NETFLIX

Company Overview:

Founded in 1997 and headquartered in Los Gatos, California, Netflix Inc.is the leading Internet subscription service for watching movies and TV shows. Netflix subscribers can instantly watch unlimited movies and TV episodes streaming over the Internet to PCs, Macs, TVs, and many other entertainment devices.

Name	Ticker	Yield	Growth	D + G
Netflix, Inc.	NFLX	0.00%	16.00%	16.00%

Company Highlights:

Yes, we understand that a hit on NFLX is the current valuation. NFLX's multiple is near other high quality consumer facing businesses. We think this is reasonable given NFLX's growth/margin profile, along with its unique business characteristics and growth opportunities. In general, we think NFLX can sustain a premium valuation vs. peers given the variety of growth drivers ahead of the business, opportunity for margin expansion/FCF growth, and scarcity value as a pure-play streaming asset with scale, profitability, a proven track record, and a high-quality management team

Bull Case:

- ***Unbelievably Strong Fundamentals –*** Despite macro headwinds, Netflix is experiencing increasing demand for its ad inventory. While these challenges may affect Linear incumbents, Netflix's ad business is still nascent enough to continue to grow as Linear ad budgets shift to Streaming. Whether ad revenue growth can offset the ad-tier discount remains to be seen, but Netflix is optimizing for member growth and, more importantly, earnings. The trade-off between volume and rates continue to work well, as evidenced by sustained revenue growth and expanding margins.
- ***Different Levers to Grow Ad Spend –*** Management also recently shared that there is a runway of sequential improvements/innovation that their ad suite will enable. The first stage is having the tool available in every ad market while improving the targeting capabilities. Then, expand to more international markets as measuring capabilities are developed/improved. The company expects these to improve both the value to buyers of ad slots and users that can have a more tailored or relevant ad experience.
- ***Pricing Inelasticity –*** Earlier this year, NFLX raised prices (+16% for standard plans,+14% for ad plans) without impacting strong retention (as the management has specifically mentioned), highlighting its strong pricing power and market leadership despite the market downturn. NFLX typically adjusts pricing after enhancing content quality and gauging user stickiness. With increased content in the future, further price hikes remain likely, even amid market volatility. We expect increased pricing to contribute to 2% of revenue growth.

Bear Case:

- ***More Concentrated Content Development Effort Could Heighten Execution Risk –*** We acknowledge that a more concentrated production effort, to manage content spend, could heighten the execution risk around the business. In particular, in any given year, the platform may be increasingly dependent on the success of a smaller set of projects—compared to the benefits of publishing a wider slate of material that captures a more diverse set of audience interests.
- ***Competitive Environment Presents an Ongoing Risk to Economics –*** NFLX operates in a highly competitive environment that is constantly evolving. Across the board, there are a variety of product tiers, content options, and partnerships that influence consumer purchasing decisions. Coupled with low switching costs for consumers, all of this heightens the need for platforms to remain relevant. All of these dynamics can weigh on the business at times through subscriber additions, content costs, and/or customer acquisition costs.
- ***Relatively Lower Visibility into the Business Compared to Prior Years –*** Starting with 1Q22, NFLX stopped providing quarterly guidance for subscriber additions — highlighting that this metric was becoming less relevant on a stand-alone basis since the company is more focused on optimizing total revenue. Additionally, beginning in 2025, NFLX will no longer disclose quarterly membership or ARM metrics.

Overall Thesis:

NFLX offers a compelling platform with a demonstrated track record of delivering high quality content to its users and should benefit from the ongoing secular trend toward streaming. Our constructive stance is predicated on: 1) a positive bias regarding monetization opportunities such as advertising, and price increases, 2) a meaningful runway ahead to support sustained double-digit revenue growth, increased profitability/FCF, and continued share gains within global entertainment hours over a multi-year period, and 3)potential for investor sentiment to further improve as the business executes against longer-term initiatives (live programming, video games, etc.) and benefits from its scarcity value in the public markets.

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