Comprehensive Case Study
Valuation of "Netflix" – Stock Price Analysis

NETFLIX

as of February 2019

Title of each class	**Name of Exchange on which registered**
Common stock, $0.001 par value	**NASDAQ Stock Market LLC (NASDAQ Global Select Market)**

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Executive Summary

In the ever-evolving landscape of the entertainment industry, few companies have captivated audiences and reshaped consumption habits as profoundly as Netflix. What began as an innovative online DVD rental service in 1997 has blossomed into a global powerhouse synonymous with streaming entertainment and original content production. Netflix's journey from a disruptive upstart challenging traditional video rental models to a dominant force in the digital entertainment realm is a testament to its agile business strategy that stays ahead of competitors to meet the evolving demands of consumers. As the company transitioned from mailing DVDs to pioneering the concept of online streaming, it not only revolutionized how audiences engage with media but also positioned itself as a leader in the burgeoning subscription streaming market. However, Netflix's metamorphosis did not stop there; recognizing the opportunities in content creation, as well as content delivery, the company embarked on a bold endeavor to invest aggressively in original programming, transforming itself from a mere distributor to a content creator in its own right.

In 2018, Netflix, Inc. is a global internet entertainment service with over 139 million paid memberships across 190 countries, offering a diverse range of TV series, documentaries, and feature films (industry leader - holding **49.1%** of the U.S. OTT subscription market). After launching its streaming service in 2007, it has since built an ecosystem for internet-connected screens, experiencing growing consumer acceptance of online content delivery. The company's core strategy is to grow its streaming membership business globally while maintaining operating margin targets. It continuously enhances member experience by expanding its content library, improving its user interface, and extending its service to more internet-connected screens. Netflix has three reportable segments: Domestic streaming, International streaming, and Domestic DVD, each deriving revenues from monthly membership fees. In a fiercely competitive market, Netflix competes against various entertainment providers and content producers, aiming to attract consumers to its platform in their moments of free time. In the process of disrupting the entertainment industry, Netflix has also enriched its shareholders, with a market capitalization that climbed to $116 **billion** in December 2018, valuing it as one of the largest entertainment companies in the world.

This comprehensive analysis of Netflix delves into the firm's financial performance throughout the pivotal year of 2018, charting the trajectory of its ascent and examining the intricacies of its business strategy as it navigated the competitive landscape of the global streaming and entertainment industry.

Our accounting analysis provides an overview of Netflix's financial statements, highlighting insights into its disruptive approach to content delivery, expansion into international markets and overall financial strategy. We assess Netflix's financial performance, including its profitability and creditworthiness, through key financial metrics and indicators that shed light on its recent performance and future prospects.

To gauge the true value of Netflix's stock, we employ both an intrinsic valuation technique (DCF) as well as an industry-relative valuation method (comparable analysis). These methodologies allow us to estimate the intrinsic/implied value of Netflix at the start of fiscal year 2019 to evaluate the company's investment potential (buy, hold, overweight or underweight) relative to its actual market price.

C-1 Explain and illustrate a review of financial statements and their components.

Analysis of the Statement of Income:

In this section, we will review the income statements of Netflix for the year ended December 31, 2018, and analyze the changes in each prominent component of the statement. We will also provide researched explanations for the changes and connect the story behind the numbers.

	Year ended December 31,		
	2018	2017	2016
Revenues	$ 15,794,341	$ 11,692,713	$ 8,830,669
Cost of revenues	9,967,538	8,033,000	6,257,462
Marketing	2,369,469	1,436,281	1,097,519
Technology and development	1,221,814	953,710	780,232
General and administrative	630,294	431,043	315,663
Operating income	1,605,226	838,679	379,793
Other income (expense):			
Interest expense	(420,493)	(238,204)	(150,114)
Interest and other income (expense)	41,725	(115,154)	30,828
Income before income taxes	1,226,458	485,321	260,507
Provision for (benefit from) income taxes	15,216	(73,608)	73,829
Net income	$ 1,211,242	$ 558,929	$ 186,678
Earnings per share:			
Basic	$ 2.78	$ 1.29	$ 0.44
Diluted	$ 2.68	$ 1.25	$ 0.43
Weighted-average common shares outstanding:			
Basic	435,374	431,885	428,822
Diluted	451,244	446,814	438,652

Exhibit 1: *Income Statement for Netflix (SEC, 2018)*

Revenues

Netflix's revenues for the year ended December 31, 2018, increased by 79% to $15.8 billion from $8.8 billion in 2016 (Exhibit 1); with an average YoY growth of 34%. The increase in revenues was primarily due to the net increase of streaming paid memberships globally, totaling 21.6 million and 28.6 million in 2017 and 2018 respectively. These auspicious subscription figures are rooted in the company's emphasis on growing international memberships (Exhibit 1.1 & 1.2). The average monthly revenue per paying membership also increased primarily due to price changes and a shift in the plan mix towards higher-priced plans.

Cost of Revenues

The cost of revenues for Netflix has seen a significant increase over the years too. From 2018 to 2016, there was an increase of 59%, with the cost rising to $10 billion from $6.3 billion (average YoY growth of 26%). This upward trajectory of costs correlates with the company's aggressive growth strategy to create more in-house movies/shows as opposed to licensing them, which demands closer scrutiny to ensure sustainable profit margins.

However, Netflix's revenue growth has outpaced its rise in costs. Whereas the company's cost of revenues represented as much as 71% of revenues in 2016, that number fell to 69% in 2017, and further to 63% in 2018. Therefore, even though the cost of revenues has been consistently rising, improved sales have justified these increased costs and support Netflix's aggressive growth strategy.

Netflix's 2018 Statement of Operations, which also includes comparative data for 2017 and 2016, provides the following three subcategories within "Cost of Revenues":

Marketing Expenses

Netflix's marketing expenditure has grown significantly (from 2016 to 2018), showing an increase of around **116%**. Marketing costs rose to $2.37 billion in 2018 from $1.10 billion in 2016 (average **YoY growth** of **48%**). This sharp rise underscores Netflix's efforts to maintain and expand its subscriber base, despite fierce industry competition. Considering the net growth of paid memberships and the correlated rise in revenues over that same period, Netflix can justify these costly marketing efforts.

Technology and Development

The technology and development costs increased by approximately **54%** over the same period, $1.2 billion in 2018 from $780 million in 2016 (average **YoY growth** of **25%**). This rise reflects Netflix's commitment to technological innovation and improving the user experience (through their API improvements & general R&D). While investments in technology are essential for staying competitive, the company must continue to ensure these expenditures generate a positive return on investment to improve margins.

General and Administrative Expenses:

General and administrative expenses nearly doubled, showing an increase of approximately **100%**; $630 million in 2018 from $316 million in 2016 (average **YoY growth** of **41%**). This significant rise is justified by the plans for Netflix to expand globally & respectively match its operational needs. International expansion often entails added costs navigating in complex legal and regulatory landscapes in different countries. Netflix will incur expenses related to legal counsel, compliance with local regulations, licensing agreements, and intellectual property protection. A stronger international presence also includes recruiting local staff, training employees on company policies and procedures, and establishing regional offices or support centers. Streamlining administrative processes could be crucial for optimizing costs as Netflix continues its expansion strategy.

Operating Income

The operating income for the year ended December 31, 2018, increased by **323%** to $1.6 billion from $379 million in 2016 (average **YoY growth** of approximately **100% - doubling every year**). The increase in operating income was due to increased revenues, partially offset by increased content expenses as the company continues to acquire, license and produce content, including more Netflix originals, as well as increased marketing expenses and headcount costs to support continued improvements in the streaming service, the company's international expansion, and its growing content production activities.

Interest Expense

The interest expense for Netflix has been on an upward trajectory, reflecting the company's increasing debt levels. Interest expenses grew by approximately 180% from 2016 to 2018, rising to $420 million in 2018 from $150 million in 2016. This escalating trend underscores the importance of managing debt effectively and the potential financial strain it can have on a company's bottom line. Netflix's aggressive growth strategy requires substantial investments in its content library, both in the form of licensing and production. The expansion and enhancement of its content library assets is essential to Netflix's strategy to woo subscribers and create higher costs of entry for competitors. From 2016 to 2018, these investments in content assets were financed through long-term debt with varying dates of maturity (Exhibit 2.3). The company's debt strategy will be further explored in further detail in the analysis of the balance sheet.

Provision for Income Taxes

The provision for income taxes shows a volatile pattern over the years. In 2016, Netflix recorded a tax benefit of $73.8 million, while in 2017 and 2018, it reported tax expenses of $73.6 million and $15.2 million, respectively. These fluctuations may result from the utilization of tax credits or adjustments to deferred tax assets and liabilities. The effective tax rates were 1.24% (2018), -15.17% (2017), and 28.34% (2016), reflecting the same pattern of inconsistency.

Net Income

Netflix's net income has exhibited **robust growth**, reflecting the company's expanding revenues and effective cost management (whilst simultaneously focusing on growth over margins). Net income surged by approximately **548%**, soaring from $186.7 million in 2016 to **$1.21 billion in 2018** (average **YoY growth** of about **158%**). This remarkable growth signifies Netflix's successful execution of its business model amidst intense competition in the streaming industry.

Profit Margin

Considering the aforementioned growth in revenues and net income, there is also ample evidence of Netflix's improving profit margins from 2016 to 2018.

	2018	**2017**	**2016**
Gross Profit Margin	36.89%	31.3%	29.14%
Operating Profit Margin	10.16%	7.17%	4.3%
Net Profit Margin	7.67%	4.78%	2.11%

This encouraging trend of improving profit margins, despite rising costs of revenues and interest expense, is another positive sign for the effectiveness of Netflix's growth strategy. While there are substantial upfront costs to their acquisition of licensed content and in-house content production, Netflix can continue to rapidly increase revenues if it focuses on acquiring new subscribers if these content investments are rooted in consumer demand. Meanwhile, the increased marketing costs exhibited from 2016 to 2018 are an essential complement to attract and retain subscribers to fuel the company's strategy for growth.

Earnings Per Share (EPS):

Earnings Per Share (EPS) has also seen a substantial increase over the years, driven by the growth in net income and share repurchases. The basic EPS grew to $2.78 in 2018 from $0.44 in 2016, while the diluted EPS rose from $0.43 to $2.68 during the same period. This upward trend indicates that Netflix's profitability on a per-share basis has been improving, which is a positive sign for shareholders and could bolster demand for the stock.

	As of/ Year Ended December 31,			Change	
	2018	2017	2016	2018 vs. 2017	2017 vs. 2016
	(in thousands, except revenue per membership and percentages)				
Global Streaming Memberships:					
Paid memberships at end of period	139,259	110,644	89,090	26%	24%
Paid net membership additions	28,615	21,554	18,251	33%	18%
Average monthly revenue per paying membership	$ 10.31	$ 9.43	$ 8.61	9%	10%
Free trials at end of period	9,196	6,938	4,706	33%	47%
Financial Results:					
Revenues	$ 15,794,341	$ 11,692,713	$ 8,830,669	35%	32%
Operating income	$ 1,605,226	$ 838,679	$ 379,793	91%	121%
Operating margin	10%	7%	4%	43%	75%
Net income	$ 1,211,242	$ 558,929	$ 186,678	117%	199%

Exhibit 1.1: *Global Streaming Membership (SEC, 2018).*

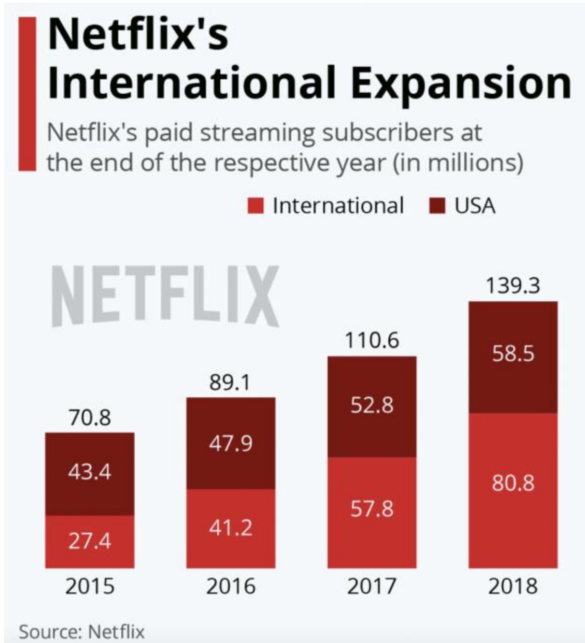


Exhibit 1.2: *International vs USA Streaming Subscribers (Netflix, 2018).*

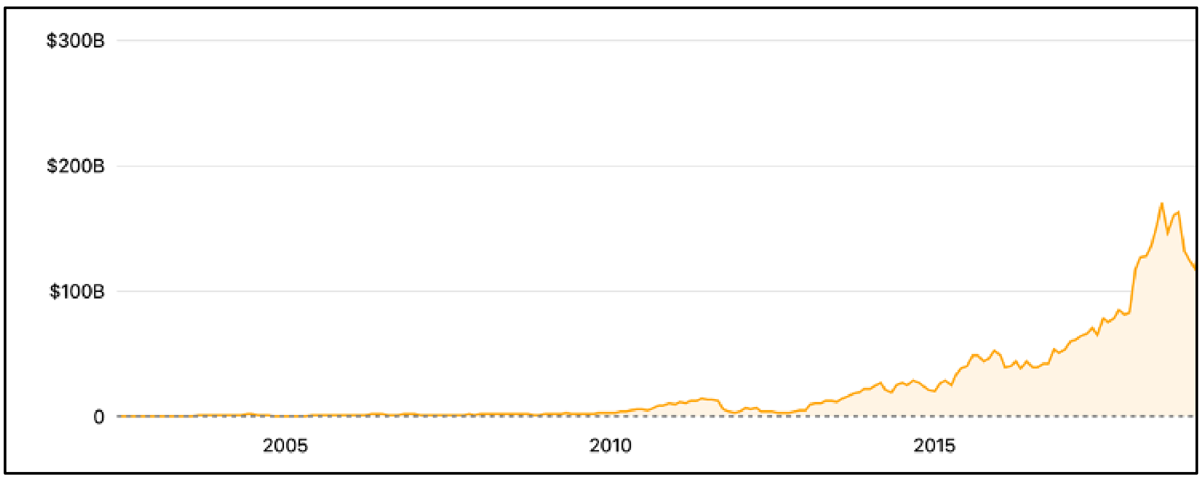


Exhibit 1.3: *Market Capitalization from 2002 to 2018 - $116.8B (companiesmarketcap, 2018).*

Analysis of Consolidated Balance Sheet

In this section, we will review the balance sheet of Netflix for the year ended December 31, 2018. Netflix's 10-K for 2018 also supplied comparative data for 2017, enabling us to examine year-to-year changes, as well as a snapshot view of 2018 itself.

		As of December 31,		
		2018		2017
Assets				
Current assets:				
Cash and cash equivalents	$	3,794,483	$	2,822,795
Current content assets, net		5,151,186		4,310,934
Other current assets		748,466		536,245
Total current assets		9,694,135		7,669,974
Non-current content assets, net		14,960,954		10,371,055
Property and equipment, net		418,281		319,404
Other non-current assets		901,030		652,309
Total assets	$	25,974,400	$	19,012,742
Liabilities and Stockholders' Equity				
Current liabilities:				
Current content liabilities	$	4,686,019	$	4,173,041
Accounts payable		562,985		359,555
Accrued expenses		477,417		315,094
Deferred revenue		760,899		618,622
Total current liabilities		6,487,320		5,466,312
Non-current content liabilities		3,759,026		3,329,796
Long-term debt		10,360,058		6,499,432
Other non-current liabilities		129,231		135,246
Total liabilities		20,735,635		15,430,786
Commitments and contingencies (Note 5)				
Stockholders' equity:				
Preferred stock, $0.001 par value; 10,000,000 shares authorized at December 31, 2018 and 2017; no shares issued and outstanding at December 31, 2018 and 2017		—		—
Common stock, $0.001 par value; 4,990,000,000 shares authorized at December 31, 2018 and December 31, 2017, respectively; 436,598,597 and 433,392,686 issued and outstanding at December 31, 2018 and December 31, 2017, respectively		2,315,988		1,871,396
Accumulated other comprehensive loss		(19,582)		(20,557)
Retained earnings		2,942,359		1,731,117
Total stockholders' equity		5,238,765		3,581,956
Total liabilities and stockholders' equity	$	25,974,400	$	19,012,742

Exhibit 2: *Consolidated Balance Sheet for Netflix (SEC, 2018)*

Netflix's consolidated balance sheet (Exhibit 2) reported **total assets** of 25.9 billion in 2018, representing a **37%** increase from 2017. Streaming content accounts for the majority of the company's assets. The company acquires, licenses, and produces content, including original programming, in order to offer members unlimited viewing of TV series and films. The content licenses are for a fixed fee and specific windows of availability. For licenses, the Company capitalizes the fee per title and records a corresponding liability at the gross amount of the liability when the license period begins, the cost of the title is known, and the title is accepted and available for streaming. The portion available for streaming within one year is recognized as "current content assets, net" and the remaining portion as "non-current content assets, net" on the consolidated balance sheet. For production, the Company capitalizes on costs associated with the production, including development costs, direct costs, and production overhead. These amounts are included in "non-current content assets, net" on the consolidated balance sheet.

"**Noncurrent content assets**" *increased* by **44%** in 2018 to a balance of 14.9 billion and represented 58% of total assets compared to 55% of total assets in 2017. "Current content assets" also increased by 19% to 5.1 billion but declined as a percentage of total assets down from 23% in 2017 to 20% in 2018. This trend connects to the company's growing emphasis on produced content, which can be retained as a noncurrent asset, as opposed to the licensing deals that eventually expire. In 2018 (Exhibit 2.1), produced content increased by 108% to 6 billion, while licensed content increased by just 20% over that same timeframe, even though it still accounts for a larger total of 14.1 billion. Meanwhile, "cash and cash equivalents" increased by 34% in 2018 yet remained at 15% of total assets over 2017 and 2018.

The buildup of Netflix's content assets and cash reserves during 2018 was enabled by a 59% increase in long-term debt, which represented 40% of total assets. "Total streaming content obligations" amounted to 19.3 billion and 93% of total liabilities. 79% of total assets were financed with debt, while just 21% were financed with equity. Consequently, the firm carried a liabilities-to-equity ratio of 3.96, further suggesting it is a highly levered firm. Nevertheless, Netflix exhibited a relatively healthy current ratio of 1.49 thanks to its increase in cash and cash equivalents. 75% of Netflix's debt obligations are not due for more than 5 years and new debt issued through bonds in 2018 will not mature for more than ten years. During this time, the company will increase its revenue from subscribers to generate cash for future debt payments.

Total stockholders' equity increased by 37% in 2018 due mainly to a 70% increase in retained earnings, underlining Netflix's improving profitability. This figure also helps support the company's stance on issuing long-term debt to increase leverage since these growing cash inflows will ensure future debt obligations can be met. Meanwhile, the total common shares outstanding increased by 444,592 (24%), which likely contributed to the company's aforementioned increase in cash as the company sold off treasury stock.

Current & Non-current Content Assets:

Content Assets

Content assets consisted of the following:

	As of December 31, 2018	As of December 31, 2017
	(in thousands)	
Licensed content, net	$ 14,081,463	$ 11,771,778
Produced content, net		
Released, less amortization	2,403,896	1,427,256
In production	3,305,126	1,311,137
In development and pre-production	311,842	158,517
	6,020,864	2,896,910
DVD, net	9,813	13,301
Total	$ 20,112,140	$ 14,681,989
Current content assets, net	$ 5,151,186	$ 4,310,934
Non-current content assets, net	$ 14,960,954	$ 10,371,055

On average, over 90% of a licensed or produced streaming content asset is expected to be amortized within four years after its month of first availability.

As of December 31, 2018, over 30% of the $20.1 billion unamortized cost is expected to be amortized within one year and 33% and 82% of the $2.4 billion unamortized cost of the produced content that has been released is expected to be amortized within one year and three years, respectively.

Exhibit 2.1: *Breakdown of content assets for Netflix (SEC, 2018)*

Property & Equipment:

Property and Equipment, Net

Property and equipment and accumulated depreciation consisted of the following:

	As of December 31, 2018	As of December 31, 2017	Estimated Useful Lives (in Years)
	(in thousands)		
Leasehold improvements	$ 282,028	$ 229,848	Over life of lease
Information technology	224,296	223,850	3 years
Furniture and fixtures	63,667	49,217	3-15 years
Buildings	73,468	40,681	30 years
Corporate aircraft	62,560	30,039	8 years
DVD operations equipment	53,416	59,316	5 years
Machinery and equipment	1,692	—	3 years
Land	6,125	—	
Capital work-in-progress	19,548	8,267	
Property and equipment, gross	786,800	641,218	
Less: Accumulated depreciation	(368,519)	(321,814)	
Property and equipment, net	$ 418,281	$ 319,404	

Exhibit 2.2: *Breakdown of PP&E for Netflix (SEC, 2018)*

PPE represents a very marginal portion (2%) of Netflix's total assets. Such a low figure is to be expected for a streaming company since it invests so much capital in its content assets. Meanwhile, Netflix has respectively limited needs for land, buildings and equipment.

Debt Table:

The following table provides a summary of the Company's outstanding long-term debt and the fair values based on quoted market prices in less active markets as of December 31, 2018 and December 31, 2017:

	Principal Amount at Par	Issuance Date	Maturity	Interest Due Dates	Level 2 Fair Value as of December 31, 2018	Level 2 Fair Value as of December 31, 2017
	(in millions)				(in millions)	
5.375% Senior Notes	500	February 2013	February 2021	February and August	$ 509	$ 530
5.50% Senior Notes	700	February 2015	February 2022	April and October	706	739
5.750% Senior Notes	400	February 2014	March 2024	March and September	407	427
5.875% Senior Notes	800	February 2015	February 2025	April and October	812	856
4.375% Senior Notes	1,000	October 2016	November 2026	May and November	915	983
3.625% Senior Notes (1)	1,489	May 2017	May 2027	May and November	1,446	1,575
4.875% Senior Notes	1,600	October 2017	April 2028	April and October	1,464	1,571
5.875% Senior Notes	1,900	April 2018	November 2028	May and November	1,851	—
4.625% Senior Notes (2)	1,260	October 2018	May 2029	May and November	1,241	—
6.375% Senior Notes	800	October 2018	May 2029	May and November	797	—
	10,449					

	As of December 31, 2018	As of December 31, 2017
	(in thousands)	
Less than one year	$ 538,384	$ 311,339
Due after one year and through three years	1,550,581	627,444
Due after three years and through five years	1,646,101	1,761,465
Due after five years	11,138,129	6,348,580
Total debt obligations	$ 14,873,195	$ 9,048,828

Exhibit 2.3: *Breakdown of debt maturities for Netflix (SEC, 2018)*

Netflix's debt table exemplifies a key component of the firm's financial strategy to support ambitious content spending. Management believes that Netflix will rapidly expand its global subscriber base by investing in its content library and marketing efforts. The lion's share of these investments has been financed through long-term debt, which typically matures approximately ten years after issuance. Netflix is increasing leverage to create value for shareholders through financing the expansion of its content assets, which it believes will lead to YoY growth of revenues. Netflix has strategically structured the debt so that increased cash flows from revenue will enable the firm to pay down its climbing debt obligations over many years. As of December 31, 2018, Netflix has $14.9 billion in total debt obligations, but nearly 75% of these obligations are not due for at least five to ten years. Meanwhile, just 3.6% of total debt is due within one year, posing no substantive financial burden on the firm in the short term. However, it is important for Netflix to continue its growth trajectory to avoid hardship as its more substantial debt payments become due in the coming decade.

<u>Analysis of the Statement of Cash Flows:</u>

In this section, we will review the statement of cash flows of Netflix for the year ended December 31, 2018. We also compare the changes over the years & tie it to the balance sheet.

	Year Ended December 31,		
	2018	2017	2016
Cash flows from operating activities:			
Net income	$ 1,211,242	$ 558,929	$ 186,678
Adjustments to reconcile net income to net cash used in operating activities:			
Additions to streaming content assets	(13,043,437)	(9,805,763)	(8,653,286)
Change in streaming content liabilities	999,880	900,006	1,772,650
Amortization of streaming content assets	7,532,088	6,197,817	4,788,498
Amortization of DVD content assets	41,212	60,657	78,952
Depreciation and amortization of property, equipment and intangibles	83,157	71,911	57,528
Stock-based compensation expense	320,657	182,209	173,675
Excess tax benefits from stock-based compensation	—	—	(65,121)
Other non-cash items	40,428	57,207	40,909
Foreign currency remeasurement loss (gain) on long-term debt	(73,953)	140,790	—
Deferred taxes	(85,520)	(208,688)	(46,847)
Changes in operating assets and liabilities:			
Other current assets	(200,192)	(234,090)	46,970
Accounts payable	199,198	74,559	32,247
Accrued expenses	150,422	114,337	68,706
Deferred revenue	142,277	177,974	96,751
Other non-current assets and liabilities	2,062	(73,803)	(52,294)
Net cash used in operating activities	(2,680,479)	(1,785,948)	(1,473,984)
Cash flows from investing activities:			
Purchases of property and equipment	(173,946)	(173,302)	(107,653)
Acquisition of DVD content assets	(38,586)	(53,720)	(77,177)
Other assets	(126,588)	(6,689)	(941)
Purchases of short-term investments	—	(74,819)	(187,193)
Proceeds from sale of short-term investments	—	320,154	282,484
Proceeds from maturities of short-term investments	—	22,705	140,245
Net cash provided by (used in) investing activities	(339,120)	34,329	49,765
Cash flows from financing activities:			
Proceeds from issuance of debt	3,961,852	3,020,510	1,000,000
Issuance costs	(35,871)	(32,153)	(10,700)
Proceeds from issuance of common stock	124,502	88,378	36,979
Excess tax benefits from stock-based compensation	—	—	65,121
Other financing activities	(1,956)	255	230
Net cash provided by financing activities	4,048,527	3,076,990	1,091,630
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(39,682)	29,848	(9,165)
Net increase (decrease) in cash, cash equivalents and restricted cash	989,246	1,355,219	(341,754)
Cash, cash equivalents and restricted cash, beginning of year	2,822,795	1,467,576	1,809,330
Cash, cash equivalents and restricted cash, end of year	$ 3,812,041	$ 2,822,795	$ 1,467,576
Supplemental disclosure:			
Income taxes paid	$ 131,069	$ 113,591	$ 26,806
Interest paid	375,831	213,313	138,566
Increase (decrease) in investing activities included in liabilities	2,560	(32,643)	27,504

Exhibit 3: *Statement of Cash Flows for Netflix (SEC, 2018)*

Net cash provided by (used in) operating activities:

Netflix had negative operating cash flows in all three years from 2016 to 2018, demonstrating an accelerating trend that resulted in $2.68b cash used by operations in 2018 and a -49.7% rate of change from 2017 ($1.79b). The increase in net cash used by operating activities in 2018 compared to 2017 and 2016 was primarily due to an increase in cash used for working capital, including additions to content assets, which are discussed with the balance sheet, and marketing expenses, which aligns with the pattern revealed on the statement of operations. Netflix's growth strategy to rapidly acquire and retain more subscribers through enhancing its streaming content library and marketing these assets to a global audience comes at a significant cost. Management is betting that the company will increasingly reap the benefits of a growing subscriber base.

Net cash provided by (used in) investing activities:
Cash provided from Netflix's investing activities declined from $49.8m in 2016 to $34.3m in 2017, before falling sharply to $(339.1) million in 2018. While cash outflows from investing activities showed only minor shifts, net cash provided by investing activities were bolstered in 2016 and 2017 by the sale of short-term investments, which were not included for 2018.

Net cash provided by financing activities:
Netflix's financing activities provided over $4 billion in cash for 2018, nearly all of which came from the proceeds from issuing long-term debt. The same pattern is reflected for 2017 and 2016, albeit at a smaller scale. Cash from financing activities grew 181.9% from 2016 to 2017 and a further 31.6% from 2017 to 2018 due to the company's strategy of financing content acquisition and development through debt.

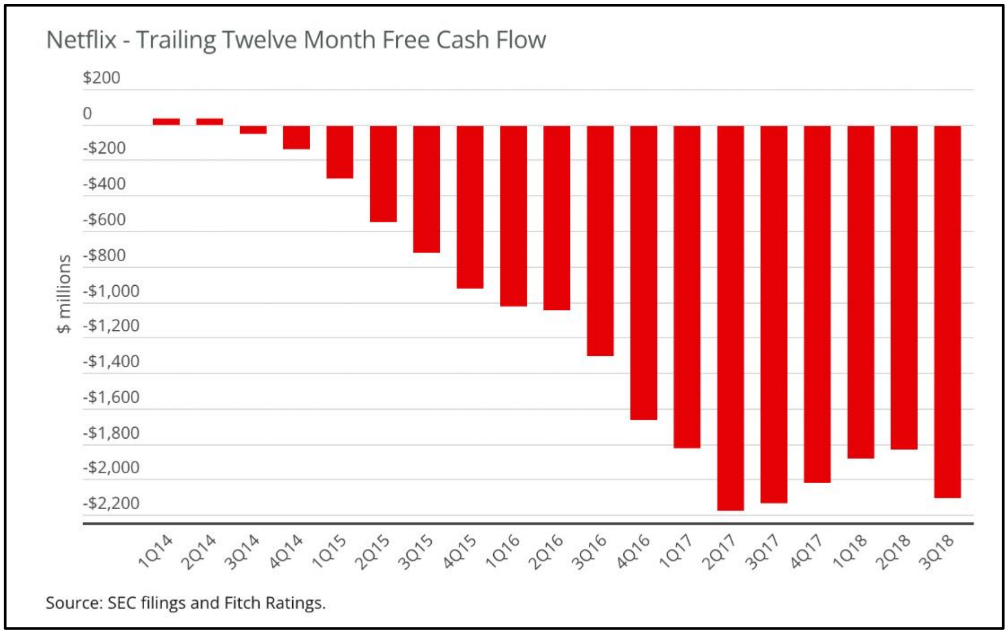


Exhibit 3.1 *(SEC, 2018)*

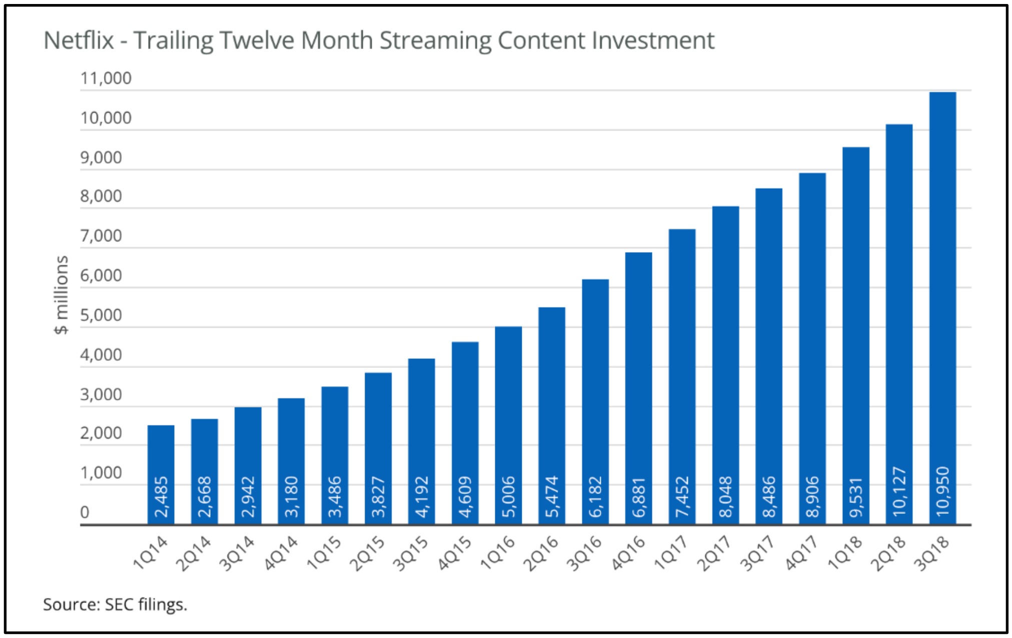


Exhibit 3.2 *(SEC, 2018)*

<u>Analysis of Statement of Stockholders Equity (as of 2018):</u>

Stockholders' equity has been increasing consistently from 2015 - 2018 according to the Netflix statements of stockholders' equity. The balance as of December 31st, 2018, reached a high of $5.2 billion. This is an indication that the company has been able to generate positive returns for its shareholders year to year.

Balances as of December 31st, 2015, included total stockholders' equity of $2.2 billion, Net Income of $186 million, comprehensive loss of $5 million, issuance of common stock upon exercise of options of $37 million, stock-based compensation expense of $173 million, and excess stock options of $64 million. This resulted in a 2016 ending balance of $2.7 billion. A $456 million increase from the previous year. In 2016, Netflix's Net Income stood at $558 million, OCI was a gain of $28 million, issuance of common stock upon exercise of options was $89 million, stock-based compensation expenses totaled $182 million, and lastly, a cumulative adjustment of $43 million. The ending balance as of December 31, 2017, stood at $3.6 billion. Another increase of $902 million from the previous year. To conclude the year of 2017, net income was recorded at $1.2 billion, OCI was $975 thousand, issuance of common stock was $123 million, stock-based compensation expense was $321 million. This left the balance as of December 31, 2018, to total $5.3 billion. An increase of $1.6 billion from the previous year (a 46% increase). The consistent increase in ending balances from year to year helped emphasize the success of Netflix during this time-period.

NETFLIX, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)

	Common Stock and Additional Paid-in Capital		Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount			
Balances as of December 31, 2015	427,940,440	$ 1,324,809	$ (43,308)	$ 941,925	$ 2,223,426
Net income	—	—	—	186,678	186,678
Other comprehensive loss	—	—	(5,257)	—	(5,257)
Issuance of common stock upon exercise of options	2,113,772	36,979	—	—	36,979
Stock-based compensation expense	—	173,675	—	—	173,675
Excess stock option income tax benefits	—	64,299	—	—	64,299
Balances as of December 31, 2016	430,054,212	$ 1,599,762	$ (48,565)	$ 1,128,603	$ 2,679,800
Net income	—	—	—	558,929	558,929
Other comprehensive income	—	—	28,008	—	28,008
Issuance of common stock upon exercise of options	3,338,474	89,425	—	—	89,425
Stock-based compensation expense	—	182,209	—	—	182,209
Cumulative Effect Adjustment of ASU 2016-09	—	—	—	43,585	43,585
Balances as of December 31, 2017	433,392,686	$ 1,871,396	$ (20,557)	$ 1,731,117	$ 3,581,956
Net income	—	—	—	1,211,242	1,211,242
Other comprehensive income	—	—	975	—	975
Issuance of common stock upon exercise of options	3,205,911	123,935	—	—	123,935
Stock-based compensation expense	—	320,657	—	—	320,657
Balances as of December 31, 2018	436,598,597	$ 2,315,988	$ (19,582)	$ 2,942,359	$ 5,238,765

See accompanying notes to consolidated financial statements.

Exhibit 4: *Statement of Stakeholders' Equity for Netflix (SEC, 2018)*

Stock-Based Compensation

Stock options granted are exercisable for the full ten-year contractual term regardless of employment status. Netflix believes that implied volatility of publicly traded options in its common stock is more reflective of market conditions, and given consistently high trade volumes of the options, can reasonably be expected to be a better indicator of expected volatility than historical volatility of its common stock. In valuing shares, Netflix does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The options are fully vested upon grant date.

Stock-Based Compensation

Stock options granted are exercisable for the full ten year contractual term regardless of employment status. The following table summarizes the assumptions used to value option grants using the lattice-binomial model and the valuation data:

	Year Ended December 31,		
	2018	2017	2016
Dividend yield	—%	—%	—%
Expected volatility	40% - 42%	34% - 37%	40% - 50%
Risk-free interest rate	2.61% - 3.09%	2.24% - 2.45%	1.57% - 2.04%
Suboptimal exercise factor	2.80 - 3.01	2.48 - 2.63	2.48
Valuation data:			
Weighted-average fair value (per share)	$ 157.19	$ 71.45	$ 48.85
Total stock-based compensation expense (in thousands)	320,657	182,209	173,675
Total income tax impact on provision (in thousands)	67,575	61,842	65,173

Exhibit 4.1: *Assumptions used to value option grants (SEC, 2018)*

Other Comprehensive Income

The table details the changes in accumulated balances of other comprehensive loss:

8. Accumulated Other Comprehensive Loss

The following table summarizes the changes in accumulated balances of other comprehensive loss, net of tax:

	Foreign currency	Change in unrealized gains on available-for-sale securities	Total
		(in thousands)	
Balances as of December 31, 2016	$ (47,966)	$ (599)	$ (48,565)
Other comprehensive income before reclassifications	27,409	728	28,137
Amounts reclassified from accumulated other comprehensive (loss) income	—	(129)	(129)
Net decrease in other comprehensive loss	27,409	599	28,008
Balances as of December 31, 2017	$ (20,557)	$ —	$ (20,557)
Other comprehensive income before reclassifications	975	—	975
Net decrease in other comprehensive loss	975	—	975
Balances as of December 31, 2018	$ (19,582)	$ —	$ (19,582)

Exhibit 4.2 *(SEC, 2018)*

Preferred Stock

The company has authorized 10,000,000 shares of undesignated **preferred** stock with a par value of $0.001 per share. None of the shares were issued and outstanding on December 31st, 2018, and 2017. This is seen in the consolidated balance sheet section under Stockholders' Equity.

C-2 Assess company profitability and creditworthiness.

Profitability

ROE = Net Income/Average Stockholders' Equity

Net Income for 2018 (Exhibit 1) = $1,211,242
Average Stockholders' Equity = ($5,238,765+$3,581,956)/2 = $4,410,360.5

ROE = $1,211,242/ $4,410,360.5 = 27.47%

ROE Disaggregation - Traditional DuPont Analysis:

The Dupont analysis is a method of decomposing return on equity (ROE) into three components: net profit margin, asset turnover, and financial leverage. The formula for ROE is:
ROE = Net Profit Margin x Asset Turnover x Financial Leverage

Dupont ROE Breakdown = Net Income ÷ Revenue x Revenue ÷ Average Total Assets x Average Total Assets ÷ Average Stockholders' Equity

Ratio Component	Calculation	Value
Net Profit Margin	$1,211,242 / $15,794,341 = 7.67%	7.67%
Asset Turnover	$15,794,341 / $22,493,571 = 0.70	0.70
Return on Assets (ROA)	$1,211,242 / $22,493,571 = 5.38%	5.38%
Financial Leverage	$22,493,571 / $4,410,360.5 = 5.10	5.10
Return on Equity (ROE)	7.67% x 0.70 x 5.10 = 27.47%	27.47%

Ratio Component	2018	2017	2016
Net Profit Margin	7.67%	4.78%	2.11%
Asset Turnover	0.70	0.72	0.74
Return on Assets (ROA)	5.38%	3.43%	1.57%
Financial Leverage	5.10	5.21	4.85
Return on Equity (ROE)	27.47%	17.85%	7.61%

Net Profit Margin: Calculated by Net Income / Total Revenue being calculated at 7.67% in 2018 demonstrates Netflix's ability to succeed in a competitive market and the overall strength of its brand. It has seen a steady increase from the previous two years indicating stronger margins.

Asset Turnover: Calculated by Total Revenue / Average total assets resulting in an asset turnover number of .70 which means that Netflix may not efficiently be using its assets to generate revenue. However, this is expected in a streaming service company and is not a major cause of concern at the moment.

Return on Assets: Calculated by Net Income / Average Total Assets and resulted in a 2018 percentage of 5.38%. ROA indicates a company's profitability in relation to its total assets. At over 5% and steadily increasing over the past 3 years, Netflix is in a good position in this category.

Financial Leverage: Calculated by Average Total Assets / Shareholders Equity which resulted in a value of 5.10 in 2018. This number is an indicator of how much debt a company has in relation to the amount of money its shareholders invested in it. The figure indicates if a company would be able to repay all its debts through the funds it's raised.

Return on Equity: Calculated by, as stated above, Net Profit Margin x Asset Turnover x Financial Leverage. The 2018 number is calculated to be 27.47%. It has increased over the past three years which indicates the profitability of a company and how efficiently the company generates profits. The numbers for Netflix demonstrate great profitability which is a good look to investors when monitoring Netflix's profitability figures.

ROE Disaggregation - Operating Focus Analysis:

Now, let's focus on reorienting the balance sheet to configure the return the shareholders receive given the financial leverage undertaken by Netflix.

ROE = RNOA + Nonoperating Return

27.47% = 15.81% + 11.66%

RNOA (Return on Net Operating Assets) = Operating Margin / Average Net Operating Assets

$1,506,681 / $9,531,467 = **15.81%**

RNOA is a good indicator on how well a company uses operating assets to create profit. It is similar to ROA, but the difference is that RNOA captures the return on the company's assets that are generating revenue.

Disaggregation of RNOA

NOPM (Net Operating Profit Margin) = NOPAT (Net Operating Profit After Tax) / Sales

($1,506,681 / $15,794,341) * 100 = **9.54%**

NOAT (Net Operating Asset Turnover) = Sales / Average Operating Assets

$15,794,341 / $9,531,467 = **1.66**

NOPM x NOAT = RNOA

9.54% * 1.66 = **15.8%**

Netflix's RNOA & FLEV Analysis			
Items	**2018**	**2017**	**Averages**
Operating Assets	$ 22,179,917	$ 16,189,947	
Operating Liabilities	$ 10,375,577	$ 8,931,354	
Net Operating Asets	$ 11,804,340	$ 7,258,593	$ 9,531,467
Shareholders' Equity	5,238,765	3,581,956	$ 4,410,361
Net Non-Operating Obligations	**$ 6,565,575**	**$ 3,676,637**	**$ 5,121,106**
Financial Leverage **(FLEV)**	1.16		
Net Income	$ 1,211,242		
ROE	27.46%		
ROA	5.83%		
NOPAT	$ 1,506,681		
RNOA	*15.81%*		
FLEV x Spread	**11.66%**		
NNE	$ 295,439		
Spread	10.04%		
NNEP	5.77%		
DuPont (ROE/ROA)	4.71		
Operating Focus (ROE/RNOA)	1.74		

Exhibit 5: *Summary Table*

Benefit (in %) of financial leverage over their RNOA is **11.66%.**
This indicates the benefit a shareholder receives given the debt intake by Netflix.

Creditworthiness

Netflix's creditworthiness can be assessed by analyzing various **financial ratios**, including the *current ratio, quick ratio, debt/equity ratio, and interest coverage ratio*.
Let's break down each ratio and examine how it has evolved for Netflix over the past three years.

Ratio Component	**2018**	**2017**	**2016**
Current Ratio	1.49	1.40	1.25
Quick Ratio	0.58	0.52	0.38
Debt / Equity Ratio	1.98	1.81	1.26
Interest Coverage Ratio	3.82	3.52	2.53

Beginning with the ***current ratio*** (which measures the company's ability to cover its short-term liabilities with its short-term assets). In 2018, Netflix's current ratio was 1.49, indicating that for every dollar of current liabilities - the company had $1.49 in current assets. This ratio has improved progressively from 2017 when it was 1.40, and from 2016 when it stood at 1.25.
The increasing trend suggests a strengthening liquidity position for Netflix, which is positive for its creditworthiness (relative to an ideal range of 1.2 to 2).

Moving on to the ***quick ratio***, which provides a more stringent measure of liquidity by excluding *inventory* from current assets. In 2018, Netflix's quick ratio was about 0.58, showing that the company had $0.58 in liquid assets to cover each dollar of current liabilities. Even though it seemed to have improved from 2017 (0.52) and 2016 (0.38), indicating an increasing ability to meet short-term obligations without relying on inventory, it still indicates an insufficiency of liquidity for Netflix to meet its short-term obligations (typically, anything above 1 is ideal).

Next, let's analyze the ***debt-to-equity ratio***, which is intended to measure the proportion of debt financing relative to equity, perhaps the most **important** ratio to analyze the efficiency of a tech firm as it gives you a picture of the risk related to investments. In 2018, Netflix's debt-to-equity ratio was 1.98, suggesting that the company had $1.98 in debt for every dollar of equity. This ratio increased from 2017 (1.81) and 2016 (1.26), indicating a rising reliance on debt for financing its operations. While moderate utilization of debt can be beneficial for growth (leverage), excessively high levels (indicated by Netflix) may increase financial risk and impact its creditworthiness deleteriously.

Finally, the ***interest coverage ratio*** indicates a company's ability to meet interest expenses (investors typically look for a ratio between 2.5 to 3x). In 2018, Netflix's interest coverage ratio improved to 3.82x from 3.52x in 2017 and 2.53x in 2016. This indicates that the company's earnings before interest & taxes relative to its interest expenses have strengthened over the years, reflecting a very strong positive trend for creditworthiness.

	Short-Term	**Long-Term**	**Outlook**
Moody’s	**N/A**	**Ba3**	**Stable**
Standard & Poor’s	**B**	**BBB+**	**Stable**
Fitch	**B**	**BB+**	**Stable**

Considering the overall ratio assessment and the provided credit ratings from Moody’s, S&P and Fitch (fiscal year ended 2018), As much as all three rating agencies seem to have given the firm a stable outlook given its size & market share, Netflix appears to have a relatively poor credit position, with Moody's and Fitch providing the firm with a “junk rating” or “non-investment/speculative grade”. Whereas, S&P seems to have them higher up in the “lower medium grade” bracket. This is primarily due to its low margins, rising debt levels and negative free cash flows over the past few years.

Nevertheless, Netflix is expected to improve its margins and optimize its capital structure over the next few years, which therein will result in an incremental move towards a higher rating in the future.

Summarizing Profitability and Creditworthiness

Netflix has demonstrated robust profitability in 2018, boasting a return on equity (ROE) of 27.47% (with an increase from 17% in 2017). Notably, Netflix's NPM too has improved from 2016 to 2018, indicating increased efficiency in generating profits from revenue.
Furthermore, the company's liquidity seems to have strengthened over the past three years, as evidenced by improving liquidity ratios such as the current and quick ratios. Additionally, Netflix's ability to cover interest expenses improved, reflecting a positive trend in profitability relative to interest obligations.
Though our FLEV percentage seems to indicate a spread enjoyed through leverage, it is important to be wary of the high debt-to-equity ratio. Unless they are able to borrow at cheaper rates, they should be more defensive and averse in their capital approach.
Netflix appears to have a weak credit position, as indicated by credit ratings from Moody's, S&P, and Fitch. While there is a negative outlook from these agencies, the stable outlooks suggest overall confidence in Netflix's financial stability.

C-3 Forecast financial statements.

To calculate the intrinsic value of Netflix's share price, we must forecast their free cash flows over 5 years (typical range for a tech firm), and a forecast terminal period. The approach we have taken to come up with the assumptions is to observe analysts' predictions and read industry articles & company expectations issued.

Highlighted here are some of the most significant forecast assumptions over the next year i.e., 2019.

2019 Expectations

Content & Subscriber related segment	Subscriber Count	160 - 173.7 million
	Gross Margin	Higher yr./yr. - 42%
	SG&A	no change (percentage of revenue)
	Marketing	increases by 2% from previous % of Revenues
	Operating Margin	13% of Revenue (increases yr./.yr.)
Financial Services segment	NFLXFS Operating Income	Down 42%
Netflix, Inc.	Capital Expenditures	$16-16.3 billion
	Effective Tax Rate	2-3%

Revenue: Netflix is expected to continue with its double-digit top-line revenue growth of 25% (yr./yr.), however, at a slight decline from the previous two years as it starts to focus more on profit margins.

Subscriber Growth: It's important to note that an increase in subscriber count is imminent but not at historical rates, they're expected to increase to about 173 million in 2019 from 139 million in 2018 (25% increase).

Taxes: Netflix is expected to pay an effective tax rate of about 3%, as opposed to 1% in 2018 (marginal tax rate of 21%).

Assets: All operating assets other than current content assets follow the respective percentage of revenue observed in 2018. However, given their reinvestment in content, we have assumed an increase of 15% from the past year.

Liabilities: All operating liabilities remain as a percentage of revenue as observed in 2018.

Long-Term Debt: Netflix is expected to take another $2-2.3 billion in debt in 2019.

Utilizing this debt, they're expected to leverage it to invest more into the long-term (in-house) production of content assets.

These assumptions result in the following forecasted income statement and balance sheet for Netflix (next page).

NETFLIX, INC.

Forecasted Income Statement & Balance Sheet
(in thousands)

			Historical	Forecast Computations		
		As of December 31,				
		2018	Historical	Forecast Computations		2019
Revenues	$	15,794,341	35%^	$15,794,341 x 125%	$	19,742,926
Cost of revenues		9,967,538	63%	19,742,926 x 58%	$	11,450,897
Marketing		2,369,469	15%	$19,742,926 x 17%	$	3,356,297
Technology and development		1,221,814	8%	no change	$	1,579,434
General and administrative		630,294	4%	no change	$	789,717
Operating income		1,605,226	10%	$19,742,926 x 13%	$	2,566,580
Other income (expense):						
Interest expense		(420,493)		no change	$	(420,493)
Interest and other income (expense)		41,725		no change	$	41,725
Income before income taxes	$	1,226,458		subtotal	$	2,187,812
Provision for (benefit from) income taxes		15,216	1%	$2,556,580 x 3%	$	76,997
Net income	**$**	**1,211,242**			**$**	**2,110,815**
Assets						
Current assets:						
Cash and cash equivalents	$	3,794,483		plug	$	3,796,025
Current content assets, net		5,151,186	33%	$19,742,926 x 40%		7,897,171
Other current assets		748,466	5%	$19,742,926 x 5%		935,583
Total current assets		9,694,135		subtotal		12,628,778
Non-current content assets, net		14,960,954	95%	$19,742,926 x 95%		18,701,193
Property and equipment, net		418,281	3%	$19,742,926 x 3%		522,851
Other non-current assets		901,030	6%	$19,742,926 x 6%		1,126,288
Total assets	$	25,974,400		total	$	32,979,109
Liabilities and Stockholders' Equity						
Current liabilities:						
Current content liabilities	$	4,686,019	30%	$19,742,926 x 30%		5,857,524
Accounts payable		562,985	4%	$19,742,926 x 4%		703,731
Accrued expenses		477,417	3%	$19,742,926 x 3%		596,771
Deferred revenue		760,899	5%	$19,742,926 x 5%		951,124
Total current liabilities		6,487,320		subtotal		8,109,150
Non-current content liabilities		3,759,026	24%	$19,742,926 x 24%		4,698,783
Long-term debt		10,360,058	66%	$10,360,058 x 122%		12,660,058
Other non-current liabilities		129,231	1%	$19,742,926 x 1%		161,539
Total liabilities		20,735,635		total		25,629,529
Commitments and contingencies (Note 5)						
Stockholders' equity:						
Preferred stock, $0.001 par value; 10,000,000 shares authorized at December 31, 2018 and 2017; no shares issued and outstanding at December 31, 2018 and 2017		-				
Common stock, $0.001 par value; 4,990,000,000 shares authorized at December 31, 2018 and December 31, 2017, respectively; 436,598,597 and 433,392,686 issued and outstanding at December 31, 2018 and December 31, 2017, respectively		2,315,988		no change		2,315,988
Accumulated other comprehensive loss		(19,582)		no change		(19,582)
Retained earnings		2,942,359		$2,942,359 + $2,110,815		5,053,174
Total stockholders' equity		5,238,765		subtotal		7,349,580
Total liabilities and stockholders' equity	$	25,974,400		total	$	32,979,109

The following "***statement of cash flows***" adheres to the assumptions used in the prior two statements to paint a congruent story.
We forecast that Netflix will have used $1.9 billion in operating activities in 2019 and a CAPEX of $394 million.
We have forecasted an additional borrowing of $2.3 billion of long-term debt to further amplify their expansion strategy.

NETFLIX, INC.			
Forecasted Values of the Consolidated Statement of Cash Flows			
(in thousands)			
	As of December 31,		
	Forecasted Assumptions		**2019 Est.**
Cash flows from operating activities:			
Net income		$	2,110,815
Adjustments to reconcile net income to net cash used in operating activities:			
Additions to streaming content assets	increases by 22%		(15,930,883)
Change in streaming content liabilities	increases by 1%		1,008,056
Amortization of streaming content assets	increases by 36%		10,305,403
Amortization of DVD content assets	increases by 50%		61,818
Depreciation and amortization of property, equipment and intangibles	increases by 41.9%		117,991
Stock-based compensation expense	increases by 40.45%		448,920
Excess tax benefits from stock-based compensation			
Other non-cash items	increases by 5%		42,449
Foreign currency remeasurement loss (gain) on long-term debt	no change		(73,953)
Deferred taxes	no change		(85,520)
Changes in operating assets and liabilities:			
Other current assets	748466 - 935,583		(187,117)
Accounts payable	703,731 - 562985		140,746
Accrued expenses	596,771 - 477417		119,354
Deferred revenue	951,124 - 760899		190,225
Other non-current assets and liabilities	(901,030 - 1,126,288) + (161,539 - 129,231)		(192,950)
Net cash used in operating activities			**(1,924,644)**
Cash flows from investing activities:			
Purchases of property and equipment	increases by 16%		(201,777)
Acquisition of DVD content assets	decreases by 30%		(27,010)
Other assets	increases by 31.19%		(166,071)
Purchases of short-term investments	no change		-
Proceeds from sale of short-term investments	no change		-
Proceeds from maturities of short-term investments	no change		-
Net cash provided by (used in) investing activities			**(394,859)**
Cash flows from financing activities:			
Proceeds from issuance of debt			2,300,000
Issuance costs	1%		23,000
Proceeds from issuance of common stock	no change		-
Excess tax benefits from stock-based compensation	no change		-
Other financing activities	no change		(1,956)
Net cash provided by financing activities			**2,321,044**
Effect of exchange rate changes on cash, cash equivalents and restricte	no change		(6,333)
Net increase (decrease) in cash, cash equivalents and restricted cash		$	1,541
Cash, cash equivalents and restricted cash, beginning of year		$	3,794,483
Cash, cash equivalents and restricted cash, end of year		$	3,796,024
Supplemental disclosure:			
Income taxes paid		$	76,997
Interest paid			420,493

C-4 Describe and illustrate the valuation of firm equity.

Intrinsic Valuation (DCF)

Assumptions:

1. Subscriber count increases to around 300 million by 2023.
2. Netflix increases its monthly subscription fee for all three packages (basic, standard & premium).
3. Netflix is expected to move into more in-house production of films & shows.
4. Utilize their debt intake (leverage) to produce more non-current & current content thereby reflecting their growth in subscribers.
5. Netflix is expected to start streaming sports.
6. Netflix starts to focus on profitability (EBIT margin of 13%) as opposed to their average margin of 7% (past three years).
7. Double margin starts to decline as a subscriber ceiling starts to become more prominent.
8. We assume a discount rate of 10% as their base case.

WACC Calculation

WACC			
Market Value of Debt	$	10,360,058	*8%*
Market Value of Equity	$	118,156,356	*92%*
Total	$	128,516,414	*100%*

Cost of Debt (Pre-tax)	4.9%
After-tax Cost of Debt (21%)	3.9%
Cost of Equity	
Risk free rate	3.0%
Beta	1.30
Equity Risk Premium	6.0%
CAPM	10.8%
WACC	**10%**

Exhibit 6: *Weighted Average Cost of Capital Computation (Discount Rate)*

Netflix DCF

Ticker	NFLX
Date	28/02/2019

Implied Share Price	$	271.39	
Current Share Price	$	358.10	32% overvaluation

Assumptions							
Switches		**Conservative Case**		**Base Case**		**Optimsitic Case**	
Revenue Growth	2	Revenue 2020-2021	80%			Revenue 2020-2021	120%
EBIT Margin	3	Revenue 2023	3%	Revenue 2023	9%	Revenue 2023	11%
		EBIT 2020-2021	90%			EBIT 2020-2021	110%
Taxes	2	EBIT 2023	16%	EBIT 2023	22%	EBIT 2023	35%
D&A	2	Taxes	14%			Taxes	9%
CapEx	2			D&A 2023	63%		
WACC	2			CapEx 2023	52%		
TGR	3	WACC	11.00%	WACC	10.00%	WACC	9.00%
		TGR	2%	TGR	2.50%	TGR	4.5%
Valuation Assumptions							
WACC	10.00%						
TGR	4.50%						

Income Statement	2016	2017	2018	2019	2020	2021	2022	2023
Revenues	$ 8,830,669	$ 11,692,713	$ 15,794,341	$ 19,742,926	$ 23,938,298	$ 27,753,464	$ 31,070,871	$ 33,856,326
% growth		32%	35%	25%	21%	16%	12%	9%
EBIT	379,793	838,679	1,605,226	$ 2,566,580	$ 3,889,973	$ 5,637,422	$ 7,889,088	$ 10,745,416
% of sales	4%	7%	10%	13%	16%	20%	25%	32%
Taxes	73,829	(73,608)	15,216	$ 76,997	$ 183,801	$ 355,158	$ 621,266	$ 1,015,442
% of EBIT	19%	-9%	1%	3%	5%	6%	8%	9%

Cash Flow Items	2016	2017	2018	2019	2020	2021	2022	2023
Depreciation	57,528	71,911	83,157	117,994	157,375	200,702	247,162	296,251
% of sales	1%	1%	1%	1%	1%	1%	1%	1%
% of capital expenditures	31%	31%	25%	29%	48%	48%	48%	48%
Other Non-Cash Items	1,875,266	1,071,524	1,201,492	2,501,229	3,184,377	3,876,482	4,773,827	5,721,972
% of sales	21%	9%	8%	13%	13%	14%	15%	17%
% of capital expenditures	1009%	458%	354%					
Ammortization of Content Library + DVD	4,867,450	6,258,474	7,573,300	10,305,403	11,969,149	14,486,740	13,981,892	15,573,910
% of sales	55%	54%	48%	52%	50%	52%	45%	46%
% of addition to streaming contet	56%	64%	58%	59%	59%	59%	59%	59%
Total D&A + Other Non-Cash Expenses	**6,800,244**	**7,401,909**	**8,857,949**	**12,924,627**	**15,310,902**	**18,563,924**	**19,002,881**	**21,592,134**
% of sales	**77%**	**63%**	**56%**	**65%**	**64%**	**67%**	**61%**	**64%**
% of CapEx + Additions	**77%**	**74%**	**66%**	**79%**	**89%**	**100%**	**118%**	**123%**
Capital Expenditure	185,771	233,711	339,120	394,859	478,766	555,069	621,417	677,127
% of sales	2%	2%	2%	2%	2%	2%	2%	2%
Addition to streaming content	8,653,286	9,805,763	13,043,437	15,930,883	16,756,809	18,039,752	15,535,435	16,928,163
% of sales	98%	84%	83%	81%	70%	65%	50%	50%
Capital Expenditure + Addition	**8,839,057**	**10,039,474**	**13,382,557**	**16,325,742**	**17,235,575**	**18,594,821**	**16,156,853**	**17,605,289**
% of sales	**100%**	**86%**	**85%**	**83%**	**72%**	**67%**	**52%**	**52%**
Change in Networking Capital	192,380	58,977	293,767	197,429	239,383	277,535	310,709	338,563
% of sales	2%	1%	2%	1%	1%	1%	1%	1%
% change in sales		2%	7%					

				1	2	3	4	5
DCF	2016	2017	2018	2019	2020	2021	2022	2023
Revenues	$ 8,830,669	$ 11,692,713	$ 15,794,341	$ 19,742,926	$ 23,938,298	$ 27,753,464	$ 31,213,974	$ 34,023,232
% growth		32%	35%	25%	21%	16%	12%	9%
Conservative Case				25%	17%	13%	8%	3%
Base Cae				25%	21%	16%	12%	9%
Optimistic Case				30%	26%	19%	15%	11%
EBIT	379,793	838,679	1,605,226	$ 2,566,580	$ 4,278,971	$ 6,201,165	$ 8,717,966	$ 11,878,228
% margin	4%	7%	10%	13%	18%	22%	28%	35%
Conservative Case				13%	15%	18%	23%	29%
Base Cae				13%	16%	20%	25%	32%
Optimistic Case				13%	18%	22%	28%	35%
Taxes	73,829	(73,608)	15,216	$ 76,997	$ 202,181	$ 390,673	$ 686,540	$ 1,122,493
% of EBIT	19%	-9%	1%	3%	5%	6%	8%	9%
Conservative Case				3%	5.75%	8.50%	11.25%	14.00%
Base Cae				3%	4.73%	6.30%	7.88%	9.45%
Optimistic Case				3%	4.50%	6.00%	7.50%	9.00%
EBIAT	305,964	912,287	1,590,010	$ 2,489,583	$ 4,076,789	$ 5,810,491	$ 8,031,426	$ 10,755,735
D&A + Other Non-Cash Expenses	6,800,244	7,401,909	8,857,949	$ 12,924,627	$ 15,310,902	$ 18,563,924	$ 19,090,403	$ 21,698,580
% of sales	77%	63%	56%	65%	64%	67%	61%	64%
% of CapEx	77%	74%	66%					
CapEx	8,839,057	10,039,474	13,382,557	$ 16,325,742	$ 17,235,575	$ 18,594,821	$ 16,231,267	$ 17,692,081
% of sales	100%	86%	85%	83%	72%	67%	52%	52%
Change in NWC	192,380	58,977	293,767	$ 298,966	$ 362,676	$ 420,686	$ 473,374	$ 516,233
% of sales	2%	1%	2%	2%	2%	2%	2%	2%
Unlevered Free Cash Flow	(1,925,229)	(1,784,255)	(3,228,365)	(1,210,498)	1,789,440	5,358,909	10,417,188	14,246,001
Present Value of FCF				$ (1,100,453)	$ 1,478,876	$ 4,026,227	$ 7,115,079	$ 8,845,646
Terminal Value								$ 168,067,276
Present Value of TV								$ 104,356,555
Enterprise Value								$ 124,721,931
(+) Cash								$ 3,794,483
(-) Debt								$ 10,360,058
Equity Value								$ 118,156,356
Number of Shares								435,374
Implied Share Price								$ 271.39

Sensitivity Analysis on Per Share Value

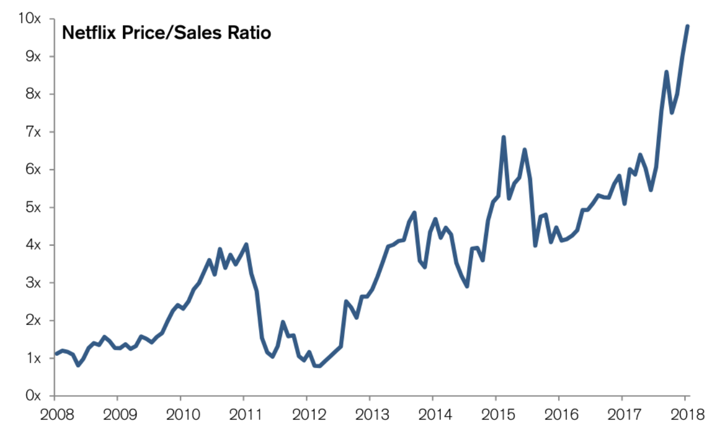
		Terminal Growth Rate (TGR)				
		1.50%	3.50%	**4.50%**	5.50%	7.50%
Discount Rate (WACC)	9.00%	220.61	293.65	354.52	450.18	1024.11
	9.50%	200.13	260.37	308.57	380.85	742.30
	10.00%	182.34	232.57	**271.39**	327.46	574.16
	10.50%	166.77	209.06	240.78	285.19	462.81
	11.00%	153.05	188.96	215.20	250.98	383.88

Relative Valuation

	Market Data				Financial Data			Valuation			
Company Name	Price ($/share)	Market Cap ($M)	Net Debt ($M)	Enterprise Value ($M)	Revenue ($M)	EBITDA ($M)	Net Income ($M)	EV/Revenue x	EV/EBITDA x	P/E x	
Netflix	363.02	116,800	6,565	123,365	15,794	9,220	1,211	7.8x	13.4x	96.4x	
Disney	104.22	164,480	16,210	180,690	59,434	17,815	12,598	3.0x	10.1x	13.1x	
Amazon	73.90	737,470	(7,759)	729,711	232,887	27,762	10,073	3.1x	26.3x	73.2x	
Warner Bros	30.59	13,700	13,988	27,688	10,553	6,620	594	2.6x	4.2x	23.1x	
Tencent Music Entertainment Grou	13.40	21,590	(2,300)	19,290	2,869	555	277	6.7x	34.8x	77.9x	
Live Nation Entertainment Inc	48.24	10,350	458	10,808	10,788	759	(18)	1.0x	14.2x	-575.0x	EXCLUDED
Spotify	112.16	20,530	(891)	19,639	6,211	(13)	(92)	3.2x	-1510.7x	-223.2x	
Average								3.9x	18.8x	46.8x	
Median								**3.1x**	**18.2x**	**48.1x**	

Netflix Valuation	EV/Revenue	EV/EBITDA	P/E
Implied Enterprise Value	48,752.17	167,928.94	64,860.43
Net Debt	6,565	6,565	6,565
Implied Market Value	42,187.17	161,363.94	58,295.43
Shares Outstanding	435	435	435
Implied Value Per Share	$ **96.90**	$ **370.63**	$ **133.90**

Exhibit 7: *Relative Valuation of Netflix*



Source: Company data, Thomson Reuters, Credit Suisse estimates

Exhibit 7.1: *Netflix's Price to Sales Ratio over the years (Credit Suisse, 2018)*

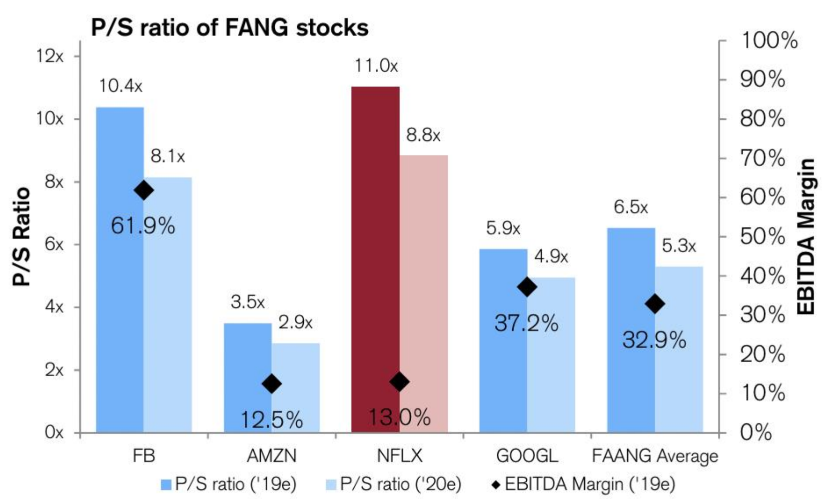
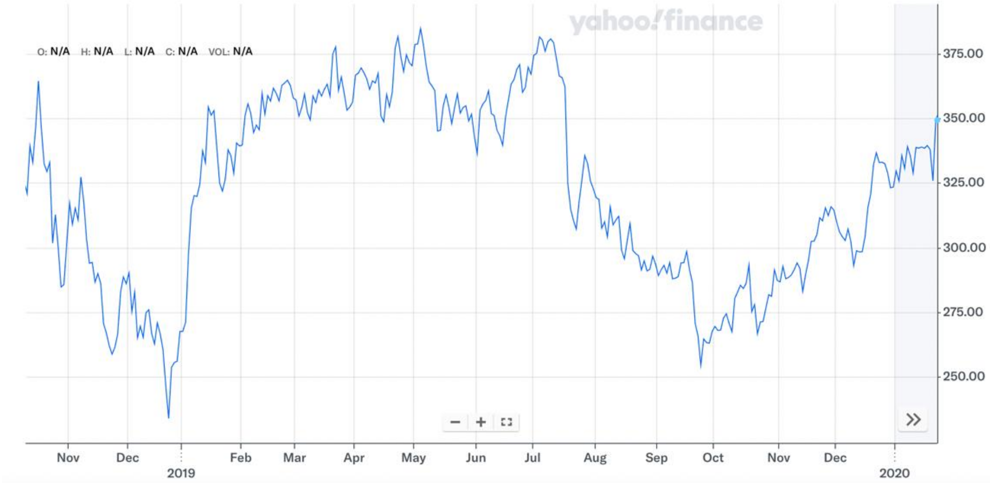


Exhibit 7.2: *P/S Ratio (& EBITDA Margins) relative to the FANG stock (Thomas Reuters, 2018)*

<u>Assessment of the Valuation Estimate</u>



The closing share price on December 31, 2018, for Netflix (NSFX), was $267.66 per share. The stock price then increased to $358.10 by February 28, 2019. As much as our valuation indicates a 32% overvaluation of the stock, we do not think the stock will drop down to its fair value in the near future as markets are notorious for over-valuing stocks for a prolonged period. Given the sensitivity analysis, an investor is said to have an accurately valued or undervalued stock given they expect a terminal growth rate of 5-6% for Netflix.
In terms of a relative valuation, applying median values of its comparable, we can presume Netflix's implied share price would be in the range of $120 - 350.
(We have decided to exclude Spotify & Live Nation Entertainment from our comparable calculation as they had negative net income for those years leading to negative multiples - disrupting our valuation).

Summary Observations

This comprehensive analysis of Netflix's financial performance and value underscores the company's strategic focus on bolstering its content library, particularly through robust investments in original content production aimed at reducing dependence on licensing agreements to retain a content quality advantage over its numerous competitors. Netflix aims to stimulate further expansion of its subscriber base, with a pronounced emphasis on international markets where substantial growth opportunities exist. The debt structure used to finance investments in content underscores management's confidence in the company's ability to service obligations over time with cash from anticipated revenue growth from subscriptions. The decision to increase leverage has translated into enhanced profitability metrics, creating value for shareholders. Despite the inherent risks associated with escalating leverage, Netflix maintains solid liquidity and coverage ratios, affirming the viability of its financial strategy. However, our discounted cash flow valuation indicates a significant disparity between Netflix's intrinsic value and its stock price during the first quarter of fiscal year 2019, suggesting it is overvalued by the market. Investors may have overly optimistic expectations regarding Netflix's future growth potential, particularly in terms of subscriber acquisition and revenue expansion through its content acquisition and development strategy. Perhaps some projections do not adequately factor in the growing strength of Netflix's industry competitors, who it will need to increasingly battle for market share both domestically and abroad. Netflix will likely need to continue high level spending to outmaneuver competitors, in addition to paying down the debts incurred through recent investments in content assets. General market sentiment can also sometimes drive stock prices to levels that are disconnected from underlying fundamentals. Positive media coverage, hype surrounding new releases or partnerships, and favorable analyst reports could have contributed to an overvaluation of Netflix's stock at this time. Considering these factors, our DCF analysis projects the firm’s rate of revenue growth to begin declining following the auspicious run from 2016 to 2019. While recognizing Netflix's commendable strides in content expansion and financial management, prudent consideration of valuation metrics remains imperative for investors navigating the dynamic landscape of streaming entertainment.