

A Work Project, presented as part of the requirements for the Award of a Master's degree in
Finance from the Nova School of Business and Economics.

EQUITY RESEARCH NETFLIX, INC.

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Abstract (100 words maximum)

This Equity Research WP focuses on the American streaming service Netflix. The task is to find out whether the share price is justified in a 12-month preview. Based on this, a recommendation is formulated to buy, hold or sell the stock.

The share price was analyzed using a Discounted Cash Flow method and a relative multiple method with peer companies. In addition, company-specific information such as turnover or costs had to be forecasted, but also various macroeconomic factors had to be taken into account. Particular attention had to be paid to the 4 core regions Netflix is operating in.

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Keywords (minimum of four)

- Subscription video service
- on-demand streaming
- ARPU
- Content investment

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This report is part of the “EQUITY RESEARCH NEFTLIX, INC” report (annexed), developed by Fabian Louis Jonas Hilke (50797) and António Maria Gonçalves De Sousa (46223) and should be read has an integral part of it.

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Introduction

This report's purpose is to explain the fundamentals and analysis of the valuation of Netflix, Inc. The focus is on giving insights about the forecasting, value drivers and the actual share price of the streaming service company. To have the framework for the valuation the most important financial statement positions needed to be forecasted. Beginning with revenues, the position got decomposed in its core regions and then got individually forecasted. Different value drivers like population growth, access to internet and the US \$ inflation rate were used. Further, the cost of revenues, other costs, and assets and liabilities were forecasted in a similar scheme. To better understand the company's position, the liquidity and profitability of the company were analyzed. After that, the key part of the equity research is presented, the valuation. Before deriving at the share price, first the WACC, FCF, growth rate and ROIC calculations are shown. To have additional approaches for the calculation of the Enterprise Value., an analysis of comparable companies and a multiple valuation was conducted. In the final recommendation of the report, the share price and the recommendation for the stock gets summarized. As the methodology used for this part, the main sources were the annual reports of the company from the current and previous years, databases, and industry reports.

My partner, Antonia Sousa (46223) will provide the fundamentals of the whole valuation. He gives insights about the landscape and economic conditions the company is operating in. He covers the company and how it operates, with regards to its business model and business segmentations. After that, the industry and its market players will be described. For the industry part, an outlook for the video and entertainment industry is provided, followed a deeper insight for the video on demand market. Since Covid-19 had a huge impact on the sector, an extra paragraph was dedicated for this. The descending DVD sector is explained, followed by a competitive analysis of Netflix competitors and the strong race within this industry called streaming war". After the "Industry" part, the analysis of the Netflix company itself is discussed, including the stock performance of the last years, the future content strategy and the new subscription plan that Netflix wants to introduce next year.

Company Overview

Business Model & Business Segments



Figure 1 - Logo Evolution
Source: Netflix

Netflix is one of the pioneers regarding subscription-based content. Unlike other platforms that run on premium subscriptions such as Spotify, Netflix does not offer a free option, meaning that all subscribers pay for the platform's content, guaranteeing recurring income from each subscriber. Also, it operates in two distinguishable segments: streaming and DVD. While streaming services are offered both domestically and internationally, DVD rental is only available for the domestic segment. It is important to mention that although the domestic DVD segment is accounted for, we will focus on the other two segments, given their low significance when compared to the total revenues. To understand how this business model made the company the most relevant competitor in the market, there are 5 differentiation properties. The sophisticated recommendation engine plays a critical part in leading individuals to the best few alternatives for them, resulting in better selections, by utilizing the massive quantity of data accessible to assist customers in making choices effortlessly. Split testing is primarily employed when big changes, such as a new homepage, are implemented. This chance is utilized to learn about users' reactions to the modifications. Users are also made more comfortable with the new adjustments, which increases user retention. In addition, user preferences have been thoroughly examined. The Netflix recommendation algorithm tracks the number of users who watch an episode, a whole series, and the time between two episodes. Subsequently the algorithm delivers deep information into when users pause, rewind and fast forward. Other data used to study user preferences include user views of episodes, browsing and scrolling behaviours, device type (mobile/laptop), ratings, etc. The recommendation engine can deliver customized recommendations based on user choices to increase client engagement. One other factor is push notifications. Netflix does not miss an opportunity to inform customers about new seasons or episodes, tailoring what may be a user's top interest, by studying its behaviour. The last feature is personalized mail recommendations.

Pricing (US Dollar)

- **Basic with ads***: \$6.99/month
- **Basic**: \$9.99/month
- **Standard**: \$15.49/month
- **Premium**: \$19.99/month

Figure 2 - Netflix Pricing
Source: Netflix

Industry Overview

Industry's trends, opportunities and risk

In such a competitive market, there are always new trends and risks associated that heavily influence companies' performance. Cord cutting is something that has been increasingly throughout the years, highly benefiting companies that operate in the SVOD market, such as Netflix. It can be defined as the drop of a cable or satellite TV subscription in favour of an alternative. In the US this is a very common practice, that will result in a significant decrease in cable TV penetration in the present decade, where the value of 81% will decrease to around 55% by 2030 (Search 2022). Amongst several reasons for cord cutting, the number one is the high price paid, since the average person pays around \$ 107 for a monthly subscription. Although cable is bigger in term of subscribers, Netflix has more views than cable and satellite combined. Given this indication, Netflix has great prospects for the SVOD industry, since the price of a monthly subscription never surpassed \$ 17 per month. In addition, cord cutters are particularly motivated by original content, where 57% of US streaming subscribers are driven by original content, with more special relevance for the 71% millenials that stated original content as its main factor (Cook 2022). Both factors combined represent an excellent opportunity for Netflix to increase its customer base since its main focus has been the production of original content and its target market are members from Gen Z or Millenials, with a lower income range of \$ 25,000-50,000.

A further trend involves the production and licensing of sports documentaries and series. Netflix was the pioneer with the launch of "The Last Dance" or "Formula 1: Drive to Survive", attracting sports lovers and awakening the interest of people who would not use streaming platforms in other circumstances. After that, Netflix's biggest competitors have replicated it, with HBO Max launching "Magic & Bird: A Courtship of Rivals" or "Tiger" and Amazon Prime with "Senna" or "Messi". In such competitive market, the first-mover advantage tends to benefit the company, as in the case of Netflix. Supplementary, sport streaming is a further trend in the streaming market. The sector shifted from being broadcasted through traditional television networks to various streaming services. Therefore, the sports streaming sector became very competitive over the years with established players like DAZN, Sky, and ESPN+. However, this development has resulted in the market becoming highly fragmented, unclear and requiring many subscriptions to follow all sporting events. Netflix's already well-known competitors Amazon Prime, Paramount and Peacock are strongly active in this sector. For example, Amazon has guaranteed the rights of Thursday Night Football for \$ 1.2 bn

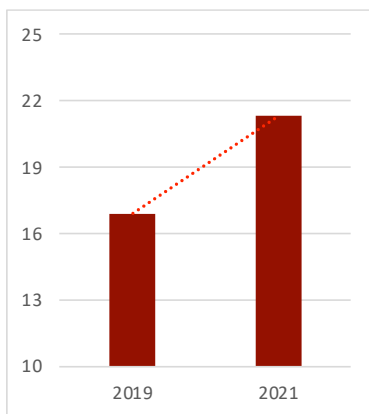


Figure 3 – US Sports Streaming market size (in \$ bn)
Source: Statista

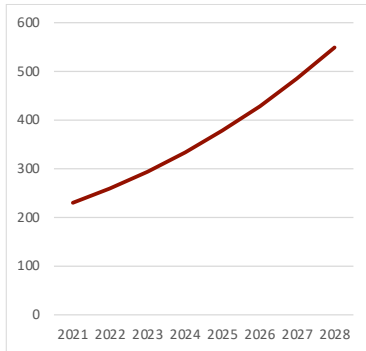


Figure 4 – Gaming industry growth (in \$ bn)
Source: Toonkel

per year. Subsequently, ESPN and Turner, which are part of Warner Bros. Discovery Inc. investing \$ 2.7 bn per year for the rights to telecast NBA games in the United States. Sports streaming rights are very expensive and highly in demand. In the US, the amount paid for the sports in 2022 streaming market reached \$ 21.3 bn from \$ 16.9 bn in 2019 (Figure 7), showing significant growth in this specific market segment. Globally the sports streaming market is projected to grow with a 21.5% CAGR till 2028 (Figure 8) (Toonkel 2022).

In recent years, the gaming industry has boomed alongside the streaming service industry. Driven by trends such as AI, metaverse and the pandemic, the market grew to \$ 229.1 bn in 2021 and is expected to grow with a CAGR of 13.2% to \$ 545.9 bn by 2028 (Fortune 2021). Especially the market for subscription-based gaming service, is seen as a market with a lot of potential in the future. For Netflix users, apps are available on mobile devices. As of December 2022, Netflix offers a huge selection of apps which are included in their paid memberships. However, so far no monetarize elements like ads or in-app purchases are included. Therefore, this segment for now cannot be seen as a further stream of income for now.

Average Industry KPIs	
ROIC	25,46%
RoE	31,40%

Figure 5 – Media & Entertainment industry KPIs
Source: Damodaran

The industry margins of profitability are relatively high. (Figure 9) This is due to the scalability of the streaming companies. New customers can be added to the customer base without large additional costs and generate revenue immediately. Costs such as SG&A are not affected. Thus, profitability can be improved easily and quickly. Likewise strong margins can be seen when looking at the average ROIC (25.46%) and return on equity (31.4%). The companies invest heavily in their content assets, which subsequently generate further revenues in future years without producing further costs. The high ROE is confirmed by the equally high reinvestment in the company and its content. Sustainable shareholder value creation can only be achieved through continuously reinvestments in assets.

Competitor Pricing	
Amazon-Prime Video	
\$ 8.99	only Prime-video
\$ 14.99	Prime
Disney+	
\$ 7.99	with ads
\$ 10.99	without ads
Peacock	
\$4.99	with ads
\$ 9.99	without ads
HBO Max	
\$ 9.99	with ads
\$ 14.99	without ads
Discovery+	
\$ 4.99	with ads
\$ 6.99	without ads
Apple+	
\$ 6.99	single subscription
\$ 16.95	bundle subscription

Figure 6 - Competitor Pricing
Source: Company Forecast

Competitive Landscape

Due to the high attractiveness and growth opportunities, the market is particularly competitive. In particular, large media conglomerates seized this opportunity and launched their own SVoD services to compete with Netflix. The most important players are Disney+ from The Walt Disney Company and Amazon Prime Video from Amazon.com, Inc. Further Competitors are Peacock from the Comcast Corporation, Discovery+ and HBO Max, which are both owned by Warner Bros. Discovery., and Apple

TV+ from tech-giant Apple Inc. All these companies are currently competing in the so-called “streaming war”, which harms and decelerates the development and growth of Netflix.

Amazon Prime Video

Amazon’s in-house streaming service was released on September 7, 2006, making it one of the most established products on the market. The service is already included in the standard Amazon Prime subscription, nevertheless, it can also be subscribed to as a stand-alone service. Their price range for the standard Amazon Prime subscription depends on the payment method. The customer is either charged \$ 14.99 per month or \$ 139 per year if the payment is made annually. Thereby Amazon.com Inc. tries to retain its customers for the long term, by giving them nearly a \$ 40.88 discount if the annual payment is chosen. For non-Prime members, Prime Video can be purchased for \$ 8.99 a month as standalone streaming. (Amazon 2022) As of November 2022, Amazon Prime currently serves over 200 million subscribers, which generates a yearly turnover of \$ 31.77 bn (Statista 2022).

Disney+

Disney+ was launched on November 12th, 2019, by The Walt Disney Company. Disney+ can be acquired either as a standalone service or as part of “The Disney Bundle”. Regarding the standalone service, the company offers two subscription solutions: \$ 7.99/month or \$ 79.99/year. Like Amazon Prime Video, Disney tries to retain its customers for the long term, by offering a \$ 15.89 discount, equivalent to almost 17% discount if the annual payment is chosen. “The Disney Bundle” includes its other U.S. streaming services such as Hulu and ESPN+, with plans that range between \$ 9.99 and \$ 82.99 per month. (Disney+ 2022) It is also important to mention the increase, not only in revenues but also in the number of subscribers of this streaming service, posing as one of the main competitors and threats to Netflix. By the 3rd quarter in 2022, Disney+ has 152.1 million users (Statista 2022), resulting in yearly revenues of \$ 5.2 bn for the year 2021. (Iqbal 2022)

Peacock

Publicly available since April 15th, 2020, for Xfinity Flex customers and on July 15th, 2020, for the general public in the US, Peacock is part of Comcast. Peacock has multiple subscription tiers: Peacock Free, Peacock Premium, and Peacock Premium Plus. For starters, the Peacock Free is a free subscription plan, where you can only watch selected

Competitor KPIs	
Amazon.com, Inc.	
Operating margin	5,30%
Gross margin	42,03%
ROIC	15,98%
Return on Equity	24,13%
Return on Assets	7,93%
Invested Capital (in bn)	202,84

Figure 7 - Amazon.com KPIs
Source: Financial Times

Competitor KPIs	
The Walt Disney Company	
Operating margin	16,50%
Gross margin	33,06%
ROIC	2,35%
Return on Equity	2,14%
Return on Assets	0,98%
Invested Capital (in bn)	172,90

Figure 8 - The Walt Disney Company KPIs
Source: Financial Times

Competitor KPIs	
Comcast Corp	
Operating margin	11,82%
Gross margin	68,41%
ROIC	2,12%
Return on Equity	6,14%
Return on Assets	1,89%
Invested Capital (in bn)	229,23

Figure 9 - Comcast Corp KPIs
Source: Financial Times

Competitor KPIs	
Warner Bros. Discovery Inc.	
Operating margin	16,50%
Gross margin	62,10%
ROIC	5,83%
Return on Equity	7,72%
Return on Assets	2,92%
Invested Capital (in bn)	65,87

Figure 10 - Warner Bros. Discovery Inc.
Source: Financial Times

movies and where ads are included. If the customer wants full library access, there are the remaining options: Peacock Premium for \$ 4.99/month and Peacock Premium Plus for \$ 9.99/month. Being a recent streaming platform, Peacock's strategy is based on an aggressive price strategy, in order to enter the market, not only by offering lower prices than the competitors but also by having deep discounts like the one that happened last October where the price for an annual premium subscription membership was \$ 19.99. (Sledge 2022) Peacock has registered strong growth in its number of paid subscribers, since as of September of the current year, the service has 15 million paid subscribers, representing a 70% increase in this group, since the start of the year. (Fletcher 2022)

Discovery+ and HBO Max

Discovery+ and HBO Max are both American streaming platforms, belonging to Warner Bros. Discovery, which resulted from the fusion between WarnerMedia and Discovery Inc., on April 8th, 2022. Regarding HBO Max, the latter was launched on May 27th, 2020. HBO Max came as a replacement for the popular HBO Go and HBO Now and offers two subscription plans: With ads or ad-free with both plans having either a monthly or annual billing. While the with ads plan goes for \$ 9.99/month or \$ 99.99/year, the ad-free plan goes for \$ 14.99/month or \$ 149.99/year, representing a discount of 16% in both plans. (HBO Max 2022) As of the end of the Q2 of this year, HBO Max had 81.2 million subscribers. The projections for this company are of a continuous increase in revenues, subscribers, and content assets, being one of the main competitors in this industry, and responsible for the reduction in Netflix's market share in recent years. From Q1 2021, HBO has increased its market share from 8% to 15% in Q3 2022, assuming to be one of the main competitors in this industry. (Curry 2022)

When it comes to Discovery+, the streaming platform was launched on January 4th, 2021. It offers two subscription plans: the one with limited ads that goes for \$ 4.99/month and the ad-free for \$ 6.99/month. (Discovery+ 2022) Nowadays, Discovery+ accounts for almost 23% of Warner Bros. Discovery streaming platforms subscribers, with 24 million subscribers. It is important to mention that the services are expected to merge in spring 2023 to increase their competitiveness since Discovery+ is still regarded as a completely different streaming platform from HBO Max. In addition, it can be observed that the company follows the usual strategy in this industry, which is retaining customers in the long term,

accomplished by making a discount on the long-term subscription plan. (Chang 2022)

Apple TV+

Finally, Apple TV+, launched on November 1st, 2019, is Apple's subscription streaming service. This streaming service has a monthly subscription of \$ 6.99/month after a free seven-day trial. Moreover, it is included in "Apple One", a bundle that can include up to five other Apple services and starts at a value of \$ 16.95/month. (Apple 2022) Furthermore, Apple TV+ is used by the company to increase its sales of other products, since the streaming service has a 3-month free trial if you buy any other device. This is part of Apple's strategy of trying to dominate and unify several industries, such as streaming platforms, communication, or broadcast entertainment. As of 2022, Apple TV+ had a total of around 25 million members, with expectations of an increase in the following years. (Gruenwedel 2022)

Streaming war

Now who will win the streaming war? To be able to define a winner, the number of subscribers plays the most important role. While Netflix's business model is based on streaming services and is extremely transparent about the number of subscribers, the competition is more secretive here. For the competitors, the streaming service is only an add-on for their current business model and therefore not in the foreground. Either they keep their subscriber numbers completely confidential or present them in a way that is favourable to them, e.g., Disney counting a streaming bundle, which includes Disney+, Hulu, and ESPN+, as three separate subscriptions (Powers 2022). In the revenue industry comparison (Figure 19), Netflix and Amazon Prime are the leading streaming providers. For the financial year 2021, Amazon records higher revenues, but the competitor also records revenues from its music service as streaming revenues, which do not belong to the SVoD market. Compared to the other competitors, Netflix has a clear lead over its smaller rivals.

Company analysis / Forecasting

Ability to retain customers

The competition in the streaming market ensures stronger competition and more customers leaving, or changing, streaming services. To prevent

Competitor KPIs	
Apple Inc.	
Operating margin	30,29%
Gross margin	43,31%
ROIC	47,04%
Return on Equity	175,46%
Return on Assets	28,36%
Invested Capital (in bn)	336,30

Figure 11 - Apple Inc. KPIs
Source: Financial Times

Revenues (in \$ bn)	
Amazon-Prime	31,8
Disney+	5,2
Peacock	0,8
HBO Max	3,8
Discovery+	3,2
Apple+	2,2
Netflix	29,7

Figure 12 - Competitors Revenues
Source: Various Sources

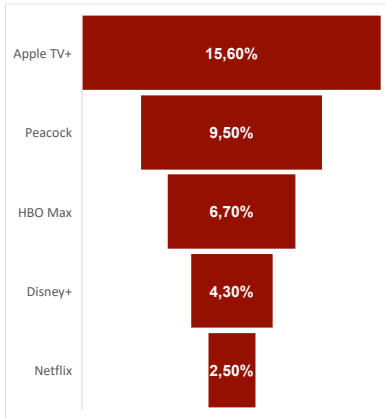


Figure 13 – Churn rates of competitors
Source: Netflix

these problems, customers must be constantly entertained with new content. Moreover, a lot of financial resources must be invested in marketing activities. However, the high marketing spends, which at Netflix amounts to just under 10% of revenue, and the content spend of \$ 17 bn, imply that Netflix is aware of the problems and is spending time, effort, and money on them.

When it comes to the actual customer retention, Netflix stands out with a churn rate of 2.5%. The ratio is defined as the percentage of customers that ceased using a company’s product or service within a certain time period. Netflix is a leader in the market, when compared with HBO Max, one of its main competitors, that has a value of 6.7% or Apple TV+ with 15.6% (Figure 22). This means that Netflix’s retention rate is 97.5%. Despite the customer loss in the first two quarters of the present year, which was accounted for in the valuation model, it is expected that the retention rate value remains for the forecasted time window. This happens because the loss of customers that happened this year was a one-time event since the beginning of the company. Therefore, there are no expectations of further loss of customers throughout the years. Historically, the number of subscribers has been increasing every year, so the most likely is that, in the case of an eventual loss of subscribers in one quarter, the increase in subscribers in other quarters will compensate such losses. This sustained growth in subscriptions, as well as the high value of customer retention rate are justified by the company’s business model (Muralidharan 2022).

Domestic DVD Revenues

DVD revenue		
	DVD revenue in m	% of Total Revenue
2017	450 497	3,85%
2018	365 589	2,31%
2019	297 217	1,47%
2020	239 381	0,96%
2021	182 348	0,61%

Figure 14 - DVD Revenues
Source: Company Forecast

When it comes to the DVD Revenues, they all have been considered domestic, since this segment only exists in the UCAN region. Even though Netflix started its business as a DVD mail delivery service, the preponderance of this segment has been steadily decreasing throughout the years, becoming a segment with almost no relevance when it comes to Netflix’s revenue decomposition, resulting from globalization and technology development as well as the increase in demand of streaming video platforms. Although, there still is a group of passionate DVD users, the latter is composed in its majority by older people that are still tied to the traditional method of viewing content, so it is expected to lose relevance as time passes. Therefore, DVD revenues expect to decrease at an average stable rate of 20.0%, mimicking the last four years' trend, from a value of \$ 365.6 m in 2018 to \$ 151.9 m at the end of the current year and \$ 21.9 m by the end of 2032. These values are in line with the

industry evolution that has dropped more than 86% in the last 13 years and growing at a CAGR of -28.8% over the analysis period.

International Streaming Revenues

When it comes to International Streaming Revenues there are 3 regions that must be considered and that will be individually analysed: EMEA, LATAM and APAC.

EMEA

EMEA (Europe, Middle East, and Africa) is the second largest market of Netflix, little behind UCAN. Currently has 74.0 m subscribers, generating around \$ 9.7 bn now. The evolution and behaviour of this region is highly correlated with the behaviour of Europe because of the 74 m total Netflix subscribers in 2021, 60 m were from Europe, corresponding to 81% of the total. Despite being the second largest market, this will rapidly change. Firstly, it is expected that by the end of the present year EMEA has surpassed UCAN in terms of subscribers, and that the overtaking in revenues happens in 2027. This leads us to conclude that EMEA presents itself as the region that shows the highest growth potential both in total number of subscribers and revenues, in absolute terms, because of the bigger population and market users. Normally, Africa and the Middle East are always two regions with a lot of potential due to their underdeveloped economies, but that is not the case in this instance, as both places are still missing basic parts of technological development and where services like these are considered luxury services. To forecast the number of existing households with SVoD the same technique as in UCAN was used. Due to the high growth potential and margin available for the industry to grow, we believe that this growth is sustainable and stable through the time window forecasted. The average number of people per household has been weighted averaged to account for the largest impact of Europe as a whole, resulting in an increase in SVoD households from the current 92.5 m to 152.7 m by 2032. As to the average number of streaming services per household, the current value is 2.38, reaching 2.48 in 2032, for the same previously mentioned reasons. Netflix's market share in EMEA is expected to have a similar behaviour as the one in UCAN, due to the similarities of both regions' main markets. In the current year a market share loss of 1.5% is expected, strongly influenced by the negative results obtained by the company in Q1 and Q2 of the year. An increase in the market share of this region is expected until it reaches the mark of 45% in 2032, given the small number of alternatives when compared to UCAN, being a market where Netflix is a forefront leader,

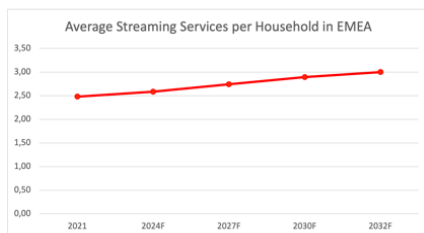


Figure 15 - Average Streaming Services per Household in EMEA
Source: Company Forecast

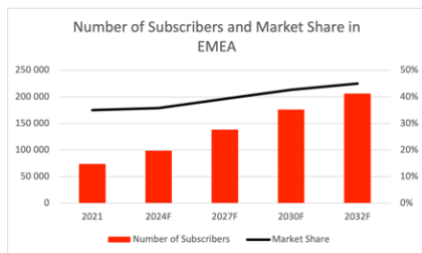


Figure 16 - Number of Subscribers and Market Share in EMEA
Source: Company Forecast

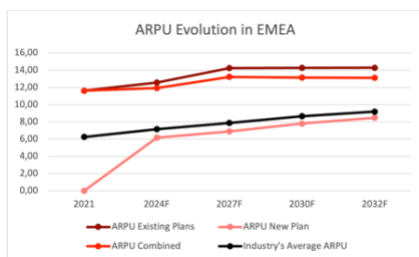


Figure 17 - ARPU Evolution in EMEA
Source: Company Forecast

followed by its main competitors worldwide (Disney+, Amazon Prime and HBO Max). This will result in an increase in the number of subscribers from the current 74.0 m to 206.1, in 2032. Similarly, to UCAN, there will be a significant increase in penetration rates in every subregion, where Europe is expected to have the higher one, more than doubling its current value of 22.2% to 44.8% in 2032. As previously mentioned, Netflix will only start to notice the impact of the new plan in 2023, as the time between the plan launch and the end of the year is quite short. Due to the existing similarities between UCAN and EMEA, the new subscription plan expects to have the same short-term impact as in UCAN. The higher weight of the new subscription plan is explained by the impact of Africa and Middle East, that with lower economic power will have most adhesion to the plan. Similarly, to other regions, it is expected that the ARPU of the new plan does not suffer any changes and will grow at the adjusted inflation rate. Regarding the ARPU of the existing subscription plans, it is expected to increase at the 4-year average rate of 5% in the first two years. Following that and until 2027, the ARPU will grow at the industry revenue CAGR of 4.2% slightly above to the industry's ARPU CAGR for this time window (2022-2027) of 3.9%, since Netflix's ARPU in this region has been constantly higher than the average industry's one and is expected to continue as that. This happens because of Netflix's maturity, efficiency of processes and lack of competitors that could make Netflix to decrease its ARPU. From 2027 onwards, ARPU will increase at the adjusted inflation rate in the remaining years of the prediction where the current value of \$ 11.1 will reach \$ 13.7 in 2032.

LATAM

LATAM (Latin America) can be considered the third largest region for Netflix with approximately 40 m subscribers that currently generate total revenues of \$ 3.5 bn. The lowest number of SVoD households (23.6 m) among all regions can be explained by factors such as the lowest value of people with access to internet among all regions, the low penetration rate (16.0%) and a high number of people per household (4.0), indicating an underdevelopment of this region. The average number of streaming services per household is expected to increase from the current 2.5 to 2.8 in 2032. Such increase can be explained, not only by other factors previously stated, but also by the entrance of new competitors in the market, which will result in a higher demand from customers and the slowly recovery of the Latin American economy is other factor that weighs significantly in this number. Still, it is the region that has the lowest increase in this variable due to its economic conditions. When it comes to

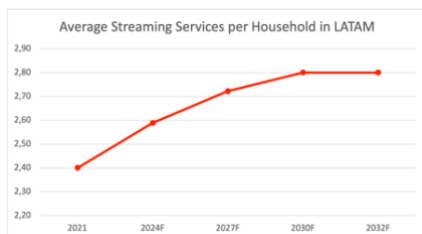


Figure 18 - Average Streaming Services per Household in LATAM
Source: LabsNews.com

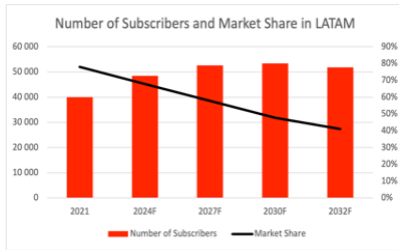


Figure 19 - Number of Subscribers and Market Share in LATAM
Source: Company Forecast

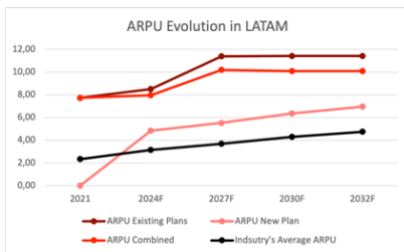


Figure 20 - ARPU Evolution in LATAM
Source: Company Forecast

the market share, this region presents a contrary trend. Despite being where Netflix has more dominance in terms of relative numbers, a sharp decrease is expected in the following years because of the increase in the number of competitors and appearance of cheapest subscription packages. According to WorldScreen, the 78% market share in 2021 was expected to decrease to 41% in 2027 (Daswani 2022). Since the announcement of the new subscription plan was after such previsions, we expect Netflix’s market share to decrease, but at a slower pace than initially predicted, only reaching the 41% in 2032. Still, it is expected that Netflix will be gaining subscribers throughout the forecasted years. Regarding the new subscription plan, it is expected that it will have a weight of 30% in the total ARPU in 2032. This happen because regions with lower economic power have the necessity, and consequently, higher demand for cheaper plans. This way and following the same pattern, it is expected a higher increase in weight in the first two years following the introduction of the plan due to its implementation in the main markets of the region and interest in it. When it comes to the ARPU value, it is expected to increase throughout the time at the adjusted inflation rate. Existing plans’ ARPU is expected to decrease due to a negative 4-year average rate of -2.9% in the first two years of the predictions. In the years of 2023 to 2027, it is expected a sharp increase in the ARPU at the LATAM Media Streaming Market CAGR to 10.2% at region’s main market (Brazil) Media and Entertainment industry CAGR. Since Netflix’s ARPU has been constantly above the industry’s average, we agreed that the average ARPU CAGR for this interval (7.9%) would not reflect the real growth. Also, the ARPU of the existing plans starts to increase a year earlier than in other regions since we expect that it will attract subscribers for every plan since the moment of the new plan’s release. In concordance with other regions, from 2027 onwards, the ARPU will increase at the adjusted inflation rate. Being the region with the least favourable economic scenario, it makes sense that it presents the lowest ARPU from all the existing regions as well as average subscription price, with a current value of \$ 7.1 that is expected to reach \$ 10.1 by 2032.

APAC

Finally, the results presented by this region are heavily influenced by the dynamics of Asia, due to the small representation of Oceania and the Pacific Islands. APAC is the region that presents both the lowest number of subscribers and revenues for Netflix. This can be justified by the fact that there are countries that adopted strict rules regarding the entrance of new competitors, such as China, that is not included in the group of

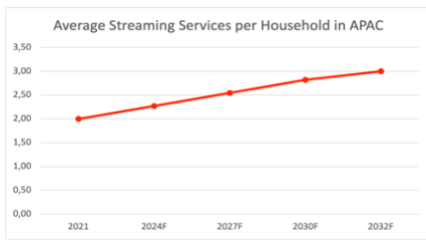


Figure 21 - Average Streaming Services per Household in APAC
Source: LinkedIn

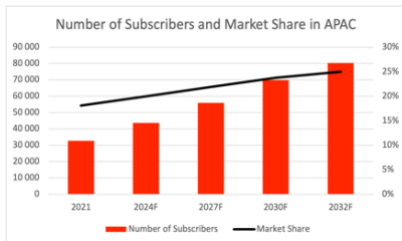


Figure 22 - Number of Subscribers and Market Share in APAC
Source: Company Forecast

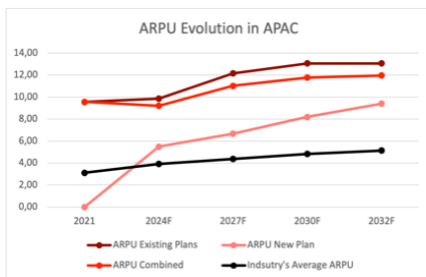


Figure 23 - ARPU Evolution in APAC
Source: Company Forecast

countries that are licensed to stream Netflix content. In addition to this, APAC's SVoD penetration rate is the lowest from all regions (14.7%). Having this in mind, the low number of SVoD households (92.9 m) is justifiable, since a large portion of the market is lost due to China's exclusion. According to Netflix, there are no immediate plans to launch in China due to, among others, low prices, fierce competition, censorship, and existing content restrictions. Anyways, the rest of the territories have a significant potential for Netflix and that is why we predict that APAC surpasses LATAM in terms of revenues by the end of this year (\$ 3,998.8 m in APAC vs \$ 3,728.9 m in LATAM) and in subscribers by 2027 (55.8 m in APAC vs 52.5 m in LATAM). When it comes to the average number of streaming services per household, we can observe that this is the lowest value of all the existing regions with the current value of 2.0. The rise of multi-subscription households in this region and the fact that the group of 2-3 streaming services is becoming the mainstream, makes us believe that will achieve the value of 3.0 by 2032. When it comes to APAC's market share, it is the lowest from every Netflix region. This can be explained by the previously mentioned entry restrictions. This allows for the national companies to be the most dominant in such countries, potentiating them. The current market share value of 18.7% is expected to gradually increase to 25% in 2032. Even with such restrictions, the remaining market is somewhat unexplored, having potential for Netflix to increase its presence in this region. Furthermore, and in similarity with LATAM, the weight of the new subscription plan is forecasted to be 30% by 2032. When it comes to the specific value of the new plan's ARPU, there is not any prediction towards its increase since the new subscription price is expected to remain the same, only being influenced by the adjusted inflation rate. On top of that, the ARPU of the existing subscription plans is forecasted to increase at the 4-year average rate of 0.3% in the first two years of the predictions, followed by 5 years in which it will increase at the Media and Entertainment market CAGR of 7.2%, growing at the adjusted inflation rate from then onwards. Again, and because Netflix's ARPU is constantly above the average one from the industry, it is applied a higher growth rate than the industry's average ARPU CAGR for this period (5.9%). It is important to point that this is the only region that is expected to continuously increase its ARPU value in the long term. After a decrease from \$ 9.2 in 2022 to \$ 8.9 in 2023, we expect this value to reach its maximum in 2032, with a value of \$ 12.0. Although there are some entry barriers in this region, as previously said, this region is the one with higher local real growth forecast, demonstrating

the region’s potential, giving us a basis to believe that it will surpass LATAM both in number of subscribers as well as revenues during the forecasted time window. Additionally, APAC will increase from 32.6 m subscribers generating \$3,266.6 m in 2021 to 80.3 m subscribers contributing with \$11,532.8 m in 2032.

Cost of Revenue

The position “Cost of revenues” represents Netflix’s highest cost and can be separated into “cost of revenues” and “other cost of revenues”. Most of the cost of revenues account to the amortization of content assets. The amortization period of content assets is based on an estimate of future viewing patterns which in turn are predicated on historical and forecasted viewing. If the actual viewing pattern differs from the aforementioned strategy, the amortization period will be readjusted. To forecast the amortization of content assets, a ratio between the cashflow statement positions “Amortization of content assets” in period t and “Additions to content assets” in period t-1 was established. This shows the timing disparities between cash payment on content and the recognition of content expenses. For 2021, a value of 0.78 was obtained, and used as a proxy for consecutive years. Regarding “Cost of Revenues”, a ratio between the amortizations of the period and the cash spent in the same period was used, with a value of 0.71, in line with the value of the previous years.

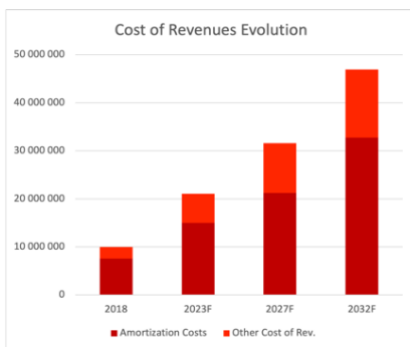


Figure 24 - Cost of Revenues Evolution
Source: Company Forecast

Other costs of revenue include expenses directly associated with the acquisition, licensing, and production of content. The latter, for instance, includes personnel expenses, costs for music rights, various production costs like participations and residuals. Analysing the streaming revenues in relation to the other cost of revenues over the previous 5 years, a stable measure of around 16% was observed and used as proxy for the forecast years. By comparing Netflix's COGS/Revenue ratio with the sector average, a much higher KPI is obtained. The industry average is at 35.5%, whereas Netflix is at 58.3%. This is due to the fact that Netflix includes the depreciation of content assets in the cost of revenue. If we adjust the ratio by the depreciation, Netflix is performing at industry level. Forecasting and add up both components of the cost of revenue, the position will pass \$ 20 bn by 2023 and \$ 45 bn by 2032



Figure 25 - Cost of Revenues Growth
Source: Company Forecast

Performance analysis

Profitability

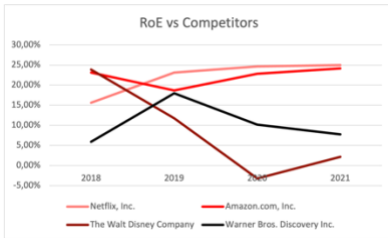


Figure 26 - RoE vs Competitors
Source: Company Forecast



Figure 27 - Operating Margin vs Competitors
Source: Company Forecast



Figure 28 - Gross Margin vs Competitors
Source: Company Forecast

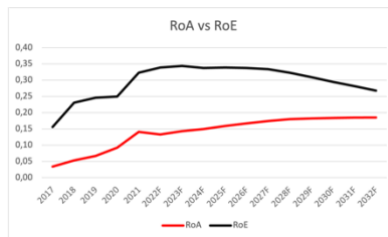


Figure 29 - RoA vs RoE
Source: Company Forecast

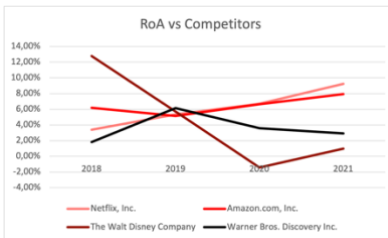


Figure 30 - RoA vs Competitors
Source: Company Forecast

The operating margin of Netflix reveals a strong upwards trend in previous years. In 2017, the operating margin was at its weakest point at 7.2%. From there on it increased to 20.9% by 2021. Regarding the forecasting period, the ratio will grow to its peak, above the sector average of 31.1%, at 32.0% by 2027 and have a slight decrease for consecutive years due to the expected market saturation in this year (Damodaran 2022). When compared to the main competitors, Netflix outperforms them, still below the industry's one but with prospects to surpass it as previously mentioned. The gross margin displays similar the same course, growing from 31.3% in 2017 to 49.4% in 2027. This development can be observed by the faster increase of revenues than costs due to the exploitation and penetration of high potential markets. However, after 2027 a slight decrease of 4.5% till 2032 is expected. The company is not able to achieve the high industry average for the US entertainment sector of 64.4% (Damodaran 2022). Netflix is surpassed by two of its main competitors, but the growing trend associated to the forecasted increase demonstrates Netflix's ability to position in front of its main competitors.

Netflix's net margin demonstrates a strong increase from 4.8% in 2021, to 16.9% for the present year. The positive momentum is set to continue and improving the net margin to above 20% for the following years. Analysing the margins by geography, UCAN demonstrates the most profitable margins, followed by EMEA and LATAM. APAC exhibits the relatively lowest margins, nevertheless all regions are very profitable.

The return on assets shows a nearly ninefold increase in the considered period between 2017 and 2032 with a growth from 0.03 to 0.18. In addition, is the highest when compared to its main competitors, above the industry average. This provides a clear image that Netflix content strategy is successful and can be sustained through the forecasted years. The return on equity displays a different evolution. The average ratio of 0.34 between 2022 and 2026, is followed by a decrease of the RoE for the consecutive years until 0.27 in 2032. The main reason behind that is the decreasing level of debt in the long term, which Netflix wants to establish due to the highly levered capital structure in past years. According to Damodaran, the US entertainment sector average RoE is around 0.31 (Damodaran 2022), which Netflix outperforms till 2028. Making the comparison its main competitors, Netflix has the highest RoE, closely followed by Amazon. Thus, the company is the most efficient in converting its equity financing into profits. The convergence of both in the long term, as well as the deacceleration in its growth can be justified by the industry's slowdown.

Financial leverage

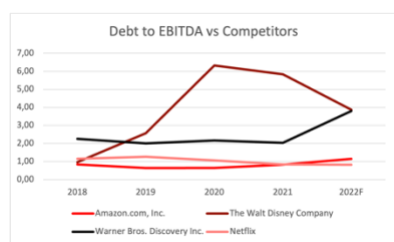


Figure 31 - Debt to EBITDA vs Competitors

Source: Company Forecast

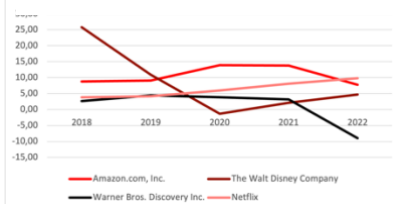


Figure 32 - Interest Coverage Ratio vs Competitors

Source: Company Forecast

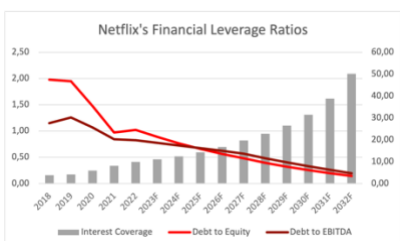


Figure 33 - Netflix's Financial Leverage Ratios

Source: Company Forecast

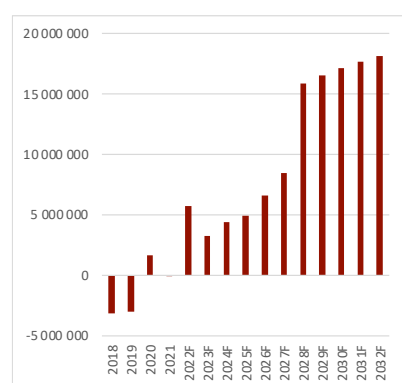


Figure 34 – FCF forecast

Source: Company Forecast

When it comes to Netflix's D/E, we can observe a continuous decline from 2019 onwards, after an increase in the previous years. Netflix's expansion years required high capital, resorting to borrowed funds, therefore the high D/E in 2019 (1.98). This risky strategy has been successful, since according to Netflix's CEO, the company does not need any more debt to survive. This way, and as the company has significantly reduced its D/E ratio, the value can reach the industry's average of 0.15 by the end of the forecasted time frame. Consequently, the debt to EBITDA ratio will follow the same tendency as the D/E since the value of debt has a lower weight, reaching the 0.19 by 2032. Contrarily, the Interest Coverage Ratio will have an exponential increase as the interest expense decreases and the EBIT grows as a result of the company's increasing revenues, with a value of 50.21 in 2032. When comparing to its main competitors, we can observe that Netflix is a leader in both Debt to EBITDA and Interest Coverage Ratio. This leads to the conclusion that in the case of the need of additional financing, Netflix presents as a good option.

Taking into consideration Netflix's performance in every variable of this performance analysis, the company seems financially healthy, with good growth prospects and margins, reflecting its potential as being promising to investors.

Valuation

FCF – Free Cash Flow

For an accurate valuation of Netflix share price, the free cash flow has been calculated. For 2018 und 2019 the FCF was negative around the \$ 3 bn mark. In 2020, the FCF became positive with a value of \$ 1.6 bn in the consecutive year it turned slightly negative again. While the operational cash flow in 2021 remained at similar levels as in 2020, the investment cashflow decline resulting in negative values. Due to the recent development of the last two years and the positive outlook for the future a positive FCF value is predicted for 2022 and onwards. By the end of the forecasting period, a value of \$ 18.1 bn is projected

Growth, Reinvestment Rate, ROIC

Netflix growth rate was calculated from its reinvestment rate and return on invested capital (ROIC). While the growth rate is quite high in the mid-term, reaching a maximum of 24.8% in 2025, it decelerates in the long-

term and terminates at 2.8% in 2032. The obtained growth rate serves at the stable growth rate for the consecutive years after the forecasting period and was therefore used as the terminal growth ratio.

The reinvestment rate demonstrates a decreasing development, starting from 470.1% the ratio will decrease to 324.3%. This development is a result of Netflix successful implementation of new strategies and forecasted increasing revenues. Accordingly, the core invested capital is not growing at the same pace as the core result and a deterioration of the ratio is the consequence. The high reinvestment rate is particularly relevant for Netflix. Being one of the biggest players, continuous investments in the company and its operations are necessary to maintain and expand market leadership. The industry average reinvestment rate is at 46.68%.

The Core ROIC – return on invested capital - is set be 23.7% for the year 2022, before rising to 31.7% over the forecast period. As ROIC is higher than the cost of capital, like in the case of Netflix, the company indicates healthy growth and sustainable value-creation. The value driver of this KPI is the content strategy once again. It demonstrates the profitability and right asset allocation of capital in the long term. Due to the strong investment in content assets, video content is created which, once produced, no longer produces costs but remains available and expands Netflix's offering. This is particularly positive for the development of ROIC and return on equity. In the year 2023, Netflix ROIC surpasses the software/entertainment industry average of 25.5%. (Damodaran 2022) Having a look at Netflix direct competitors, the company operates more profitable than it peers, outperforming all of them, demonstrating a strong value creation for its shareholders. (Figure 61) However, it must be taken into account that their business models are divergent and the peers are untransparent about their streaming sectors financials.

Comparing the ROIC of the entire company with the ROIC of the core business, an equal trend line can be identified. The core ROIC logically has higher values than the overall ROIC. This again shows the operational efficiency of the core business and the efficient use of resources and capital. Core ROIC is therefore the driving force behind the analysis and the associated value creation. In absolute terms, the ROIC achieves a maximum value of 28.6%, whereas the Core ROIC reaches 34.7%.

To further analyze value creation, RONIC must also be considered. Especially the comparison with the WACC is considered to see the cost of capital for an investor in relation to the returns. For 2021, the RONIC is

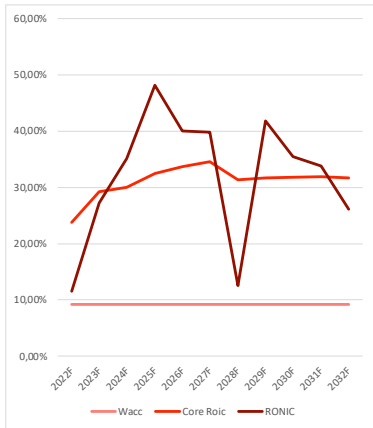


Figure 35 – Comparison of ROIC, RONIC and WACC
Source: Company Forecast

ROIC	
Netflix, Inc.	27,06%
Amazon	15,98%
Disney	2,35%
WarnerBros	5,83%

Figure 36 – Competitor ROIC comparison
Source: Company Forecast

at a low level of 11.6%. This is due to the negative impact of the Corona pandemic and the generally challenging year for Netflix. Looking ahead, the RONIC is showing a positive trend. The maximum RONIC of 48.2% will be reached in 2025, when the new subscription plan is introduced worldwide. Increased investment in content strategy is also boosting RONIC. In summary, the RONIC is always above the WACC, which means that Netflix is creating value for its shareholders. In 2028, due to the expected market saturation, the RONIC will decrease before increasing to over 25.0% for the final forecast years.

Scenario analysis

To evaluate a proper scenario analysis, three factors need to be considered. Subscriber growth and revenue growth were considered as the two main risks. Also, there is a relation of dependency between both, since revenue growth will be directly impacted by subscriber growth, and Netflix's ability to retain, and gain, customers. Netflix's investment in content assets is subject to uncertainty, since if there is any change of strategy this is the main line to be adjusted. Therefore, this analysis was conducted considering the three variables that are more subject to uncertainty: Average Revenue Per User (ARPU), Market Share and Content Assets Growth. Regarding ARPU and its optimistic scenario, we have assumed that the ARPU grows at the four-year average rate (2018-2021) of 10.5% from 2022 to 2027, where the growth rate decreasing at a constant rate until 2032, when it reaches 0% and the ARPU grows at the inflation rate, in UCAN. In EMEA, the same logic was applied, with the difference that the 4-year average rate is 5%. In APAC, instead of using the 4-year average rate, the Media and Entertainment CAGR was used, with a value 7.2%. Finally, in LATAM, after a year of 2022, where the 4-year average rate is used (-2.9%), from 2023 until 2027, the ARPU grows at the CAGR of the industry in that region, at 17.7%. From then on, and similarly to the remaining regions, the ARPU decreases until 0% in 2032, growing at the inflation rate. This results in a price per share of \$ 603.93. In the pessimistic scenario, the outlook is different. We have considered that the ARPU would grow at a constant rate from 2022 until 2028, where from then on would increase at the adjusted inflation rate. In UCAN, a growth rate of 5% was used, whereas in EMEA, the value of 2.5% (half of the 4-year average growth rate) was chosen. Such values are significantly lower than the ones in the base case, reflecting bad growth perspectives for both regions. In LATAM and APAC, given that the 4-year average rate represents a low value, and our forecasts indicate a base case with higher

Change in ARPU			
ARPU	Pessimistic	Base Case	Optimistic
Price per share	176,09	357,48	603,93
Weight	20%	60%	20%
= Price per share		370,49	

Figure 37 - Scenario Analysis with Change in ARPU
Source: Company Forecast

perspectives, the values of -2.9% and 0.3% were used for LATAM and APAC, respectively. All in all, we obtained a price per share of \$ 176.09. Given the uncertainty climate that the world is currently going through, we have decided to attribute a weight of 20% to each scenario, with the remaining 60% allocated to the base case, resulting in a price per share of \$ 370.15, and a recommendation to BUY.

Change in Market Share			
Market Share	Pessimistic	Base Case	Optimistic
Price per share	62,09	357,48	803,05
Weight	20%	60%	20%
= Price per share	387,52		

Figure 38 - Scenario Analysis with change in Market Share
Source: Company Forecast

When it comes to the market share and its most optimistic scenario, we established target values for 2032, assuming a constant growth from year to year. Such values were 35% for UCAN, 50% for EMEA and LATAM and 30% for APAC. These assumptions result in a price per share of \$ 803.05. In the most pessimistic scenario, we have considered that in Netflix's bigger markets, the market share would return to 2021 levels, representing no growth during the forecasted time horizon, meaning that UCAN would remain with a value of 20%, with EMEA having 35%. In relation to LATAM, the prediction was for a decrease in the market share of 78% in 2021 to 41% in 2027. It is important to mention that this prediction did not account for the impact of the new subscription plan. Having that in mind, we believe that a pessimistic scenario would be the one where the 41% market share would be a reality even with the implementation of the new subscription plan, maintaining its value for the forecasted time window. Finally, in APAC, the value of 18.1% was used for every year, not reflecting the growth potential of this region. Such assumptions result in a price per share of \$ 62.09. Having this in mind, and using the weights previously applied (20% for each different scenario and 60% for the base case), we came up with a value of \$ 387.52 per share, resulting in our recommendation to BUY. Finally, and in the case of a change in Netflix's strategy we calculated the impact of different content assets acquisitions. In the optimistic scenario, the growth rate of the industry's has been used, with a value of 9.90% until 2027, when it starts to grow at the inflation rate. This will result in a share price of \$ 399.97. Regarding the pessimistic scenario, the investment in content assets is expected to grow at the average values pre-COVID, with an average value of 29.4% until, growing at the inflation rate onwards, giving us a total price per share of \$ 271.41. At last, and taking into consideration the previously used weights, the final price per share it \$ 348.77 and our recommendation to HOLD. One last important value that it needs to be explored is the ROIC and the Reinvestment Rate in the long term, since is an important measure to evaluate the performance of the company as it reflects the investment in content assets. We can observe that the optimistic scenario always presents higher values for the RONIC and

Change in Content Growth			
ARPU	Pessimistic	Base Case	Optimistic
Price per share	271,41	357,48	399,97
Weight	20%	60%	20%
= Price per share	348,77		

Figure 39 - Scenario Analysis with Change in Content Growth
Source: Company Forecast

Indicators (with change in content growth)			
	Pessimistic	Base Case	Optimistic
2024			
Core RONIC	19,38%	35,18%	65,02%
Core ROIC	25,64%	30,06%	34,94%
Reinvestment Rate	467,99%	399,31%	343,46%
2028			
Core RONIC	4,79%	12,56%	31,70%
Core ROIC	18,42%	31,38%	47,45%
Reinvestment Rate	560,54%	338,26%	223,75%
2032			
Core RONIC	15,79%	26,09%	38,00%
Core ROIC	18,65%	31,70%	47,79%
Reinvestment Rate	551,41%	324,34%	215,16%

Figure 40 - Impact of change in content growth
Source: Company Forecast

ROIC, with lower values for the Reinvestment Rate. This confirms that in the optimistic scenario Netflix will be investing in the right content, meaning that the lower amount of money invested in content assets will result in a higher return of the money invested. Contrary, in the worst scenario, there is much more wasted investment in content, since for long-term (2028 and 2032) reinvestment rates that double the ones in the optimistic case, both ROIC and RONIC will be much lower.

Appendix

NETFLIX, INC.

MEDIA & ENTERTAINMENT INDUSTRY

FABIAN HILKE / ANTONIO SOUSA

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COMPANY REPORT

16 DECEMBER 2022

Equity Research – Netflix, Inc.

- Due to the Corona pandemic, and the associated restrictions, Netflix was able to grow strong in 2020 and 2021. However, this rapid pace could not be maintained in 2022 and Netflix even lost memberships in the first two quarters.
- Netflix competes with its many rivals, for example Amazon Prime or Disney+, in the so-called "streaming wars". Therefore, the battle for growth and new memberships is tough and Netflix is adapting its content strategy accordingly.
- In order to compete in the competitive market, Netflix is changing its content strategy from licensed to self-produced content, which gives the company a great USP. In addition, the company introduced an add-based subscription model in November 2022, which is intended to further expand revenue and growth.
- Based on a DCF valuation, with cash flows forecasted to the year 2032, Netflix's price target for the FY23 corresponds to \$ 357.48, meaning it is trading at a 12.48% discount. This leads to a final BUY recommendation.

Company description

Netflix is one of the world's leading entertainment services with 223 million paid memberships in over 190 countries enjoying TV series, documentaries, feature films and mobile games across a wide variety of genres and languages.

Recommendation: BUY

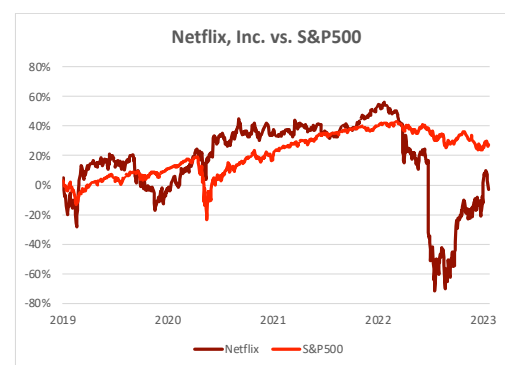
Price Target FY23: 357.48 \$

Price (as of 5-Feb-23) 317.83 \$

Reuters: NFLX.OQ, Bloomberg: NFLX:US

52-week range (€)	\$ 162.71-\$ 632.45
Market Cap (€m)	142.59
Outstanding Shares (m)	450.0

Source: Bloomberg



Source: Bloomberg

(Values in \$ millions)	2021	2022E	2023F
Revenues	29,697	33,731	37,874
Revenue Growth	18.8%	13.6%	12.3%
Operating Income	6,194	7,321	9,195
Operating Margin	20.9%	21.7%	24.2%
Paid Memberships	221,8	232,5	255,2
NOPLAT	5,396	6,023	7,504
Net Income	5,116	5,702	7,152
EPS	11.37	12.67	15.89
P/E	52.99	25.08	22.49

Source: Annual Reports, Valuation Forecasts

THIS REPORT WAS PREPARED EXCLUSIVELY FOR ACADEMIC PURPOSES BY ANTÓNIO SOUSA AND FABIAN HILKE, A MASTER IN FINANCE STUDENT OF THE NOVA SCHOOL OF BUSINESS AND ECONOMICS. THE REPORT WAS SUPERVISED BY A NOVA SBE FACULTY MEMBER, ACTING IN A MERE ACADEMIC CAPACITY, WHO REVIEWED THE VALUATION METHODOLOGY AND THE FINANCIAL MODEL. (PLEASE REFER TO THE DISCLOSURES AND DISCLAIMERS AT END OF THE DOCUMENT)

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Company Overview

Company description

Netflix, Inc. is an American media and entertainment company, founded in 1997 by Reed Hastings and Marc Randolph in Scotts Valley, California. Headquartered in Los Gatos, California, the streaming service and production company, initially started by selling and renting DVDs by mail, introducing video on demand and streaming media in 2007. Its internationalization started in 2010, when the company expanded to Canada, followed by its entrance into Latin America and the Caribbean. Regarding television production, Netflix made its debut with the series “House of Cards” in 2013. Since then, the company has been increasingly involved in film and series production, totalling more than 17,000 titles globally (Netflix 2022). By 2016, the company made a worldwide expansion to an additional 130 countries, operating in 190 countries in total. The company has become a leader in the Service Video on Demand (SVoD) market, totalling 220.67 m subscribers nowadays (Netflix 2022).

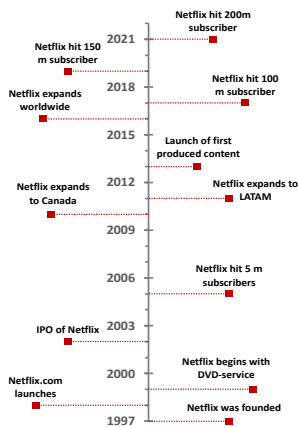


Figure 1 - Netflix Chronology
Source: Netflix

Business Model and Business Segments

Netflix is one of the pioneers regarding subscription-based content. Unlike other platforms that run on premium subscriptions such as Spotify, Netflix does not offer a free option, meaning that all subscribers pay for the platform’s content, guaranteeing recurring income from each subscriber. Also, it operates in two distinguishable segments: streaming and DVD. While streaming services are offered both domestically and internationally, DVD rental is only available for the domestic segment. It is important to mention that although the domestic DVD segment is accounted for, we will focus on the other two segments, given their low significance when compared to the total revenues. To understand how this business model made the company the most relevant competitor in the market, there are 5 differentiation properties. The sophisticated recommendation engine plays a critical part in leading individuals to the best few alternatives for them, resulting in better selections, by utilizing the massive quantity of data accessible to assist customers in making choices effortlessly. Split testing is primarily employed when big changes, such as a new homepage, are implemented. This chance is utilized to learn about users' reactions to the modifications. Users are also made more comfortable with the new adjustments, which increases user retention. In addition, user preferences have been thoroughly examined. The Netflix recommendation algorithm tracks the number of users who watch an episode, a whole series, and the time between two episodes. Subsequently the algorithm delivers deep information into when users



Figure 2 - Logo Evolution
Source: Netflix

pause, rewind and fast forward. Other data used to study user preferences include user views of episodes, browsing and scrolling behaviours, device type (mobile/laptop), ratings, etc. The recommendation engine can deliver customized recommendations based on user choices to increase client engagement. One other factor is push notifications. Netflix does not miss an opportunity to inform customers about new seasons or episodes, tailoring what may be a user's top interest, by studying its behaviour. The last feature is personalized mail recommendations. Netflix not only sends pop-ups but also emails recommendations, customizing the experience when a new program is added based on your viewing history. The customized email allows you to play the episode directly from the email on your mobile device or add it to your watch list (Netflix 2022). Moreover, the company offers four subscription plans – Basic with Ads, Basic, Standard, and Premium. It is important to mention that the Basic with Ads subscription was recently launched but is only available in 12 countries (Netflix 2022). As a result, we will account for this addition in this report, assuming the total implementation of this plan in all countries by 2025. Each of these plans has its specificities, according to the customers' preferences and needs. Regarding the price, the company adopts a strategy with different prices according to the country, ranging between \$ 6.99 and \$ 19.99 in the United States and between a \$USD equivalent of \$ 1.94 and \$ 25.47 internationally (Netflix 2022).

Pricing (US Dollar)

- **Basic with ads***: \$6.99/month
- **Basic**: \$9.99/month
- **Standard**: \$15.49/month
- **Premium**: \$19.99/month

Figure 3 - Netflix Pricing
Source: Netflix

Industry Overview

Media and Entertainment Industry

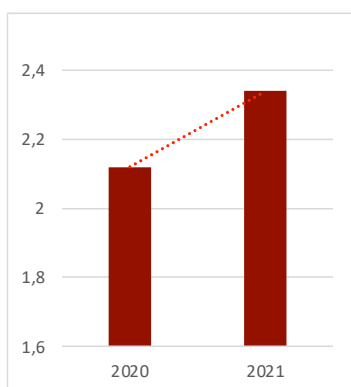


Figure 4 – Media & Entertainment industry growth (in \$ trn)
Source: Statista

As technology and digitalization are increasingly influencing most industries, the Media and Entertainment one is not an exception. Following the pandemic, and the resultant decline of 2.3% in 2020, the revenue generated by the industry increased by 10.4% in 2021, ascending to \$ 2.34 trn, when compared to the \$ 2.12 trn of the previous year. The industry is expected to grow but at a slower pace, with a 4.6% CAGR from 2021 until 2026 (PWC 2022). Boosted by its main growth drivers, such as digital advertising, virtual reality (VR) and gaming, the industry is increasingly becoming more digital and mobile, as well as youth oriented. It is also important to mention the industry's response and adaptability. According to the most recent available data, significant geographic disparities were noticed when it comes to Entertainment & Media spending throughout the world. As expected, North America spends the most, followed by Europe. This favours content development for companies headquartered in the above-mentioned regions, such as Netflix. Consequently, this results in a huge potential for investment in other regions, where

the industry is underdeveloped, allowing for the penetration of well-established companies in such regions. (PWC 2022)

Video-on-demand

Video-on-demand refers to all methods of downloading digital video material on demand from an internet provider or service or viewing it directly via a video stream using suitable software. Video-on-demand allows viewers to have access to video content, such as movies and television shows at any time. (Statista 2022) The Video-on-demand market has grown significantly over recent years. For the current year 2022, a market size of \$ 94.8 bn is projected for the video-on-demand market. In 2017, the industry sales reached \$ 36.9 bn, making the market more than doubling in 5 years. The revenue CAGR between 2022-2027 is projected to 10.7%, resulting in an anticipated market size of \$ 157.9 bn by 2027. The Video Streaming (SVoD) is the largest sector with a market volume of \$ 80.8 bn in 2022, followed by Pay-per-view (\$ 8.9 bn) and Video downloads (\$ 5.2 bn). For 2027, the target market SVoD is projected to reach \$ 139.2 bn in turnover (Figure 5). (Statista 2022) For 2022, the total user count for the SVoD market is projected to be 1,160.4 m worldwide. In 2027 the user amount is set to grow to approximately 1,636.6 m (Figure 6). In the US and Canada, the number of users is at a value of approximately 161.2 m users in 2022. With 171.9 m users, Europe tops that off. In Asia, 620.1 m SVoD subscriptions are currently active, being the highest potential market for Netflix. (Statista 2022) Regarding the penetration rate for subscription video-on-demand, US, Canada, and Denmark are at the top 3 leading countries. In the US, 44.0% of the population is subscribed to a Video-on-demand service. Second place goes to Canada with 38.6%, followed by Denmark with 36.9% for 2022. The worldwide penetration rate is projected to be 15.2% for the current year. (Statista 2022)

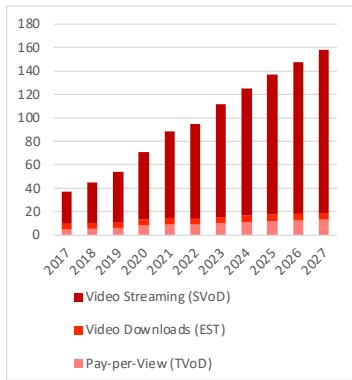


Figure 5 – Revenue per segment
Source: Statista

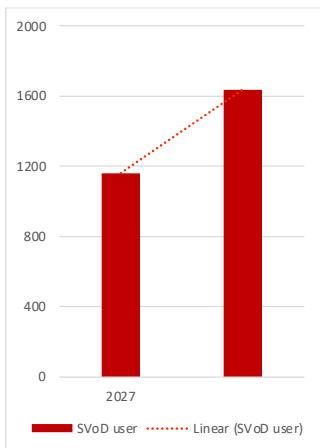


Figure 6 – SVoD user growth
Source: Statista

Industry’s trends, opportunities and risks

In such a competitive market, there are always new trends and risks associated that heavily influence companies’ performance. Cord cutting is something that has been increasingly throughout the years, highly benefiting companies that operate in the SVOD market, such as Netflix. It can be defined as the drop of a cable or satellite TV subscription in favour of an alternative. In the US this is a very common practice, that will result in a significant decrease in cable TV penetration in the present decade, where the value of 81% will decrease to around 55% by 2030 (Search 2022). Amongst several reasons for cord cutting, the number one is the high price paid, since the average person pays around \$ 107 for a monthly subscription. Although cable is bigger in term of subscribers, Netflix has more views than cable

and satellite combined. Given this indication, Netflix has great prospects for the SVOD industry, since the price of a monthly subscription never surpassed \$ 17 per month. In addition, cord cutters are particularly motivated by original content, where 57% of US streaming subscribers are driven by original content, with more special relevance for the 71% millennials that stated original content as its main factor (Cook 2022). Both factors combined represent an excellent opportunity for Netflix to increase its customer base since its main focus has been the production of original content and its target market are members from Gen Z or Millennials, with a lower income range of \$ 25,000-50,000.

A further trend involves the production and licensing of sports documentaries and series. Netflix was the pioneer with the launch of “The Last Dance” or “Formula 1: Drive to Survive”, attracting sports lovers and awakening the interest of people who would not use streaming platforms in other circumstances. After that, Netflix’s biggest competitors have replicated it, with HBO Max launching “Magic & Bird: A Courtship of Rivals” or “Tiger” and Amazon Prime with “Senna” or “Messi”. In such competitive market, the first-mover advantage tends to benefit the company, as in the case of Netflix. Supplementary, sport streaming is a further trend in the streaming market. The sector shifted from being broadcasted through traditional television networks to various streaming services. Therefore, the sports streaming sector became very competitive over the years with established players like DAZN, Sky, and ESPN+. However, this development has resulted in the market becoming highly fragmented, unclear and requiring many subscriptions to follow all sporting events. Netflix’s already well-known competitors Amazon Prime, Paramount and Peacock are strongly active in this sector. For example, Amazon has guaranteed the rights of Thursday Night Football for \$ 1.2 bn per year. Subsequently, ESPN and Turner, which are part of Warner Bros. Discovery Inc. investing \$ 2.7 bn per year for the rights to telecast NBA games in the United States. Sports streaming rights are very expensive and highly in demand. In the US, the amount paid for the sports in 2022 streaming market reached \$ 21.3 bn from \$ 16.9 bn in 2019 (Figure 7), showing significant growth in this specific market segment. Globally the sports streaming market is projected to grow with a 21.5% CAGR till 2028 (Figure 8). (Toonkel 2022)

In recent years, the gaming industry has boomed alongside the streaming service industry. Driven by trends such as AI, metaverse and the pandemic, the market grew to \$ 229.1 bn in 2021 and is expected to grow with a CAGR of 13.2% to \$ 545.9 bn by 2028. (Fortune 2021) Especially the market for subscription-based gaming service, is seen as a market with a lot of potential in the future. For Netflix users, apps are available on mobile devices. As of December 2022, Netflix offers a

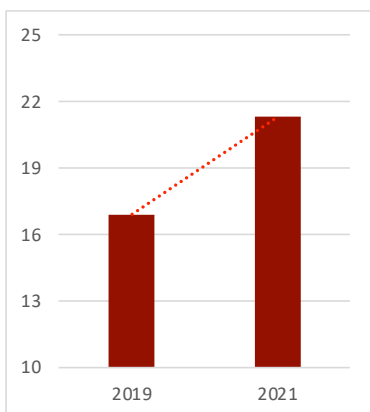


Figure 7 – US Sports Streaming market size (in \$ bn)
Source: Statista

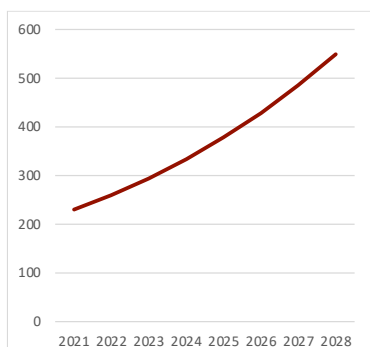


Figure 8 – Gaming industry growth (in \$ bn)
Source: Toonkel

huge selection of apps which are included in their paid memberships. However, so far no monetarize elements like ads or in-app purchases are included. Therefore, this segment for now cannot be seen as a further stream of income for now.

The industry margins of profitability are relatively high. (Figure 9) This is due to the scalability of the streaming companies. New customers can be added to the customer base without large additional costs and generate revenue immediately. Costs such as SG&A are not affected. Thus, profitability can be improved easily and quickly. Likewise strong margins can be seen when looking at the average ROIC (25.46%) and return on equity (31.4%). The companies invest heavily in their content assets, which subsequently generate further revenues in future years without producing further costs. The high ROE is confirmed by the equally high reinvestment in the company and its content. Sustainable shareholder value creation can only be achieved through continuously reinvestments in assets.

Average Industry KPIs	
ROIC	25,46%
RoE	31,40%

Figure 9 – Media & Entertainment industry KPIs
Source: Damodaran

COVID-19 and the aftermath

While the COVID-19 outbreak at the beginning of 2020 was a major setback for most industries and companies, Netflix, Inc. is one of the few beneficiaries of the pandemic. Analyzing the cumulative returns of Netflix, compared to the S&P500 index, during the pandemic a clear winner can be determined. While the S&P500 dropped significant at the start of the pandemic, Netflix share price actually rose. The growth continuously applies to the next two financial years, driving the share price from \$ 325.90 in the beginning of 2020, to \$ 602.44 by the 31st of December 2021. Thus, the share price almost doubled withing 48 months.

Macroeconomic conditions were heavily affected mainly in the GDP growth of each region that have suffered a blow in its growth, registering negative values in the most problematic years. The consequences are now being felt with the increase of inflation and interest rates. In 2021, the U.S dollar inflation reflected such effects with its higher inflation rate throughout the analysed time window, with a value of 4.7% (Figure 10). However, the post pandemic reaction surpassed expectations and is expected a stabilization in GDP growth in the following years.

The restrictions and the associated lockdowns were a major driver for the streaming service industry and Netflix in particular. Due to the fear of the pandemic and exit locks, the population spent more time at home and the demand for video streaming platforms increased tremendously. While the pandemic forced millions to work from home, this trend has regressed little in the post-pandemic period. Taking the US as an example, 58% of US works state they're able to work remotely at least one day a week. 35% of US workers even work from home all days of the week. (Solis-Moreira 2022) People prefer flexible working and spend significantly more time at home than

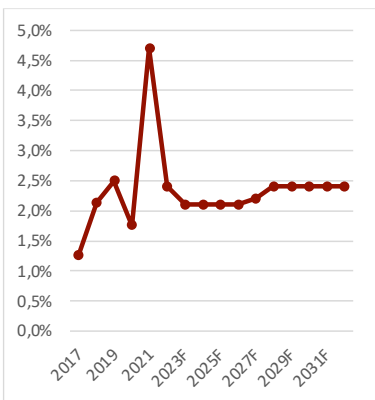


Figure 10 – US\$ inflation forecast
Source: Damodaran

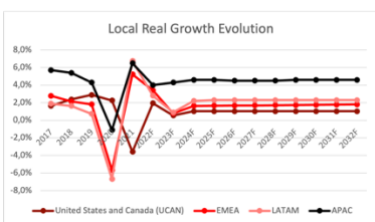


Figure 11 - Local Real Growth Evolution
Source: WorldDataBank

2 years ago. This has led to people watching television (streaming services included) during working hours. A study by CordCutting found that 49% of US workers watch TV during work hours. The most popular consumption medium by far was streaming services, led by Netflix. (Lovely 2022) However, the trend is not limited to working hours; since the pandemic, leisure time is also being spent more at home. This is a particularly positive development for Netflix and the time consumers spend in the app.

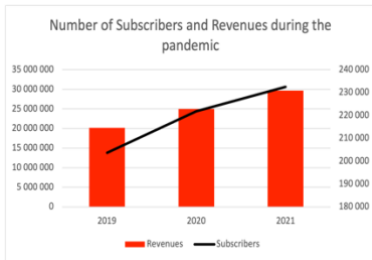


Figure 12 - Number of Subscribers and Revenues during the pandemic
Source: Netflix

In 2020, Netflix gained over 37.5 m new subscribers, breaking the 200 m subscriber mark. It is questionable, however, whether this growth can be sustained not only in the short term but also in the long term. (Deloitte 2020) For the consecutive year, the growth declined by 50% and only 18.2 m customers joined the company. In the current year 2022, the recession hit, and Netflix, Inc. subscriber amount decreased in the first half of the year by nearly 1.2 m subscribers. (Netflix 2022)

To re-accelerate its growth, Netflix implemented two important tactics to boost its revenue: First of all, the company wants to crack down more on account/password sharing. Many subscribers share their passwords with friends and family to save on the cost of a subscription. Netflix now wants to put a stop to this, beginning in early 2023. In case of password sharing, Netflix will charge the owner of the account and add fees for the “subaccounts/sub-profiles”, if the membership is used outside of one household. The actual detection of free riders is based on an analysis of IP addresses, device IDs and account activity. The price for the subaccounts is estimated to be between \$ 3.50 and \$ 4.0. (Solsman, 2022) Secondly, the ability to transfer sub-profiles to paid accounts will be activated by October 2022 in order to prevent the beforementioned fees. This feature helps people, who free ride on other memberships, to create an account for themselves. In that way, the transition to obtaining an own membership is easier and the new customer won't lose his Netflix recommendations. This technic will prevent password sharing and get users to pay for their own subscriptions. (Wallaker, 2022)

DVD-Market

In Netflix, Inc.'s early business years, the focus laid on lending DVDs. Their goal was to create an online video store that did not charge penalties for late media returns and delivered the videos conveniently to the customer's home. Thus, all interactions took place via the post or the internet, so customers did not have to leave their homes. For now, the DVD business of Netflix is shrinking year-by-year and has not been the core business for a considerable time. Over the years, the video-on-demand market started to substitute the DVD (and Blu-Ray) market, however, the service is still active in the US and Canada. The DVD, Game & Video

Competitor Pricing	
Amazon-Prime Video	
\$ 8.99	only Prime-video
\$ 14.99	Prime
Disney+	
\$ 7.99	with ads
\$ 10.99	without ads
Peacock	
\$4.99	with ads
\$ 9.99	without ads
HBO Max	
\$ 9.99	with ads
\$ 14.99	without ads
Discovery+	
\$ 4.99	with ads
\$ 6.99	without ads
Apple+	
\$ 6.99	single subscription
\$ 16.95	bundle subscription

Rental market in the US declined strongly from 5,603.3 m in the year 2012 to 1,056.3 m in revenue. (Ibisworld 2021).

Competitive Landscape

Due to the high attractiveness and growth opportunities, the market is particularly competitive. In particular, large media conglomerates seized this opportunity and launched their own SVoD services to compete with Netflix. The most important players are Disney+ from The Walt Disney Company and Amazon Prime Video from Amazon.com, Inc. Further Competitors are Peacock from the Comcast Corporation, Discovery+ and HBO Max, which are both owned by Warner Bros. Discovery., and Apple TV+ from tech-giant Apple Inc. All these companies are currently competing in the so-called “streaming war”, which harms and decelerates the development and growth of Netflix.

Figure 13 - Competitor Pricing
Source: Company Forecast

Amazon Prime Video

Amazon’s in-house streaming service was released on September 7, 2006, making it one of the most established products on the market. The service is already included in the standard Amazon Prime subscription, nevertheless, it can also be subscribed to as a stand-alone service. Their price range for the standard Amazon Prime subscription depends on the payment method. The customer is either charged \$ 14.99 per month or \$ 139 per year if the payment is made annually. Thereby Amazon.com Inc. tries to retain its customers for the long term, by giving them nearly a \$ 40.88 discount if the annual payment is chosen. For non-Prime members, Prime Video can be purchased for \$ 8.99 a month as standalone streaming. (Amazon 2022) As of November 2022, Amazon Prime currently serves over 200 m subscribers, which generates a yearly turnover of \$ 31.77 bn (Statista 2022).

Disney+

Disney+ was launched on November 12th, 2019, by The Walt Disney Company. Disney+ can be acquired either as a standalone service or as part of “The Disney Bundle”. Regarding the standalone service, the company offers two subscription solutions: \$ 7.99/month or \$ 79.99/year. Like Amazon Prime Video, Disney tries to retain its customers for the long term, by offering a \$ 15.89 discount, equivalent to almost 17% discount if the annual payment is chosen. “The Disney Bundle” includes its other U.S. streaming services such as Hulu and ESPN+, with plans that range between \$ 9.99 and \$ 82.99 per month. (Disney+ 2022) It is also important to mention the increase, not only in revenues but also in the number of subscribers of this streaming service, posing as one of the main competitors and threats to Netflix.

Competitor KPIs	
Amazon.com, Inc.	
Operating margin	5,30%
Gross margin	42,03%
ROIC	15,98%
Return on Equity	24,13%
Return on Assets	7,93%
Invested Capital (in bn)	202,84

Figure 14 - Amazon.com KPIs
Source: Financial Times

Competitor KPIs	
The Walt Disney Company	
Operating margin	16,50%
Gross margin	33,06%
ROIC	2,35%
Return on Equity	2,14%
Return on Assets	0,98%
Invested Capital (in bn)	172,90

Figure 15 - The Walt Disney Company KPIs
Source: Financial Times

By the 3rd quarter in 2022, Disney+ has 152.1 million users (Statista 2022), resulting in yearly revenues of \$ 5.2 bn for the year 2021. (Iqbal 2022)

Peacock

Publicly available since April 15th, 2020, for Xfinity Flex customers and on July 15th, 2020, for the general public in the US, Peacock is part of Comcast. Peacock has multiple subscription tiers: Peacock Free, Peacock Premium, and Peacock Premium Plus. For starters, the Peacock Free is a free subscription plan, where you can only watch selected movies and where ads are included. If the customer wants full library access, there are the remaining options: Peacock Premium for \$ 4.99/month and Peacock Premium Plus for \$ 9.99/month. Being a recent streaming platform, Peacock's strategy is based on an aggressive price strategy, in order to enter the market, not only by offering lower prices than the competitors but also by having deep discounts like the one that happened last October where the price for an annual premium subscription membership was \$ 19.99. (Sledge 2022) Peacock has registered strong growth in its number of paid subscribers, since as of September of the current year, the service has 15 million paid subscribers, representing a 70% increase in this group, since the start of the year. (Fletcher 2022)

Discovery+ and HBO Max

Discovery+ and HBO Max are both American streaming platforms, belonging to Warner Bros. Discovery, which resulted from the fusion between WarnerMedia and Discovery Inc., on April 8th, 2022. Regarding HBO Max, the latter was launched on May 27th, 2020. HBO Max came as a replacement for the popular HBO Go and HBO Now and offers two subscription plans: With ads or ad-free with both plans having either a monthly or annual billing. While the with ads plan goes for \$ 9.99/month or \$ 99.99/year, the ad-free plan goes for \$ 14.99/month or \$ 149.99/year, representing a discount of 16% in both plans. (HBO Max 2022) As of the end of the Q2 of this year, HBO Max had 81.2 million subscribers. The projections for this company are of a continuous increase in revenues, subscribers, and content assets, being one of the main competitors in this industry, and responsible for the reduction in Netflix's market share in recent years. From Q1 2021, HBO has increased its market share from 8% to 15% in Q3 2022, assuming to be one of the main competitors in this industry. (Curry 2022)

When it comes to Discovery+, the streaming platform was launched on January 4th, 2021. It offers two subscription plans: the one with limited ads that goes for \$ 4.99/month and the ad-free for \$ 6.99/month. (Discovery+ 2022) Nowadays, Discovery+ accounts for almost 23% of Warner Bros. Discovery streaming platforms subscribers, with 24 million subscribers. It is important to mention that the services

Competitor KPIs	
Comcast Corp	
Operating margin	11,82%
Gross margin	68,41%
ROIC	2,12%
Return on Equity	6,14%
Return on Assets	1,89%
Invested Capital (in bn)	229,23

Figure 16 - Comcast Corp KPIs
Source: Financial Times

Competitor KPIs	
Warner Bros. Discovery Inc.	
Operating margin	16,50%
Gross margin	62,10%
ROIC	5,83%
Return on Equity	7,72%
Return on Assets	2,92%
Invested Capital (in bn)	65,87

Figure 17 - Warner Bros. Discovery Inc.
Source: Financial Times

are expected to merge in spring 2023 to increase their competitiveness since Discovery+ is still regarded as a completely different streaming platform from HBO Max. In addition, it can be observed that the company follows the usual strategy in this industry, which is retaining customers in the long term, accomplished by making a discount on the long-term subscription plan. (Chang 2022)

Apple TV+

Finally, Apple TV+, launched on November 1st, 2019, is Apple's subscription streaming service. This streaming service has a monthly subscription of \$ 6.99/month after a free seven-day trial. Moreover, it is included in "Apple One", a bundle that can include up to five other Apple services and starts at a value of \$ 16.95/month. (Apple 2022) Furthermore, Apple TV+ is used by the company to increase its sales of other products, since the streaming service has a 3-month free trial if you buy any other device. This is part of Apple's strategy of trying to dominate and unify several industries, such as streaming platforms, communication, or broadcast entertainment. As of 2022, Apple TV+ had a total of around 25 million members, with expectations of an increase in the following years. (Gruenwedel 2022)

Competitor KPIs

Competitor KPIs	
Apple Inc.	
Operating margin	30,29%
Gross margin	43,31%
ROIC	47,04%
Return on Equity	175,46%
Return on Assets	28,36%
Invested Capital (in bn)	336,30

Figure 18 - Apple Inc. KPIs
Source: Financial Times

Streaming War

Now who will win the streaming war? To be able to define a winner, the number of subscribers plays the most important role. While Netflix's business model is based on streaming services and is extremely transparent about the number of subscribers, the competition is more secretive here. For the competitors, the streaming service is only an add-on for their current business model and therefore not in the foreground. Either they keep their subscriber numbers completely confidential or present them in a way that is favourable to them, e.g., Disney counting a streaming bundle, which includes Disney+, Hulu, and ESPN+, as three separate subscriptions (Powers 2022). In the revenue industry comparison (Figure 19), Netflix and Amazon Prime are the leading streaming providers. For the financial year 2021, Amazon records higher revenues, but the competitor also records revenues from its music service as streaming revenues, which do not belong to the SVoD market. Compared to the other competitors, Netflix has a clear lead over its smaller rivals.

Revenues (in \$ bn)

Amazon-Prime	31,8
Disney+	5,2
Peacock	0,8
HBO Max	3,8
Discovery+	3,2
Apple+	2,2
Netflix	29,7

Figure 19 - Competitors
Revenues
Source: Various Sources

Company Analysis / Forecasting

Stock performance

Netflix's common stock, represented by the ticker "NFLX", is traded on the Nasdaq Stock Exchange, one of the biggest and most prestigious stock exchange markets in the world. At a price of \$ 15.00 per share, the company went public on May 2002 and closed its first day trading at \$ 16.75, or \$ 1.20 per present-day share after stock split adjustments (Yahoo Finance 2022). The first 10 years after the IPO were characterized by volatility, where the stock price stood between \$ 0.64 and a maximum of \$ 38.69 in 2011. The rise of the share price is the result of Netflix's expansion to Latin America in the same year, signalling to investors the company's health. Henceforth, high volatility has been predominant, because of both Netflix's strategy and the fast pace changing economic conditions. From 2012 until 2018, Netflix's stock price had a strong increase reaching \$ 391.43 in June 2018 as a result of continuous expansion to all continents. Regarding the more recent years, Netflix's stock reached its all-time high on November 17, 2021, with a closing price of \$ 691.69. The restrictions of the pandemic increased Netflix's popularity and the number of subscribers to skyrocket, leading to a rise in the share price. As the situation returned to normality, so did the markets, and after a deep dive, Netflix's stock price reached the value of \$ 174.87 in June of the present year. Moreover, and in agreement with what has been said, Netflix presents itself as the most volatile stock in the FAANG stocks, which refers to 5 of the most prominent American technology companies: Alphabet, Amazon, Netflix, Meta, and Apple.

	2017	2018	2019	2020	2021
EPS	\$1.25	\$2.68	\$4.13	\$6.08	\$11.24
P/E ratio	143.8	96.3	75.8	86.4	52.2

Figure 20 - Netflix's EPS and P/E ratio
Source: Company Forecast

Finally, when it comes to Earnings per Share (EPS) and Price-to-Earnings ratio (P/E), there is an opposite tendency in both measures. While EPS have been increasing (\$ 1.25 in 2017 to \$ 11.37 in 2021), the P/E ratio has been decreasing (149.0 in 2017 to 52,9 in 2021). The outlier value contradicting the trend in the P/E ratio in 2020 is directly related to the effects of the COVID-19 pandemic.

Content Strategy

The content strategy of Netflix, Inc. consists of licensed and produced content. With licensed content, the company republishes video material for a fixed fee and specific windows of availability. In the early days, Netflix's content strategy exclusively consisted of licensed content. (Netflix 2022) In 2013, the company first tried a shift in its content strategy and released its first own produced drama series "House of Cards". The series became a huge success and 6 seasons have been produced (Netflix 2022). Following the hit, Netflix released further successful series e.g., "Stranger Things" in 2016, "La Casa de Papel (Money Heist)" in 2017, „The Witcher“ in 2018 or "Lupin" in 2021. Netflix's most successful series "Squid Game" was released in 2021 and managed to reach 142 million households in the first 4 weeks of playing (Tong 2021).

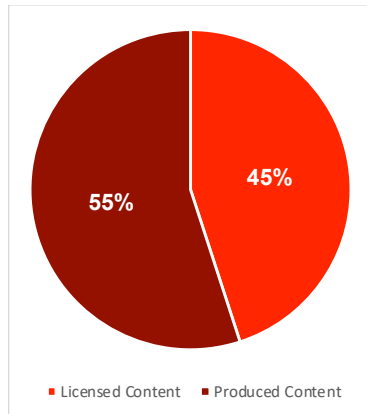


Figure 21 – Licensed vs. produced content
Source: Netflix

Over the years, the strategy had a drastic shift, going from 80% licensed content in 2017, to 45% licensed content and 55% produced content. Netflix calls their in-house produced content “Netflix Originals” and by the end of 2021, Netflix’s library offered more than 2,400 original titles. The company wants to increase its investments in global content, particularly in original content. Netflix operates various production hubs to expand its own production. As of 2022, the company produces content in Toronto (Canada), Vancouver (Canada), Shepperton (UK), Albuquerque (US), New York City (US), Los Angeles (US) and Madrid (Spain). (Netflix 2022)

Looking into the future, Netflix wants to further expand its production capacity and “Netflix Originals” titles. The reason behind this strategy is clear: maintaining and expanding the competitive position in the streaming wars. By opening further production hubs, the advantages of economies of scale will drop the production costs of its own content. In addition, vertical integration gives Netflix more control over its content and business model. Finally, Netflix Originals gives the company a strong USP. Through the successful series, the company manages to get customers to sign up for a Netflix subscription, boosting revenue, just to be able to watch these series, as they are exclusive to Netflix. A disadvantage of producing own content compared to licensed content is that investments in original content demand more upfront cash in relation to licensed content. It is more lavish and studio rents, hiring actors and production teams, etc. drive up the costs. However, if enough viewers watch a produced series, the cost-per-view drops. If the cost-per-view for produced series falls below the one of the licensed content, Netflix operates more cost-effectively producing its series in-house.

As of November 2022, Netflix is looking to invest in the sports streaming sector. The company bids include EU streaming rights for ATP tennis, U.K. rights to the Women’s Tennis Association as well as cycling competitions and the World Surf League (Reuters 2022). Netflix tried to enter the sports segment before, however, the negotiations to exclusively stream the World Surf League failed because no agreement in terms of the price for the streaming rights could be arranged. Early in 2022, Netflix tried to obtain the streaming rights for Formula 1 but failed as well due to a higher bid from competitor Walt Disney. The financial aspect will continue to be an entry barrier for Netflix. High bidding prices are Netflix main issue since other competitors are mature companies with higher power and resources. Another preponderant fact, Netflix lacks the infrastructures to live broadcast competitions such as the World Cup or Super Bowl and most of the spectators watches these kinds of events live, questioning Netflix’s platform capability to handle with many subscribers at once. It is most advisable to invest in the rights of smaller competitions, to increase spectator numbers and merchandising in order to be ready

for the bigger competitions. This would allow Netflix to increase its subscriber base as well as its ARPU by at least 20%. It is important to notice that an increase in the content assets has a decreasing effect in the price per share. This happens since the higher the acquisition of content assets, the higher will be the debt used and amortization of such assets. Since Netflix heavily relies on the acquisition and production of content assets to increase its subscribers base, the investment made has to be done in order not to have wasted investment. Despite the average industry investment grows at the CAGR of 9.90%, we have decided to use Netflix's 4-year average growth, that is the one that has allowed Netflix to be successful until now.

Ability to retain customers

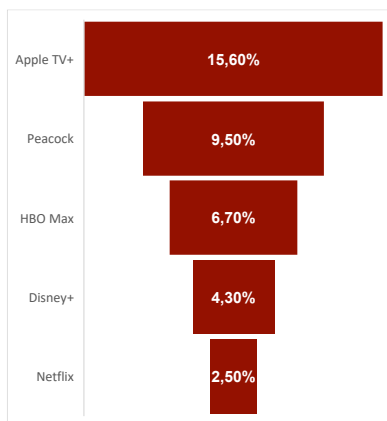


Figure 22 – Churn rates of competitors
Source: Netflix

The competition in the streaming market ensures stronger competition and more customers leaving, or changing, streaming services. To prevent these problems, customers must be constantly entertained with new content. Moreover, a lot of financial resources must be invested in marketing activities. However, the high marketing spends, which at Netflix amounts to just under 10% of revenue, and the content spend of \$ 17 bn, imply that Netflix is aware of the problems and is spending time, effort, and money on them.

When it comes to the actual customer retention, Netflix stands out with a churn rate of 2.5%. The ratio is defined as the percentage of customers that ceased using a company's product or service within a certain time period. Netflix is a leader in the market, when compared with HBO Max, one of its main competitors, that has a value of 6.7% or Apple TV+ with 15.6% (Figure 22). This means that Netflix's retention rate is 97.5%. Despite the customer loss in the first two quarters of the present year, which was accounted for in the valuation model, it is expected that the retention rate value remains for the forecasted time window. This happens because the loss of customers that happened this year was a one-time event since the beginning of the company. Therefore, there are no expectations of further loss of customers throughout the years. Historically, the number of subscribers has been increasing every year, so the most likely is that, in the case of an eventual loss of subscribers in one quarter, the increase in subscribers in other quarters will compensate such losses. This sustained growth in subscriptions, as well as the high value of customer retention rate are justified by the company's business model (Muralidharan 2022).

New Subscription Plan

Netflix has announced the launch of a new subscription plan, "Basic with Ads", to the initial days of November. The plan will cost \$ 6.99/month in the United States becoming the most affordable Netflix subscription. It will allow Netflix subscribers to

watch films and series at a lower price, but advertisements will be displayed either before or during the film or series. Regarding its specificities, the subscription will allow watching HD quality content, the same as Netflix's basic plan. The customer will be able to access the app either through a mobile phone, tablet, computer, or TV. It will also be possible to access Netflix games without ads. Moreover, there will be some unavailable films and series due to licensing restrictions and downloads will not be included (Shermann 2022).

According to Netflix, the plan will be first implemented in 12 countries: Canada, Mexico, Australia, Brazil, France, Germany, Italy, Japan, South Korea, Spain, UK, and US (Hayes 2022). These can be considered as the countries where Netflix has more subscribers and has the greatest impact on the respective market, according to Netflix's regional breakdown. There is no prediction regarding the entrance in other countries but given Netflix's history, which made its expansion into 190 countries in just 7 years, we predict that the "Basic with Ads" will be available in every Netflix country in 2025. This new plan comes as a solution for the most pointed out problem of Netflix, the high subscription price, allowing for the company to increase its market share in the following years. We have also considered that the ARPU will be the same as the average subscription price since the expected costs will be offset by the value paid for the advertisements. The new plan is not expected to require additional investment in infrastructure or additional relevant costs. Besides, Netflix does not expect any consumer shift from existing subscribers to new subscriptions, meaning that the new subscribers will be indeed new customers of the company. As previously mentioned, this new subscription plan is Netflix's response to an increasing market loss and as sports streaming broadcast still seems far from feasible, Netflix's current strategy of producing its own content seems the best way to approach the future. It is important to mention that most competitors already have ad-based plans, so it does not make sense to be introducing another one. Given that Netflix's subscription price is lower than other (\$ 6.99 vs \$ 7.99 of Disney+ or \$ 9.99 of HBO Max), the reaction of these companies will be either decreasing the price or explore new sources of income, that is what it seems to be happening. In terms of customer type, Netflix particularly wants to reach and convince budget-conscious customers. Furthermore, the economic conditions and high inflation are pushing millions of households to reduce their spending. Complementing this, Netflix wants to target the younger generation of GenZ and Millennials, who also have less financial strength. Moreover, financial strength is lower in less developed countries such as LATAM and APAC, that the new plan can serve as an engine for growth.

Revenue Decomposition

Competitor ARPU	
Amazon Prime Video	<i>n.a.</i>
Disney+	\$ 3.91
Peacock	\$ 4.55
Discovery+	\$ 7.26
HBO Max	\$ 11.25
AppleTV+	<i>n.a.</i>
Netflix	\$ 11.67

Figure 23 - Competitors' ARPU
Source: Various Sources

Netflix decomposes its revenues into four geographical regions: UCAN (North America), LATAM (Latin America), EMEA (Europe, Middle East, and Africa) and APAC (Asia and Pacific). Given the existing resemblances and availability of existing data, the same division will be applied in this equity research. There is also a separation between Domestic Streaming, International Streaming and Domestic DVD revenues. It is important to mention that UCAN has been considered as the domestic region, while the remaining belong to the international region. The value drivers considered are the number of Households with SVoD (Streaming Video on Demand), the number of average streaming services per household, Netflix's market share and ARPU (Average Revenue per Subscriber). The number of subscriptions would result from Number of households with SVoD * Number of average streaming services per household * Netflix Market Share. The value for revenue is achieved by multiplying the number of subscribers by the Average Revenue per Subscriber. To forecast the ARPU we have separated it in two: the ARPU of the existing plans and the ARPU of the new subscription plans, establishing a target weight for the forecasted time horizon. It is important to mention that each weight is dependent on the region. For example, regions with higher purchasing and economic power such as EMEA and UCAN are expected to have lower weights than for LATAM. The ARPU calculations also reflect the dollar inflation rate and local real growth for each region. Furthermore, it does not seem reasonable to increase the price of the new subscription, as Netflix wanted to offer a cheaper solution with this launch, which is often described as the company's biggest drawback. Given that this is something completely new in the market, since the majority of competitors offers two subscription plans (with ads and without ads) and have maintained this model since the beginning, there are no comparable operations. Also, the fact that the subscription plan was recently launched makes it impossible to have real information on the impact of this model in the company. Moreover, Netflix's average ARPU is the highest among the competitors, strengthening the idea that the company grows at above the industry average.

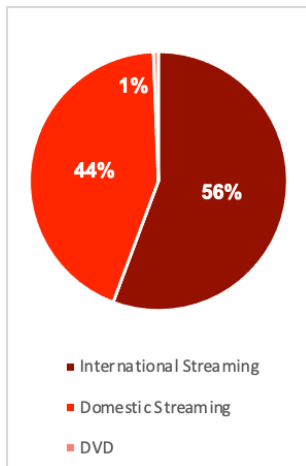


Figure 24 - Revenue Decomposition
Source: Company Forecast

DVD revenue		
	DVD revenue in m	% of Total Revenue
2017	450 497	3,85%
2018	365 589	2,31%
2019	297 217	1,47%
2020	239 381	0,96%
2021	182 348	0,61%

Figure 25 - DVD Revenues
Source: Company Forecast

Domestic DVD Revenues

When it comes to the DVD Revenues, they all have been considered domestic, since this segment only exists in the UCAN region. Even though Netflix started its business as a DVD mail delivery service, the preponderance of this segment has been steadily decreasing throughout the years, becoming a segment with almost no relevance when it comes to Netflix's revenue decomposition, resulting from globalization and technology development as well as the increase in demand of streaming video platforms. Although, there still is a group of passionate DVD users, the latter is composed in its majority by older people that are still tied to the

traditional method of viewing content, so it is expected to lose relevance as time passes. Therefore, DVD revenues expect to decrease at an average stable rate of 20.0%, mimicking the last four years' trend, from a value of \$ 365.6 m in 2018 to \$ 151.9 m at the end of the current year and \$ 21.9 m by the end of 2032. These values are in line with the industry evolution that has dropped more than 86% in the last 13 years and growing at a CAGR of -28.8% over the analysis period.

Domestic Streaming Revenues

Regarding Domestic Streaming Revenues, we only need to take into consideration the evolution of UCAN. UCAN presents itself as the main market for Netflix, accounting for almost 45% of the total revenues and 32% of the total number of subscribers in the present year, with these values slightly decreasing in the future to 44% of total revenues and 30% of the total number of subscribers. The projected number of households with access to SVoD was forecasted based on several factors. We took into consideration the total population in the area and its access to SVoD. According to the World Data Bank, is estimated that 85% of UCAN population has access to streaming services. This value is expected to reach 90% by 2031. This way, we predict a constant growth rate increase of 0.5% through the forecasted time horizon. In addition, the number of people per household were forecasted, in order to get the final value of SVoD households. Given that in UCAN, the average household size currently is 2.80, divided by the 315.3 m users in 2021, a value of 112.6 m SVoD households were obtained. It is important to mention that to forecast the number of people per household a population growth rate for each region was used, as there is a linear relationship between population growth and the number of people per household. When it comes to the average streaming services per household, the current value of 3.6 in the present year will constantly grow until it reaches the mark of 4.0 by 2032. This can be explained by factors such as the fact that UCAN is the most mature and largest market for Netflix, that there are the most streaming video providers in this region and therefore more competition, with many having their headquarters in the US. Also, people are spending more and more time at home and are looking for new entertainment alternatives. In addition, the increase in the SVoD penetration rate from the current value of 45% to 60% in 2032, shows a higher acceptance of streaming platforms, increasing its average number per household. Concerning market share, a significant decrease was observed, from 30% in 2018 to 20% in 2021, due to the large number of available options potentiated by the COVID-19 pandemic. Given the negative results in both Q1 and Q2, where Netflix lost almost a million subscribers it is expected that the company's market share slightly decreases by 1.5% to 18.5% in the present year. Additionally, the increase in subscribers is mainly due to the great third quarter where the number

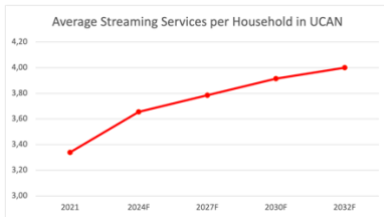


Figure 26 - Average Streaming Services per Household in UCAN
Source: Mountain.Com

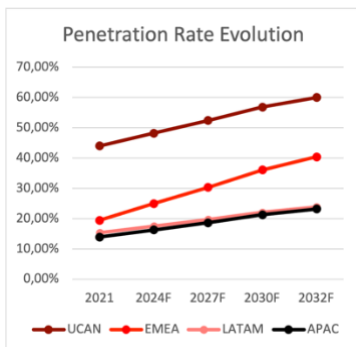


Figure 27 - Penetration Rates Evolution
Source: Statista

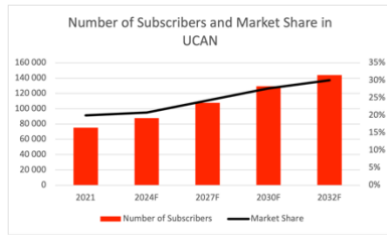


Figure 28 - Number of Subscribers and Market Share in UCAN
Source: Company Forecast

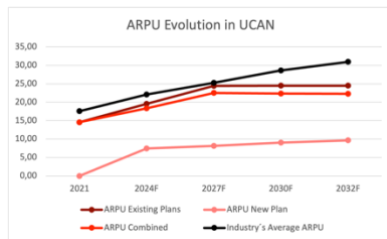


Figure 29 - ARPU Evolution in UCAN
Source: Company Forecast

of customers has increased beyond expectations, since the last quarter of the year historically is the one with worst figures. Besides, the new subscription, that although being launched this year, will only reveal its true effects in the following years, but will allow Netflix to recover its market share to 30% by 2032, returning to the pre-COVID values where Netflix was a clear leader in terms of market share, with a total of 114.1 million subscribers. As it can be observed the ARPU has the highest value in this region since is where the market size is bigger and more mature. Also, the better economic conditions as well as the fact that the company is headquartered in this region contribute to this ARPU value. In UCAN, the new subscription plan will have a weight of 15% by 2032, with the first two years of the implementation being the one with a higher accession by the public since is a new thing in the market, constantly growing onwards. ARPU of existing plans is expected to increase by a four-year average of 10.5% for two years, as this rate takes into account pre-COVID development and Netflix's adjustments to it and reflects the industry and company's response to the pandemic. Following the two years where the new plan has its higher impact and attracts more subscribers for Netflix, the ARPU will grow at the industry's revenue CAGR of 7.7%, since UCAN'S ARPU has constantly increase below the industry's one, at around 12%. From then on, the ARPU will grow at the adjusted inflation rate of 4%, similarly to the industry that will suffer a slowdown. When it comes to the new subscription plan, there will be no change in its price and will grow at the adjusted inflation rate. It is important to mention that in the long term the ARPU is expected to slightly decrease because of the new subscription plan. However, the gain in subscribers will offset the lost in the ARPU, explaining the forecasted growth in revenues. This way, the 2021 ARPU of \$ 14.4 is expected to reach its maximum in 2027 and 2028, with a value of \$ 22.5, slowly decreasing to \$ 22.3 in 2032.

International Streaming Revenues

When it comes to International Streaming Revenues there are 3 regions that must be considered and that will be individually analysed: EMEA, LATAM and APAC.

EMEA

EMEA (Europe, Middle East, and Africa) is the second largest market of Netflix, little behind UCAN. Currently has 74.0 m subscribers, generating around \$ 9.7 bn now. The evolution and behaviour of this region is highly correlated with the behaviour of Europe because of the 74 m total Netflix subscribers in 2021, 60 m were from Europe, corresponding to 81% of the total. Despite being the second largest market, this will rapidly change. Firstly, it is expected that by the end of the present year EMEA has surpassed UCAN in terms of subscribers, and that the overtaking in

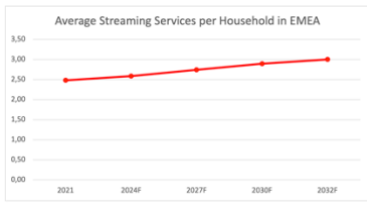


Figure 30 - Average Streaming Services per Household in EMEA
Source: Company Forecast

revenues happens in 2027. This leads us to conclude that EMEA presents itself as the region that shows the highest growth potential both in total number of subscribers and revenues, in absolute terms, because of the bigger population and market users. Normally, Africa and the Middle East are always two regions with a lot of potential due to their underdeveloped economies, but that is not the case in this instance, as both places are still missing basic parts of technological development and where services like these are considered luxury services. To forecast the number of existing households with SVoD the same technique as in UCAN was used. Due to the high growth potential and margin available for the industry to grow, we believe that this growth is sustainable and stable through the time window forecasted. The average number of people per household has been weighted averaged to account for the largest impact of Europe as a whole, resulting in an increase in SVoD households from the current 92.5 m to 152.7 m by 2032. As to the average number of streaming services per household, the current value is 2.38, reaching 2.48 in 2032, for the same previously mentioned reasons. Netflix's market share in EMEA is expected to have a similar behaviour as the one in UCAN, due to the similarities of both regions' main markets. In the current year a market share loss of 1.5% is expected, strongly influenced by the negative results obtained by the company in Q1 and Q2 of the year. An increase in the market share of this region is expected until it reaches the mark of 45% in 2032, given the small number of alternatives when compared to UCAN, being a market where Netflix is a forefront leader, followed by its main competitors worldwide (Disney+, Amazon Prime and HBO Max). This will result in an increase in the number of subscribers from the current 74.0 m to 206.1, in 2032. Similarly, to UCAN, there will be a significant increase in penetration rates in every subregion, where Europe is expected to have the higher one, more than doubling its current value of 22.2% to 44.8% in 2032. As previously mentioned, Netflix will only start to notice the impact of the new plan in 2023, as the time between the plan launch and the end of the year is quite short. Due to the existing similarities between UCAN and EMEA, the new subscription plan expects to have the same short-term impact as in UCAN. The higher weight of the new subscription plan is explained by the impact of Africa and Middle East, that with lower economic power will have most adhesion to the plan. Similarly, to other regions, it is expected that the ARPU of the new plan does not suffer any changes and will grow at the adjusted inflation rate. Regarding the ARPU of the existing subscription plans, it is expected to increase at the 4-year average rate of 5% in the first two years. Following that and until 2027, the ARPU will grow at the industry revenue CAGR of 4.2% slightly above to the industry's ARPU CAGR for this time window (2022-2027) of 3.9%, since Netflix's ARPU in this region has been constantly higher than the average industry's one and is expected to continue as

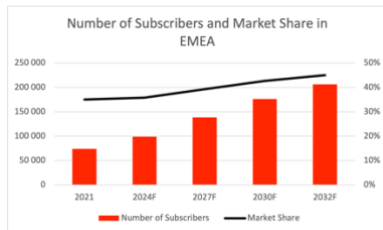


Figure 31 - Number of Subscribers and Market Share in EMEA
Source: Company Forecast

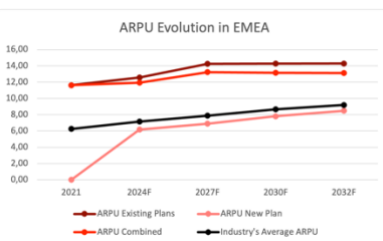


Figure 32 - ARPU Evolution in EMEA
Source: Company Forecast

that. This happens because of Netflix’s maturity, efficiency of processes and lack of competitors that could make Netflix to decrease its ARPU. From 2027 onwards, ARPU will increase at the adjusted inflation rate in the remaining years of the prediction where the current value of \$ 11.1 will reach \$ 13.7 in 2032.

LATAM

LATAM (Latin America) can be considered the third largest region for Netflix with approximately 40 m subscribers that currently generate total revenues of \$ 3.5 bn. The lowest number of SVoD households (23.6 m) among all regions can be explained by factors such as the lowest value of people with access to internet among all regions, the low penetration rate (16.0%) and a high number of people per household (4.0), indicating an underdevelopment of this region. The average number of streaming services per household is expected to increase from the current 2.5 to 2.8 in 2032. Such increase can be explained, not only by other factors previously stated, but also by the entrance of new competitors in the market, which will result in a higher demand from customers and the slowly recovery of the Latin American economy is other factor that weighs significantly in this number. Still, it is the region that has the lowest increase in this variable due to its economic conditions. When it comes to the market share, this region presents a contrary trend. Despite being where Netflix has more dominance in terms of relative numbers, a sharp decrease is expected in the following years because of the increase in the number of competitors and appearance of cheapest subscription packages. According to WorldScreen, the 78% market share in 2021 was expected to decrease to 41% in 2027 (Daswani 2022). Since the announcement of the new subscription plan was after such previsions, we expect Netflix’s market share to decrease, but at a slower pace than initially predicted, only reaching the 41% in 2032. Still, it is expected that Netflix will be gaining subscribers throughout the forecasted years. Regarding the new subscription plan, it is expected that it will have a weight of 30% in the total ARPU in 2032. This happen because regions with lower economic power have the necessity, and consequently, higher demand for cheaper plans. This way and following the same pattern, it is expected a higher increase in weight in the first two years following the introduction of the plan due to its implementation in the main markets of the region and interest in it. When it comes to the ARPU value, it is expected to increase throughout the time at the adjusted inflation rate. Existing plans’ ARPU is expected to decrease due to a negative 4-year average rate of -2.9% in the first two years of the predictions. In the years of 2023 to 2027, it is expected a sharp increase in the ARPU at the LATAM Media Streaming Market CAGR to 10.2% at region’s main market (Brazil) Media and Entertainment industry CAGR. Since Netflix’s ARPU has been constantly above the industry’s average, we

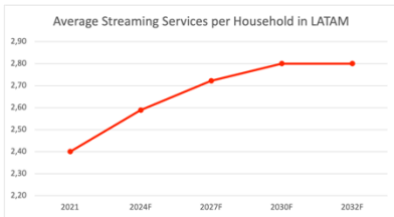


Figure 33 - Average Streaming Services per Household in LATAM
Source: LabsNews.com

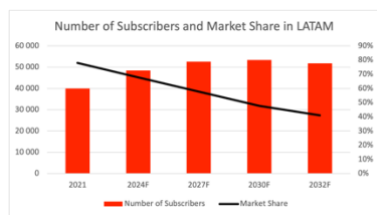


Figure 34 - Number of Subscribers and Market Share in LATAM
Source: Company Forecast

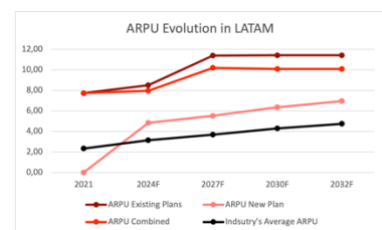


Figure 35 - ARPU Evolution in LATAM
Source: Company Forecast

agreed that the average ARPU CAGR for this interval (7.9%) would not reflect the real growth. Also, the ARPU of the existing plans starts to increase a year earlier than in other regions since we expect that it will attract subscribers for every plan since the moment of the new plan’s release. In concordance with other regions, from 2027 onwards, the ARPU will increase at the adjusted inflation rate. Being the region with the least favourable economic scenario, it makes sense that it presents the lowest ARPU from all the existing regions as well as average subscription price, with a current value of \$ 7.1 that is expected to reach \$ 10.1 by 2032.

APAC

Finally, the results presented by this region are heavily influenced by the dynamics of Asia, due to the small representation of Oceania and the Pacific Islands. APAC is the region that presents both the lowest number of subscribers and revenues for Netflix. This can be justified by the fact that there are countries that adopted strict rules regarding the entrance of new competitors, such as China, that is not included in the group of countries that are licensed to stream Netflix content. In addition to this, APAC’s SVoD penetration rate is the lowest from all regions (14.7%). Having this in mind, the low number of SVoD households (92.9 m) is justifiable, since a large portion of the market is lost due to China’s exclusion. According to Netflix, there are no immediate plans to launch in China due to, among others, low prices, fierce competition, censorship, and existing content restrictions. Anyways, the rest of the territories have a significant potential for Netflix and that is why we predict that APAC surpasses LATAM in terms of revenues by the end of this year (\$ 3,998.8 m in APAC vs \$ 3,728.9 m in LATAM) and in subscribers by 2027 (55.8 m in APAC vs 52.5 m in LATAM). When it comes to the average number of streaming services per household, we can observe that this is the lowest value of all the existing regions with the current value of 2.0. The rise of multi-subscription households in this region and the fact that the group of 2-3 streaming services is becoming the mainstream, makes us believe that will achieve the value of 3.0 by 2032. When it comes to APAC’s market share, it is the lowest from every Netflix region. This can be explained by the previously mentioned entry restrictions. This allows for the national companies to be the most dominant in such countries, potentiating them. The current market share value of 18.7% is expected to gradually increase to 25% in 2032. Even with such restrictions, the remaining market is somewhat unexplored, having potential for Netflix to increase its presence in this region. Furthermore, and in similarity with LATAM, the weight of the new subscription plan is forecasted to be 30% by 2032. When it comes to the specific value of the new plan’s ARPU, there is not any prediction towards its increase since the new subscription price is expected to remain the same, only being influenced by the adjusted inflation rate. On top of

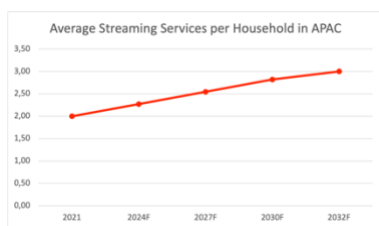


Figure 36 - Average Streaming Services per Household in APAC
Source: LinkedIn



Figure 37 - Number of Subscribers and Market Share in APAC
Source: Company Forecast

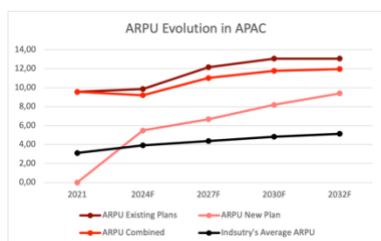


Figure 38 - ARPU Evolution in APAC
Source: Company Forecast

that, the ARPU of the existing subscription plans is forecasted to increase at the 4-year average rate of 0.3% in the first two years of the predictions, followed by 5 years in which it will increase at the Media and Entertainment market CAGR of 7.2%, growing at the adjusted inflation rate from then onwards. Again, and because Netflix's ARPU is constantly above the average one from the industry, it is applied a higher growth rate than the industry's average ARPU CAGR for this period (5.9%). It is important to point that this is the only region that is expected to continuously increase its ARPU value in the long term. After a decrease from \$ 9.2 in 2022 to \$ 8.9 in 2023, we expect this value to reach its maximum in 2032, with a value of \$ 12.0. Although there are some entry barriers in this region, as previously said, this region is the one with higher local real growth forecast, demonstrating the region's potential, giving us a basis to believe that it will surpass LATAM both in number of subscribers as well as revenues during the forecasted time window. Additionally, APAC will increase from 32.6 m subscribers generating \$3,266.6 m in 2021 to 80.3 m subscribers contributing with \$11,532.8 m in 2032.

Cost of Revenue

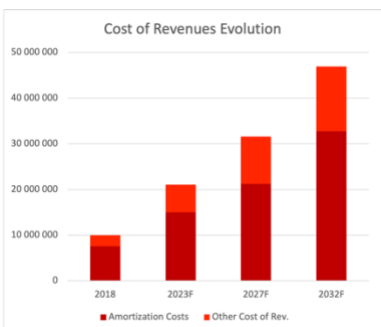


Figure 39 - Cost of Revenues Evolution
Source: Company Forecast

The position "Cost of revenues" represents Netflix's highest cost and can be separated into "cost of revenues" and "other cost of revenues". Most of the cost of revenues account to the amortization of content assets. The amortization period of content assets is based on an estimate of future viewing patterns which in turn are predicated on historical and forecasted viewing. If the actual viewing pattern differs from the aforementioned strategy, the amortization period will be readjusted. To forecast the amortization of content assets, a ratio between the cashflow statement positions "Amortization of content assets" in period t and "Additions to content assets" in period t-1 was established. This shows the timing disparities between cash payment on content and the recognition of content expenses. For 2021, a value of 0.78 was obtained, and used as a proxy for consecutive years. Regarding "Cost of Revenues", a ratio between the amortizations of the period and the cash spent in the same period was used, with a value of 0.71, in line with the value of the previous years.

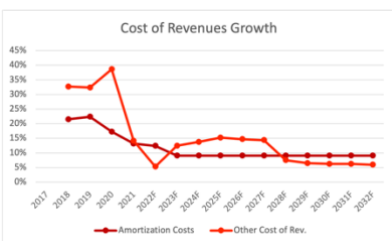


Figure 40 - Cost of Revenues Growth
Source: Company Forecast

Other costs of revenue include expenses directly associated with the acquisition, licensing, and production of content. The latter, for instance, includes personnel expenses, costs for music rights, various production costs like participations and residuals. Analysing the streaming revenues in relation to the other cost of revenues over the previous 5 years, a stable measure of around 16% was observed and used as proxy for the forecast years. By comparing Netflix's COGS/Revenue ratio with the sector average, a much higher KPI is obtained. The industry average is at 35.5%, whereas Netflix is at 58.3%. This is due to the fact that Netflix includes the

depreciation of content assets in the cost of revenue. If we adjust the ratio by the depreciation, Netflix is performing at industry level. Forecasting and add up both components of the cost of revenue, the position will pass \$ 20 bn by 2023 and \$ 45 bn by 2032.

Marketing, Technology and SGA Forecast

Netflix is renowned for handling most media internally, like marketing strategy, content, and PR. The tech-focused business gives no indication to change their current handling of the marketing strategy. Marketing expenses consist primarily of expenses for advertising or payments to marketing partners. Advertising expenses include digital and television advertising. Personnel costs for marketing related activities are also included in the caption (Netflix 2022). To forecast beforementioned expenses, amounted to an average of 13% between 2017-2019. In the consecutive two years, the ratio decreased to 9%. Due to the expected revenue increase, a constant level of 7% is determined for future marketing costs reaching \$ 6.2 bn by the end of the forecasting period in 2032.

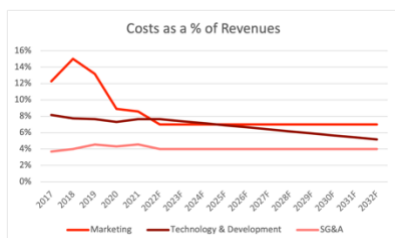


Figure 41 - Costs as a % of Revenues
Source: Company Forecast

Technology and development expenses consist primarily of payroll and related expenses for technology personnel. In addition, costs for hardware and software, infrastructure, development of user experience and interface are included. (Netflix 2022) Between 2017 and 2021, the costs have been on average 7.7% of the total revenues. Technology and development costs are expected to decrease, as the company becomes more efficient in its operations in future years. Furthermore, larger companies tend to spend lower percentage of revenue on IT expenses (approximately 3.2%) (Morlen 2022), thus the ratio is decreasing by 0.25% per year to approach this metric. In absolute terms, the costs will surpass the \$ 4 bn mark by 2027. Relatively speaking, Netflix's R&D costs are 50% below the industry average, as competitors spend 15.1% of their revenues on R&D (Damodaran 2022).

SG&A expenses mainly consist of payroll and expenses, professional fees and other general corporate expenses (Netflix 2022). In the past 5 years (2017-2021), the SG&A expenses accounted on average for 4% of the total revenues. There is no change expected in the percentage relation to turnover. Comparing it to the sector average, Netflix has very low spending. Netflix is more than one third below the sector average of 17.9%, showing high operating efficiency. (Damodaran 2022).

Assets and liabilities

When it comes to the company's balance sheet, the Invested Capital is increasing every year, more than doubling until the end of the forecast (approx. \$ 27 bn in 2021 to more than \$ 70 bn in 2032). This is mainly influenced by its core business, that



Figure 42 - Invested Capital Forecast
Source: Company Forecast

represents a 92% of the total invested capital. The Invested Capital is primarily driven by the content assets and the content liabilities. The first includes costs for the licensed and self-produced content of the company. In 2021, total content assets amount to \$ 30.9 bn, which indicates 69.3% of the total assets recorded on the balance sheet. The content liabilities are costs for content for which payment has not yet been made. In 2021, these amounted to \$ 7.4 bn, respectively 25.7% of total liabilities.

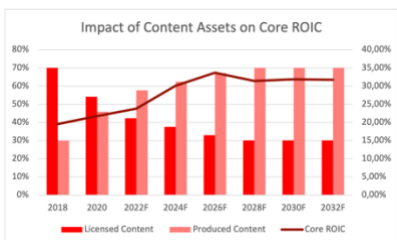


Figure 43 - Impact of Content Assets on Core ROIC
Source: Company Forecast

Regarding Content Assets, for the years 2022 till 2027 the average growth of the previous years was used, amounting in a strong increase of 15-20% per year. This growth ratio is significantly higher than the industry CAGR of 9.9%, implicating the high growth of Netflix and its strategy of content differentiation and supply. The year 2027 was chosen as the final year of that growth analysis, as the industry will most likely stabilize there, and streaming wars will be largely over. From 2028 onwards, the content assets are set at the inflation forecast of 3.2% as growth rate till the end of the forecasting period. Regarding the split between licensed and produced content we expect a strong deviation of the two categories. By 2028, a ratio of 70.0% produced content and 30.0% licensed content will be reached and maintained until the end of the forecast period in 2032. Historically, with exception for the year of 2018, it can be observed that a different composition of content assets results in different ROICs. The increase in the weight of produced content results in an increase in the ROIC, due to the fact that produced content does not have any other cost rather than its production costs, while with licensed content there is an annual fee paid to the producer. In addition, Netflix's best successes are the ones that were produced by the company.

Over the past years, the company has financed its growth using a lot of leverage. The main expenditure fell on the expansion of the content library. Since the end of 2021, the company no longer requires debt financing for its day-to-day operations. Netflix's cash flows are expected to be positive for the next few years and a reduction in debt is imminent. For the year 2032, a D/E ratio of 0.15 is targeted, which corresponds to the industry average of the media & entertainment industry. In absolute terms, the debt volume will fall from \$ 17 bn in 2022 to \$ 11 bn within the next decade.

The content liabilities are the costs related to the streaming content, and therefore correlating with the content assets. In order to forecast them, a ratio between content liabilities and content assets was established. The average of the previous 5 years was used for the consecutive forecast years. The gathered ratio is 0.35, which indicates content liabilities of \$ 13.2 bn in 2022 and \$ 34.6 bn in 2029.

Furthermore, Netflix’s expansion will require additional infrastructures. Since the already made household improvements, to the renewal of the lease contract for the Vancouver Hub or the expansion in South Korea, the value of the PP&E is expected to continually increase, as it has in the past. Therefore, the current value of \$ 1.5 bn is expected to reach \$ 3.2 bn by 2032.

Performance Analysis

Profitability

The operating margin of Netflix reveals a strong upwards trend in previous years. In 2017, the operating margin was at its weakest point at 7.2%. From there on it increased to 20.9% by 2021. Regarding the forecasting period, the ratio will grow to its peak, above the sector average of 31.1%, at 32.0% by 2027 and have a slight decrease for consecutive years due to the expected market saturation in this year (Damodaran 2022). When compared to the main competitors, Netflix outperforms them, still below the industry’s one but with prospects to surpass it as previously mentioned. The gross margin displays similar the same course, growing from 31.3% in 2017 to 49.4% in 2027. This development can be observed by the faster increase of revenues than costs due to the exploitation and penetration of high potential markets. However, after 2027 a slight decrease of 4.5% till 2032 is expected. The company is not able to achieve the high industry average for the US entertainment sector of 64.4% (Damodaran 2022). Netflix is surpassed by two of its main competitors, but the growing trend associated to the forecasted increase demonstrates Netflix’s ability to position in front of its main competitors.

Netflix’s net margin demonstrates a strong increase from 4.8% in 2021, to 16.9% for the present year. The positive momentum is set to continue and improving the net margin to above 20% for the following years. Analysing the margins by geography, UCAN demonstrates the most profitable margins, followed by EMEA and LATAM. APAC exhibits the relatively lowest margins, nevertheless all regions are very profitable.

The return on assets shows a nearly ninefold increase in the considered period between 2017 and 2032 with a growth from 0.03 to 0.18. In addition, is the highest when compared to its main competitors, above the industry average. This provides a clear image that Netflix content strategy is successful and can be sustained through the forecasted years. The return on equity displays a different evolution. The average ratio of 0.34 between 2022 and 2026, is followed by a decrease of the RoE for the consecutive years until 0.27 in 2032. The main reason behind that is the decreasing level of debt in the long term, which Netflix wants to establish due to the

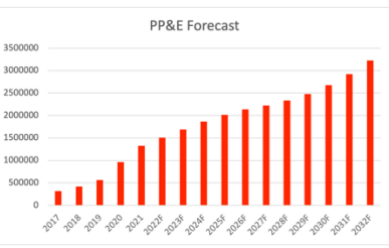


Figure 44 - PP&E Forecast
Source: Company Forecast



Figure 45 - Operating Margin vs Competitors
Source: Company Forecast

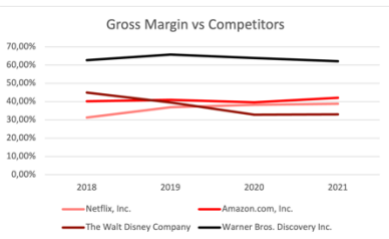


Figure 46 - Gross Margin vs Competitors
Source: Company Forecast

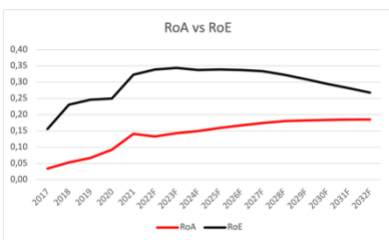


Figure 47 - RoA vs RoE
Source: Company Forecast

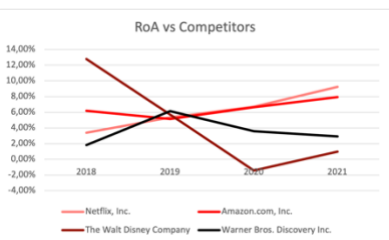


Figure 48 - RoA vs Competitors
Source: Company Forecast

highly levered capital structure in past years. According to Damodaran, the US entertainment sector average RoE is around 0.31 (Damodaran 2022), which Netflix outperforms till 2028. Making the comparison its main competitors, Netflix has the highest RoE, closely followed by Amazon. Thus, the company is the most efficient in converting its equity financing into profits. The convergence of both in the long term, as well as the deacceleration in its growth can be justified by the industry's slowdown.

Liquidity

Netflix liquidity was analyzed using the current, quick and cash ratio. Since Netflix does not own any kind of inventory, the quick and current ratio are equivalent. The current/quick ratio demonstrates a strong decrease from 1.40 in 2017 to 0.88 for the current fiscal year. When comparing to its peers, Netflix's current ratio is one of the lowest, despite the apparent convergency of values towards 0.88. The differences from the previous ratio to the quick ratio are almost none, since two of the main competitors do not have inventory (Netflix and Warner Bros). The most relevant change comes from Amazon as expected, since as being in the product distribution industry has the necessity to have high level of inventory, and as a consequence the lowest quick ratio. The cash ratio is currently at 0.72 in 2022, showing a stable development course to 0.71 until 2032. The company will most likely use the reserves for investments or distributions to shareholders at some point, but no such indication can be given at the present time. Despite the decreasing trend in the evolution of these ratios throughout the forecasted time horizon, their values are still relatively close to 1, indicating that Netflix has the capacity to transform its assets into cash and readily available cash to pay short-term debt.

Financial Leverage

When it comes to Netflix's D/E, we can observe a continuous decline from 2019 onwards, after an increase in the previous years. Netflix's expansion years required high capital, resorting to borrowed funds, therefore the high D/E in 2019 (1.98). This risky strategy has been successful, since according to Netflix's CEO, the company does not need any more debt to survive. This way, and as the company has significantly reduced its D/E ratio, the value can reach the industry's average of 0.15 by the end of the forecasted time frame. Consequently, the debt to EBITDA ratio will follow the same tendency as the D/E since the value of debt has a lower weight, reaching the 0.19 by 2032. Contrarily, the Interest Coverage Ratio will have an exponential increase as the interest expense decreases and the EBIT grows as a result of the company's increasing revenues, with a value of 50.21 in 2032. When comparing to its main competitors, we can observe that Netflix is a leader in both

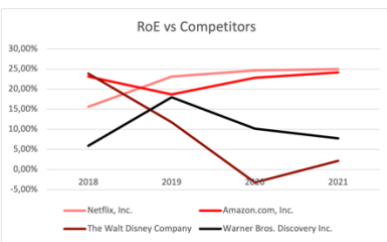


Figure 49 - RoE vs Competitors
Source: Company Forecast

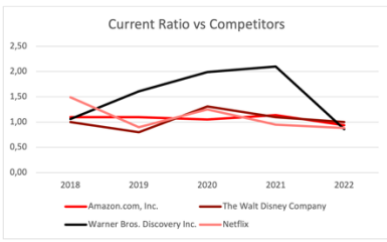


Figure 50 - Current Ratio vs Competitors
Source: Company Forecast

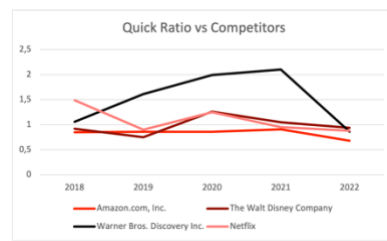


Figure 51 - Quick Ratio vs Competitors
Source: Company Forecast

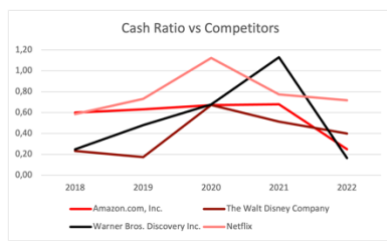


Figure 52 - Cash Ratio vs Competitors
Source: Company Forecast



Figure 53 - Netflix's Financial Leverage Ratios
Source: Company Forecast

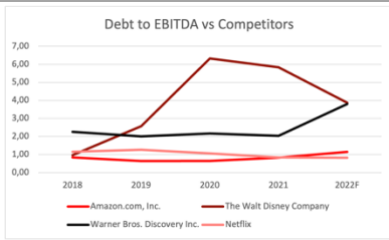


Figure 54 - Debt to EBITDA vs Competitors
Source: Company Forecast

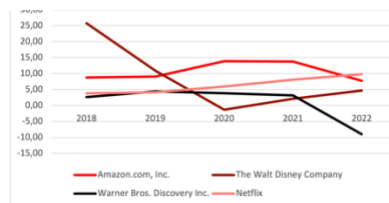


Figure 55 - Interest Coverage Ratio vs Competitors
Source: Company Forecast

Debt to EBITDA and Interest Coverage Ratio. This leads to the conclusion that in the case of the need of additional financing, Netflix presents as a good option.

Taking into consideration Netflix's performance in every variable of this performance analysis, the company seems financially healthy, with good growth prospects and margins, reflecting its potential as being promising to investors.

Valuation

WACC – Weighed Average Cost of Capital

For gathering the EV of Netflix, Netflix's core FCF gets discounted by the Weighted Average Cost of Capital (WACC). The capital structure used is not the current D/E of 4.2%, but the sector average of 15.2%, as this represents the long-term D/E of the entertainment industry. The company's default probability (1.55%), yield-to-maturity (4.62%), for which the 10-year fixed coupon corporate bond was taken as proxy, and the loss given default (46.10%) result in a cost of debt of 3.91%.

Cost of Debt	
Netflix rating	Ba3
YTM	4,62%
Probability of default	1,55%
Loss given default	46,10%

Figure 56 – Cost of Debt calculation
Source: Company Forecast

As Netflix has been pursuing strong international growth for years, 4 years of daily return data of Netflix stock and S&P500 index were observed for the beta estimation to provide an accurate estimation. The levered beta obtained via a regression amount to 0.7. Analyzing the rolling beta, a minimum of 0.47 was observed during the COVID-19 pandemic, whereby the maximum of 2.95 acts as an outlier without specific reasoning. Since the competitors pursue a different core business and are not exclusively active in the streaming sector, a comparison of the betas of the peers is misleading. Incorporating Netflix long-term capital structure by unlevering and relevering the beta, a final relevered beta of 0.76 was obtained. Given, the average beta for US entertainment companies of 1.01 Netflix beta seems reasonable. (Damodaran 2022).

Beta	
Levered Beta	0,70
D/E	0,04
Effective Tax Rate	17,72%
Unlevered β	0,67
Target D/E	0,15
Relevered β	0,76

Figure 57 – Beta calculation
Source: Company Forecast

The cost of equity the CAPM (capital asset pricing model) include the market risk premium, risk-free rate and beforementioned levered beta. The MRP of 6.86% is calculated by subtracting the risk-free rate, proxy used is the 10-year US treasury bond, from the expected market return, proxy used is the average return of the MSCI World between 1978-2022. Using all gathered information in the CAPM, we derive at cost of equity of 9.51%. Netflix cost of Capital are slightly above the industry's average of 7.66% due to the highly levered capital structure. (Damodaran 2022) Including all gathered components in the WACC calculation a value of 9.25% is derived.

WACC	
Re	9,51%
D/EV	0,04
E/EV	0,96
D/E	0,15
Rd	3,91%
Corporate Tax Rate	21,00%
WACC	9,25%

Figure 58 – WACC calculation
Source: Company Forecast

FCF – Free Cash Flow

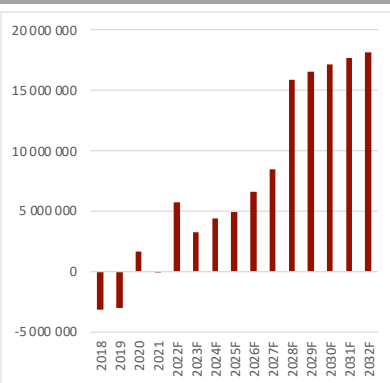


Figure 59 – FCF forecast
Source: Company Forecast

For an accurate valuation of Netflix share price, the free cash flow has been calculated. For 2018 und 2019 the FCF was negative around the \$ 3 bn mark. In 2020, the FCF became positive with a value of \$ 1.6 bn in the consecutive year it turned slightly negative again. While the operational cash flow in 2021 remained at similar levels as in 2020, the investment cashflow decline resulting in negative values. Due to the recent development of the last two years and the positive outlook for the future a positive FCF value is predicted for 2022 and onwards. By the end of the forecasting period, a value of \$ 18.1 bn is projected.

Growth, Reinvestment Rate, ROIC

Netflix growth rate was calculated from its reinvestment rate and return on invested capital (ROIC). While the growth rate is quite high in the mid-term, reaching a maximum of 24.8% in 2025, it decelerates in the long-term and terminates at 2.8% in 2032. The obtained growth rate serves at the stable growth rate for the consecutive years after the forecasting period and was therefore used as the terminal growth ratio.

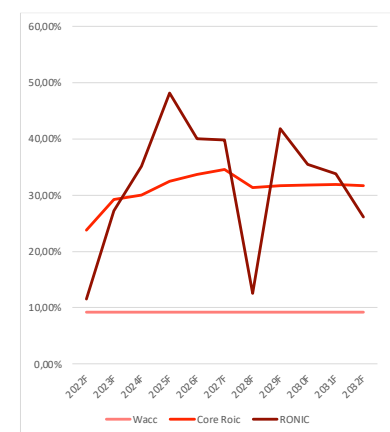


Figure 60 – Comparison of ROIC, RONIC and WACC
Source: Company Forecast

The reinvestment rate demonstrates a decreasing development, starting from 470.1% the ratio will decrease to 324.3%. This development is a result of Netflix successful implementation of new strategies and forecasted increasing revenues. Accordingly, the core invested capital is not growing at the same pace as the core result and a deterioration of the ratio is the consequence. The high reinvestment rate is particularly relevant for Netflix. Being one of the biggest players, continuous investments in the company and its operations are necessary to maintain and expand market leadership. The industry average reinvestment rate is at 46.68%.

The Core ROIC – return on invested capital - is set be 23.7% for the year 2022, before rising to 31.7% over the forecast period. As ROIC is higher than the cost of capital, like in the case of Netflix, the company indicates healthy growth and sustainable value-creation The value driver of this KPI is the content strategy once again. It demonstrates the profitability and right asset allocation of capital in the long term. Due to the strong investment in content assets, video content is created which, once produced, no longer produces costs but remains available and expands Netflix's offering. This is particularly positive for the development of ROIC and return on equity. In the year 2023, Netflix ROIC surpasses the software/entertainment industry average of 25.5%. (Damodaran 2022) Having a look at Netflix direct competitors, the company operates more profitable than it peers, outperforming all of them, demonstrating a strong value creation for its shareholders. However, it must be taken into account that their business models are divergent and the peers are untransparent about their streaming sectors financials.

ROIC	
Netflix, Inc.	27,06%
Amazon	15,98%
Disney	2,35%
WamerBros	5,83%

Figure 61 – Competitor ROIC comparison
Source: Company Forecast

Comparing the ROIC of the entire company with the ROIC of the core business, an equal trend line can be identified. The core ROIC logically has higher values than the overall ROIC. This again shows the operational efficiency of the core business and the efficient use of resources and capital. Core ROIC is therefore the driving force behind the analysis and the associated value creation. In absolute terms, the ROIC achieves a maximum value of 28.6%, whereas the Core ROIC reaches 34.7%.

To further analyze value creation, RONIC must also be considered. Especially the comparison with the WACC is considered to see the cost of capital for an investor in relation to the returns. For 2021, the RONIC is at a low level of 11.6%. This is due to the negative impact of the Corona pandemic and the generally challenging year for Netflix. Looking ahead, the RONIC is showing a positive trend. The maximum RONIC of 48.2% will be reached in 2025, when the new subscription plan is introduced worldwide. Increased investment in content strategy is also boosting RONIC. In summary, the RONIC is always above the WACC, which means that Netflix is creating value for its shareholders. In 2028, due to the expected market saturation, the RONIC will decrease before increasing to over 25.0% for the final forecast years.

Sensitivity analysis

Using the DCF method as a valuation method has a major disadvantage. While minor changes in the FCF don't impact on the valuation strongly, changes in the WACC or growth rate do have a substantial impact on the share price of the company. To analyze these changes, a sensitivity analysis for the beforementioned variables was conducted. In the analysis, the growth rate ranges from 1.82% to 3.82%, whilst the WACCs range is between 7.25% and 11.25%. The initial valuation, using a WACC of 9.25% and growth rate of 2.82%, implies a share price of \$ 357.48. The worst-case scenario would occur if the WACC is at the higher end and the growth rate the lowest end. Analyzing this case, a lower end share price of \$ 232.62 was observed. Vice versa the upper end of the company's stock price indicates a value of \$ 697.93. Given the significant deviation between the upper and lower share price end, it can be concluded that Netflix share price is highly sensitive to changes in these variables.

		Perpetual Growth Rate				
		1.82%	2.32%	2.82%	3.32%	3.82%
W A C C	7.25%	482.87	525.27	566.11	603.91	639.91
	8.25%	389.87	412.79	442.22	476.20	507.98
	9.25%	322.66	338.81	357.48	379.31	404.51
	10.25%	272.01	283.37	296.26	311.01	328.05
	11.25%	232.62	240.86	250.07	260.45	272.21

Figure 62 - Sensitivity Analysis
Source: Company Forecast

Scenario analysis

To evaluate a proper scenario analysis, three factors need to be considered. Subscriber growth and revenue growth were considered as the two main risks. Also, there is a relation of dependency between both, since revenue growth will be directly impacted by subscriber growth, and Netflix's ability to retain, and gain, customers.

Change in ARPU			
ARPU	Pessimistic	Base Case	Optimistic
Price per share	176,09	357,48	603,93
Weight	20%	60%	20%
= Price per share	370,49		

Figure 63 - Scenario Analysis with Change in ARPU
Source: Company Forecast

Netflix's investment in content assets is subject to uncertainty, since if there is any change of strategy this is the main line to be adjusted. Therefore, this analysis was conducted considering the three variables that are more subject to uncertainty: Average Revenue Per User (ARPU), Market Share and Content Assets Growth. Regarding ARPU and its optimistic scenario, we have assumed that the ARPU grows at the four-year average rate (2018-2021) of 10.5% from 2022 to 2027, where the growth rate decreasing at a constant rate until 2032, when it reaches 0% and the ARPU grows at the inflation rate, in UCAN. In EMEA, the same logic was applied, with the difference that the 4-year average rate is 5%. In APAC, instead of using the 4-year average rate, the Media and Entertainment CAGR was used, with a value 7.2%. Finally, in LATAM, after a year of 2022, where the 4-year average rate is used (-2.9%), from 2023 until 2027, the ARPU grows at the CAGR of the industry in that region, at 17.7%. From then on, and similarly to the remaining regions, the ARPU decreases until 0% in 2032, growing at the inflation rate. This results in a price per share of \$ 603.93. In the pessimistic scenario, the outlook is different. We have considered that the ARPU would grow at a constant rate from 2022 until 2028, where from then on would increase at the adjusted inflation rate. In UCAN, a growth rate of 5% was used, whereas in EMEA, the value of 2.5% (half of the 4-year average growth rate) was chosen. Such values are significantly lower than the ones in the base case, reflecting bad growth perspectives for both regions. In LATAM and APAC, given that the 4-year average rate represents a low value, and our forecasts indicate a base case with higher perspectives, the values of -2.9% and 0.3% were used for LATAM and APAC, respectively. All in all, we obtained a price per share of \$ 176.09. Given the uncertainty climate that the world is currently going through, we have decided to attribute a weight of 20% to each scenario, with the remaining 60% allocated to the base case, resulting in a price per share of \$ 370.15, and a recommendation to BUY.

Change in Market Share			
Market Share	Pessimistic	Base Case	Optimistic
Price per share	62,09	357,48	803,05
Weight	20%	60%	20%
= Price per share	387,52		

Figure 64 - Scenario Analysis with change in Market Share
Source: Company Forecast

When it comes to the market share and its most optimistic scenario, we established target values for 2032, assuming a constant growth from year to year. Such values were 35% for UCAN, 50% for EMEA and LATAM and 30% for APAC. These assumptions result in a price per share of \$ 803.05. In the most pessimistic scenario, we have considered that in Netflix's bigger markets, the market share would return to 2021 levels, representing no growth during the forecasted time horizon, meaning that UCAN would remain with a value of 20%, with EMEA having 35%. In relation to LATAM, the prediction was for a decrease in the market share of 78% in 2021 to 41% in 2027. It is important to mention that this prediction did not account for the impact of the new subscription plan. Having that in mind, we believe that a pessimistic scenario would be the one where the 41% market share would be a reality even with the implementation of the new subscription plan, maintaining its

value for the forecasted time window. Finally, in APAC, the value of 18.1% was used for every year, not reflecting the growth potential of this region. Such assumptions result in a price per share of \$ 62.09. Having this in mind, and using the weights previously applied (20% for each different scenario and 60% for the base case), we came up with a value of \$ 387.52 per share, resulting in our recommendation to BUY. Finally, and in the case of a change in Netflix's strategy we calculated the impact of different content assets acquisitions. In the optimistic scenario, the growth rate of the industry's has been used, with a value of 9.90% until 2027, when it starts to grow at the inflation rate. This will result in a share price of \$ 399.97. Regarding the pessimistic scenario, the investment in content assets is expected to grow at the average values pre-COVID, with an average value of 29.4% until, growing at the inflation rate onwards, giving us a total price per share of \$ 271.41. At last, and taking into consideration the previously used weights, the final price per share it \$ 348.77 and our recommendation to HOLD. One last important value that it needs

to be explored is the ROIC and the Reinvestment Rate in the long term, since is an important measure to evaluate the performance of the company as it reflects the investment in content assets. We can observe that the optimistic scenario always presents higher values for the RONIC and ROIC, with lower values for the Reinvestment Rate. This confirms that in the optimistic scenario Netflix will be investing in the right content, meaning that the lower amount of money invested in content assets will result in a higher return of the money invested. Contrary, in the worst scenario, there is much more wasted investment in content, since for long-term (2028 and 2032) reinvestment rates that double the ones in the optimistic case, both ROIC and RONIC will be much lower.

Relative valuation

In addition to the intrinsic valuation, a relative valuation with Netflix competitors was conducted. The selection of comparable companies was conducted regarding the industry and/or similar business models. The selected companies are Warner Bros. Discovery, Inc., The Walt Disney Company, Roku, Inc., Amazon.com, Inc., Comcast Corp., Charter Communications and Paramount Global. The analysis is based on the company figures (EV, market cap, revenues, debt, subscriber count, and EBITDA) and the corresponding multiples EV/EBITDA, EV/Revenues, and EV/subscriber count. The main problem with relative valuation of Netflix is the following: Netflix business model focuses entirely and exclusively on the streaming service. They do not have any other sources of income. Looking at Amazon.com, Inc. for example, their many businesses model is the e-commerce / wholesale segment (Amazon 2022). Similar scenario applies for Disney+ from The Walt Disney Company, which is also involved in following industries: Media Networks; Parks,

Change in Content Growth			
ARPU	Pessimistic	Base Case	Optimistic
Price per share	271,41	357,48	399,97
Weight	20%	60%	20%
= Price per share	348,77		

Figure 65 - Scenario Analysis with Change in Content Growth
Source: Company Forecast

Indicators (with change in content growth)			
	Pessimistic	Base Case	Optimistic
2024			
Core RONIC	19,38%	35,18%	65,02%
Core ROIC	25,64%	30,06%	34,94%
Reinvestment Rate	467,99%	399,31%	343,46%
2028			
Core RONIC	4,79%	12,56%	31,70%
Core ROIC	18,42%	31,38%	47,45%
Reinvestment Rate	560,54%	338,26%	223,75%
2032			
Core RONIC	15,79%	26,09%	38,00%
Core ROIC	18,65%	31,70%	47,79%
Reinvestment Rate	551,41%	324,34%	215,16%

Figure 66 - Impact of change in content growth
Source: Company Forecast

Multiple Share Price Analysis	
EBITDA Multiple	886,62
Revenue Multiple	171,66
Subscriber Multiple	899,79
Average Price per share	652,69

Figure 67 – Multiple valuation overview
Source: Company Forecast

Experiences and Products; Studio Entertainment; and Direct-to-Consumer & International. Therefore, the actual valuation of the streaming service is falsified by these other sectors as well as actual business size, and the valuation elaborates a strong divergence in the share price. To eliminate outlier, the median of each multiple as used. The actual valuation denotes share prices for Netflix ranging from \$ 171.66 to \$ 899.79. By averaging all gathered share prices, a value of \$ 652.69 arises.

Final recommendation

Summarizing the conducted analysis on Netflix, the discounted cash flow indicates an equity value of \$ 160.8 bn Using the by November 2022 445.02 m outstanding shares lead to a share price of \$ 357.48. Netflix currently trades at \$ 317.83 as of the 14th of December 2022, indicating that the company trades at a 12.48% discount. Therefore, giving all this information, the investor recommends BUY the stock of Netflix

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Appendix

Financial Statements - Reformulated Income Statement

Core	2017	2018	2019	2020	2021	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Revenues	11 692 713	15 794 341	20 156 447	24 996 056	29 697 844	33 731 035	37 874 322	43 034 525	49 558 005	56 814 065	64 948 686	69 808 431	74 310 634	78 915 914	83 814 630	88 792 612
Streaming Revenues	11 242 216	15 428 752	19 859 230	24 756 675	29 515 496	33 579 154	37 749 909	42 932 125	49 473 724	56 744 696	64 891 535	69 761 254	74 271 690	78 883 767	83 788 093	88 770 707
United States and Canada (UCAN)	6 660 859	8 281 532	10 051 208	11 455 396	12 972 100	15 034 660	17 131 785	19 314 023	22 202 984	25 445 404	29 108 016	30 976 114	32 836 603	34 745 708	36 705 304	38 503 532
%	56%	52%	51%	46%	43%	45%	46%	45%	45%	45%	45%	44%	44%	44%	44%	44%
Europe, Middle East and Africa (EMEA)	2 362 813	3 963 707	5 543 067	7 772 252	9 609 819	10 816 735	12 248 612	14 168 794	16 481 180	19 063 229	21 962 918	23 786 176	25 709 434	27 786 864	30 032 673	32 463 493
%	21%	25%	28%	31%	33%	32%	32%	33%	33%	34%	34%	34%	34%	35%	35%	37%
Latin America (LATAM)	1 642 616	2 237 697	2 795 434	3 156 727	3 576 976	3 728 956	4 119 322	4 629 798	5 214 811	5 814 363	6 431 946	6 512 414	6 565 559	6 471 274	6 382 788	6 270 844
%	15%	15%	14%	13%	12%	11%	11%	11%	11%	11%	10%	10%	9%	9%	9%	7%
Asia-Pacific (APAC)	755 928	945 816	1 469 521	2 372 300	3 266 661	3 998 803	4 250 279	4 819 509	5 574 750	6 421 700	7 388 655	8 485 550	9 160 093	9 879 921	10 667 327	11 532 837
%	6%	6%	7%	10%	11%	12%	11%	11%	11%	11%	11%	12%	12%	13%	13%	13%
DVD Revenues	450 497	365 589	297 217	239 381	182 348	151 881	124 413	102 400	84 282	69 369	57 151	47 177	38 944	32 147	26 537	21 906
Cost of revenues	(8 033 000)	(9 967 538)	(12 440 213)	(15 276 319)	(17 332 683)	(20 116 708)	(21 707 585)	(24 124 349)	(26 756 312)	(29 642 650)	(32 862 506)	(35 752 235)	(38 698 879)	(41 857 122)	(45 281 829)	(48 958 122)
United States and Canada (UCAN)	(4 759 442)	(5 350 173)	(6 296 275)	(7 068 651)	(7 708 651)	(8 935 896)	(9 799 028)	(10 775 429)	(11 919 869)	(13 195 898)	(14 633 224)	(15 754 716)	(16 975 839)	(18 290 873)	(19 677 376)	(21 061 084)
Europe, Middle East and Africa (EMEA)	(1 688 323)	(2 560 700)	(3 472 286)	(4 795 335)	(5 696 123)	(6 521 069)	(7 022 501)	(7 952 158)	(8 903 023)	(9 948 887)	(11 113 140)	(12 179 031)	(13 383 302)	(14 732 029)	(16 218 955)	(17 802 555)
Latin America (LATAM)	(1 173 713)	(1 445 634)	(1 751 115)	(1 947 886)	(2 100 544)	(2 235 014)	(2 364 317)	(2 613 910)	(2 834 810)	(3 053 212)	(3 274 124)	(3 353 906)	(3 436 925)	(3 449 438)	(3 464 767)	(3 473 213)
Asia-Pacific (APAC)	(411 523)	(611 032)	(920 537)	(1 463 848)	(1 918 279)	(2 424 729)	(2 521 739)	(2 823 851)	(3 008 609)	(3 444 653)	(3 842 012)	(4 464 582)	(4 902 914)	(5 384 781)	(5 920 731)	(6 531 270)
Gross profit	3 659 713	5 826 803	7 716 234	9 719 737	12 365 161	13 614 327	16 166 737	18 910 176	22 801 694	27 171 415	32 086 180	34 056 196	35 611 754	37 058 792	38 532 801	39 834 491
Sales/Marketing/Advertising expenses	(1 436 281)	(2 369 469)	(2 652 462)	(2 228 362)	(2 545 146)	(2 361 172)	(2 651 203)	(3 012 417)	(3 469 600)	(3 976 985)	(4 546 040)	(4 886 590)	(5 201 744)	(5 524 114)	(5 867 024)	(6 215 483)
Technology and development expenses	(959 810)	(1 221 814)	(1 545 149)	(1 829 600)	(2 273 737)	(2 582 696)	(2 805 250)	(3 079 867)	(3 422 840)	(3 781 961)	(4 161 090)	(4 299 520)	(4 389 332)	(4 464 064)	(4 531 634)	(4 578 799)
General and administrative expenses	(431 043)	(630 294)	(914 369)	(1 076 486)	(1 351 621)	(1 349 241)	(1 514 973)	(1 721 381)	(1 982 320)	(2 272 563)	(2 597 947)	(2 792 337)	(2 972 425)	(3 156 637)	(3 352 585)	(3 551 704)
Operating income	838 679	1 605 226	2 604 254	4 585 289	6 194 509	7 321 217	9 195 311	11 096 512	13 927 473	17 139 907	20 780 735	22 079 349	23 048 253	23 913 978	24 781 557	25 488 504
Core Taxes	(50 067)	(94 757)	(309 140)	(729 001)	(798 300)	(1 297 456)	(1 691 015)	(2 090 267)	(2 684 769)	(3 359 380)	(4 123 954)	(4 396 663)	(4 600 133)	(4 781 935)	(4 964 122)	(5 112 586)
Statutory tax rate	35%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%
Provision for income taxes	73 608	(15 216)	(195 315)	(437 954)	(723 875)	(1 212 160)	(1 509 367)	(1 993 601)	(2 584 513)	(3 262 703)	(4 038 741)	(4 339 687)	(4 573 520)	(4 788 262)	(5 006 215)	(5 198 442)
Effective tax rate	9%	1%	8%	1%	1%	16%	17%	18%	16%	16%	16%	16%	16%	16%	16%	16%
Result	788 612	1 510 469	2 295 114	3 856 288	5 396 209	6 023 761	7 504 296	9 006 244	11 242 704	13 780 526	16 656 790	17 682 666	18 448 120	19 132 043	19 817 430	20 375 918

Non-Core	2017	2018	2019	2020	2021	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Interest and other income (expenses)	(115 154)	41 725	84 000	(618 441)	411 214	337 310	378 743	430 345	495 580	568 141	649 487	698 084	743 106	789 159	838 146	887 926
Non-Core Taxes	40 304	(8 762)	(17 640)	129 873	(86 355)	(70 835)	(79 536)	(90 373)	(104 072)	(119 310)	(136 392)	(146 598)	(156 052)	(165 723)	(176 011)	(186 464)
Other Comprehensive Income	28 008	975	(3 939)	67 919	(84 893)	1 494	1 494	1 494	1 494	1 494	1 494	1 494	1 494	1 494	1 494	1 494
Result	(46 842)	33 938	62 421	(420 649)	239 966	267 969	300 701	341 467	393 002	450 325	514 589	552 981	588 548	624 930	663 630	702 956

Financial	2017	2018	2019	2020	2021	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Interest Expense	(238 204)	(420 493)	(626 023)	(767 499)	(765 620)	(743 478)	(824 687)	(900 661)	(972 593)	(1 028 511)	(1 055 263)	(969 399)	(869 836)	(759 035)	(637 729)	(507 651)
Tax Rate	35%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%	21%
Tax Shield	83 371	88 304	131 465	161 175	120 780	156 130	173 184	187 039	204 629	215 987	221 605	203 574	182 666	159 397	133 923	106 609
Result	(154 833)	(332 189)	(494 558)	(606 324)	(604 840)	(587 348)	(651 503)	(703 622)	(768 665)	(812 524)	(833 658)	(765 825)	(687 171)	(599 637)	(503 806)	(401 052)

Financial Statements – Reformulated Balance Sheet

Core	2017	2018	2019	2020	2021	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Core Business Assets																
Licensed content	11 771 778	14 081 463	14 703 352	13 747 607	13 799 221	15 828 822	17 505 849	19 097 725	21 304 080	23 518 836	25 460 743	25 990 071	26 821 753	27 680 049	28 565 811	29 479 917
Produced content	2 896 910	6 020 864	9 801 215	11 636 343	17 120 318	21 600 894	26 314 148	31 681 332	39 099 693	47 903 050	58 486 513	60 643 498	62 584 090	64 586 781	66 653 558	68 786 472
DVD	13 301	9 813	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Content Assets	14 681 989	20 112 140	24 504 567	25 383 950	30 919 539	37 429 716	43 819 997	50 799 057	60 403 773	71 421 887	83 947 257	86 633 569	89 405 843	92 266 830	95 219 369	98 266 389
Operating Cash	701 563	347 660	1 209 387	1 499 763	1 781 871	2 097 910	2 309 483	2 600 583	2 982 736	3 408 844	3 896 921	4 188 506	4 458 618	4 724 955	5 028 878	5 327 557
Other Current Assets	536 245	748 466	1 160 067	1 556 030	2 042 021	1 901 174	2 134 701	2 425 544	2 793 226	3 202 197	3 660 687	3 934 596	4 188 352	4 447 919	4 724 024	5 004 596
Property, Plant and Equipment (net)	319 404	418 281	565 221	960 183	1 323 453	1 506 727	1 690 107	1 863 857	2 013 496	2 134 691	2 221 507	2 331 790	2 479 793	2 673 567	2 919 144	3 226 760
Operating Deferred Tax Assets	292 546	435 371	485 652	465 507	384 965	0	0	0	0	0	0	0	0	0	0	0
Total Core Assets	16 531 747	22 661 918	27 924 894	29 865 433	36 251 849	42 935 527	49 954 289	57 669 042	68 193 231	80 167 619	93 726 372	97 088 461	100 532 627	104 123 271	107 891 414	111 825 302
Core Business Liabilities																
Content Liabilities	7 502 837	8 445 045	7 747 884	7 047 620	7 387 180	13 202 654	15 456 709	17 911 392	21 306 336	25 192 776	29 610 873	30 558 421	31 536 290	32 545 451	33 586 906	34 661 687
Deferred Revenue	618 622	760 899	924 745	1 117 992	1 209 342	1 349 241	1 514 973	1 721 381	1 982 320	2 272 563	2 597 947	2 792 337	2 972 425	3 156 637	3 352 585	3 551 704
Accounts Payable	359 555	562 985	674 347	656 183	837 483	1 040 955	1 168 819	1 328 065	1 529 383	1 753 308	2 004 347	2 154 320	2 293 261	2 435 382	2 586 558	2 740 181
Accrued Expenses and Other Liabilities	315 094	477 417	843 043	1 102 196	1 449 351	1 646 184	1 848 390	2 100 224	2 418 591	2 772 710	3 169 706	3 406 878	3 626 600	3 851 352	4 090 425	4 333 367
Total Core Liabilities	8 796 108	10 246 346	10 190 019	9 923 991	10 883 356	17 239 034	19 988 891	23 061 062	2							

Financial Statements – Reformulated Cash Flow Statement

	2017	2018	2019	2020	2021	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Operating																
NOPIAT	788 613	1 510 469	2 295 117	3 856 287	5 396 209	6 023 761	7 504 296	9 006 244	11 242 704	13 780 526	16 656 780	17 682 686	18 448 120	19 132 043	19 817 430	20 375 918
Depreciation and Amortization	-6 065 249	-7 407 719	-9 112 668	-10 691 202	-12 021 955	-13 494 239	-14 697 030	-16 008 901	-17 425 953	-18 967 920	-20 646 210	-22 550 576	-24 628 599	-26 896 051	-29 370 136	-32 069 617
Operational Cash Flow	(5 276 636)	(5 897 250)	(6 817 551)	(6 834 915)	(6 625 746)	(7 470 478)	(7 192 734)	(7 002 657)	(6 183 249)	(5 187 394)	(3 989 430)	(4 867 890)	(6 180 479)	(7 764 008)	(9 552 706)	(11 693 698)
Invested Capital Fincl Assets	15 001 393	20 380 421	23 009 798	20 344 123	32 212 383	39 930 443	43 160 104	52 040 294	62 431 269	73 536 918	86 189 764	88 362 366	91 865 664	96 940 397	98 538 913	101 493 249
Gross Capex Investment	(5 529 026)	(4 539 367)	(3 274 345)	(5 988 659)	(6 693 451)	(6 573 631)	(7 132 810)	(9 774 355)	(11 139 308)	(12 612 186)	(12 796 586)	(12 920 277)	(13 054 761)	(13 198 116)	(13 354 636)	
Net Capex	1 878 691	4 573 301	9 416 857	6 123 096	6 800 788	8 123 369	8 876 092	7 651 598	7 828 611	8 034 024	19 753 981	21 708 322	23 841 290	26 172 020	28 714 980	
Invested Capital NWC and others	(7 265 754)	(8 114 849)	(7 334 913)	(6 402 651)	(6 874 459)	(13 239 951)	(15 544 707)	(18 034 934)	(21 460 668)	(25 380 316)	(29 825 265)	(30 788 855)	(31 781 585)	(32 805 949)	(33 863 573)	(34 954 786)
Investment in NWC and others	849 094	(779 935)	(932 233)	471 809	6 365 451	2 304 756	2 490 228	3 425 734	3 919 648	4 444 949	963 590	992 731	1 024 363	1 057 625	1 091 213	
Investment Cash Flow	2 727 785	3 793 366	8 484 634	6 594 905	13 166 239	10 428 125	11 366 319	11 077 332	11 748 259	12 478 973	22 717 570	22 701 053	24 865 653	27 229 645	29 806 193	
Core Free Cash Flow	(3 169 465)	(3 024 186)	1 649 720	(30 841)	5 695 761	3 235 391	4 363 662	4 894 083	6 560 865	8 489 543	15 949 680	16 520 574	17 101 645	17 676 940	18 112 495	
Non-operating																
Operational Cash Flow	(46 842)	33 938	62 421	(420 649)	239 966	267 969	300 701	341 467	393 002	450 325	514 589	552 981	588 548	624 930	663 630	702 956
Invested Capital	224 517	396 498	397 892	726 964	1 437 917	2 023 862	2 772 199	2 837 074	2 993 486	3 438 814	3 896 361	4 198 596	4 433 638	4 748 965	5 039 878	5 321 359
Investment Cash Flow	(111 911)	(461 064)	70 508	(900 723)	(396 145)	(248 597)	(309 612)	(391 409)	(435 364)	(488 077)	(591 585)	(720 132)	(876 217)	(1 043 823)	(1 296 670)	
Non-core Free Cash Flow	(77 973)	(398 643)	(350 141)	(660 767)	(128 176)	52 104	31 855	1 594	14 962	26 512	261 396	318 416	348 613	369 707	404 277	
Total Operating Free Cash Flow	-	(3 247 438)	(3 422 829)	1 299 578	(691 608)	5 567 586	3 287 495	4 395 517	4 895 676	6 575 827	8 516 055	16 111 076	16 838 990	17 450 258	18 046 646	18 516 772
Financing																
Financial Result	(154 833)	(332 189)	(494 558)	(606 324)	(604 840)	(587 348)	(651 503)	(703 622)	(768 665)	(812 524)	(833 658)	(765 825)	(687 171)	(599 637)	(503 806)	(401 052)
Net Financial Assets	(4 378 200)	(7 513 235)	(10 950 210)	(9 603 186)	(11 346 963)	(10 887 571)	(11 424 239)	(11 586 891)	(11 903 501)	(11 858 181)	(11 326 746)	(9 348 877)	(5 251 514)	(1 951 727)	1 595 114	5 366 241
Investment in Net Financial Assets	3 135 036	3 436 974	(1 347 023)	1 543 775	(259 391)	536 669	162 652	316 610	(45 320)	(531 435)	(2 977 869)	(3 097 363)	(3 299 787)	(3 546 840)	(3 771 128)	
Transactions with Shareholders	444 592	480 415	653 769	(247 327)	(4 720 847)	(3 172 661)	(3 854 546)	(4 443 622)	(5 717 983)	(7 150 963)	(12 367 382)	(13 054 457)	(13 550 833)	(13 996 001)	(14 344 592)	
Financing Cash Flow	3 247 438	3 422 831	(1 299 579)	691 608	(5 567 586)	(3 287 495)	(4 395 517)	(4 895 676)	(6 575 827)	(8 516 055)	(16 111 076)	(16 838 990)	(17 450 258)	(18 046 646)	(18 516 772)	

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Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

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