NUS INVESTMENT SOCIETY

Netflix, Inc.

BUY: US$350 (+22.87%)

Equity Research Department

10 November 2018

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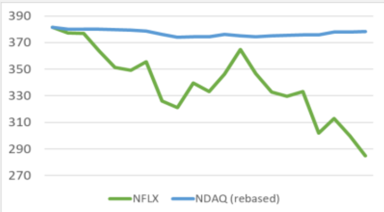
Basic Information

Last Closed Price	US$284.84
12M Target Price	US$350
+/- Potential	+22.87%
Bloomberg Ticker	NASDAQ: NFLX
GICS Sector	Communication Services
GICS Sub-Industry	Entertainment

1Y Price v Relative Index



Company Description

Netflix, Inc. is an American media-services provider headquartered in Los Gatos, California. It provides DVD subscription service, and video streaming service internationally and is the producer popular video contents such as "House of Cards". It operates through the following geographical segments: North America, Latin America, Europe, the Middle East, Africa and APAC.

Key Financials

Market Cap	124.21B
Basic Shares O/S	436.08M
Free Float	98.5%
52-Wk High-Low	US$423.21 - US$178.38
Fiscal Year End	31-Dec-17

(US$ M)	FY17A	FY18E	FY19E
Revenue	11,692	14,458	18,836
Gr Rate (%)	32.4%	23%	30%
EBITDA	908	1185	1480
Margin (%)	7.77%	8.19%	7.86%
Net Income	557	406	625
Margin (%)	4.78%	2.81%	3.32%
ROA	2.93%	1.36%	1.50%
ROE	15.56%	10.14%	13.48%
EV/EBITDA	143.92	111.55	89.88
P/E Ratio	153.57	112.17	75.76
D/E Ratio	1.81	2.87	3.99

Key Executives

Wilmot Reed Hastings Jr.	Chairman & CEO
David B. Wells	Chief Financial Officer
Theodore A. Sarandos	Chief Content Officer

Netflix and Chill

We are initiating coverage of NFLX with a Buy rating and a $350 12M price target.

3Q18 Earnings Review

- Streaming revenue increased by 36% in the third quarter from the year earlier.
- Revenue in the third quarter of $4 billion met the $4 billion estimate as per Refinitiv consensus; EPS was at $0.89, above the $0.68 estimate.
- Subscriber addition was at 6.96 million, with 1.09million coming from domestic subscribers and 5.87 million coming from international regions, beating out estimates of 673,800 and 4.46 million respectively.

Investment Thesis

- Netflix is well-positioned in the market to reap benefits of their current investments into original content production; The high amount of investments spent on producing original content has the allows Netflix to remain dominant in the media industry and boost subscriber gains. New "unscripted" content genre content has also proven to be successful in enlarging the subscriber base at lower costs. The aggressive investment in original content helps Netflix retain its competitive edge amidst increased competition from M&A deals by Disney.

- Netflix has strong proven strategies to expand into new markets and can be replicated in their future plans. With local content produced for each region, Netflix is becoming more relevant in the international markets, which results in stronger subscriber growth. Furthermore, the demand for Netflix's service is increasing in the international market as video streaming becomes more accessible.

- Bundling strategy to pair Netflix subscription to traditional television network subscriptions has allowed Netflix to access a broader target group both domestically and internationally.

Catalysts

- Successful expansion into Latin America and emerging markets would spark greater growth subscriber volume as they are able to penetrate into a nascent market and would be able to capture a larger market share.
- The increase in adoption rate for bundling plans in new markets to show further credibility to their strategy in boosting future plans to grow in average revenue per subscribers.

Valuations

Our 12-month price target from date of coverage is based on a comparables analysis achieved by projecting the 1 year forward revenue and EBITDA.

Investment Risks

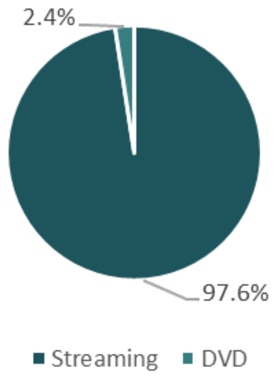
- Rising interest rates would make borrowing more expensive, hindering their ability for continued growth through new content
- Increased income inflow from international regions opens up NFLX to greater forex risk
- Slower than expected overall sales growth would put a constant financing strain on NFLX
- Increased competition by DisneyFlix and AT&T acquisition of Time Warner Inc.

Company Overview

Established in 1997 by Reed Hastings and Marc Randolph in California, the company's primary business is its subscription-based streaming media service which offers online streaming of a library of films and television programs including those produced in-house. As of October 2018, Netflix has 137 million total subscribers worldwide, including 58.46 million in the United States. It is available worldwide except Mainland China, Syria, North Korea, and Crimea. Netflix also has offices in the Netherlands, Brazil, India, Japan, and South Korea.

It has greatly expanded the production and distribution of both film and television series since 2012 and offers a variety of "Netflix Original" content through its online library. By January 2016, Netflix services operated in over 190 countries. Netflix released an estimated 126 original series and films in 2016, more than any other network or cable channel. Their efforts to produce new content, secure the rights for additional content, and diversify through 190 countries have resulted in the company racking up billions in debt: $21.9 billion as of September 2017, up from $16.8 billion from the previous year. $6.5 billion of this is long-term debt, while the remaining are long-term obligations.

Figure 1. Revenue by Products, FY18



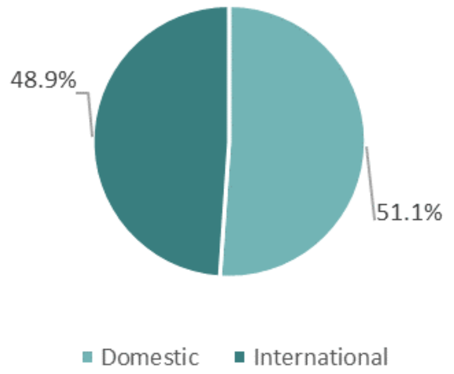
Source: NFLX Q3 Quarterly Report 2018

Business model

The business model of Netflix is mainly streaming content online. The company primarily has three different segments of revenue: Domestic Streaming, International Streaming, and Domestic DVD.

Domestic streaming derives revenue from monthly membership for services consisting solely of streaming content to members in the United States. International streaming derives revenue from monthly membership fees for services consisting solely of streaming content to members outside the United States. While Domestic DVD derives revenue from monthly membership fees for services consisting of DVD-by-mail.

Figure 2. Revenue by Geography, FY18



Source: NFLX Q3 Quarterly Report 2018

The domestic streaming of Netflix takes up 52.6% of their revenue, international streaming of Netflix is 43.5% while Domestic DVD takes up 3.9% of the consolidated revenue. We can see that the domestic DVD segment of revenue is taking up a very little portion of the entire revenue. This is partly due to declining demand for DVD as the consumer preferences shifted to online streaming.

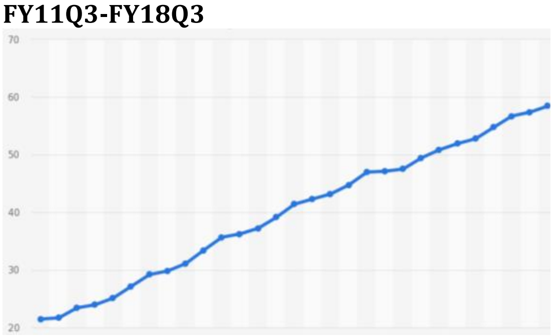
Aggressive expansion plans for future growth

With the slowing growth of the domestic streaming market, Netflix has doubled down on expansion efforts in the international market, banking on high growth in Asia to boost revenues from Asia to 15-20% of its revenue. Moving forward to Q4, Netflix has planned for the debut of more original content that would increase the variety of genres that Netflix carries as well as move into original movies.

3Q18 Earnings Review

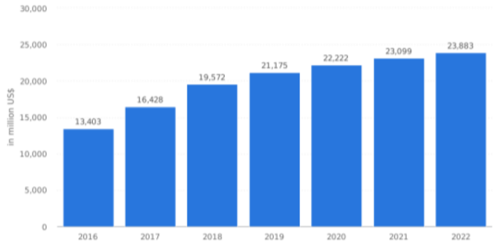
- Streaming revenue increased by 36% in the third quarter from the year earlier.
- Revenue in the third quarter of $4 billion met the $4 billion estimate as per Refinitiv consensus; EPS was at $0.89, above the $0.68 estimate.
- Subscriber addition was at 6.96 million, with 1.09million coming from domestic subscribers and 5.87 million coming from international regions.
- Subscribers addition for both domestic and international beat out estimates of 673,800 and 4.46 million respectively.
- They managed to attain a 207% YoY EPS growth.
- Netflix was able to keep operating margins low this quarter at 12% of revenue.

Figure 3. Growth in Netflix Subscriber from FY11Q3-FY18Q3



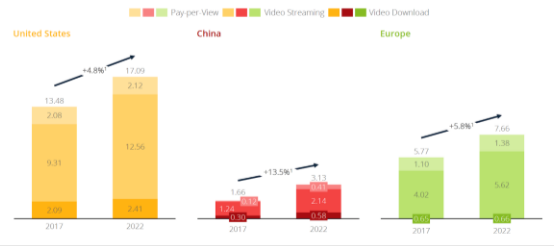
Source: Statista

Figure 4. Revenue in Video Streaming (SVoD) market



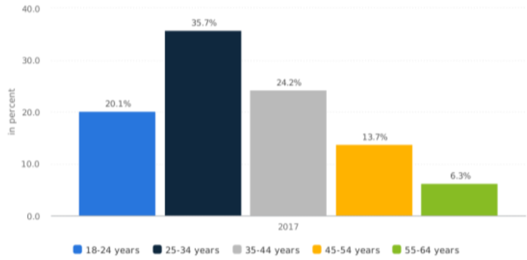
Source: Statista

Figure 5. Revenue composition by region



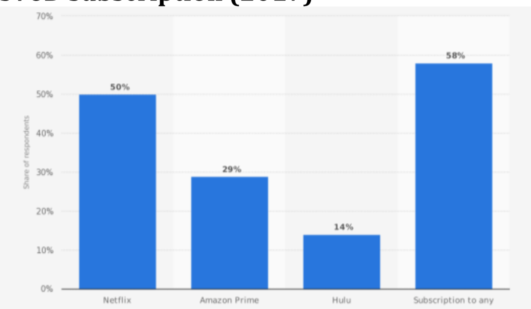
Source: DigitalTV Research

Figure 6. User by Age in sVoD Market



Source: Statista

Figure 7. Share of consumers who have a sVoD subscription (2017)



Source: Statista

Industry Outlook

The Video Streaming (SVoD) market is a 1.9 billion USD market growing at an average of 6.7% CAGR from 2017 to 2022. Video streaming services offer consumers unlimited access to a vast collection of video content and allow them to watch their favourite content without the limitation of a schedule.

Market segment by region

In 2017, the US represents the bulk of SVoD revenues, which accounts for the largest segment (56.8%) of the US Video-On-Demand market. SVoD also accounts for 69% of the VoD revenue in Europe. Finally, China accounts for the smallest market size for VoD due to consumers' unwillingness to pay for digital media content, and thus a low adoption rate of SVoD in China.

By 2022, the total market size for VoD would have increased. Due to the saturating market in the US, only a mid-single-digit growth (4.8%) would be expected. The Europe region is expected to face the same issue with only a 5.8% growth. The Chinese market is expected to have the largest growth of 13.5% by 2022, although it will still be the smallest in terms of revenue amount.

Market segment by demographics

In the 2017 global SVoD market, 35.7% of the consumers are aged between 25-34 years old, making up the largest demographic group to use SVoD. The main users of SVoD is skewed towards a younger audience as they are more technology-savvy and would be more willing to spend on digital content.

SVoD market competitors

With the declining ratings in traditional TV due to the shift to digital platforms, media owners have been increasing their content libraries through M&A, and the trend has boosted the performance of traditional media companies. Thus, Netflix faces competition not only from dedicated video streamers like Amazon Prime, but also traditional media company such as Disney, Discovery and CBS.

In the US, Netflix is a dominant content streamer with 50% market share. Its 2 closest competitors are Amazon Prime owned by Amazon, and Hulu, owned by 21st Century Fox (FOX), the Walt Disney Co. (DIS) and NBCUniversal, a subsidiary of Comcast Corp. (CMCSK). Amazon Prime offers content streaming as part of its package and has acquired award-winning series such as The Big Sick and Transparent. However, the content streaming on Amazon Prime is offered as a package with other services of Prime which result in a high subscription fee. It is estimated that Prime has 60-90 million subscribers in the US, as compared to 125 million subscribers for Netflix. Regarding Hulu, it currently lacks a clear direction and innovation due to the split in ownership. Thus, Netflix still remains the best of the breed due to its large number of subscribers and more focused service. Netflix has also overtaken the once dominant HBO in terms of original content creation, with more than 1000 hours of original content in 2017 compared to HBO's 600 hours. HBO now has about 3.5 million viewers, whereas Netflix has over 100 million.

Currently, Netflix is able to be the top video streaming service in both content streaming and original content, and the large number of subscribers creates a vast network that acts as a strong moat for the business.

Increasing costs in the future

With the race between Amazon and Netflix in generating original content, the cost of production for such content is on the rise. Soon, Netflix would face higher costs. However, this may also serve as a barrier to entry for further competition against Netflix.

S.W.O.T Analysis

Strength
Huge network effect when more people subscribe to their platform, forming a strong moat.
A large amount of content catering to a different group of demographics.
Creating original content to ensure the sustainability of the platform

Weakness
A large amount of cash flow is needed to create the original content which does not guarantee a return on investment.
Depends on external content providers to supply new contents for their viewers while they are creating their own content.

Opportunities
Leveraging on growth internationally by providing low subscription cost, hence scaling the business fast worldwide.

Threat
Increased competition by content providers such as Disney, Amazon, and Apple. These companies are creating their own content platform to serve their customers and to gain market share in the entertainment industry.

Investment Thesis

1. Netflix is well-positioned in the market to reap benefits of their current investments into original content production.

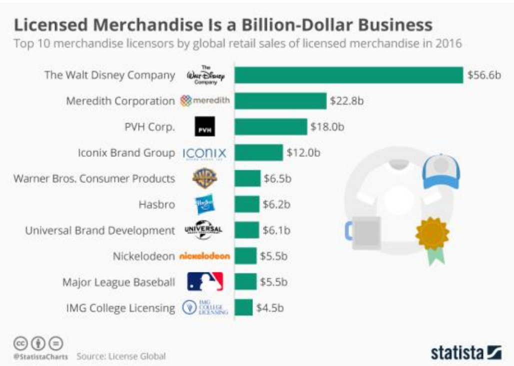
Creating brand loyalty and user base
The strategy of original content generation allows Netflix to establish their own brand and create their own viewer instead of depending on viewers that are attracted by renowned titles produced by other production houses. This reduces their reliance on purchasing licences to sustain viewer interest on their platform. This strategy has been the key to ensure that their core business is minimally affected by the potential exit of Disney's Marvel series on Netflix after their 2012 deal expires in 2019.

Grouping their target consumers into "taste communities" that have been drawn up based on viewers' commonality in taste, Netflix is able to consistently produce high quality shows that cater to their preferences. This 'build-to-fit" method used by Netflix has been known to create more brand loyalty due to the increased satisfaction that consumers obtain from their subscriptions. This increased user loyalty and rapport would greatly increase customer retention rate and reduce the churn rate that is critical for Netflix to have a sustainable business in the future. By being able to carve out their unique viewer base, they would be able to strengthen their position in the market and continue to reap the benefits of their original content production while being minimally affected by other external factors.

Higher quality and content control
By creating original content, Netflix is able to control the quality and types of content generated. Netflix is able to create better quality content to enhance the users' satisfaction level and also create specific content tailored to local tastes to better target niche market. Before Netflix began original content production, they had to source for limited quality content available on the secondary market and would be unable to ensure the timeliness of quality content and shows that complements their entry into new regions.

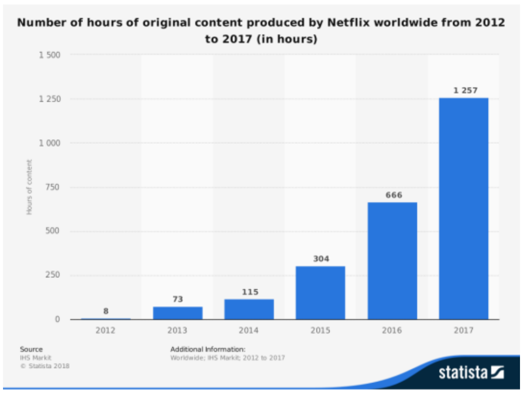
Most notably, the newfound control over the content produced has proven to be effective in their venture into the Indian market. Netflix released 7 new original content from India that was well received by the market and aid in their successful penetration of the huge India market. This increased in ability to shape the content that the company put their resources behind would go a long way in helping Netflix continue their content propagation.

Figure 8. Licensed merchandise sales (2016)



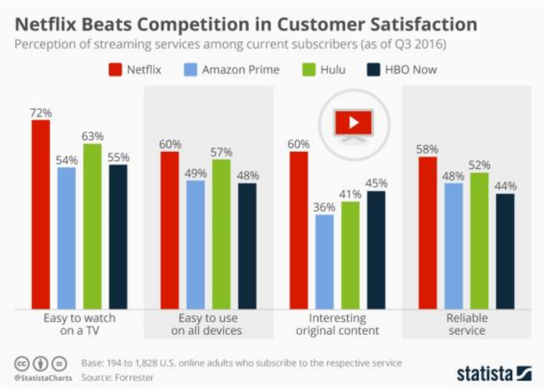
Source: Statista

Figure 9. Netflix original content hours (2012 - 2017)



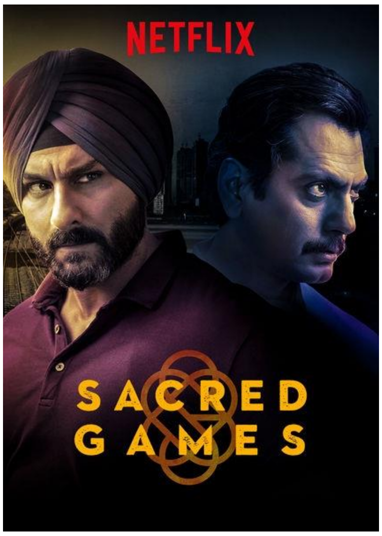
Source: Statista

Figure 10. Customer review of streaming service (2016)



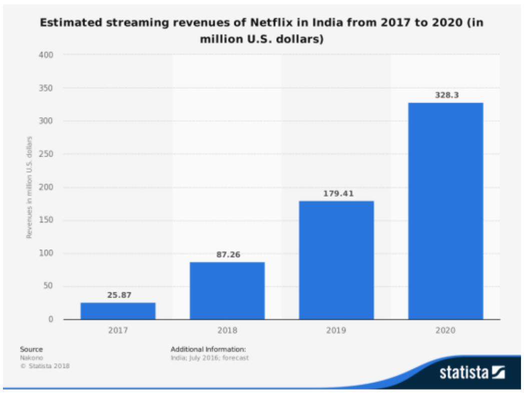
Source: Statista

Figure 11. Popular original content in India



Source: Google Images

Fig. 12 Estimated Streaming revenue of Netflix in India (2017-2020)



Source: Statista

Massive potential cost savings and additional income stream

The high amount of investments spent on producing original content has the potential to reap huge cost savings in the long run as Netflix Studios would be able to control and enhance the operational efficiency of production and also avoid the huge mark-up costs that other production houses would charge. According to CFO, Ted Sarandos, the mark-up on the shows could reach 30-50% of the costs and as the content budget reaches $8 billion this year, the potential savings could be enormous in the long run. Furthermore, Netflix could save on the need to pay for licensing and could retain intellectual property for further licensing and merchandising of the content to generate further sources of revenue. This has been experimented on *Stranger Things* where intellectual property has been sold for use in merchandises.

As such, it would be important that as Netflix moves in a new direction, they start to diverge from their initial model of a content distributor to one that includes content creation. This introduces a new dynamic into the value proposition of Netflix which would make them less coupled and at the mercy of their media distributors. Their successes in the creation of original content already goes to show that this vertical integration would be one that is beneficial to the company, stabilising their core business of media by ensuring that cost and rights are more so in their control moving forward.

2. Netflix has strong proven strategies to expand into new markets and can be replicated in their future plans.

Successful entry into India market

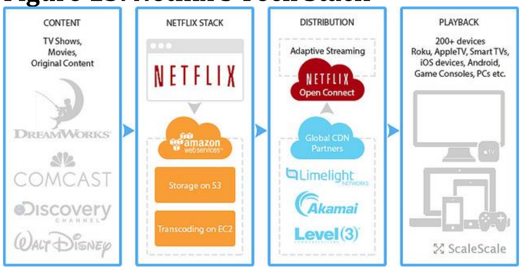
As the Indian market has huge potential to be reaped, Netflix focused their efforts on developing local content production and introduced lower subscription fee to entice the viewers in India. Netflix has introduced more than 7 Netflix Originals content for the India market and a 40% reduction in subscription fees as compared to the US market, with a partnership with Vodafone to offer free one-year subscription. Their entry strategies have shown to be highly successful, as Netflix is estimated to have added 0.5 million subscribers in India since its expansion with the hit local series *Sacred Games*, and streaming revenue in India increased from 25.87 million dollars in 2017 to 87.26 million dollars in 2018. Based off Statista estimates, revenues from India is expected in increase to 179.41 million in 2019 and 328.3 million in 2020. Netflix is positioned well in the local market through their use of region-specific original films that they are trying to roll out more extensively. For the Indian market, one such series that has garnered much internet attention is Little Things, adapted from short web shows that were uploaded onto video site YouTube in 2017, it has successfully garnered up to 32 million views today. As Netflix has picked up the series to air in Oct 2015 for eight 30-minutes episodes, they are situated nicely to enjoy similar upsides from the show moving forward. In view of the increase in internet presence of India and the successful efforts that Netflix has shown that they are capable of in the market, it is clear then Netflix is definitely picking up speed in the region. To have such an intimate understanding of the market to craft specific strategies to target a niche market, Netflix definitely have the ability to understand other potential markets and create content and price their subscriptions that can allow them to best penetrate new markets.

Large untapped developing market has the potential for greater revenue to be reaped with increased global connectivity.

Since 2017, Internet penetration rate amongst youths aged 15-24 in developing country is 67% and is projected to increase in the future. In the global trend of increased global connectivity, especially in developing nations, the total addressable market (TAM) for Netflix to tap into is expanding exponentially and give them the ability to continue penetrating into various markets. As more people in the world owns a phone and have access to high-speed internet connections, they are able subscribe to Netflix's service to stream their content on their phones throughout the world. Currently, Netflix also identified the potential value of reaching out to regions with poorer connectivity. Netflix are able to introduce their newly developed technology of encoding video files into extremely latent size that enable fast loading and high quality viewing on everyone's mobile phones. This greatly facilitates their ability to deliver positive streaming experience to customers around the world as they get access to these technologies.

With the various successful implementation of strategies to target new markets such as India, they are able to replicate these strategies as they continue their expansion into less developed markets. As more developing countries are having greater internet connectivity, Netflix is primed to capture more viewers from these expanding markets. The management has also pledged to release the profitability report of the international segment in 1H2019.

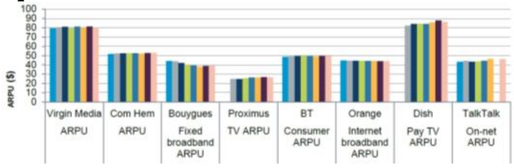
Figure 13: Netflix's Tech Stack



Source: High Scalability

Advanced technology takes advantage of big data to create unique selling propositions that differentiates itself from its competitors.
Netflix also uses proprietary collaborative filtering algorithms that provides intelligent show recommendations based on users' past viewing history and preferences. In December 2017, Netflix has updated its recommendation algorithm to recommend shows based on images that prompts a reaction from users, which is a significant upgrade as the artwork of a show constitutes 82% of the users' focus. With such an algorithm, Netflix can improve the viewership rates of their future shows through more effective artworks, and also create more eye-catching marketing campaigns that will boost its subscriber rates. As Netflix has such a large user base to supply it with the necessary data, the technology capitalised on Netflix's market share to create a distinct advantage that is unique to Netflix. Therefore, Netflix has effectively created a moat against their competitors by having the capability to better attract viewers. This creates huge opportunity when they are attempting to enter new markets and can maintain its market share by having an edge over new competitors.

Figure 14: Netflix ARPU of partnering operators



Source: HIS

3. Introduction of bundling strategy as potential driver to greatly increase subscriber count.

Netflix has recently introduced a new strategy to capture a wider group of customers from markets that they have already penetrated and also the newly entered ones. The bundling strategy has the potential to significantly increase the penetration of Netflix to attract customers that has been slow to adopt technology.

Following a strong growth in subscriber count in US market shows the potential market available for Netflix to capture. Furthermore, there are strong signs of cooperation with telecoms and TV providers. The partnership with Japan telco KDDI, allow Netflix to reach out to older and less technologically savvy demographics. The bundling strategy with Vodafone in India which includes free 1-year subscription to Netflix with any contract signed with Vodafone allows Netflix to tap into a huge customer base and increase the subscription base as they are beginning their penetration into the India market. Meanwhile, in mature international markets like Europe, the bunding strategy also aims to bring more customers on board the Netflix video streaming platform to allow families to watch Netflix shows just like other television programmes. The partnership with T-Mobile, which introduced free Netflix bundling for qualifying T-Mobile One family plans would enable them to reach out to more households.

Catalyst

1. Successful expansion into Latin America and emerging markets
With the successful execution of entry into the India market, the strategies used to penetrate niche market have shown huge potential to penetrate more markets. As Latin America is a key region Netflix is expanding into and has a huge total addressable market, the ability of Netflix to replicate its strategy to enter this geographical region would allow them to experience a huge increase in subscriber count and revenue generate. This would spark a huge growth phase for Netflix.

2. Anticipated content releases strengthens cashflow for next year
Netflix has also planned several new titles (*Sex Education* and *Russian Doll*) to be aired in 2019, as well as new seasons of hit series such as *Stranger Tales* and *13 Reasons Why*. Based on the business success of original contents, these new releases will enable Netflix to maintain its revenue stream for the coming year.

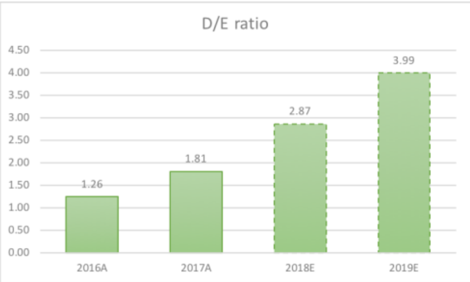
3. Increased adoption rate for bundling plans
The bundling strategy was just recently introduced and has shown to be a sound and robust plan to increase its subscriber base in both the nascent regions like India and also the mature markets such as the United States. Further success shown in the bundling strategy through the growth in subscriber rates and ARPU would show the effectiveness of this strategy in charting further growth for Netflix. Netflix would also be able to extend such bundling strategies to new markets and achieve more effective penetration of these areas to experience greater growth in the future.

Financial Analysis

Financial Analysis

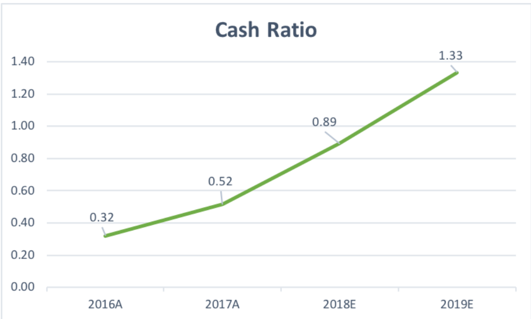
	2016A	2017A	2018E	2019E
Profitability				
Net Profit Margin	2.11%	4.77%	2.81%	3.32%
Return on Asset	1.37%	2.93%	1.36%	1.50%
Return on Equity	6.97%	15.56%	10.14%	13.48%
Liquidity				
Current Ratio	1.25	1.40	2.17	2.61
Cash Ratio	0.32	0.52	0.89	1.33
Asset Utilization				
Total Asset Turnover	0.65	0.61	0.48	0.45
Financial Leverage				
LT Debt to Assets	0.25	0.34	0.39	0.44
LT Debt to Equities	1.26	1.81	2.87	3.99
Debt to Equity	1.26	1.81	2.87	3.99
Debt to Asset	0.25	0.34	0.39	0.44
Interest Coverage	3.19	2.37	2.64	3.44
Market Value				
Price to Earnings		153.57	112.17	75.76
EV/EBITDA		143.92	114.81	94.85

Figure 15: Projected D/E ratio



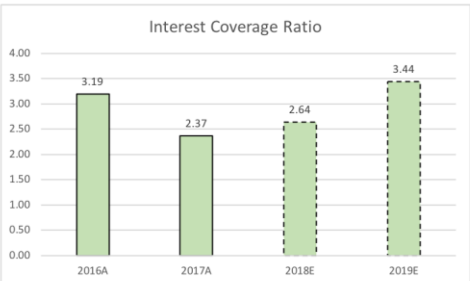
Source: Team estimates

Figure 16: Cash Ratio



Source: Team estimates

Figure 17: Interest Coverage Ratio



Source: Team estimates

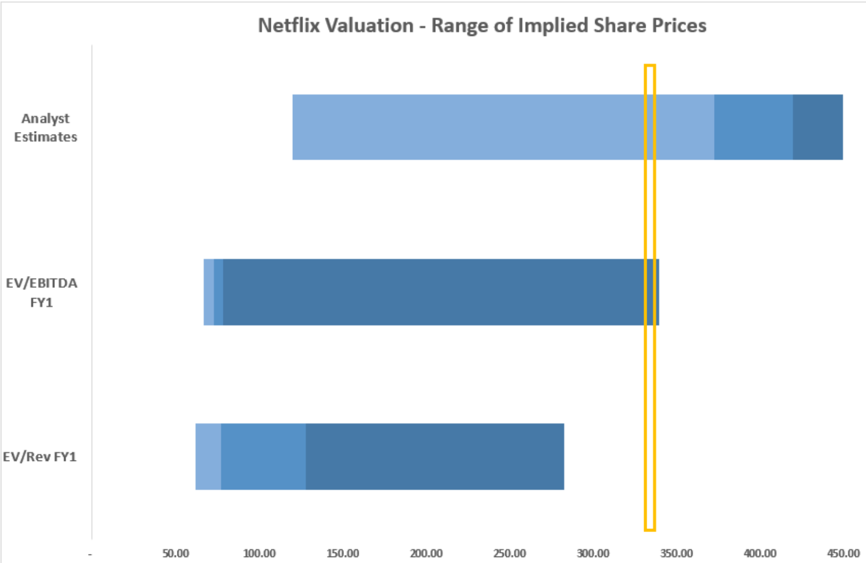
1. **Increasing D/E ratio due to increasing use of debt to fund their future growth.**
   As Netflix is growing at a high rate and would require capital expansion for their growing Netflix originals and international expansion plans, Netflix will likely continue to tap the high yield bond market for funding. The net leverage ratio is projected to increase from 2.7x to 3.3x for the next quarter. We have estimated that with the expansion plans of Netflix to project the leverage ratio to 3.99 in 2019.

2. **High cash ratio to reflect the healthier balance sheet to meet their loan obligations.**
   As Netflix are aggressively increasing growth through debt, increasing interest and operating expenses may require short-term debt to meet their payments. The increase in cash ratio due to the higher cash and cash equivalents in their balance sheet would enable them to meet short-term debt obligations. As the cash ratio is projected to increase above 1, they would then have more cash than their current liabilities, which shows their healthy cash position. Netflix has announced that it will increase cash through corporate bond issuance.

3. **High interest coverage ratio shows their ability to fund their debt incurred**
   With higher usage of debt to drive their increasing growth for original content production, the increase in interest coverage ratios shows the growing capability to fund these debt through their strong earnings power. The alarming high debt in Netflix's balance sheet should be allayed by their ability to pay off their interest expenses.

Valuations

Valuation Price Target: **$350**



RV Model

As Netflix is a growing company that is not generating free-cashflow due to their aggressive expansion strategy to gain market share, a DCF valuation is not an applicable valuation method. Thus, a relative valuation was used to estimate intrinsic value of Netflix's share price instead. The multiple used is the 1 year forward EV/Revenue, 1 year forward EV/EBITDA, and Analyst Estimates. Comparable peers of Netflix are chosen based on industry group and business model. As Netflix operates a unique business model that involves both the traditional business of content creation and the new business of video streaming, comparable peers are chosen from both types of business models.

Company	Ticker	Last Price	Market Cap (B)
Netflix Inc	NFLX	284.84	127.03
Walt Disney CO/THE	DIS	58.49	172.67
Viacom Inc -Class B	VIAB	116.1	13.41
Twenty-First Century Fox - A	FOXA	33.05	85.9
Discovery - A	DISCA	32.78	22.36
CBS Corp - Class B	CBS	46.54	22
ROKU	ROKU	57.83	6.13

1 Year Forward Revenue and EBITDA

1 Year Forward Revenue and EBITDA is then projected for Netflix. Revenue of DVD subscription in the US is projected based on historical rates. Revenue projection for content streaming is based on an aggregated sum of the projected number of subscribers in each region that Netflix operates in multiplied by the average revenue per user.

Projections show that revenue from DVD services are declining every year, which is expected due to DVD being increasingly obsolete. With regards to content streaming revenue, the US market is already saturated and thus is unlikely to see significant growth in the year forward. However, the international market is likely to see continued strong growth in the following year, especially in the newly expanded India market, which has been separately projected to reflect the strong growth potential due to Netflix's focus in the region with more local content produced.

For full model, please refer to the appendix at the end of the report.

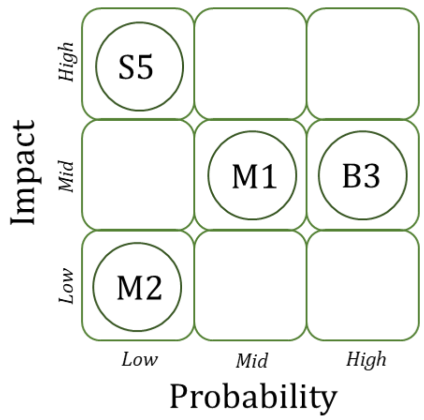
Relative Valuation

Based on EV/EBITDA, EV/Revenue, analyst estimates, Netflix is valued at $350. Relative Valuation was primarily focused on EV/Revenue This is due to the nature of the content streaming business, which is dependent on market share as a driver of growth. EV/EBITDA accounts for expenses, depreciation and amortisation of assets which would understate the growth potential of the company. As Netflix is a leader in both content production and video streaming, expected price range is taken at the 75th percentile of the implied share price based on EV/Revenue.

This analysis leads to an intrinsic value of $350 for Netflix, a 22.78 % upside on the current trading price, which falls in line with the analyst recommended price and the 52 week price range. Thus, we remain confident that this valuation reaffirm our Buy recommendation and validates our view of upcoming 12 month period.

Investment Risks

Figure 18. Investment Risk Matrix



Source: NUS Investment Society Estimates

Market Risks
M1: Rising interest rates would make borrowing more expensive, hindering their ability for continued growth through new content

M2: Increased income inflow from international regions opens up NFLX to greater forex risk

Business Risks
B3: Slower than expected overall sales growth would put a constant financing strain on NFLX. Pooling of content by competitors through M&A would also increase competition.

Strategic Risk
S4: Increased competition by DisneyFlix and AT&T acquisition of Time Warner Inc.

Appendix:

Revenue and Financial Projections

Netflix (NFLX)
Revenue Drivers

	Units		2016A	2017A	2018A	CAGR	2019E		
Net Sales	USD$ Millions		**8,831**	**11,691**	**14,458**		**18,836**		
Sales by Segments:									
US DVD	USD$ Millions		542	451	366		300		
% of total	%		*6%*	*4%*	*3%*		*2%*		
% y/y	%	-		-17%	-19%		-18%		
US Streaming	USD$ Millions		5,074	6,159	7,962		9,804		
% of total	%		*57%*	*53%*	*55%*		*52%*		
% y/y	%	-		21%	29%		23%		
Intl Streaming	USD$ Millions		3,214	5,082	6,130		8,732		
% of total	%		*36%*	*43%*	*42%*		*46%*		
% y/y	%	-		58%	21%		42%		
Total net sales	USD$ Millions		**8,830.76**	**11,691.27**	**14,457.90**		**18,836**		
Segments									
Total Sales	USD$ Millions		8830.76	11691.27	14457.90		18836.32		
% y/y	%	-		*32%*	*24%*		*30%*		
US DVD									
Total Revenue	USD$ Millions		**542.30**	**450.50**	**365.80**	**-17.9%**	**300.43**		
% change y/y		-		-16.9%	-18.8%				
US Streaming									
No. of subscribers	#		49.4	54.8	61.9	10.02%	68		
y/y growth	%	-		10.9%	13.0%		10.0%		
Sub. Net Adds.	#		**4.5**	**4.9**	5.9	15%	6.8	68.66	Net adds numbers were projected independently and used as a sanity check for our "growth in subscribers" projection
Average Revenue per Subscriber	USD		102.715	112.384	128.634	11.91%	144	2019E Subscriber based on net adds growth	
% y/y Growth	%	-		9.4%	14.5%		11.9%		
Total Sales	USD$ Millions		**5,074.12**	**6,158.64**	**7,962.44**		**9,803.63**		
International Streaming:									
No. of subscribers (millions)	#		44.40	62.75	84.91		104.30		
y/y growth	%	-		41.3%	35.3%		22.8%		
Sub. Net Adds.	#		**13.7**	**16.6**	20	21%	24.1	109.03	Net adds numbers were projected independently and used as a sanity check for our "growth in subscribers" projection
Average Revenue per Subscriber	USD		72.4	80.99	72.19	11.91%	81	2019E Subscriber based on net adds growth	
% y/y	%	-		11.9%	-10.9%		11.9%		
Total Sales (USD millions)	USD$ Millions		**3,214.34**	**5,082.12**	**6,129.65**		**8,732.25**		

	Units	2016A	2017A	2018A	CAGR	2019E
Region						
Europe						
No. of subscribers (millions)	#	19.72	29.35	39.81	17.00%	46.58
y/y openings/(closures)	#	-	48.8%	35.6%		17.0%
Average Revenue per Subscriber	USD	72.4	80.99	72.19	15.98%	84
% y/y	%	-	11.9%	-10.9%		16.0%
Total Sales	USD$ Millions	**1,427.73**	**2,377.06**	**2,873.88**		**3,899.76**
MENA & Africa						
No. of subscribers (millions)	#	0.83	2.70	7.00	72.16%	12
y/y openings/(closures)	#	-	226.5%	159.3%		72.2%
Average Revenue per Subscriber	USD	72.4	80.99	72.19	15.98%	84
% y/y	%	-	11.9%	-10.9%		16.0%
Total Sales	USD$ Millions	**59.87**	**218.67**	**505.33**		**1,009.00**
APAC (Excluding India)						
No. of subscribers (millions)	#	2.9	4.4	7.1	55.50%	11
y/y openings/(closures)	#	-	51.7%	61.4%		55.5%
Average Revenue per Subscriber	USD	72.4	80.99	72.19	15.98%	84
% y/y	%	-	11.9%	-10.9%		16.0%
Total Sales	USD$ Millions	**209.96**	**356.36**	**512.55**		**924.38**
India						
No. of subscribers (millions)	#	0.35	0.5	0.95	60.00%	1.52
y/y openings/(closures)	#	-	42.9%	90.0%		60.0%
Average Revenue per Subscriber	USD	72.4	80.99	72.19	15.98%	84
% y/y	%	-	11.9%	-10.9%		16.0%
Total Sales	USD$ Millions	**25.34**	**40.50**	**68.58**		**127.26**
Latin America						
No. of subscribers (millions)	#	10.5	13.7	16.75	11.10%	19
y/y openings/(closures)	#	-	30.5%	22.3%		11.1%
Average Revenue per Subscriber	USD	72.4	80.99	72.19	15.98%	84
% y/y	%	-	11.9%	-10.9%		16.0%
Total Sales	USD$ Millions	**760.20**	**1,109.56**	**1,209.18**		**1,558.08**
Canada						
No. of subscribers (millions)	#	10.1	12.1	13.3	9.00%	14
y/y openings/(closures)	#	-	19.8%	9.9%		9.0%
Average Revenue per Subscriber	USD$ Millions	72.4	80.99	72.19	15.98%	84
% y/y	%	-	11.9%	-10.9%		16.0%
Total Sales	USD$ Millions	**731.24**	**979.98**	**960.13**		**1,213.78**

Netflix
Financial Projections

	Units	2016A	2017A	2018E	2019E	
Expenses						
Net Sales	US$ (millions)	$8,831	$11,691	$14,458	18,836	
Cost of goods sold	US$ (millions)	6,030	7,660	9,673	12,602	
% of revenue	%	68%	66%	67%	67%	
Marketing, general and administrative expense	US$ (millions)	1,569	2,142	2,609	3,399	
% of revenue	%	18%	18%	18%	18%	
Technological Development	US$ (millions)	852	1,053	1,349	1,757	
% of revenue	%	9.6%	9.0%	9%	9%	
Operating Income	US$ (millions)	119	353	316	411	
% of revenue	%	1.3%	3.0%	2.18%	2.18%	
Income Tax						
Income (loss) before taxes	US$ '000	$261	$483	$512	$667	
Income tax expense (benefit)	US$ '000	74	(74)	108	140	
Tax Rate	%	28%	nm	21%	21%	
Working Capital						
Net Sales	US$ (millions)	$8,831	$11,691	$14,458	$18,836	
COGS	US$ (millions)	6,030	7,660	9,673	12,602	
Cash and Cash equivalents	US$ (millions)	1,468	2,823			
Short term investments	US$ (millions)	266	-	-	-	*Company sold all short term investments in July 2017*
Current Content Assets, net	US$ '000	3,726	4,311	8,535	11,120	
Other Current Assets	US$ (millions)	260	536	544	709	
Current content liabilities	US$ (millions)	3,633	4,173	5,548	7,229	
Accounts Payable	US$ (millions)	313	360	478	623	
Accrued Expenses	US$ (millions)	198	315	358	466	
Deferred Revenue	US$ (millions)	444	619	747	973	
Assumptions						
Cash and Cash equivalent as % of revenue	%	16.62%	24.15%	20.4%	20.4%	
Current Content Asset as % of revenue	%	61.8%	56.3%	59.0%	59.0%	
Other Current Asset as % of revenue	%	2.94%	4.58%	3.8%	3.8%	
Current Content Liabilities as % of COGS	%	60.2%	54.5%	57.4%	57.4%	
Accounts payable as % of COGS	%	5.2%	4.7%	4.9%	4.9%	
Accrued expenses as % of COGS	%	3.3%	4.1%	3.7%	3.7%	
Deferred Revenue as % of COGS	%	7.4%	8.1%	7.7%	7.7%	

	Units	2016A	2017A	2018E	2019E
Fixed Assets					
Net Sales	US$ (millions)	$8,831	$11,691	$14,458	$18,836
Non-current content assets					
Non-current content asset,net		7,275	10,371	13,136	15,818
Plant, Property & Equipment					
Information technology assets	US$ (millions)	185	224	304	407
Furniture and fixture	US$ (millions)	32	49	66	89
Buildings	US$ (millions)	41	41	56	75
Leasehold improvements	US$ (millions)	108	230	312	418
DVD operations equipment	US$ (millions)	70	59	141	247
Corporate Aircraft	US$ (millions)	-	30	41	55
Capital work-in-progress	US$ (millions)	108	8	11	15
Total Gross PPE	US$ (millions)	544	641	930	1,306
Less: Accumulated decpreciation	US$ (millions)	(294)	(322)	(323)	(325)
Total Net Non-current content assets and PPE	US$ (millions)	7,525	10,690	13,743	16,798

FY2016A Non-current content assets and PPE:	Value	Avg Useful life	% of capex
Non-current content asset,net	10,371	4 yrs	94.18%
Information technology assets	224	3 yrs	2.03%
Furniture and fixture	49	3 yrs	0.44%
Buildings	41	30 yrs	0.37%
Leasehold improvements	230	30 yrs	0.37%
DVD operations equipment	59	5 yrs	2.09%
Corporate Aircraft	30	8 yrs	0.27%
Capital work-in-progress	8		0.07%
Total Fixed Assets	11,012		99.84%
Weighted Average PPE Useful Life	**4 yrs**		

	Units	2016A	2017A	2018E	2019E
Capital Expenditure	US$ (millions)		3,166	3,915	5,101
as % of revenue	%		27.1%	27.1%	27.1%
Capex added to:					
Non-current content asset,net	US$ (millions)			3,687	4,804
Information technology assets	US$ (millions)			80	104
Furniture and fixture	US$ (millions)			17	23
Buildings	US$ (millions)			15	19
Leasehold improvements	US$ (millions)			15	19
DVD operations equipment	US$ (millions)			82	107
Corporate Aircraft	US$ (millions)			11	14
Capital work-in-progress	US$ (millions)			3	4
Depreciation					
Total depreciation	US$ (millions)			323	325

Depreciation

Total depreciation	US$ (millions)			323	325

Depreciation Method:

Useful life

Depreciation - Useful Life Method

Depreciation of existing PPE	US$ '000	294	322	322	322
Depreciation of new PPE	US$ '000			1	3
Total	US$ '000			**323**	**325**

Depreciation of additions to non current content asset:

Average useful life: **4 yrs**

Fiscal year	Capex	2018E	2019E
2018	3,687	922	922
2019	4,804		1,201
Total		**922**	**2,123**

Depreciation of additions to infromation tech and furniture :

Average useful life: **3 yrs**

Fiscal year	Capex	2018E	2019E
2018	-	-	-
2019	-		-
Total		**-**	**-**

Depreciation of additions to buildings leasehold improvement:

Average useful life: **30 yrs**

Fiscal year	Capex	2018E	2019E
2018	-	-	-
2019	-		-
Total		**-**	**-**

Depreciation of additions to corporate aircraft:

Average useful life: **8 yrs**

Fiscal year	Capex	2018E	2019E
2018	11	1	1
2019	14		2
Total		**1**	**3**

Debt

Net Sales	US$ (millions)	$8,831	$11,691	$14,458	$18,836
Cash	US$ (millions)	1,468	2,823	6,360	12,386
Cash as % of revenue	%	*16.6%*	*24.1%*	*44.0%*	*65.8%*
Total interest expense	US$ (millions)			**314**	**314**
Target minimum cash balance	US$ (millions)			2,947	3,840
% of revenue	%			*20.4%*	*20.4%*
Cashflow before short-term/revolver borrowings					
Cash from operations	US$ (millions)			(1,236)	(677)
Cash from investing	US$ (millions)			(228)	(297)
Cash from financing (ex short-term debt)	US$ (millions)			5,000	7,000
(+) Beginning cash balance	US$ (millions)			2,823	6,360
(+) Cash from new long-term borrowings	US$ (millions)			5,000	7,000
(-) Target minimum cash balance	US$ (millions)			(2,947)	(3,840)
Available cash before short-term borrowings	US$ (millions)			**8,412**	**15,546**

Long-term borrowings

	Type:	Principal:	Issuance Cost	Maturity:	nterest Paymen
4.88%	Senior Notes	1,600	15.10	2028	78.08
3.63%	Senior Notes	1561	14.73	2027	56.66
4.38%	Senior Notes	1000	9.43	2026	43.80
5.50%	Senior Notes	700	6.60	2022	38.50
5.88%	Senior Notes	800	7.55	2025	47.04
5.75%	Senior Notes	400	3.77	2024	23.00
5.38%	Senior Notes	500	4.72	2021	26.90
		6,561	61.9		314

Beginning balance	US$ (millions)			6,499	4
(-) Repayment	US$ (millions)				
(+) Issuance	US$ (millions)			5,000	7,000
Ending balance	US$ (millions)			**4**	**7,004**
Interest expense	US$ (millions)			314	314
Total proceeds from borrowings	US$ (millions)	-	-	-	-
Total repayments	US$ (millions)	-	-	-	-

Retained Earnings & Dividends

Retained Earnings					
Beginning balance	US$ (millions)			1,731	2,137
(+) Net income	US$ (millions)			406	625
(-) Dividends paid	US$ (millions)			-	-
Ending balance	US$ (millions)			2,137	2,762
Dividends					
Cash dividend per share	US$	-	-	-	-
Basic shares outstanding	# '000	67,878	68,391	68,391	68,391
Cash dividends paid	US$ (millions)	-	-	-	-

Pro Forma 3FS

Netflix

3 Financial Statements

(USD millions unless otherwise stated)	2016A	2017A	2018E	2019E
Income Statement				
Net sales	8,831	11,691	14,458	18,836
Cost of Revenue	6,030	7,660	9,673	12,602
Gross profit	2,801	4,031	4,785	6,235
Marketing, general and administrative expenses	1,569	2,142	2,609	3,399
Technological development	852	1,053	1,349	1,757
Interest and Other expenses				
Interest and Other operating income, net	119	353	314	314
Income (loss) before taxes	261	483	514	765
Income tax expense (benefit)	74	(74)	108	140
Net income	187	557	406	625
Net income per share (USD) attributable to Netflix:				
Basic	0.44	1.29	0.94	1.45
Diluted	0.43	1.25	0.91	1.40
Weighted-average shares outstanding:				
Basic	428	431	431	431
Diluted	438	446	446	446
EBITDA (exclusing Amort)	438	908	1,185	1,480
EBIT	380	836	828	1,079
EV (Market cap + Debt - Cash + NMI)		130,714.64	132,144.72	133,041.83
EV/EBITDA		143.92	111.55	89.88

(USD millions unless otherwise stated)	2016A	2017A	2018E	2019E
Balance Sheet				
Assets:				
Cash and Cash equivalents	1,468	2,823	6,393	12,496
Short term investments	266	- -	-	
Current Content Assets, net	3,726	4,311	8,535	11,120
Other Current Assets	260	536	544	709
Total current assets	5,720	7,670	15,472	24,325
Property and equipment, net	250	319	573	904
Non-current content assets	7,275	10,371	13,136	15,818
Other non-current assets	341	652	652	652 **
Total non-current assets	7,866	11,342	14,362	17,374
Total assets	13,586	19,012	29,834	41,699
Liabilities:				
Current content liabilities	3,633	4,173	5,548	7,229
Accounts Payable	313	360	478	623
Accrued Expenses	198	315	358	466
Deferred Revenue	444	619	747	973
Total current liabilities	4,588	5,467	7,131	9,291
Non-current content liabilities	2,895	3,330	6,924	8,730
Long-term debt	3,364	6,499	11,499	18,499
Other liabilities	61	135	272	546
Total long-term liabilities	6,320	9,964	18,695	27,775
Total Liabilities	10,908	15,431	25,826	37,066
Equity:				
Common Stock	1,600	1,871	1,871	1,871
Accumulated other comprehensive loss, net of tax	(49)	(21)	-	-
Retained earnings	1,129	1,731	2,137	2,762
Total Netflix stockholders' equity	2,680	3,581	4,008	4,633
Total liabilities and stockholders' equity	13,588	19,012	29,834	41,699

(USD millions unless otherwise stated)	2016A	2017A	2018E	2019E
Cash Flow Statement				
Operating:				
Net income	187	557	406	625
Adjustments:				
Addition to Streaming Content Assets	(8,653)	(9,806)	(9,806)	(9,806)
Change in streaming content liabilities	1,773	900	1,375	1,680
Amortisation of Streaming Content Assets	4,788	6,198	6,198	6,198
Amortisation of DVD Content Assets	79	61	61	61
Depreciation of PPE	58	72	323	325
Stock-based compensation to expense	174	182	-	-
Excess tax benefits from stock-based compensation	(65)	-	-	-
Other non-cash tems	41	57	-	-
Foreign currency remeasurement loss on long-term debt	-	141	-	-
Deferred taxes	(47)	(209)	-	-
Changes in assets and liabilities:				
Other current assets	47	(234)	(8)	(165)
Accounts Payable	32	75	118	145
Accrued expenses	69	114	43	108
Deferred revenue	97	178	128	226
Other non-current assets and liabilities	(52)	(74)	(74)	(74)
Net cash provided by operating activities	(1,472)	(1,788)	(1,236)	(677)
Investing:				
Acquisition of DVD content assets	(77)	(54)	-	-
Purchases of PPE	(108)	(173)	(228)	(297)
Other assets	(0.9)	(6.7)	-	-
Purchases of short term investments	(187)	(75)	-	-
Proceeds from sale of short term investments	282	320	-	-
Proceeds from maturities of short-term investments	140	23	-	-
Net cash used for investing activities	(186)	(234)	(228)	(297)
Financing:				
Dividends paid	-	-	-	-
Proceeds from issuance of debt	1,000	3,021	5,000	7,000
Cash from repayment of debt	-	-	-	-
Issuance costs	(11)	(32)		
Proceeds from issuance of common stock	37	88	-	-
Excess tax benefits from stock-based compensation	65	-	-	-
Other financing activities	0.2	0.3	-	-
Net cash used for financing activities	1,091.2	3,077.3	5,000	7,000
Effect of exchange rates on cash	(9)	30	-	-
Net increase (decrease) in cash and equivalents	(342)	1,355	3,537	6,026
Cash and equivalents, beginning of period	1,809	1,468	2,823	6,360
Cash and equivalents, end of period	1,467	2,823	6,360	12,386