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Technology Research

Company Update

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Netflix (NFLX) Highly Attractive

Daniel Ives, Head of Technology Research | 917.210.3220 | daniel.ives@gbhinsights.com

Content, Content, Content = Netflix Growth Machine Showing No Signs of Slowing Down; Raising Price Target to $375

We believe Netflix has a number of growth levers which should fuel the company's next phase of strategic penetration among both US and especially international consumers. While the landscape for original content has become increasingly competitive with new entrants entering the market by the day (Disney/Fox remains a clear competitive worry) we believe Netflix remains in a unique position of strength to grow its content and distribution tentacles over the next 12 to 18 months and thus further build out its massive content and streaming footprint. Coming off its first Oscar win this week, we believe the credibility of the Netflix platform within Hollywood circles is quickly changing as we continue to hear that A+ talent is now considering a number of major film projects, long term content deals, and other original programming initiatives that will further drive the Netflix content machine for years to come. With Netflix planning to spend up to $8 billion on content this year with 30%-35% of this towards original programming and ~120 million subs and growing on the platform, we are incrementally bullish that the company remains in the early days of a golden market opportunity. In addition, our latest survey work with our GBH FAANG Tech Tracker show that the average Netflix user is watching the streaming service 10 hours+ per week which is nearly double its nearest competitors Amazon and Hulu which is closer to 5 hours per week, an "eye popping" disparity in our opinion. Our bullish thesis on Netflix is based on our belief that the company's competitive moat, franchise appeal, ability to increase international streaming customers through 2020, and original content build out will translate into robust profitability and growth as the next phase of this story plays out over the coming years with roughly $10 of earnings power by 2022. We also believe Netflix (as well as other FANG names) is essentially "insulated" from any global tariff/trade war worries which is a safety blanket in a rocky political time potentially ahead. **We have a Highly Attractive rating on Netflix and are raising**

our price target from $310 to $375 to reflect stronger than expected net sub adds and international momentum heading into the rest of 2018/2019.

Content is King for Netflix in 2018 and Beyond

The underlying growth and franchise model at Netflix all revolves around original content build out fueling consumer engagement and subscriber growth, as we are witnessing a "content war" with Netflix in the heat of the battle vs. traditional media players as well as emerging streaming competitors. With the appetite for content among media companies reaching a feverish pitch, Netflix will be spending up to $8 billion on content in 2018, up roughly $1 billion from its spending trajectory for 2017. We estimate roughly 30% to 35% of its content spending to be allocated towards original content in 2018 with a long-term target of 50% by 2020. With more consumer dollars shifting away from traditional cable with cord cutting and towards streaming delivery, we believe Netflix has a long runway of growth and opportunity ahead of itself and clear first mover advantage despite intense competition from larger media players (Disney), pure play competitors, and new potential entrants (e.g. Apple). To this point, on the content front the recent Ryan Murphy deal was the first "shot across the bow" in our opinion as Netflix is looking to aggressively purchase content and talent with the Disney/Fox ecosystem now in major target range. Original content remains the key ingredient in Netflix's recipe for success and its eight Oscar nominations and first Academy Award win this week was another feather in the cap for the "Netflix content machine" in our opinion. Netflix is quickly establishing itself within Hollywood as a highly credible platform with broad distribution, unlimited resources, and capabilities that can get movies/documentaries recognized by the Academy and other major award circles globally, which has been a hurdle over the past few years as high level A+ film talent was worried in some cases about this dynamic and shunned Netflix for other

Daniel H. Ives
917.210.3220
daniel.ives@gbhinsights.com

traditional studios, a headwind that is no longer at play given the "Hollywood success story" Hastings & Co. has built over the past five years.

International Sub Ramp Acceleration Front and Center

Netflix has talked about its US domestic penetration potential in the 60M to 90M range with our estimate that by early 2019 they break the 60M mark and mid to high single digit domestic growth sustainable from 2019-2021. The holy grail of incremental growth (and profitability) going forward will be from international customers as we believe Netflix has a TAM of over 700M subs by 2020. With the company spending major resources over the last two years building out a global distribution arm and customer base in over 100 countries, we believe the fruits of this labor will start to be fully realized in 2018 and beyond as evidenced again by the strong international performance in 4Q. With the US market starting to see a normalized growth rate after a period of hyper-growth, we believe Netflix has potential to get 100M international subs by 2020 (vs. ~60M today), thus rounding out the long-term growth and margin story for the coming years. With the international segment turning the corner on profitability and appearing to show strong growth thus far in 1Q, we believe this incremental growth will flow to the bottom-line in 2018 and beyond and translate into significant cash flow and EPS growth, a dynamic that we believe is still underappreciated by the Street today. We also believe another core growth driver around 4K Ultra HD TV represents an opportunity both internationally as well as domestically for Netflix. Our recent survey work indicated that 87% of current Netflix customers would accept further price increases to stay with the flagship streaming service, which speaks to the "price inelasticity" the company has built with 4K Ultra HD carving out another avenue to raise prices over the next 12 to 18 months in our opinion as this content/programming ramps accordingly. To this point, as international growth

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ramps along with profitability, we believe the Netflix growth story will transition from purely domestic driven into a global streaming play, original content behemoth, and rising ARPU franchise translating into a higher multiple and significant long term earnings power and speaking to our bull case scenario for shares of Netflix over the coming year.

Disney Remains a Potential Threat; Setting up for a 2019 Battle Royale

The Fox deal puts major fuel into the Disney engine in terms of being content king and with its streaming service set to launch in 2019 Iger has a clear runway to potentially gain market and mind share from the likes of Netflix over time. We continue to view this as a “home run deal” for Disney and while its an aggressive acquisition with a high price tag, in our opinion this is the right move at the right time as the marriage of these assets creates a much more formidable Disney on both the content and streaming front for the coming years with its primary goal to invade Netflix’s “golden streaming sandbox” when it launches its competitive service in 2019. We also believe the recent launch of ESPN Plus and the announcement of James Pitaro as CEO, an experienced digital media and streaming veteran, speaks to Disney’s “all in” and laser focused holistic streaming strategy for the coming years. Watching the strategic direction that Disney takes this deal on the content and Hulu fronts (with the Comcast/Sky bid throwing another curveball in this deal), coupled by domestic box office synergies will be a key focal point of the industry and the Street for the rest of 2018, although we see minimal disruption for the Netflix machine in the near-term from this lingering threatening competitive dynamic. This also speaks to why the recent Murphy content deal is so significant as Netflix and Hastings is fully aware the next 6-12 months is a key window of opportunity to secure major talent (we expect a plethora of announcements/new content deals over the coming months) and content before

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Iger and the Disney machine hit the ground running heading into its highly anticipated 2019 streaming service launch.

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