years. Revenue was forecasted based on paid memberships breaking down the value drivers by segment and by geography. Netflix total revenue in 2019 amounts to 20,156.45 million USD and is expected to hit 85,508.86 million USD in 2029 growing at an average growth of 25%. In 2029 the international streaming sector will contribute for 79% of the company's total revenue while 21% will come from the domestic sector. In the international streaming sector Asia Pacific will be the highest contributor to the revenue increase, followed by the EMEA region.

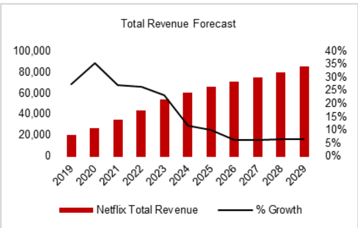


Figure 34: Total revenue forecast

- Memberships Forecast

The streaming sector was growing at an average rate of 33% over the last five years and it represents 97% of Netflix's total revenue. On the other hand, revenue from rental domestic DVD has decreased approximately 19% per year from 2017 to the end of 2019. Despite the still high profit margin of the DVD business, the company has never shown an interest in preventing its extinction (Littleton and Janko Roettgers 2018). In the light of this and of the lower demand for physical copies of the streaming contents (Statista 2019e), memberships for domestic DVD rentals are expected to decrease at a progressive rate until 2022, when the company is likely to remove it from its service offerings.

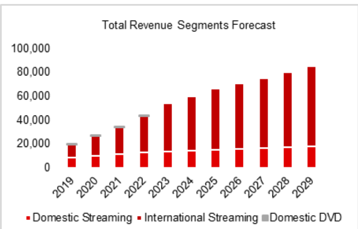


Figure 35: Total revenue segments forecast

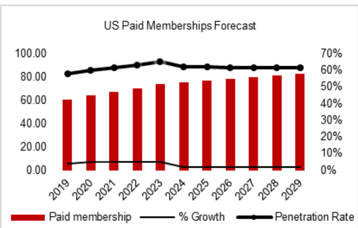


Figure 36: Domestic sector paid memberships forecast and penetration rate

The domestic streaming sector counts 61.04 million paid memberships at the end of 2019, only 4% more than in the previous year. From 2017 to 2018 the growth in the number of subscriptions was 11%, similar to the preceding period's growth of

	US Launch: 2007	
	2019	2029
#M Memberships	61.04	83.07
Penetration Rate	53.65%	59.89%
USD ARPU	12.57	18.24

Figure 37: Domestic sector overview

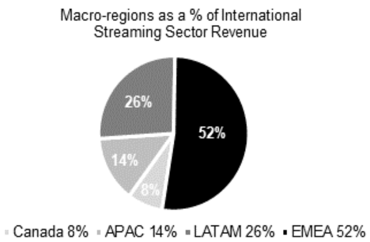


Figure 38: Macro-regions as a % of international streaming sector revenues 2019
Source: Annual Report 2019

Figure 39: International sector - Canada paid memberships forecast and penetration rate

	Canada Launch: 2010	
	2019	2029
#M Memberships	6.62	10.37
Penetration Rate	44.48%	57.15%
USD ARPU	12.57	18.88

Figure 40: International sector - Canada overview

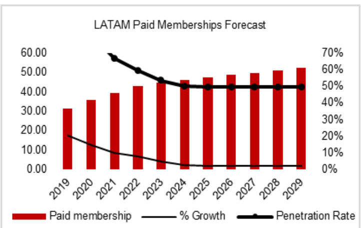


Figure 41: International sector - LATAM paid memberships forecast and penetration rate

10%, highlighting the reaching of a mature stage in the US market. From 2007 Netflix has been boosting its streaming service from niche to national level obtaining a 54% penetration rate at the end of 2019 considering 113.79 million household with broadband internet access in the country (Statista 2019f). Being that America is likely to be 100% wired for broadband by 2030 (Cooper 2020), Netflix will still increase its yearly net memberships additions by that time. Thus, taking into account its steady stage, the company is expected to grow its number of subscriptions for the next 4 years at an average rate of 5% before stabilizing and aligning with the expected 1.90% GDP growth rate of the US economy (International Monetary Fund 2020a). Therefore, in 2029 83.07 million of paid memberships and a penetration rate of 60% are forecasted.

For forecast purposes, the international streaming sector was broken down into four macro-regions: Canada, Latin America, EMEA, and Asia Pacific. Particular attention was paid to the degree of similarity that each region has with the US market in terms of consumer tastes and to market specific competition levels. Estimations were made taking the US domestic streaming sector as benchmark and considering different development and growth stage coming from SVoD industry penetration rates and Netflix platform specific launch timeline.

Netflix international expansion started in Canada in 2010. Because of the similarity of the Canadian and US markets in terms of consumer tastes, preferences, behaviors and income levels, a similar evolution in the number of memberships was assessed. Netflix subscriptions at the end of 2019 in Canada amount to 6.62 million reflecting a growth rate of 6% over the entire year. Like in the US, a growth slowing down from 12% in 2018 was recorded marking the company's approach to a mature stage in the Canadian market. Hence paid memberships are likely to growth at a shrinking rate from 10% to 3% until 2024, reaching afterwards a sustainable 1.80% level conforming to the expectations for the Canadian economy (International Monetary Fund 2020a). Penetration rate based on household with internet access is expected to intensify from 44% in 2019 to 57% in 2029.

In 2011, one year after its entrance into the Canadian market, Netflix launched its streaming service in Latin America. Using the total amount of SVoD subscriptions in the region as a benchmark, Netflix has a penetration rate of 75% in 2019. As Latin America is predicted to have 100.35 million SVOD subscriptions by 2025 against the current 42.15 million and a wave of US-based platform launches (Disney+, Hulu, HBO Max and ViacomCBS) are planned for 2020 and 2021 (Research and Markets 2020), Netflix paid memberships are expected to grow but its dominance will decline. The 31.42 million 2019 subscriptions are forecasted to grow at a lower rate than the current 20% until reaching 47.58

	LATAM Launch: 2011	
	2019	2029
#M Memberships	31.42	52.52
Penetration Rate	74.54%	47.22%
USD ARPU	8.21	13.81

Figure 42: International sector - LATAM overview

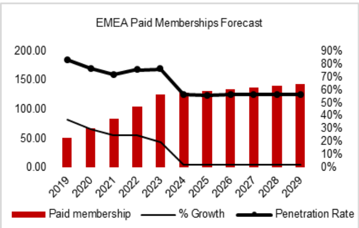


Figure 43: International sector - EMEA paid memberships forecast and penetration rate

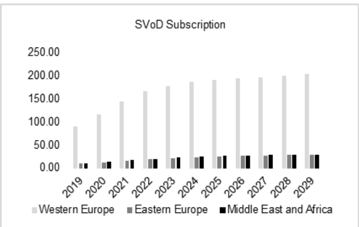


Figure 44: EMEA – Western Europe, Eastern Europe, and Middle East and Africa SVoD subscriptions

	EMEA Launch: 2012	
	2019	2029
#M Memberships	51.78	144.09
Penetration Rate	46.56%	54.63%
USD ARPU	8.21	13.81

Figure 45: International sector - EMEA Overview

million in 2025 and subsequently follow the 2.50% GDP growth rate. Because of the intensified competition and despite the rapidly expanding economies, the growth of broadband connectivity and a wide-open market for low-priced entertainment, penetration rate is forecasted to drop to 47% in 2029.

Netflix initiated its international expansion in the EMEA area in 2012. In this region, the company has not reached a steady stage yet, but its paid subscriber growth has slowed down to 37% in 2019 from 45% in 2018. At the end of 2019, the company has 51.78 million memberships corresponding to a penetration rate of 47% on the total SVoD subscriptions. At the end of 2019, this sector counts 90 million of paid subscriptions that are expected to increase to 191 million by the end of 2025 (Digital TV News 2020) preceding a stabilized growth of 1.70%. Western Europe countries are comparable to US and Canada in respect to media consumption trends, wide spread of internet and broadband connections and living standards' quality. Thus, they are expected to growth conforming to a similar pattern to the domestic streaming sector. It is expected that by the end of 2021 over four in 10 internet users in Western Europe will watch Netflix at least once a month (Brentnall 2020). However, analogous to Latin America, growth in viewership will slow down in 2020 and 2021 following a rise of competition. Amazon Prime Video and Disney+ are indeed gaining market share and local TV broadcasters have been offering their own streaming platforms and joining forces to form new local streaming services, as demand for locally produced and native-language content has increased in Western Europe. Netflix's expansion in the Eastern European market started in 2016 as local TV operators were looking for value-added initiatives for their traditional service offerings. In 2019 the number of paid SVoD subscriptions in the market reaches 10.26 million and it is expected to be more than double in 2025 (Digital TV News 2020) before continuing to grow at the GDP expected rate of 2.60%. So far international over-the-top video services have not significantly expanded their footprints across Eastern Europe markets, as they were not successful in establishing partnerships with local operators. The Netflix deal with Platforma Canal+ is the first significant partnership between the worldwide stand-alone OTT player and a large pay TV operator in Eastern Europe (Gaber 2020). Lastly, in Middle East and Africa, Netflix represents a driving force for subscription streaming video and is predicted to generate 38% of the total 2.97 billion USD estimations for 2025 (Digital TV News 2020). SVoD subscriptions in this market are expected to be 29.95 million by 2029 growing at a sustainable 2.40% growth from 2026. All these things considered, in the EMEA region Netflix is forecasted to have a penetration rate of 55% on the total paid SVoD subscriptions and its paid number of subscriptions will peak at 144.09 in 2029.

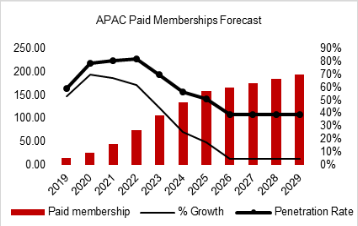


Figure 46: International sector - APAC paid memberships forecast and penetration rate (2. India expansion 50M)

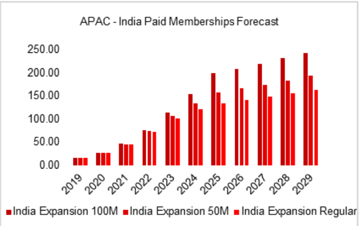


Figure 47: International sector - APAC – India paid memberships forecast 1., 2., 3., India expansion 100M, 50M, regular)

	APAC Launch: 2016	
	2019	2029
#M Memberships		
1. India Expansion 100M	16.23	244.03
2. India Expansion 50M	**16.23**	**194.06**
3. India Expansion Regular	16.23	164.27
Penetration Rate		
1. India Expansion 100M	6.08%	42.82%
2. India Expansion 50M	**6.08%**	**34.05%**
3. India Expansion Regular	6.08%	28.82%
USD ARPU	9.24	12.53

Figure 48: International sector - EMEA overview

	US Streaming Plans and Pricing		
	Basic	Standard	Premium
Monthly cost USD	8.99 USD	13.99 USD	17.99 USD
# Screens at the same time	1	2	4
# Phones or tablets to download on	1	2	4
Unlimited movies and TV Shows	✓	✓	✓
Watch on laptop, TV, phone and tablet	✓	✓	✓
HD available		✓	✓
Ultra HD available			✓

Figure 49: Domestic Streaming sector plans and pricing
Source: Netflix 2020

Netflix launched its streaming services in the Asia Pacific region in 2016 hitting a penetration rate of 6% over the 267 million total market SVoD subscriptions in 2019. Asia Pacific is Netflix's least mature region and the smallest by revenue in its international streaming sector. However, paid memberships grow of 67% from 10.61 million to 16.23 million between 2018 and 2019 accentuating the presence of a lot of room for growth. The low penetration rate in the market derives from the initial failure to enter the Chinese market due to government restrictions. Excluding China, the biggest country with a 1.37 billion population in Asia, Netflix's strategy needs to be focused on other opportunities such as India, Korea, Japan, Indonesia to boost its penetration rate. In 2018, Netflix CEO discussed the goal of reaching 100 million subscribers in India in the long run. A combination of factors including original content for India, partnership with Airtel for better access to market, fixing payment issues, and a new low cost-based variant for a price-sensitive Indian market helped the company to obtain a 67% increase from 2018 to 2019 in the percentage of existing paid memberships in India (Chanda 2019). Thus, for the forecast of paid memberships in the Asia Pacific region a sensitivity analysis with three different potential growth outcomes (Indian expansion will reach 100 million, 50 million or 20.24 following a regular development of Netflix subscribers in 2029) in India was created. If Hastings' prognosis of reaching 100 million subscribers is correct, paid memberships should growth at an average rate of 86% until reaching a steady stage of 5.10% starting from 2026. A lower average growth rate of 66% will instead lead to 50 million of memberships while a 44% growth to 20 million. Considering that APAC internet penetration is likely to reach 61% by 2024 (GlobalData Technology 2020) and SVoD subscription in India 45 million by 2025 (Digital TV Research 2020), the second scenario (average growth 44% and 50 million subscription in 2029) is assumed to be the most appropriate.

- Pricing Forecast

Netflix offers three streaming video plans (basic, standard, and premium) with different prices starting with the lowest at 8.99 USD per month and topping out at 17.99 per month. More expensive plans are associated with higher quality video and family-friendly features that allow to watch video on more than one screen at a time (Netflix 2020). Domestic DVDs can be rented in US for a minimum price of 7.99 USD up to a maximum of 14.99 USD (Gebel 2020). In the forecast an average revenue per users was considered as a value driver for each macro-region of the streaming sector and rental fees for DVD are not expected to be subjected to any changes until the company will remove it from its service offerings. Despite the increasing competition offering varying price points that make streaming services available to any budget, Netflix still have room to

	US DVD Plans and Pricing	
	Standard	Premium
Monthly cost USD	7.99 USD	11.99 USD
Monthly cost with Blu-rays USD	9.99 USD	14.99 USD
# Discs out-at-a-time	1	2
# Discs per month	Unlimited	Unlimited
No late fees	✓	✓
Free shipping and returns	✓	✓
First month free	✓	✓
Cancel anytime	✓	✓

Figure 50: Domestic DVD sector plans and pricing
Source: Gebel 2020

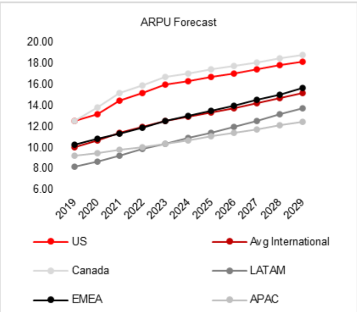


Figure 51: Domestic sector and international sector ARPU forecast

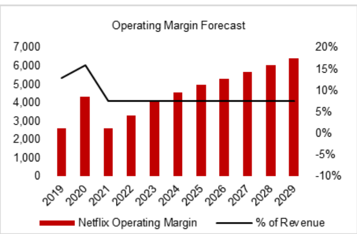


Figure 52: Operating margin forecast

increase its pricing especially in certain markets such as the U.S. and Canada. In the past, Netflix bumped its prices higher roughly every two years. At the start of 2019, it raised US prices by 2 USD for both standard and premium subscriptions and 1 USD for the basic plan (Joan Solsman, Crist 2020).

ARPU for the domestic streaming sector raised at an average growth rate of 11% from 9.21 USD in 2016 to 12.57 USD in 2019. As the US market has already reached a mature stage, it is estimated that price will increase at an average of 6% until 2023 and afterwards at the yearly estimate inflation rate for the US market of 2.20% (International Monetary Fund 2020b). Likewise, in Canada ARPU is expected to grow at an average rate of 9% for four years and 2.00% from 2024 onwards according to inflation changes' prognosis. In Latin American countries due to exchange rates, the average monthly subscription fees are among the cheapest and least profitable. In this region Netflix reduced its entry prices to scale up. Therefore, ARPU is expected to rise at the inflation rate (5.34% on average) and no major price increase policies are forecasted. In the EMEA region, prices are likely to grow in the Western European countries similarly to the North American market, while in Eastern Europe, Middle East, and Africa they will increase at a lower rate because of the developing stage the company is still in. Hence, until 2023 ARPU will grow at 5% and subsequently at an average inflation rate for the entire region of 3.77%. Finally, as the company is less mature in Asia Pacific and it is pursuing a low cost-based strategy for price-sensitive markets, ARPU is forecasted to grow following the inflation rate of average consumer prices (3.09% on average) from 2020 onwards.

Expenses Forecast and Operating Margin

Cost of revenue and operating expenses are analysed as a percentage of the total company revenue and forecasted for the next ten years considering historical trends and strategic planning for the future. Operating margin as a percentage of revenue has been increasing from 4% in 2015 to 13% in 2019 as a sign of both revenue and margin increase. The margin has been expanding primarily because Netflix pays for its content investments on a fixed-cost basis regardless of the amount of viewership and subscriptions. Hence, each additional paid membership comes with a little extra cost. However, Netflix is still making big expenditure in cost of revenue for more content licenses and production, and in marketing. The company is expected to continue along this path in the next years due to increased competition. For this reason, despite the high margin in 2019, operating result is forecasted to be 6,437.31 million USD in 2029 as a result of a 7% average operating margin over the next ten years.

- ### Cost of Revenue

The cost of revenue was broken down into licensed content amortizations, produced content amortizations and other cost of revenue to estimate the evolution of each capture over time. Costs for streaming contents depend on the amount of content licensed and produced. Payment terms for certain content licenses and the production of content require more upfront cash payments. Thus, these expenses are amortized in the cost of revenue over a maximum of ten years after the content is made available for the users and they make up the majority of cost of revenue. The amortization is on an accelerated basis, as typically more upfront viewing is expected, and film amortization is more accelerated than TV series amortization. On average, over 90% of a licensed or produced streaming content asset is expected to be amortized within four years after its month of first availability (Netflix Annual Report 2019).

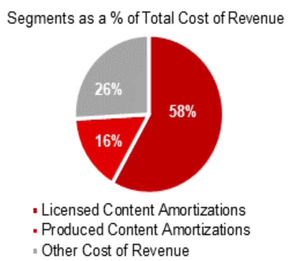


Figure 53: Segments as a % of total cost of revenue 2019
Source: Annual Report 2019

Content amortization identifies the amount of Netflix's content assets that is written off each period to extend out the cost of content. Analysing content spend by years based on both content amortization and cash spent, it can be observed that cash spent has been increasing faster than the amortized amounts over the last years highlighting the company's shift to producing originals. From 2015 to 2019 content amortization grew at an average of 28% compared to 36% of the cash spend (Next Level Finance 2020). Indeed, produced content expenses are much more upfront compared to a licensing arrangement over time.

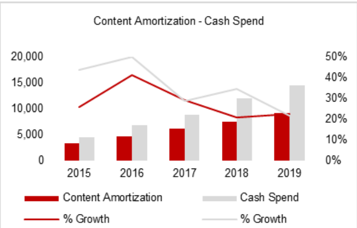


Figure 54: Content amortization and cash spend 2015-2019
Source: Next Level Finance 2020

In 2019 licensed content amortisations account for 36% of Netflix's total revenue, produced content amortisations for 10% and other cost of revenue represents 16% instead. As the company is expected to growth further over the forecast period focusing on originals' production and on gaining new licensed contents, an increase in the cost of revenue was forecasted. Licensed content amortizations are likely to grow at an average rate of 15% over the forecasted period, lightly increasing compared to the 13% over the last three years. Produced content amortizations will increase yearly at an average 16%, following the growing trend of the last years as the company is planning to invest more in Netflix originals (Vlessing 2020). Other cost of revenue will continue to grow at an average of 16% similarly to the previous period. To sum up, Netflix cost of revenue is likely to grow at an average rate of 17% for the entire forecasted period and hit 57,037.15 million USD by the end of 2029.

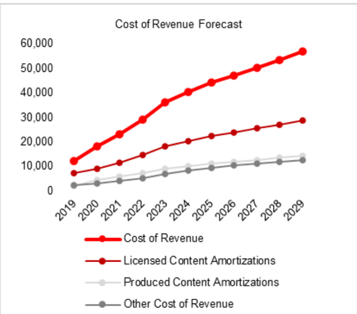


Figure 55: Cost of revenue forecast

- ### Marketing Expenses

Marketing expenses consist primarily of advertising expenses and certain payments made to marketing partners, including consumer electronics, manufacturers, MVPDs, mobile operators and ISPs. Advertising expenses comprise promotional activities such as digital and television advertising.

Figure 56: Marketing expenses forecast

Marketing expenses also include payroll and related expenses for personnel that support marketing activities (Netflix Annual Report 2019). Similarly to the cost of revenue, marketing expenses are expected to grow over the forecasted period following the company plans to boost its penetration rate where the maturity phase is still not reached and to invest more on original content's production. At the end of 2019 marketing expenses amount to 2,652.46 million USD representing 13% of the company's total revenue. It is forecasted that these expenses will grow at an average rate of 18% from 2020 onwards.

- Research, Development, General and Administrative Expenses

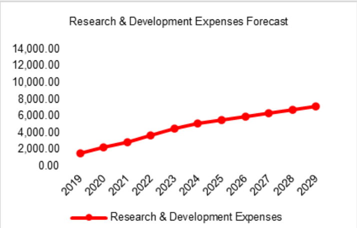


Figure 57: Research & development expenses forecast

Research and development expenses consist of payroll and related expenses for all technology personnel, as well as other costs incurred in making improvements to service offerings, including testing, maintaining, and modifying Netflix's user interface, merchandising, and streaming delivery technology and infrastructure. Technology and development expenses also include costs associated with computer hardware and software (Netflix Annual Report 2019). While reaching a mature stage in the North American market as well as in most of Western Europe countries, Netflix improved its efficiency in running its operations. Thus, research and development expenses are expected to grow at an average of 17% in the forecasted period, slightly below the 24% of the last 5 years.

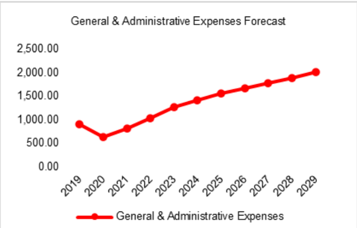


Figure 58: General & administrative expenses forecast

General and administrative expenses consist of payroll and related expenses for corporate personnel. General and administrative expenses also include professional fees and other general corporate expenses (Netflix Annual Report 2019). In 2019 general and administrative expenses reach 914.37 million USD, accounting for 5% of the entire company's total revenue. Due to the steady growth that has characterized Netflix over the last years, the headcount of personnel needed to support the increase in production and improvements in streaming service in the estimated period is not expected to be significantly different from the past. Hence, general and administrative expenses are forecasted to increase at an average rate of 17% from 2020 to 2029 compared to the previous 24%.

Streaming Content

Netflix acquires, licenses and produces content, including original programming, in order to offer its members an enhanced entertainment viewing experience. It has spent 15.0 billion USD on streaming content in 2019, more than double of Amazon's and Apple's amount (6.5 and 6.0 billion USD respectively) but less than Disney and Comcast Corporation (27.8 and 15.4 billion USD) (Variety

Intelligence Platform 2020). Streaming accounts for almost the entire revenue of the company (98.53% in 2019). Thus, the analysis of Netflix's investments in streaming content is one of the key value drivers for the company's evaluation. Some of the costs related to these investments are capitalized and some are expensed. The capitalized portion is reflected in the balance sheet both as content assets and content liabilities.

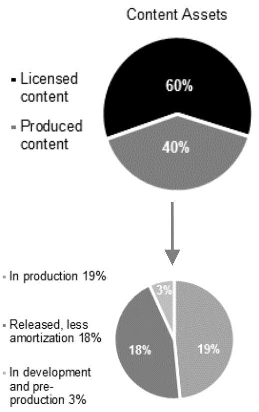


Figure 59: Content streaming assets 2019
Source: Annual Report 2019

- ## Content Assets

Content assets both licensed and produced have been recognized as "Current and Non-current content assets, net" on the consolidated balance sheet. At the end of 2019, Netflix's total content assets amount to 24,504.57 million USD and represent 72% of total assets and 122% of the total revenue. Licensed content assets account for 60% of the total content assets, while the sum of produced content released, in production content, and in development and pre-production for 40%.

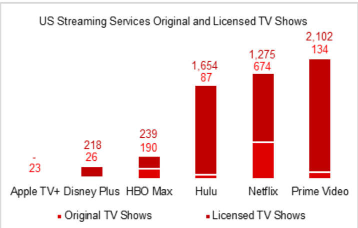


Figure 60: Licensed and original TV shows available on US streaming services Q2 2020
Source: Santos 2020

The higher number of SVoD platforms is in direct proportion with the boost of original contents. In the second quarter of 2020, Netflix offers 1,949 total TV shows, being Amazon the market leader with 2,236, and the highest amount of 674 originals in the US (Santos 2020). As competition in the streaming industry is rising worldwide and big players fight for licensed contents, Netflix is expected to invest even more in originals to gain competitive advantages within the SVoD industry. Thus, licensed contents as a percentage of Netflix's total streaming contents are forecasted to gradually decrease from the current rate to 35% in 2022. Afterwards Netflix will stabilize its product mix to 35/65, as its leadership strengthens. Content assets are estimated as a percentage of the total company's revenue and are likely to grow at an average rate of 16% from 2020 to 2029 hitting 106,686.24 million USD in 2029.

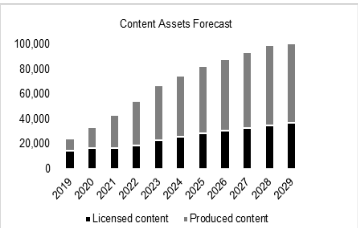


Figure 61: Content assets forecast

- ## Content Liabilities

Content liabilities have been recognized as "Current and Non-current content liabilities" on the consolidated balance sheet according to the payment due period. Licensed content fee are capitalized per title and recorded as a liability at their gross amount once the license period begins, the cost of the title is known and the title is accepted and available for streaming. For produced content, the costs associated with the production, including development cost, direct costs and production overhead are capitalized and account as a liability in the balance sheet (Netflix Annual Report 2019). Netflix's content liabilities stand at 7,747.88 million USD at the end of 2019 and account for 38% of the total company's revenue and 32% of the content assets.

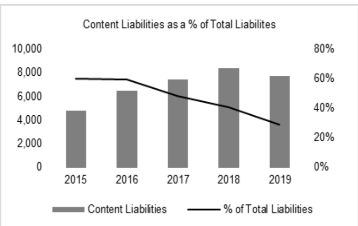


Figure 62: Content liabilities and content liabilities as a % of total liabilities 2015-2019
Source: Annual Report 2019

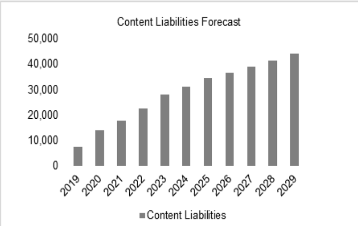


Figure 63: Content liabilities forecast

Total content liabilities have been raising at an average rate of 23% from 2015 to 2018 and marginally lowered in 2019. However, content liabilities compared to total liabilities, specifically long-term debt with payment due period longer than five years, have been steadily falling over the same period hinting that other commitments have been growing even faster than the content ones. As licensing represents the biggest component of total content liabilities and the company plans to focus more on its originals' production in the next years, content liabilities are expected to grow at a slightly lower rate over the forecasted period reaching 44,464.78 million USD in 2029.

Intrinsic Valuation

To evaluate Netflix, a discounted cash flow model combined with a market-based multiple valuation was used to come up with a fair actual share price in 2020 and estimate the gain or loss coming from an investment in Netflix stock for the timeframe of one year until the end of 2021. Total return for investors was computed considering changes in share price and net cash transactions with shareholders. Moreover, business and investments risks related to target prices and rating were analysed and the final recommendation was issued accounting for current analysts' stock criticisms.

DCF Valuation

2020 Covid Effect	FY 2019	FY 2020 Est	Annual Growth
Revenue Q1	4,520.99	5,767.69	27.58%
		5.45%	
Comprehensive Income Q1		709.07	
Revenue Q2	4,923.12	6,148.29	24.89%
	8.89%	6.60%	
Comprehensive Income Q2		720.20	
Revenue Q3	5,244.91	6,435.64	22.70%
	6.54%	4.67%	
Comprehensive Income Q3		789.98	
Revenue Q4 Est	5,469.43	6,572.00	20.16%
	4.28%	2.12%	
Comprehensive Income Q4		615.00	
	Act 2020	**24,923.62**	*-8.69%*
	Est 2020	27,296.43	
	Act 2020	**2,834.24**	*-22.70%*
	Est 2020	3,666.44	

Figure 64: Covid-19 impact on 2020 results

In the DCF valuation, the value at the end of 2020 of free cash flow available to all the company's suppliers of capital was computed. Weighted Average Cost of Capital was used to discount values as it reflects the risk of the company and its effective after-tax cost of capital. An extended forecasted period until 2039 was considered before computing a terminal value with a perpetuity using the same nominal growth rate as the world economy (6.70%) (International Monetary Fund 2020a, b). Furthermore, Covid-19 dual impact on 2020 results was considered and related adjustments were made. Finally, three sensitivity analyses and a scenario analysis were used to evaluate the effect of the different key variables' evolutions and summarized into three alternative potential scenarios (bull, regular, and bear) weighted according to their probabilities of happening to derive an average stock price.

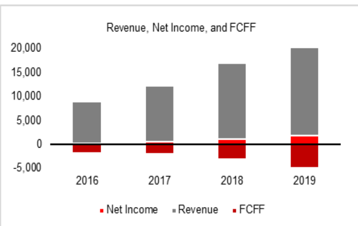


Figure 65: Revenue, net income, and FCFF 2016-2019
Source: Annual Report 2019

- Negative FCFF

FCFF gives information about how much money a company spends compared to how much it brings in. Netflix is spending a huge amount on originals' production while keeping cheap monthly subscriptions as the primary source of revenue. It bears large fixed costs associated with contents and low marginal costs per subscriber. Technically, Netflix is profitable with a revenue of 20,156.45 million USD and a net income of 2,295.11 million USD in 2019. However, as the company pays its content upfront and spreads the related costs across several years in its financial statements, its cash outflows are higher than its earnings reports implied and its FCFF is negative.

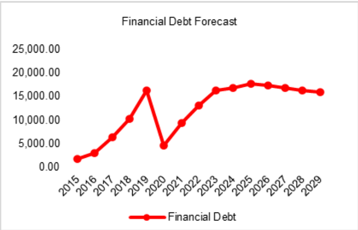


Figure 66: Financial debt 2015-2019 and Financial debt forecast
Source: Annual Report 2019

The reasoning behind Netflix's negative cash flow is the timing problem related with the payments and the amortizations of its intangible assets over time. The purchase of licensed content assets and the costs associated with its production of original films and TV series are expensed over time, but Netflix needs to pay upfront for content creators. The timing discrepancy between cash flowing out and its actual recording in the company's financial statements represents the difference between earnings per share and free cash flow. To make up for these cash outflows, Netflix has accumulated billions in debt since the start of its business. Until today Netflix has always been a cash burning machine, but this trend will change once the company finds a steady state and starts growing at the same rate of the economy.

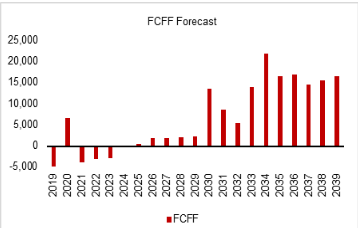


Figure 67: FCFF forecast

While Netflix reported positive earnings during the entire analysed period, its free cash flow turned positive for the first time in 2020 as a result of an increase in the number of paid subscriptions following 2019 large investments in content streaming made and the lockdown measures against the Covid-19 pandemic. However, free cash flow is expected to return to its negative trend in 2021 once net membership additions slow down and originals' production restarts. Starting from 2025 onwards Netflix's cash flow is expected to be positive as the company reaches a more mature and steady stage.

ROIC, Target Capital Structure and Sustainable Growth

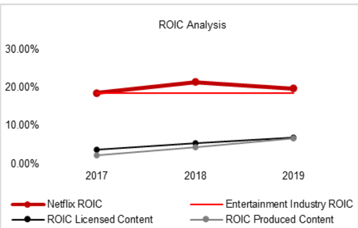


Figure 68: Netflix ROIC analysis
Source: Damodaran 2020a

To estimate a sustainable growth for Netflix's terminal value, the company's return on all invested capital was analysed. From 2016 to 2019 Netflix's ROIC has been increasing with produced content ROIC growing at an almost two times higher rate than the licensed content one. In the regular case, Netflix's ROIC is expected to peak at 30% in 2032 before starting to shrink slowly as the company is moving towards its mature stage. However, even if at a lower rate than 198% in 2017, 92% in 2018 and 59% in 2020, Netflix is believed to continue growing at a higher rate than the long-term estimations for the whole economy until 2025 and for the period 2030-2033 due to the additional revenue generated. The company is indeed in a developing stage of its international expansions since EMEA, Asia Pacific, and Latin America are far from reaching their saturations and it plans to increase penetration rates with the help of original content

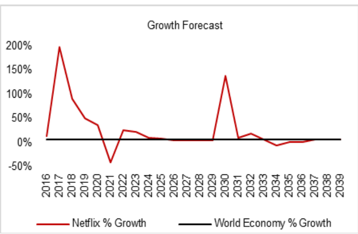


Figure 69: Netflix % growth forecast and world economy long-term estimations
Source: International Monetary Fund 2020a,b

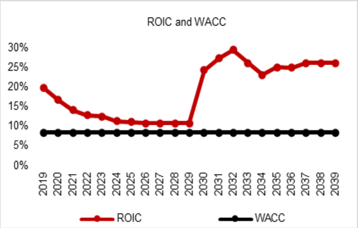


Figure 70: Netflix ROIC and WACC

productions. For the entire period of investigation in all the different scenarios analysed, Netflix ROIC was higher than its cost of capital, proving that the company has been steadily producing more value. Moreover, Netflix's ROIC was compared to the Entertainment industry's ROIC in 2019 and additionally decomposed to understand if the nature of its competitiveness is a result of a consumption or production advantage. Entertainment industry's ROIC amounts to 18.57% at the end of 2019 (Damodaran 2020a) and is lower than Netflix's ROIC 19.86% following an above average asset turnover that highlights the company's ability to use its asset in the production process.

				For developed market firms with market cap > $5 B
If Interest Coverage:				
>	≤ to	Estimated Bond Rating	Default Spread	Cost of Debt
8.50	100000	AAA	0.63%	4.77%
6.50	8.50	AA	0.78%	4.92%
5.50	6.50	A+	0.98%	5.12%
4.25	5.50	A	1.08%	5.22%
3.00	4.25	A-	1.22%	5.36%
2.50	3.00	BBB	1.56%	5.70%
2.25	2.50	BB+	2.00%	6.14%
2.00	2.25	BB	2.40%	6.54%
1.75	2.00	B+	3.51%	7.65%
1.50	1.75	B	4.21%	8.35%
1.25	1.50	B-	5.15%	9.29%
0.80	1.25	CCC	8.20%	12.34%
0.79	0.80	CC	8.64%	12.78%
0.20	0.79	C	11.34%	15.48%
-100000	0.20	D	15.12%	19.26%

Figure 71: Ratings, interest coverage ratios and default spread for non-financial firms
Source: Damodaran 2020b

For the WACC calculation, Netflix's target capital structure and cost of debt were estimated using a table that relates interest coverage ratios to a "synthetic" ratings and default spreads that go with the relative rating. The link between interest coverage ratios and ratings was developed by looking at all rated companies in the United States and default spreads are obtained from traded bonds. The sum of default spreads and 4.14% nominal risk-free rate derived from the yield of the 10Y US Treasury Note and world inflation (Fred 2020, International Monetary Fund 2020b) yield the pre-tax cost of borrowing (Damodaran 2020b). Netflix's historical interest coverage ratios were used and potential debt to equity ratio were computed starting from Netflix current ratio. Due to the company's strong preference in the past to finance itself using debt and its plans to continue to raise debt for as long as debt to enterprise value ratio and cost of debt remain low, a target capital structure with a 37.15% debt to equity ratio was selected as it combines the highest firm value and the lowest cost of capital. Thus, 4.92%, 69,806.70 million USD and 25,934.86 million USD were used respectively as cost of debt, amount of equity, and amount of debt for the WACC calculation.

Year	Average MRP
2011	5.50%
2012	5.50%
2013	5.70%
2014	5.40%
2015	5.50%
2016	5.30%
2017	5.70%
2018	5.40%
2019	5.60%
2020	5.60%

Figure 72: Average MRP
Source: Statista 2020b

- WACC

To compute the WACC the cost of equity was estimated using the CAPM model. The nominal risk-free rate employed was the 4.14% yield of the 10Y US Treasury Note adjusted for the world inflation and an average market risk premium of 5.60% was obtained from historical values over the last 10 years (Statista 2020b). To compute the company's beta, the weekly excess returns of Netflix were regressed on the market's excess returns for the period from November 2015 to November 2020. From the regression, a beta equal to 1.090230 with a 95% confidence interval was derived. Additionally, the three years rolling beta was computed to observe the development of Netflix's systematic risk compared to the market. To evaluate the result of the regression beta for comparable companies (Amazon, Walt Disney, AT&T, Comcast Corporation, Charter

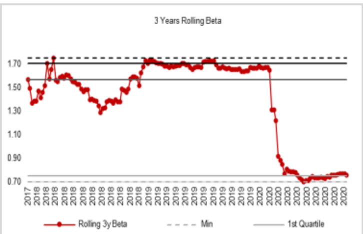


Figure 73: Netflix 3 years rolling beta
Source: Yahoo Finance 2020

Comparables Company	Beta	D/E	D/(D+E)	E/(D+E)	Beta u
Amazon	0.819524	2.40%	2.35%	97.65%	0.838497128
Walt Disney	1.036195	26.87%	21.18%	78.82%	1.248447622
AT&T	0.849817	71.02%	41.53%	58.47%	1.410845259
Comcast Corporation	0.880251	59.47%	37.29%	62.71%	1.350024882
Charter Communications	0.972129	74.00%	42.53%	57.47%	1.556728954
Average					**1.280908769**
Netflix Beta	**1.358110**	7.63%	7.09%	92.91%	1.280908769
Average		46.75%	28.97%	71.03%	

Figure 74: Comparables' Betas
Source: Yahoo Finance 2020

Assumptions	
Market Risk Premiuim	5.60%
rf (10 year US Bond Yield)	0.94%
Beta	1.090230
WACC	8.43%
Cost of Equity	10.25%
Cost of Debt	4.92%
Tax Rate	28.00%
E	69,806.70
D	25,934.86
Ku	5.39%
Beta u	0.794904

Growth Rate	
Sustaining Growth	6.70%
Average Growth 2030-2035	29.06%

Figure 75: WACC assumptions and growth rates

Communications) were computed regressing their returns to the market for the same time frame used in the Netflix's beta calculation. An average of the comparables' beta unlevered was estimated and re-levered using Netflix's debt to equity ratio resulting in a value of 1.358110. However, Netflix has a very specific business model and benchmarking its beta with the other biggest players on the market is not particularly relevant. All these things considered, the beta of 0.959329 obtained from the regression was used in the analysis resulting in an 8.43% WACC.

Sensitivity & Scenario Analysis

Scenario Analysis:
Bull Case - Espansion in India 50M, Statutory Tax Rate 28%, **Revenue Increase 20%, China Launch**
Bear Case - Espansion in India 50M, Statutory Tax Rate 28%, **Revenue Increase 20%, No China Launch**
Unlikely Case - Espansion in India 50M, Statutory Tax Rate 28%, **No Revenue Increase, No China Launch**

Selected Case:
Bear Case - Espansion in India 50M, Statutory Tax Rate 28%, Revenue Increase 20%, No China Launch

Sensitivity Analyses Overview:
Bull Case - Espansion in India 100M, 2030-2035 Other Revenue Increase 25%, Statutory Tax Rate 21%
Regular Case - Espansion in India 50M, 2030-2035 Other Revenue Increase 20%, Statutory Tax Rate 28%
Bear Case - Regular Espansion in India, 2030-2035 No Other Revenue Increase, Statutory Tax Rate 35%

Figure 76: Sensitivity analyses' and scenario analysis' overviews

In the DCF valuation three sensitivity analyses were inserted to determine how changes in three uncertain input variables affect the implied share price. Each variable was isolated and a "What-if Analysis" of the most reasonable ranges was performed to estimate the probabilities of all the possible evolutions to happen. Inputs taken into consideration for the sensitivity analyses were the amount of forecasted paid memberships in India, a potential other revenue from 2030 to 2035, and the statutory tax rate. Afterwards, the sensitivity analyses were summarized into three alternative potential scenarios (bull, regular, and bear) that were then weighted according to their probabilities of happening. Additionally, a second scenario analysis was built to account for the effect of a product offering's launch in China starting from 2023 on the estimated share price.

Sensitivity Analysis #1:
Case 1 - Espansion in India 100M subscribers
Case 2 - Espansion in India 50M subscribers
Case 3 - Regular espansion in India

Selected Case:
Case 2 - Espansion in India 50M subscribers

Figure 77: Sensitivity analysis #1 overview

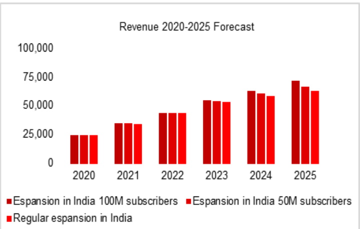


Figure 78: Revenue 2020-2025 forecast

The first sensitivity analysis evaluates the forecasted number of paid memberships in India by 2029. As already delineated in the Forecast section, three potential growth outcomes were considered and the scenario predicting an average growth of 44% and 50 million subscription by 2029 was estimated to be the most likely. Netflix is expected to approach a mature stage in the Asia Pacific region around 2029. As Asia Pacific is the international sector's area with the biggest room for growth and where the company is least mature, Netflix is expected to start growing at the same rate of the economy once it reaches a steady state in this macro-region. However, in a recent interview Netflix CEO foresaw that the company still has at least five to twenty years of growth by focusing on making its service offerings better and enhancing engagement and storytelling capabilities. He mentioned that Netflix has always added new types of programming to its content library and as animation has just begun, it will develop further in the upcoming period (Hasting 2020). The increased focus on animation came as Disney+ took off and Netflix lost the majority of Disney's licensed content and consequently the ability to cater to family-driven subscribers (Akala 2020). Yet as Disney is already the most powerful animation franchise and as the streaming market becomes increasingly saturated, Netflix is expected to disrupt the Entertainment and Media industry again entering a new segment to offer enhanced services that maximise engagement on many levels to its users. Following recent announcements of new game distribution services from Apple, Google, Microsoft, NVIDIA, and Tencent and a prospective Amazon offering, speculation within the industry forecasts that video games distribution will move from the still-dominant à la carte model toward Netflix-style subscriptions (Singer, D'Angelo 2020). All these things considered, video games streaming is estimated to be the most promising option for Netflix and therefore a second sensitivity analysis was introduced in the valuation by adding the other revenue capture in the income statement forecast. Starting from 2030, a revenue increase is expected for Netflix alongside with a 15% decrease in licensed content amortization and produced content amortisation because of the temporary shift in its business focus. Incorporating video games to its streaming video plans' offering is expected to boost the company's revenue for the period 2030-2035 as prices and subscriptions will increase following an enhanced users' reach. Netflix is already making large investments in marketing, research and development and therefore adding video games to its subscription is not expected to generate an extraordinary expenses' increase. Moreover, part of the cost of revenue destinated to licensed content will be used to acquire video game from third parties. Thus, analogously to the first sensitivity analysis, three potential scenarios were analysed (no other revenue increase, 20% average other revenue increase and 25% average other revenue increase) with the regular scenario considered to be most likely to happen. Finally, a third sensitivity analysis was employed to evaluate the effect of a possible change in the US statutory tax rate. In 2017, the tax cut reduced US federal statutory tax rate from 35% to 21% but, with the victory of the Democratic party in the 2020 elections, the new president Joe Biden is expected to make further changes starting from 2021. Biden's tax increase plans would raise corporate taxes to 28% despite some more progressive Democrats having proposed an increase of the corporate rate all the way back to 35%. Furthermore, Biden has called for a "minimum corporate tax" of 15% for companies with net income greater than 100 million USD after accusing big tech companies of not paying enough taxes in the US (Beeman 2020). Hence, three likely possibilities were taken into account (statutory tax rate 21%, 28% and 35%) with the tax rate increase to 28% estimated to be the one with the highest probability.

The three sensitivity analyses were summarized into three plausible scenario outcomes (bull, regular, and bear) that were then weighted according to their probabilities of happening to estimate a fair price. The bull case (expansion in India 100M, 2030-2035 other revenue increase 25%, and 21% statutory tax rate)

Sensitivity Analysis #2:

Case 1 - 2030-2035: Average Other Revenue Increase 25%

Case 2 - 2030-2035: Average Other Revenue Increase 20%

Case 3 - 2030-2035: No Other Revenue Increase

Selected Case:

Case 2 - 2030-2035: Average Other Revenue Increase 20%

Figure 79: Sensitivity analysis #2 overview

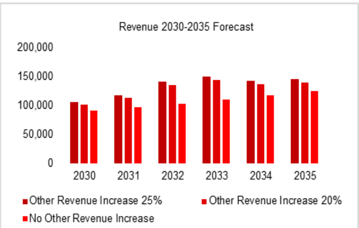


Figure 80: Revenue 2030-2035 forecast

Sensitivity Analysis #3:

Case 1 - Statutory Tax Rate 21%

Case 2 - Statutory Tax Rate 28%

Case 3 - Statutory Tax Rate 35%

Selected Case:

Case 2 - Statutory Tax Rate 28%

Figure 81: Sensitivity analysis #3 overview

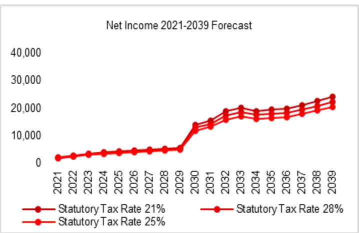


Figure 82: Net income 2021-2039 forecast

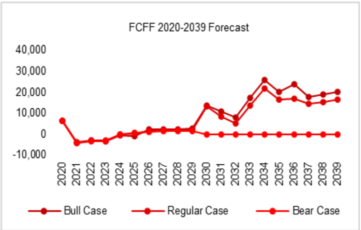


Figure 83: Sensitivity analyses overview - FCFF 2020-2039 bull case, regular case, and bear case forecast

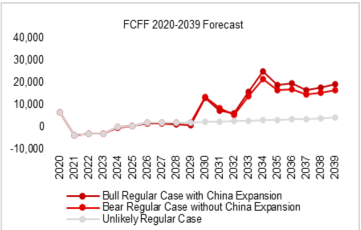


Figure 84: Sensitivity and scenario analyses overview - FCFF 2020-2039 bull regular case with China expansion, bear regular case without China expansion, and unlikely regular case

Figure 85: China paid memberships forecast and penetration rate

Sensitivity and *Scenario* Analysis Overview		
Selected Case	**Price**	**Weight**
Bull Case	671.42	10%
Regular Case	623.79	85%
with China Launch	*744.80*	*5%*
without China Launch	*617.42*	*95%*
Unlikely Case	*155.90*	*0%*
Bear Case	137.88	5%
Implied share Price	**604.26**	

Figure 86: Sensitivity and scenario analyses overview

	Price Multiples		Enterprise Value Multiples	
	Trailing P/E	P/Sales	EV/EBITDA	EV/Revenue
Netflix Price 31.12.2021	294.99	178.04	268.65	245.32
Average		**246.75**		
Netflix Price 31.12.2021	431.29	261.10	200.04	348.12
Average		**310.14**		

Figure 87: Market-based valuation
Source: Yahoo Finance 2020

was considered with a probability of 10%, while the regular case (expansion in India 50M, 2030-2035 other revenue increase 20%, and 28% statutory tax rate) accounted for 85% and the bear case (regular expansion in India, 2030-2035 no other revenue increase, and 35% statutory tax rate) for 5%. Additionally, a scenario analysis was introduced in the regular case to account for a potential launch in China in 2023. The regular case was decomposed into three possible scenarios (with China launch, without China launch and without any additional revenue increased) weighted 5%, 95% and 0% respectively.

The main reasons for targeting China beside the fact that it is the biggest Asian country and would therefore significantly boost Netflix's market share, are the very little competition and the limited amount of licensed content currently offered on the market. Thus, it is reasonable to assume that the new market would be receptive to Netflix's services and offerings. As Netflix's yearly cost usually amounts to 30% of an average person's income of a country (Clark 2018) and the average annual salary in China in 2019 was 13,855.50 USD (Statista 2019g), Netflix's launch ARPU is expected to be 3.00 and then slightly decrease before growing with the inflation from 2026 onwards. Paid memberships are estimated to be 6.30 million in 2023 and reach 533.70 by 2039 generating a revenue of 27,913.57 million USD.

To sum up, an intrinsic price of 623.79 (85%) coming from the scenario analysis was assigned to the regular case and added to the bull price of 671.42 (10%) and the bear price of 137.88 (5%) in a weighted linear combination resulting in an implied share price of 604.26.

Market-Based Valuation

To evaluate the result from the discounted cash flow valuation, a market-based valuation was used. Netflix's firm value was compared to the one of its main competitors (Amazon, Walt Disney, AT&T, Comcast Corporation, and Charter Communications) that operate internationally in the streaming video-on-demand industry. Standardized price multiples (Trailing Price-to-Earnings ratio and Price-to-Sales ratio) and enterprise value multiples (Enterprise value-to-EBITDA and Enterprise value-to-Revenue) were analysed to value Netflix based on its competitors' value. As all the comparable companies operate in multiple business sectors, the results of the multiple analysis are not to be considered particularly relevant for Netflix's valuation.

Business and Investment Risks

Netflix is facing specific risks related to its business and target prices and rating. An adverse impact to its business could in fact come from changes in the competitive offerings, including the potential adoption of piracy-based video offerings. Furthermore, payment processing, cybersecurity, economic, and political risks as well as insufficient cash to service debts and obligations might hinder the delivery of its streaming content (Netflix Annual Report 2019).

In the past Netflix's stock has shown sensitivity to missing quarterly subscribers estimates, especially if perceived to be related to competition or pricing power. Competition affecting subscriber growth or content costs could also have a negative effect on its share price. Moreover, Netflix relies on licensed content from traditional media companies and their extent of pulling back on content supply directly affects the market's valuation. Netflix projections are expected to reach large scale as the company has continuously demonstrated to be able to overcome difficulties in managing content production and maintaining high execution level. However, failures or administrative inefficiencies could lead to a stock shrink on the long run. Finally, regulations represent a big threat for the stock following the company's tendence to break into new international markets although it has avoided privacy issues related to digital advertising (Mitchelson, Russo, Durkin, Joslin 2018).

	Risks to Business - Investment
Business	Changes in competitive offerings (piracy-based video)
	Payment processing
	Cybersecurity
	Economic
	Political
Investment	Missing quarterly subscriber estimates
	Competition / Content Costs
	Access to content
	Scale challenges
	Regulations

Figure 88: Business and investment risks
Source: Mitchelson, Russo, Durkin, Joslin 2018

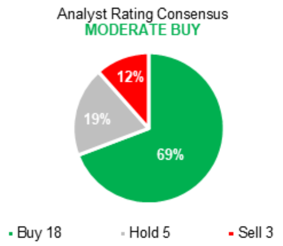
Booming Business or House of Cards?

According to the DCF valuation's most likely regular case without considering a launch in China, an investment in Netflix's stock at the end of 2020 will generate a gain of 58.11% in 2021. Currently Netflix is not paying dividends and it is not expected to start anytime soon as it continues to use its cash flow on growth initiatives to increase its paid memberships and it has a high amount of debt outstanding. However, Netflix is expected to buyback some share in 2021 as it has done in 2020 to avoid its stock to slump due to the slowdown of subscriptions' growth and resulting in a positive payout ratio for its shareholders.

Enterprise Value 12/31/2020	**267,239.64**
Net Debt	4709.11
Non core invested capital	829.54
Equity Value	**272,778.29**
Shares Outstanding (in million)	441.80
Implied Share Price	617.42
Implied Average Share Price	**604.26**
Actual Share Price	536.92
Difference to calculated share price	15.0%
Enterprise Value 12/31/2021	**260,532.12**
Net Debt	9,364.63
Non core invested capital	1,156.51
Equity Value	**271,053.26**
Shares Outstanding (in million)	420.00
Implied Share Price	645.36
Gain/loss from investment (12/31/2020-12/31/2021)	***58.11%***

Figure 89: Valuation results DCF valuation

Netflix's negative free cash flow has long been a battleground metric for bulls and bears and therefore some investors consider it only a long-term opportunity (Vena 2020). Nonetheless, Wall Street analysts rating consensus for the next 12 months is still a buy recommendation despite the stock's high volatility (Tipranks 2020). It is not the real value of the company that drives its stock price, but rather the most popular story people believe about it and Netflix still holds on to the crown of innovation making investors confident about a big room to grow in the near future. All these things considered, even if Netflix looks and acts like a booming business, it might also be a House of Cards but as of 31.12.2020 an investor should buy Debtflix and (moderately) chill.



Analyst Price Target - 12 Months Forecast		
High	Average	Low
700.00 USD	579.61 USD	235.00 USD

Figure 90: Wall Street analysts rating consensus for the next 12 months (Based on 26 Wall Street analysts)
Source: Tipranks 2020

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