GBH INSIGHTS

# Technology Research

Company Update

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Netflix (NFLX) | Highly Attractive

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## Expecting Strong 1Q and Increased 2018 Outlook; Competitive Moat and International Growth Remain Major Tailwinds for Netflix

We believe Netflix had a stronger than expected net sub add quarter for 1Q and should handily exceed the Street's estimates across the board, with international growth remaining "front and center" as the main growth catalyst going forward. Overall, based on our survey work/analysis we believe net sub adds could be roughly 7.5 million this quarter (ahead of our 6.4 million estimate) with both domestic and international net subs showing healthy momentum heading into the rest of 2018 and coming in above expectations. We believe domestic subs of 1.8 million and international subs of 5.7 million, both handily above Street expectations. To this point, 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. 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 year with $10 of earnings power by 2022. In a nutshell, we view Netflix's earnings as a clear positive catalyst for the stock and the overall tech sector with our expectations of a robust earnings season for FANG names on the horizon with Netflix kicking off the fireworks on Monday after the bell. **We have a Highly Attractive rating and $375 price target on Netflix.**

**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. With the appetite for content among media companies reaching a feverish pitch, Netflix will be spending ~$8 billion on content in 2018, up roughly $1 billion from its spending trajectory for

2017. 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. From a content perspective, 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 FANG 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.

**International growth showing major tailwinds.** 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 our strong 1Q checks. 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 stronger than expected sub growth 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

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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 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.

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