

# Valuation of Netflix, Inc. using Selected Valuation Methods

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Master's thesis  
2020

 Tomas Bata University in Zlín  
Faculty of Management and Economics

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Univerzita Tomáše Bati ve Zlíně

Fakulta managementu a ekonomiky

Ústav financí a účetnictví

Akademický rok: 2019/2020

## ZADÁNÍ DIPLOMOVÉ PRÁCE (projektu, uměleckého díla, uměleckého výkonu)

Jméno a příjmení:	Elena Matevosyan
Osobní číslo:	M180115
Studijní program:	N6202 Economic Policy and Administration
Studijní obor:	Finance
Forma studia:	Prezenční
Téma práce:	Valuation of the Selected Company using Selected Valuation Methods

### Zásady pro vypracování

#### Introduction

Define the objectives and the application methods used in the Master thesis.

#### I. Theoretical part

- Gather theories and prepare a critical literature review focused on concepts and methods of corporate valuation.

#### II. Practical part

- Describe selected company and conduct industry overview.
- Conduct financial, strategic, fundamental and technical analysis of the company.
- Determine the value of the company using selected valuation methods.
- Formulate recommendations for potential investors.

#### Conclusion

Rozsah diplomové práce: cca 70 stran  
Forma zpracování diplomové práce: Tištěná/elektronická  
Jazyk zpracování: Angličtina

Seznam doporučené literatury:

DAMODARAN, Aswath. *Investment valuation: tools and techniques for determining the value of any asset*. Third edition. Hoboken: Wiley, 2012, 874 s. ISBN 9781118011522.  
PINTO, Jerald E., Elaine HENRY, Thomas R. ROBINSON, John D. STOWE a Stephen E. WILCOX. *Equity asset valuation*. Third edition. Hoboken: Wiley, 2015, 595 s. CFA Institute investment series. ISBN 978119104261.  
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ROBINSON, Thomas R., Elaine HENRY, Wendy I. PIRIE a Michael A. BROHANN. *International financial statements analysis*. Third edition. Hoboken: Wiley, 2015, 1033 s. CFA Institute investment series. ISBN 978118999479.  
ROSS, Stephen A., Randolph WESTERFIELD a Bradford D. JORDAN. *Fundamentals of corporate finance*. Eleventh edition. New York: McGraw-Hill Education, 2016, 913 s. ISBN 9780077861704.

Vedoucí diplomové práce: Ing. Jana Vychytilová, Ph.D.  
Ústav financí a účetnictví

Datum zadání diplomové práce: 6. ledna 2020  
Termín odevzdání diplomové práce: 21. dubna 2020

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## **ABSTRAKT**

Hlavním cílem práce je zjistit hodnotu společnosti Netflix, Inc., která je veřejně obchodována na burze NASDAQ, za použití vybraných valuačních metod. Práce se skládá ze dvou částí, z části teoretické a praktické. V teoretické části je provedena kritická literární rešerše týkající se oceňování podniků a nejčastěji používaných přístupů k oceňování. Praktická část práce si klade za cíl determinovat hodnotu Netflixu pomocí vybraných valuačních metod, jmenovitě DCF a EVA. Autor pro účely ocenění provádí mimo jiné analýzu klíčových konkurentů, finanční analýzu, analýzu rizik, a analýzu corporate governance vybraného podniku a s ohledem na odvětví, ve kterém podnik působí. Kromě toho autor provádí krátkou analýzu vlivu COVID-19 na budoucí výkonnost podniku Netflix. Po determinaci hodnoty společnosti autor práce porovná výsledky použitých valuačních metod a vyvozuje praktická doporučení. Výsledkem práce je stanovení hodnoty společnosti Netflix, využitelné managementem společnosti, ale také externími uživateli, jako jsou potenciální investoři, dlužníci, veřejný sektor nebo potenciální zaměstnanci.

**Klíčová slova:** DCF, EVA®, valuační metody, hodnota společnosti

## **ABSTRACT**

The main aim of the thesis is to determine the value of Netflix, Inc. which is publicly traded on the NASDAQ stock exchange, applying selected valuation methods. The thesis consists of two parts: theoretical and practical. In the theoretical part critical literature review of the core of the business valuation and most commonly used valuation approaches is performed. While practical part of the thesis aims to calculate Netflix's value using selected valuation methods, namely DCF and EVA. In order to use these approaches, the author conducts company's analysis, including business and industry overview, analysis of core competitors, financial and risk analysis, analysis of corporate governance. Moreover, the author conducts short analysis of the COVID-19 influence on Netflix's future performance. After getting the company's value, the author of the thesis compares results from different valuation approaches and gives some recommendations. The result of the thesis is Netflix's value, which can be used by either management of the company or external users such as potential investors, debtors, public sector or potential employees.

**Key words:** DCF, EVA®, valuation approach, company's value

## **ACKNOWLEDGMENTS**

*"An investment in knowledge pays the best interest."*

Benjamin Franklin

The first sentence of my acknowledgment starts by thanking Czech Republic for the great opportunity to study and live in this amazing country. I appreciate a lot the help provided me in the form of scholarship during my master degree studies in Tomas Bata University in Zlin. A huge thank is going to the Faculty of Management and Economics, as well as to the Department of Finance and Accounting in the face of prof. Dr.Ing. Drahomíra Pavelková

I would like to thank with all my appreciation Pavla Bartošová for the help and support before my arrival in Zlin as well as during the whole period of my studies. A huge appreciation is to my supervisor Ing. Jana Vychytilová, Ph.D. for her kindness, knowledge, support and valuable guidance. Her motivation and expertise, during research projects that I was participating in due to her help within the Faculty of Management and Economics, were invaluable and resulting in great experience and knowledge that I've obtained.

The help and support from Ing. Lucie Tomancová, Ph.D., during studies and in obtaining the internship in the Czech Republic, was of great importance for me.

The knowledge and expertise received from Ing. Blanka Jarolímová, doc. Ing. Adriana Knápková, Ph.D., Ing. Martin Mikeska, Ph.D., prof. Ing. Boris Popesko, Ph.D., Ing. Přemysl Pálka, Ph.D., JUDr. Jiří Zicha, Ph.D., and Ing. Denisa Hrušecká, Ph.D., will always be invaluable for me.

Thank you for the energy and patience you contribute into your work.

And last, but not least I would like to thank my family, my parents and my brother, for their endless support and faith in me, without it I would not be able to fully change my life, give up the job in my home country, leave my family and friends, and move to Czech Republic for education. A big thanks is going to my friend Daria Dolgopolova and her family for all the support they gave me on my way.

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## INTRODUCTION

Subscription video on demand (further SVoD) sector of entertainment industry is getting popular from day-to-day, especially in today's reality, when the whole globe is in a fever from a pandemic (COVID-19). Surely, people have heard many names and brands of SVoD providers. The most well-known are Netflix, Inc. (further Netflix), Amazon.com, Inc. (further Amazon Prime Video or Amazon), Alphabet, Inc. (further YouTube Premium or Google), Walt Disney Company (further Disney, Disney+, Hulu), AT&T, Inc. (further HBO GO) and many others.

The author's first experience with SVoD sector started with Netflix. The author was using it for several months for entertainment purpose. The author was impressed with Netflix's user interface, video content provided and customers' service. Thus, it was decided to conduct business valuation of the company as part of the master thesis research.

The main goal of the thesis is to conduct appraisal process for Netflix. To do so, the thesis will be divided in two main parts: theoretical and practical. The first part will present the theoretical framework of the business valuation. To do so the author will perform literature review regarding business valuation topic. The basis of the valuation will be described. The author will describe main standards and premises of value, as well as their differences and their importance in the business valuation process. Moreover, main valuation approaches will be discussed and several classifications of valuation methods will be described. The author has chosen two methods in order to conduct appraisal process for Netflix, namely DCF (Discounted cash flow Model) and EVA (Economic value added Model). These two methods will be described in details in the theoretical part of thesis, as well as required inputs. The researched selected methods of business valuation will be used further in the practical part of the thesis. To do so, the author will conduct strategic analysis of Netflix. Strategic analysis of business is very complex process requiring analysis of the company and its stakeholders from many different perspectives, as well as industry analysis and global trends. The author will analyze target industry and current trends, as well as industry's potential. To do so, macroeconomic analysis and global trends analysis will be performed. Understanding of Netflix's competitive position will be reached by mean of worldwide known Porter's Five Forces analysis. Thus, five main forces influencing Netflix performance will be analyzed, namely 1) Threat of potential entrants; 2) Power of buyers; 3) Power of suppliers; 4) Industry rivalry; 5) Threat of substitute. The overall description of the business model, company's vision and company's strategy will be overviewed as well as

its approach to corporate governance. The author will apply its knowledge in risk management area in order to conduct risk analysis for Netflix. As a result the self-created Risk Matrix will be proposed.

As a result of strategic analysis, the author will be able to estimate some Netflix's indicators. Based on this, revenue prediction for the period 2020-2014 will be conducted. During the next step, the author will be able to define inputs for selected valuation models and to perform calculations. As a result, Netflix's intrinsic value will be estimated. Further, the author will discuss the results and will give some recommendations for target company. The results of appraisal process might be used by the company to attract more investors, debtors or other stakeholders. The author of the thesis cannot ignore the impact of COVID-19 on company's performance and on the globe as a whole, Thus, the brief overview regarding global pandemic and health crisis, as well as their possible influences on Netflix and its operations, will be discussed.

## OBJECTIVE AND METHODOLOGY

The main aim of the thesis is to determine the value of Netflix, which is publicly traded on the NASDAQ stock exchange, applying selected valuation methods.

Firstly, critical literature review will be conducted in order to determine the most widely used valuation approaches and techniques. Then the crucial step in the business valuation will be performed, namely strategic analysis of the target company.

The author will analyse Netflix from different perspectives, such as macroeconomic overview, industry and business description, product portfolio, competitive positioning and analysis of the peers, corporate governance. Moreover, investment risks will be analysed, and the author will propose self-created Risk Matrix for Netflix.

After performing financial analysis of the company, revenue prediction will be conducted using statistical method such as simple linear regression. Based on the revenue prediction, the author will forecast company's financial statements (balance sheet and income statement).

The next step will be to estimate Netflix's value using DCF and EVA valuation techniques. Based on the results, the author will give conclusion and recommendations. Moreover, a brief overview of the possible COVID-19 influence on Netflix will be done. The limitations of the research which the author will face, will be discussed after the result of the valuation will be received, as well as the suggestions for the future studies will be given.

## **I. THEORY**

## 1.1 Basis of the Valuation

### 1.1.1 Definition of Value

What does it really mean the term "value"? One of the definitions from Longman Dictionary of Contemporary English states it is "worth the money paid." (LONGMAN Dictionary of Contemporary English, 2020). Thus, every asset in the world has its value. However, the main challenge is to precisely determine the asset's value. The key components and approaches vary depending on the type of an asset and a bunch of circumstances around it. Over the past 30 years, many specific methods and approaches, to value either assets or businesses in the whole, were developed (Hitchner, 2011).

Lately business valuation is in great demand and there are many reasons for that. It is crucial to know the value of the business in case of the following events: mergers and acquisitions, legal disputes, taxation issues, buy or sell of the business, searching for funding, strategic planning, etc. (Hitchner, 2011). However, most often it is needed in mergers and acquisitions, corporate finance and portfolio management (Damodaran, 2012).

There are a lot of professional valuation service providers on the market. In order to follow, during the business valuation process, transparency and consistency, business appraisals should follow International Valuation Standards (IVS) which are set by the International Valuation Standards Council (IVSC). Following these standards gives the confidence to the users of the appraisal reports (CMS, 2020).

#### 1.1.1.1 Standards and premises of value

In order to perform a business valuation, it is crucial to understand which standard of value to apply. There are three main standards of value and two premises of value (Table 1).

**Table 1. Standards and premises of value**

Standards of value	Premises of value
Fair market value	Going concern
Investment value	Liquidation
Intrinsic value	

Source: Author's processing using (Hitchner, 2011) and (Pinto, 2015)

Fair market value is the price which the buyer is ready to pay for an asset and the seller is ready to sell for this price. Moreover, it should be without any compulsion to sell or

to buy for both sides and it's assumed that both buyer and seller are informed of all the aspects of an asset. If to assume that the market players know that the company's management is acting in the shareholder's best interests, then in the long-run, the market price should reflect fair market value (Pinto, 2015).

Investment value, simply saying, is the price that the certain investor is ready to pay for the certain asset or business.

Intrinsic value is the value which is based on the fundamental analysis of the company and is sometimes called fundamental value. The core of this standard of value is that it is so called "true" or "real" value of the company (based on company's operations and prosperity), and it doesn't determine the willingness of investors to pay. More often it is applied to publicly traded companies (Hitchner, 2011).

While performing the valuation, the premises of value should be considered as well. Thus, there are two main well-known premises of value, namely going concern and liquidation. Going concern is the assumption under which the company will continue its operation activities into the foreseeable future. Under the going concern assumption a going concern value of the company can be determined. Another assumption is the liquidation one. It can be applied for the company under the financial distress. Thus, assuming that the company is not able to continue its operations going concern, the liquidation value of the company can be estimated.

For the valuation of publicly traded stocks, to find intrinsic value which is estimated under a going-concern assumption is the goal of the appraisal process (Pinto, 2015).

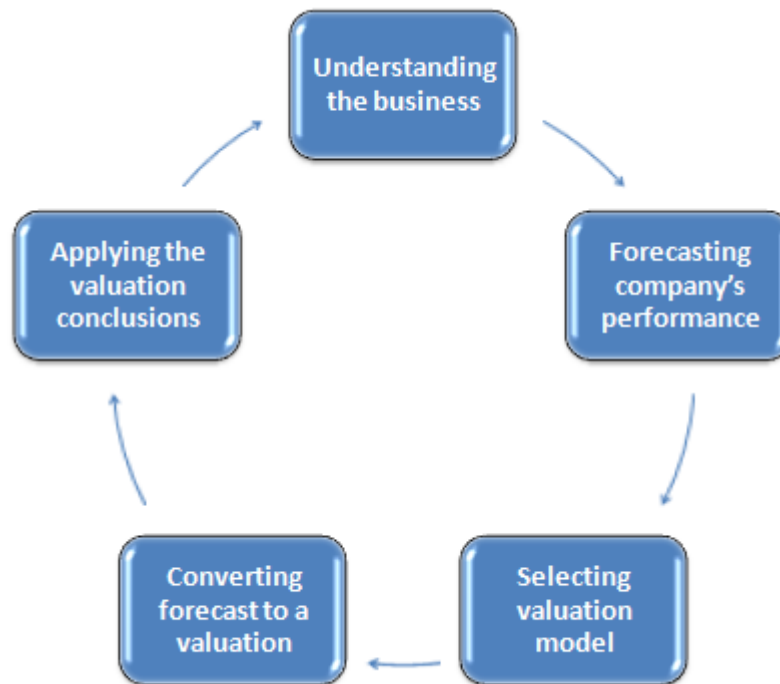
Its worth to mention, that price and value can be equal, but they must not. Thus, value is a forward-looking assumption. *"Investors buy tomorrow's cash flow, not yesterday's or even today's."* (Hitchner, 2011, 7).

### 1.1.2 Valuation process

Valuation process is a complex and tough task, requiring a wide range of expertise. Thus, five main steps of the valuation process can be defined (Pinto, 2015).

Understanding the business is the first and crucial step in the appraisal process. Industry analysis, creation and analysis of the peer group, analysis of the company's competitive positioning, strategic analysis (Porter's Five Forces, PESTEL, SWOT, etc.), analysis of the company's governance and strategy, analysis of company's financial statements - all this should be performed in order to conduct precise valuation.

**Figure 1. Steps of business valuation process**



Source: Author's processing using (Pinto, 2015)

To continue with valuation, forecast of sales, revenues, expenses and financial position should be performed. There is a bunch of statistical forecasting techniques, however the most widely used are:

- 1) straight-line;
- 2) moving average;
- 3) simple linear regression;
- 4) multiple linear regression (Corporate Finance Institute, 2020).

The next crucial step is to choose applicable valuation model. Depending on the nature of business, sources of revenue, type of the company and the aim of the valuation, some valuation techniques will perform better than others. Different types of valuation techniques will be reviewed in details further in this chapter.

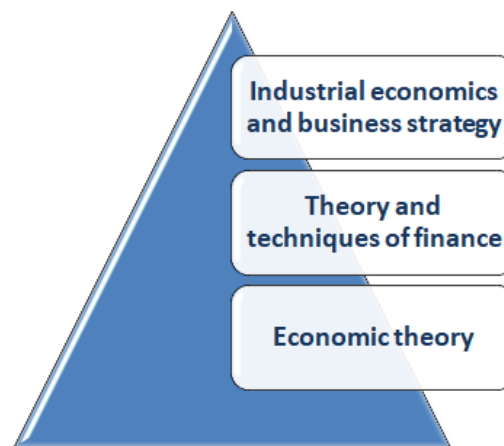
The next important step is converting a forecast to a valuation. This step doesn't include only calculations, but also the assessment of the results of the valuation and possible influence using sensitivity analysis and situational adjustments (Pinto, 2015).

The final step in the appraisal process is applying the valuation conclusions. Depending on the purpose of the valuation, the results can be used in order to make an

investment recommendation about the stock, assess benefits of potential investment or evaluate the price of the specific transaction.

Theoreticians agree, that the valuation process is a complex task with a wide range of expertise required. Massari (2016) defined three areas of expertise necessary for successful valuation, namely 1) industrial economic and business strategy; 2) theory and techniques of finance; 3) economic theory (Figure 2).

**Figure 2. Expertise required in business valuation process**



Source: Author's processing using (Massari, 2016)

Even though, all knowledge and results obtained from this three areas are of crucial importance, *"in a valuation, critical drivers are so bound together that the real distinguishing element is the "glue" that holds them together."* (Massari, 2016, 2).

It's important to note, that all valuations should be performed as of a single date (specific point in time).

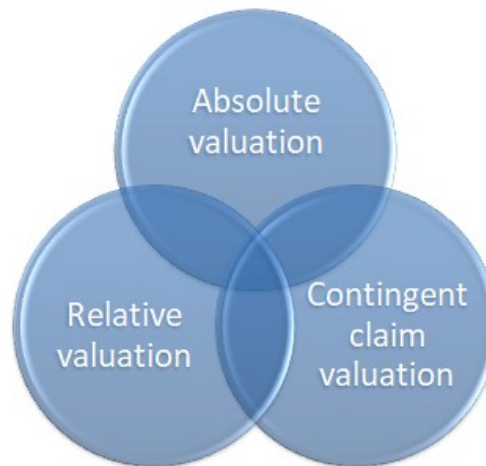
After reviewing the basis of the valuation, the author will conduct the literature review of the main valuation approaches and methods in the following chapter.

## **1.2 Valuation approaches and methods**

### **1.2.1 Valuation approaches**

Three main approaches to value can be distinguished. Thus, Damodaran (2012) describe: 1) absolute valuation; 2) relative valuation and 3) contingent claim valuation (Figure 3).



**Figure 3. Tree approaches to value**

Source: Author's processing using (Damodaran, 2012)

An absolute valuation determines the intrinsic value of an asset. Further, it can be compared with the market price of an asset, and it could be determined whether the asset is over or undervalued. The most important and frequently used is the present value model or so called discounted cash flow model (DCF). Simply saying, this model determines the present value of the forecasted future cash flows to the firm. Depending on the level applied, two types of the cash flows could be distinguished:

- 1) at the shareholders' level - dividends;
- 2) at the company's level - cash flow to the firm.

Models, which considering cash flows in the form of dividends, are called dividend discount models. At the company level there are two types of cash flows, namely free cash flows (either free cash flow to equity or free cash flow to the firm) and residual income.

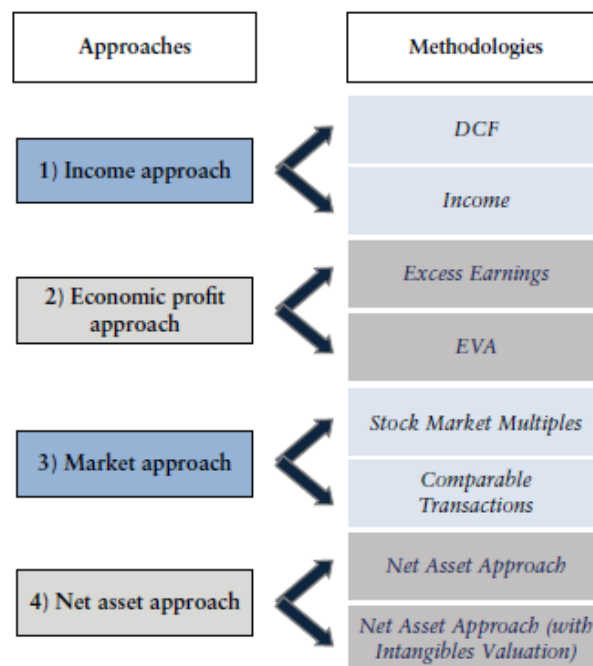
There is one more absolute valuation approach - asset-based valuation, which can be applied to the "asset-based" companies, for example, operating in natural resources sector (crude oil, wood). The value of the company is basically estimated according to the market value of its assets.

A relative valuation approach is the broader one, comparing to absolute valuation approach. According to Damodaran (2012, 19) *"the reality is that most valuations are relative valuations."* A relative valuation model is comparing the target asset with the similar one on the market and based on this, estimates the asset value. The logic behind this approach is that the similar assets should be sold at the similar prices, thus relative valuation model can be applied using price or enterprise multiples.

According to Damodaran (2012) it is possible to distinguish quite a new approach to valuation called contingent claim valuation. The idea behind this approach is that in some cases *"the value of an asset may be greater than the present value of its expected cash flows."* (Damodaran, 2012, 23). This could occur if expected cash flows are contingent with either occurrence or non-occurrence of the event.

There is another perspective of valuation approaches and it is described by the theoreticians. Thus, Hitchner (2011) notes that there are three valuation approaches: 1) income approach; 2) market approach and 3) asset approach. *"There are no other approaches to value."* (Hitchner, 2011, 8). However, Massari (2016) distinguish additional approach, namely economic profit approach. Thus, it is possible to distinguish four valuation approaches: 1) income approach; 2) economic profit approach; 3) market approach; 4) asset approach. Every approach has its own set of methodologies (techniques) (Figure 4).

**Figure 4. An overview of the main valuation methodologies/approaches**



Source: (Massari, 2016)

## 1.2.2 Valuation methods

In this chapter the author will review the theoretical background for selected methods, DCF (Discounted cash flow) and EVA (Economic value added). These two methods later will be applied to calculate the value of the target company.

### 1.2.2.1 Discounted cash flow (DCF)

*"All other things being equal, the more certain the future streams of cash flow are, the more valuable the asset or entity is."*

James R. Hitchner (2011, 143)

Discounted cash flow (DCF) valuation determines the intrinsic ("real") value of business as the sum of all expected future cash flows. For the DCF calculations free cash flow (FCF) should be determined. There are two types of cash flows which could be used in DCF model calculations, namely free cash flow to the firm (FCFF) and free cash flow to equity (FCFE).

These two indicators are not line items in company's financial statements, thus they should be properly calculated. Calculating of free cash flow is a complex task which requires

a deep understanding of company's cash flows. Free cash flow to the firm is the cash flow which is available after all necessary investments are made, such as investments in fixed assets and in inventory, and all operating expenses are paid together with taxes. Free cash flow to equity can be calculated as free cash flow to the firm excluding interest expenses after tax and including issued net debt obligations of the company.

One of the ways to calculate FCFF is through its EBIT (earnings before interest and tax). To do this, EBIT should be multiply by  $(1-T_C)$  ( $T_C$  - corporate tax rate), then D&A (depreciation and amortization) expenses should be added back and CAPEX (capital expenditure) and changes in NWC (net working capital) should be subtracted. After calculating FCFF it's possible to calculate FCFE: debt should be added to FCFF and then interest expenses after tax should be deducted.

The ways of calculating FCFF and FCFE are shown below (Table 2).

**Table 2. FCFF and FCFE calculation and its discount factors**

Cash flow type	Way of calculation	Discount rate used in DCF
<b>Free cash flow to the firm (FCFF)</b>	$EBIT \cdot (1 - T_C)$ + D&A (depreciation & amortization) - CAPEX - Changes in working capital	WACC - weighted average cost of capital
<b>Free cash flow to equity (FCFE)</b>	FCFF - Interest expenses * $(1 - T_C)$ + Debt	r - required rate of return on equity

Source: Author's processing using (Pinto, 2015)

To find company's value either FCFF or FCFE should be discounted with a discount factor. To discount FCFF, the weighted average cost of capital (WACC) should be used, while to discount FCFE, required rate of return on equity should be used (Table 2).

The idea of DCF model is to calculate sums of present values of the company's expected cash flows which determine its value, either as a whole or its equity. Here are two formulas for the calculation of the company's value and its equity value:

$$\text{Equity value} = \sum_{t=1}^{\infty} \frac{\text{FCFE}_t}{(1+r)^t} \quad \text{Firm value} = \sum_{t=1}^{\infty} \frac{\text{FCFF}_t}{(1+\text{WACC})^t}$$

(1)

In DCF two models can be distinguished, namely single-stage and two-stage models. A single-stage model assumes that company's cash flows will grow at a constant growth rate, thus it could be described with the following formula:

$$\text{Firm value} = \frac{\text{FCFF}_1}{\text{WACC} - g} = \frac{\text{FCFF}_0(1+g)}{\text{WACC} - g}$$

(2),

The same approach can be applied to calculate equity value in a single-stage model:

$$\text{Equity value} = \frac{\text{FCFE}_1}{r - g} = \frac{\text{FCFE}_0(1+g)}{r - g}$$

(3)

In two-stage model, new growth rate can be assumed - a long-run sustainable growth rate. Thus, there could be different variations of FCF growth during different stages. For example, in Stage 1 the growth rate can be constant and then in Stage 2 drop to the sustainable level. Or, it could be opposite: in Stage 1 the growth rate will decline until it reaches the sustainability in Stage 2. Thus, the following formula describes the company's value (two-stage model):

$$\text{Firm value} = \sum_{t=1}^n \frac{\text{FCFF}_t}{(1+\text{WACC})^t} + \frac{\text{FCFF}_{n+1}}{(\text{WACC} - g)(1+\text{WACC})^n}$$

(4),

where

FCFF - free cash flow to the firm;

WACC - weighted average cost of capital;

g - terminal growth rate.

The same approach can be applied to calculate equity value in two-stage model:

$$\text{Equity value} = \sum_{t=1}^n \frac{\text{FCFE}_t}{(1+r)^t} + \frac{\text{FCFE}_{n+1}}{r-g} \frac{1}{(1+r)^n}$$

(5),

where

FCFE - free cash flow to equity;

r - expected rate of return on equity;

g - terminal growth rate.

The value of either company or equity during Stage 2 is called terminal value. In DCF model the present value of terminal value should be calculated and then added to already discounted expected cash flows.

#### 1.2.2.1.1 Terminal value and terminal growth rate

Terminal value is a value of a business beyond the forecasted period, in other words in perpetuity. In DCF model the present value of terminal value should be considered. Thus, terminal value with or without constant growth should be discounted using the discount factor from the last period in the series of cash flows. Terminal value formula can be described as following:

$$\text{Terminal Value} = \frac{\text{FCF}_n(1+g)}{\text{WACC}-g}$$

(6),

where  $\text{FCF}_n$  - free cash flow from the last forecasted period;

WACC - weighted average cost of capital;

g - terminal growth rate.

Terminal growth rate is the growth rate at which the company is going to grow in perpetuity. Normally, terminal growth rate ranges between the historical inflation rate (2-3%) and the average GDP growth rate (4-5%). If the terminal growth rate is higher than the average GDP growth rate, this determines that the company is going to outperform the growth of the whole economy in perpetuity (Corporate Finance Institute, 2020).

Terminal value and terminal growth rate are applicable for EVA valuation model as well, which will be discussed further in this chapter. Due to the fact that the author has selected two methods to perform valuation of the target company, namely DCF (applying

FCFF calculation) and EVA, thus the theoretical background of WACC and its calculation will be reviewed further in this chapter.

#### 1.2.2.1.2 Weighted average cost of capital (WACC)

The capital structure of the company is the company's decision about the sources of financing. It clarifies the specific mixture of debt and equity financing chosen by the company. Thus, the cost of capital is the required rate of return on company's capital. WACC determines the required return, which company's stakeholders are expecting to receive (both shareholders and creditors).

WACC is calculated using the following formula:

$$\text{WACC} = (E/V) \times R_E + (D/V) \times R_D \times (1 - T_C) \quad (7),$$

where

$E/V$  - weight of equity in capital;

$D/V$  - weight of debt in capital;

$R_E$  - cost of equity;

$R_D$  - cost of debt;

$T_C$  - corporate tax rate.

#### ***Cost of equity***

To calculate company's cost of equity is a complex task. It could be done using CAPM - Capital Asset Pricing Model, which can be represented by the following formula:

$$R_E = R_f + \beta_M * [R_M - R_f] \quad (8),$$

where

$R_E$  - expected return on equity;

$R_f$  - risk-free rate;

$[R_M - R_f]$  - market risk premium;

$\beta_M$  - systematic risk (market risk).

The risky investment has the expected rate of return influenced by three main factors:

1) risk free rate; 2) market risk premium and 3) beta coefficient which identifies the

systematic risk of the investment (Ross, 2013). The main advantage of CAPM is that this model is adjusted for risk. However, to calculate cost of equity, two of three parameters should be estimated - market risk premium and beta coefficient. In case of wrong estimates or rapid changes on the market, the cost of equity might be estimated wrongly, and this, in turn, will result in bias in business valuation.

### ***Cost of debt***

Simply saying, cost of debt is creditor's expected return from the borrowings granted to company. Thus, the interest rate which is paid by the company on its borrowings is the company's cost of debt.

### ***Tax shield***

In general interest expenses of the company caused by debt financing are tax deductible. Due to this the value of debt in WACC calculation is adjusted for taxes. Thus, in case of debt financing, company creates tax shield which in turn reduces the company's cost of debt and increases company's value.

### ***Capital structure***

To calculate WACC, percentage of debt and equity financing should be determined. It can be calculated as a proportion to company's capital.

It is important to mention, as it is stated by professor Aswath Damodaran (2012) the market values of debt and equity should be used rather than book values in order to estimate the cost of capital.

## ***1.2.2.2 Economic value added (EVA)***

### ***1.2.2.2.1 Basis of EVA***

Shareholder value maximization is one of the main goals of corporate executives. It is created when the money left exceeds the return which is required by a shareholder in exchange for the investment. From the very first sight, it seems very easy to determine shareholder value, however in reality it is a sophisticated process. Thus, a growing number of analysts, researchers and consultants appeared in business valuation industry (Hitchner, 2011).

EVA is a trademark of consulting firm Stern Stewart & Co, based in New York. The concept of EVA was introduced in 1989. EVA is the acronym for Economic value added or so called Economic profit. EVA model has the same applicability as DCF model has and is



widely used in business valuation. EVA is a commercial representation of the residual income concept (Pinto, 2015).

The most common way of measuring earnings is to deduct all expenses connected with company's operations from its revenues. Such expenses comprise of cost of goods sold (COGS), general, administrative and selling expenses. Moreover, the charge on debt capital, as well as the charge on equity capital should be taken into consideration. The charge on debt capital is the interest expenses, while the charge on equity capital is not the line item in the company's financial statements. Thus, the remaining amount after all expenses including debt and equity charge, is the net amount left for shareholders (Hitchner, 2011). In other words, EVA is the value-driven concept and a measure of what is left to shareholders over the cost of capital. The main principal behind EVA concept is that if after applying a charge for the cost of capital, company's net income is still positive, then the company is creating value for its shareholders. In case if EVA is negative, then the company is destroying shareholder value.

To calculate EVA, the following formula should be used:

$$EVA = NOPAT - WACC * C$$

(9)

where

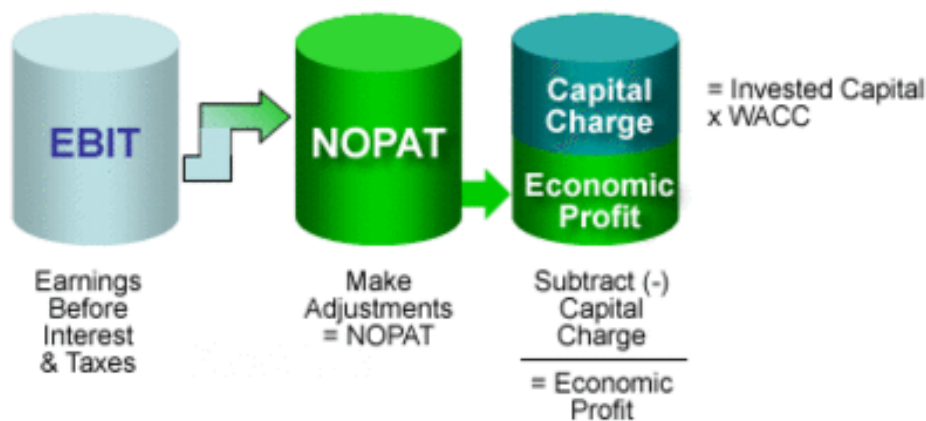
NOPAT - net operating profit after tax;

WACC - weighted average cost of capital;

C - capital invested.

The representation of the formula is on the figure below.

**Figure 5. EVA calculation process**



Source: Author's processing

To calculate NOPAT, taxes should be deducted from earnings before interest and tax. In other words, NOPAT can be represented through the following formula:

$$\text{NOPAT} = \text{EBIT} * (1 - T_c)$$

(10)

where

EBIT - earnings before interest and tax;

$T_c$  - corporate tax rate.

Weighted average cost of capital (WACC) is a percentage that determines the weighted average after-tax cost of debt and the weighted average cost of equity. The principal of WACC, inputs for its calculation and main steps are described above in this chapter.

In the literature it is possible to find several ways of calculating capital invested. According to Hitchner (2011) capital invested can be calculated when deducting non-interest bearing liabilities from total liabilities and equity.

It's important to mention, that capital invested should be considered for the year end of the previous period (Damodaran, 2012). Thus, here is adjusted formula for EVA calculation:

$$EVA_t = \text{After-tax operating income}_t - \text{Cost of Capital} * \text{Capital Invested}_{t-1} \quad (11)$$

#### 1.2.2.2.2 Business valuation using EVA

Economic value added (EVA) measures the surplus value created by a company on its existing investment. Thus, it is possible to calculate company's intrinsic value using EVA. According to Damodaran (2012) the formula for company's value using EVA is the following:

$$\text{Firm value} = \text{Capital invested}_{\text{assets in place}} + \text{NPV}_{\text{assets in place}} + \sum_{t=1}^{t=\infty} \text{NPV}_{\text{future projects, } t} \quad (12)$$

$$\begin{aligned} \text{Firm value} = & \text{Capital invested}_{\text{assets in place}} + \sum_{t=1}^{t=\infty} \frac{\text{EVA}_{t, \text{assets in place}}}{(1 + k_c)^t} \\ & + \sum_{t=1}^{t=\infty} \frac{\text{EVA}_{t, \text{future projects}}}{(1 + k_c)^t} \end{aligned} \quad (13),$$

where present value of EVA can be calculated using the following formula:

$$\text{NPV} = \sum_{t=1}^{t=n} \frac{\text{EVA}_t}{(1 + k_c)^t} \quad (14)$$

In the literature, several examples of formulas to calculate company's value can be found. Thus, the company's value can be also calculated using the following formula (Kislingerová, 2000):

$$\text{Value of a company} = C_t + \sum_{t=1}^n \frac{\text{EVA}_t}{(1 + \text{WACC}_t)^t} + \frac{\text{EVA}_n / \text{WACC}_n}{(1 + \text{WACC}_n)^n}$$

(15).

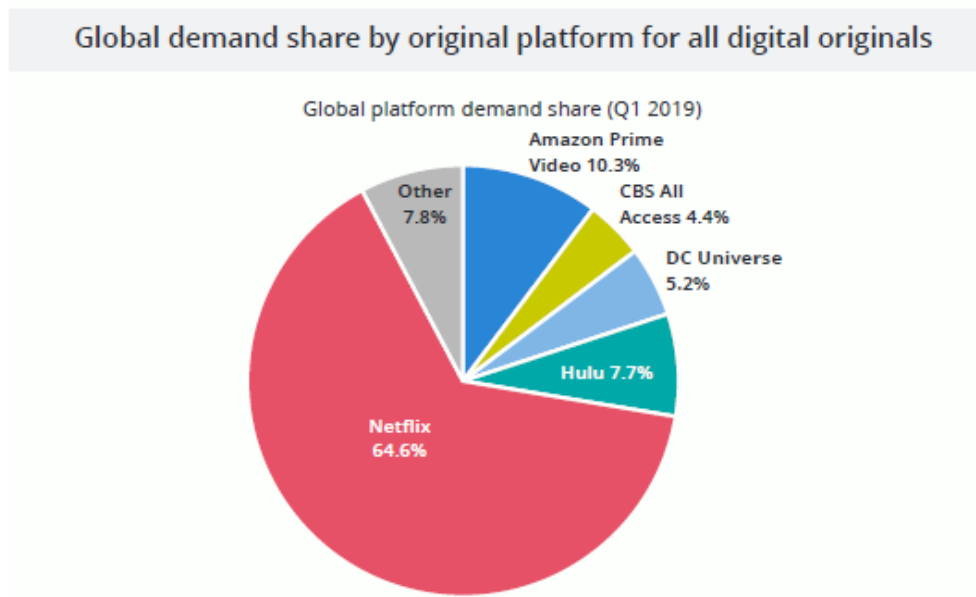
Simply saying, to calculate company's value with EVA, series of EVA should be estimated for the forecasting period. Except the series of EVA, the terminal value for EVA should be calculated. In case of estimated terminal growth of the company, terminal growth rate can be applied in terminal value calculation. After this, both series of EVA and terminal value should be discounted with the cost of capital, or in other words present value should be calculated. Thus, EVA model of company's value calculation applies the same approach as DCF model. The only difference is that, after calculating the sum of present values for expected series of EVA and terminal value, capital invested should be added. The resulting amount represents company's value according to EVA model.

## **II. ANALYSIS**

## 2 INDUSTRY OVERVIEW

Subscription Video on Demand (SVoD) is a subscription-based service which allows users all over the world at any time to enjoy their favorite shows, movies, sports or music with unlimited access for a fixed service fee. Thus, users can control their watching habits, decide what, where and on which device to stream, where to pause or rewind the video. There are plenty of SVoD providers, and their number is growing from day to day due to the intensive transition of users from original broadcast TV to streaming services. The most popular providers are Netflix, Amazon Prime Video, YouTube Premium, Hulu, HBO GO and Disney +. Despite typical competitors in the face of streaming service providers, there is another type of competition in the industry, namely local cable operators, TV channels, cinema and theatres, and last but not least digital piracy.

The global SVoD market can be divided in different segments based on the region of operations (UCAN, LATAM, EMEA, APAC), type of the content (education, entertainment, sport, music, news) and subscription model (fixed or variable fee). Users are very free in their choice of the service provider, due to many options on the market and absence of switching costs from one provider to another. Thus, this segment is very competitive. With approximately the same pricing, the main factor which influences users' choice is high quality content. SVoD providers have two main types of the content: licensed and original. Licensed content can be streamed by the provider for a fixed period of time and further there is always a risk of license non-extension, which in turn can influence customers' satisfaction and probably their churn. Thus, nowadays producing original content is of main importance for providers. However, there is a flip side of the coin - original production is highly expensive and time consuming.

**Figure 6. Global SVoD platform demand share (as of Q1 2019)**

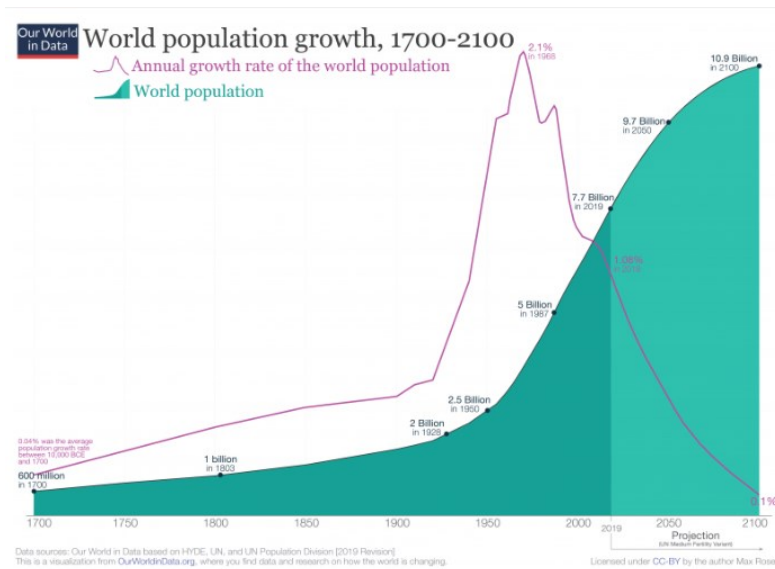
Source: ( Parrot Analytics, 2019)

The figure above shows global SVoD platform demand share as of Q1 2019, where the largest part is occupied by Netflix with 64,6% of the share. Amazon and Hulu are following with 10,3% and 7,7% respectively. Netflix has been the leader in streaming services, and still remains, however faces more intensive competition comparing to the previous periods.

### 3 MACROECONOMIC ANALYSIS

The main aim of the SVoD industry sector is to provide the end user with the content in exchange for the fee. One of the main objectives for industry players is to obtain as many customers as possible. The author believes that the industry has a growing potential in the future. Thus, one of the important factors for companies is the world population growth and world population in absolute numbers.

**Figure 7. World population growth estimates, 1700-2100**



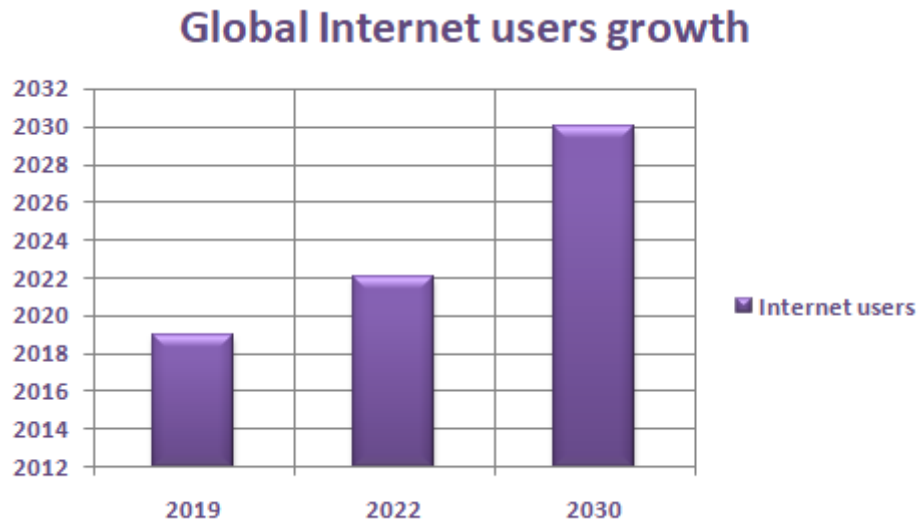
Source: (Roser, Ritchie and Ortiz-Ospina, 2020)

As it is seen from the figure above the population growth rate has the tendency to decrease, however in absolute numbers the population is going to increase. Thus, till 2024 the population will increase by 600 million inhabitants and will be 8,1 billion people; by 2030 this number will increase by 400 million and will constitute 8,5 billion people (Roser, Ritchie and Ortiz-Ospina, 2019).

According to Cybersecurity Ventures prediction, Internet user penetration will be increasing as well. Thus, the number of Internet users will be 6 billion people by 2020 (75% of the world population) in comparison to 4,4 billion in 2019 (60% of the world population). Till 2030 the Internet penetration will be 90% of the world population in the amount of 7,5 billion Internet users (Cybercrime Magazine, 2020) (Figure 8, Figure 9).

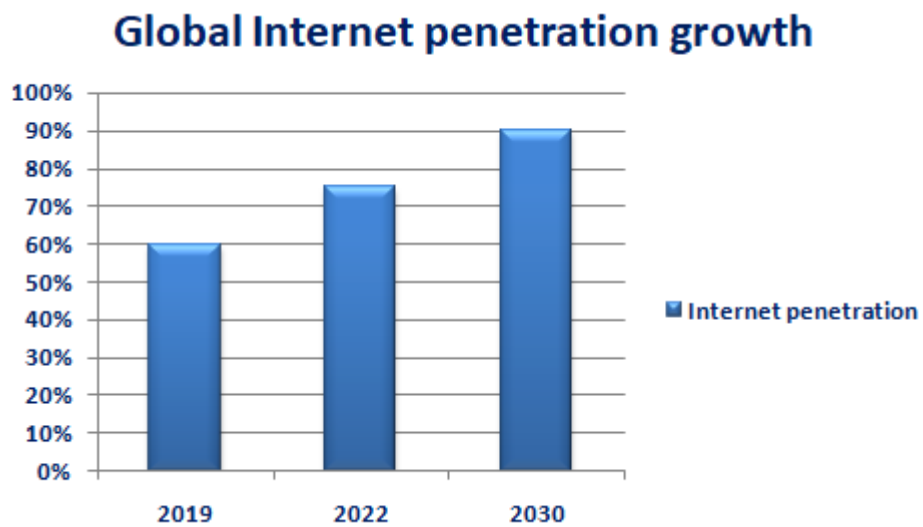


Figure 8. Global Internet users' growth till 2030



Source: Author's processing using (Cybercrime Magazine, 2020)

Figure 9. Global Internet penetration growth till 2030



Source: author's processing using (Cybercrime Magazine, 2020)

Thus, the author would like to point out that SVoD segment of entertainment industry has a lot of opportunities in the face of the growing customer base and in turn growing revenues.

Further the author overviews retrospective global inflation rate as well as its forecast till 2024 (Table 3, Figure 10).

**Table 3. Overview of global inflation rate for the period 2015A-2024F**

2015A	2016A	2017A	2018A	2019A	2020F	2021F	2022F	2023F	2024F
2,87%	3,11%	3,37%	3,52%	3,57%	3,51%	3,30%	3,23%	3,35%	3,42%

Source: (IMF, 2020)

**Figure 10. Overview of global inflation rate for the period 2015A-2024F**

Source: (IMF, 2020)

Retrospective overview as well as forecast until 2024 for GDP is done as well (Figure 11).

**Figure 11. Overview of global GDP for the period 2015A-2024F**

	GDP, Current Prices, Billion \$US	GDP, PPP, Current Prices, Billion \$US	Real GDP Growth, %
2015	74,779.5	115,799.4	3.5
2016	75,823.6	120,832.2	3.4
2017	80,262.1	127,703.4	3.8
2018	84,929.5	135,435.9	3.6
2019	86,598.8	141,859.6	3.0
2020	90,519.6	149,533.6	3.4
2021	95,353.0	157,972.1	3.6
2022	100,409.0	166,794.5	3.6
2023	105,786.2	176,187.8	3.6
2024	111,569.5	186,155.7	3.6

Source: (IMF, 2020)

These parameters will be used further in the thesis to estimate company's terminal growth rate.

## 4 BUSINESS DESCRIPTION

*"Quantitative data are useful only to the extent that they are supported by a qualitative survey of the enterprise."*

Benjamin Graham  
(Schmidlin, 2014, 102)

# NETFLIX

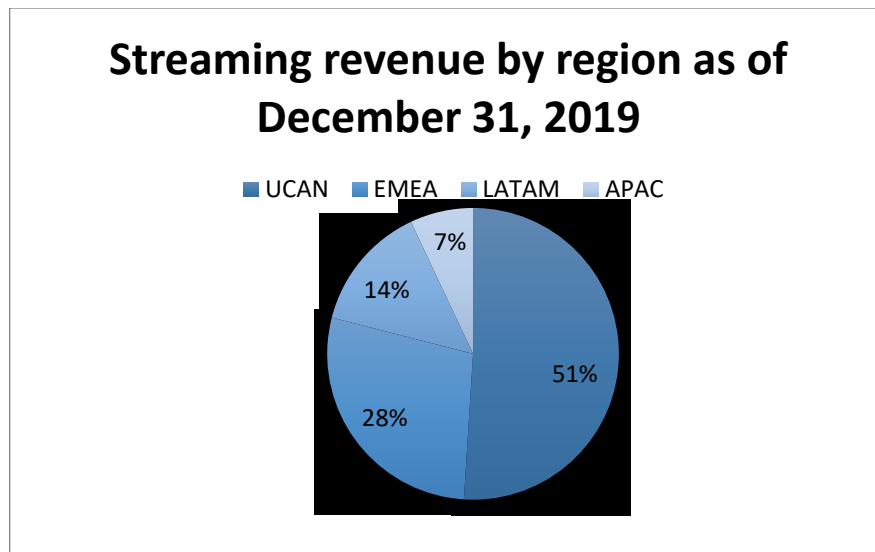
Netflix is the world's leading subscription streaming entertainment service. It offers TV series, documentaries and feature films across a wide variety of genres and languages. Members can watch as much as they want, anytime, anywhere, on any internet-connected screen. Members can play, pause and resume watching, all without commercials, moreover, they can download a selection of titles for offline viewing.

Founded in 1997 by Reed Hastings and Marc Randolph in Scotts Valley, California, Netflix started as online movie rental service. From 1998 Netflix launched the first DVD rental and sales website. In 1999 Netflix debuted a subscription service and in 2000 introduced a personalized movie recommendation system. In 2007 Netflix introduced streaming, which is the core business of the company as of today. The streaming video allows members to instantly watch television shows and movies on their personal computers and other types of devices without downloading them on the hard drive, because the media is sent in a continuous stream of data which can be played as it arrives.

Netflix grew from 1 million in 2003 in the United States to 167 million of paid membership in 2019 all over 190 countries. The company used to operate in three segments: Domestic streaming, International streaming and Domestic DVD. However, effectively since the fourth quarter of 2019, the company operates as one operating segment, as the company increasingly obtains multi-territory or global rights for streaming content. Reed Hastings explained during Netflix's Q4 2019 Earnings Interview (Youtube, 2020): *"So we worked hard internally to not be U.S. and international. There's no such as international."*

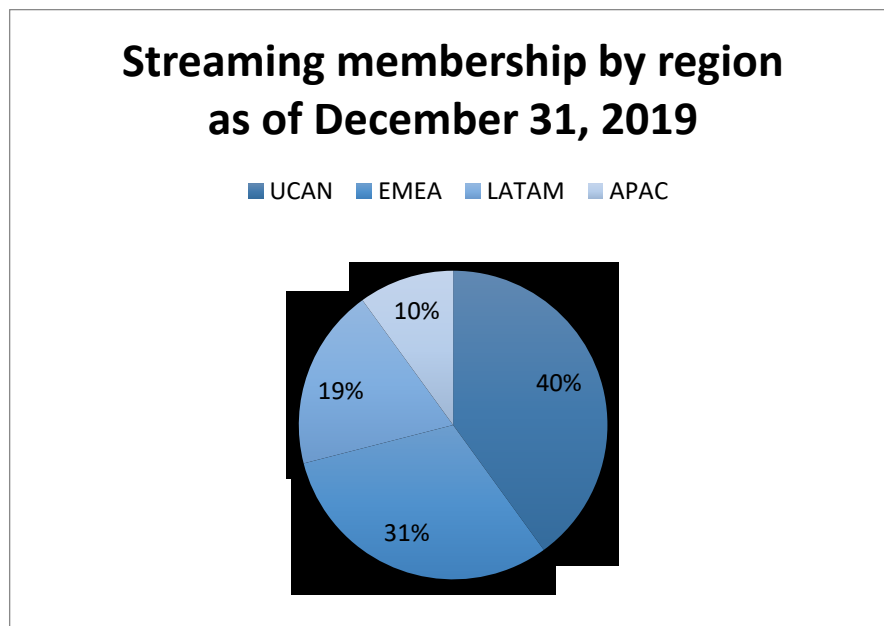
*There's a bunch of nuances of every market around the world."* However, there are four Netflix's operating regions: UCAN (United States of America and Canada), LATAM (Latin America), EMEA (Europe, Middle East, Africa) and APAC (Asia-Pacific). As it was highlighted by Reed Hastings during the Netflix's Q4 2019 Earnings Interview (Youtube, 2020) all these regions are equal: *"And instead think of it as 4 equal regions, and we're growing all of them, and we're sophisticated about all of them."* (Figure 12, Figure 13).

**Figure 12. Streaming revenue by region as of December 31, 2019**



Source: Author's processing using company's data

**Figure 13. Streaming membership by region as of December 31, 2019**



Source: Author's processing using company's data

Netflix has changed its business model several times throughout its existence. The first change was done in 1999, when Netflix debuted a subscription service, further in 2007, when introducing streaming and the last one in 2013, when started to produce original content. According to Spencer Neumann from Netflix's Q4 2019 Earnings Interview Netflix now is in the period of change and aims to switch their content library mostly to the original content. *"The future of our business is mostly originals."* (Youtube, 2020).

Netflix has aggregate outstanding long-term notes of \$14 759 million, net of \$114 million of issuance costs, with varying maturities (further Notes). Each of the Notes is issued at par and are senior unsecured obligations of the company. Interest is payable semi-annually at fixed rates. Below is the table with detailed information, where Notes are divided into two groups considering their maturity.

**Table 4. Detailed information on the Netflix's long-term debt in the form of senior unsecured Notes as of December 31, 2019**

Maturity	Principal amount at par (in million)	Fair value as of 31.12.2019 (in million)
to 2024 inclusive	\$1 600	\$1 706
to 2030 inclusive	\$13 273	\$14 243
<b>Total:</b>	<b>\$14 873</b>	<b>\$15 949</b>

Source: Author's processing using company's data.

Thus, Netflix uses a high level of leverage (book values) due to their needs for financing and investing in the original production (Table 5).

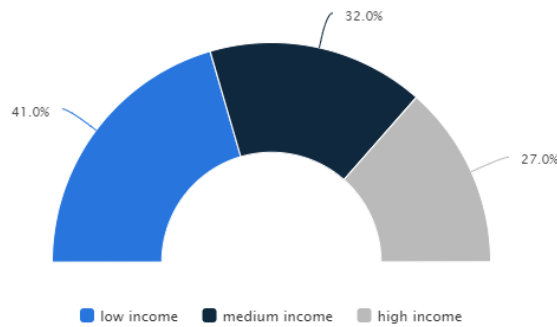
**Table 5. Netflix's Book Capital Structure for the period 2015-2019**

	2019	2018	2017	2016	2015
<b>Equity</b>	34%	34%	36%	44%	48%
<b>Debt</b>	66%	66%	64%	56%	52%

Source: Author's processing using company's data.

Netflix's users' distribution follows an inverse relationship considering users' income - the lower the income, the higher number of subscriptions. As it is seen from the figure below, Netflix's users constitute 41% of low income households comparing to lower percentage of high income households in the amount of 27%.

**Figure 14. Netflix's users by income**



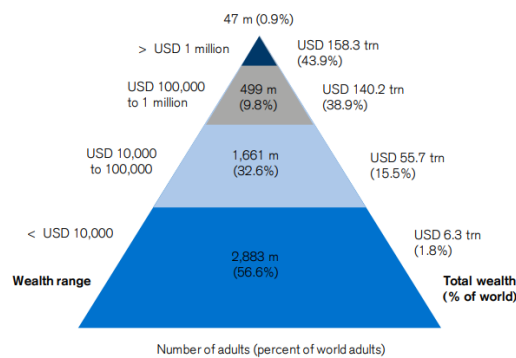
Source:(Statista, 2020)

The global wealth distribution shows that, there is a high level of inequality among adult population in the world.

The Credit Suisse Research Institute conducts on a yearly basis a research about global wealth distribution and publishes it in the Global wealth databook. Thus, the research for 2019 shows, that low income adults are counted in the amount of 4,5 billion people what, in turn, is 89,2% of the global adult population (Shorrocks, Davies and Llubers, 2019)(Figure 15). Considering that Netflix's users are mostly low income, the author believes that Netflix has huge opportunities and potential for the extension of its customer base.

**Figure 15. The global wealth pyramid 2019**

**Figure 5: The global wealth pyramid 2019**



Source: James Davies, Rodrigo Lluberas and Anthony Shorrocks, Global wealth databook 2019

Source: (Shorrocks, Davies and Llubers, 2019)

## 5 COMPETITIVE POSITIONING

### 5.1 Peer analysis

In order to analyze Netflix's competitive positioning, the author of the thesis created and analyzed the peer group, consisting of main Netflix's competitors, such as Amazon, Google and Disney. Google stands for YouTube Premium, while Walt Disney Company represents both Disney + and Hulu streaming services.

In the table below there is information about number of subscribers worldwide for Netflix and its peers. Thus, Netflix is segment leader, three times exciding Walt Disney Company and 50% exciding its main competitor Amazon.

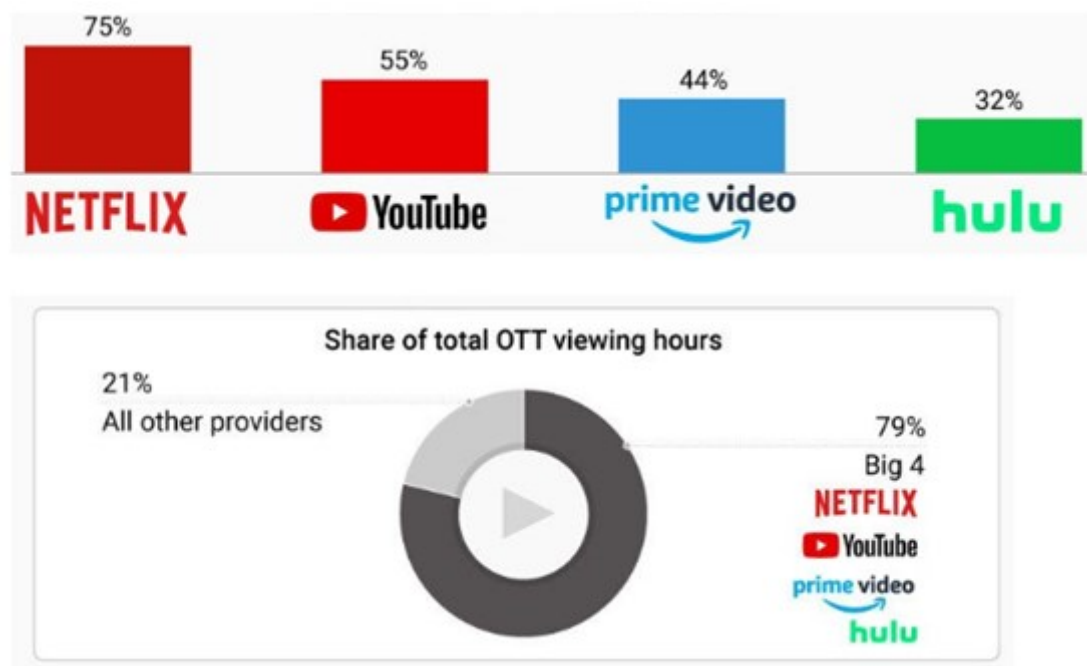
**Table 6. Netflix's and its main competitors' number of customers**

In thousands	Netflix	Amazon Prime Video	Youtube Premium	Disney (Hulu & Disney +)
<b>Subscribers</b>	167 000	112 000	20 000	57 000

Source: Author's processing using companies' data

Furthermore, in the United States Netflix is the sector's leader. There is Big 4 of streaming providers occupying nearly 80% of SVoD sector, with Netflix's share around 75% out of this 80% (Figure 16).

**Figure 16. Big 4 - SVoD providers in the United States**



Source: (Marvin, 2020)

In the table below there is information about P/E ratios for the target company and its peers and further the graph, which illustrates the data.

**Table 7. P/E for peers and its market capitalization**

Ticker	Company	Market Cap (in million \$ )	P/E as of 31.12.2019 (times)
<b>NFLX.O</b>	Netflix, Inc.	157 018	102,75
<b>AMZN.O</b>	Amazon.com, Inc.	920 220	82,91
<b>GOOGL.O</b>	Alphabet, Inc.	921 140	28,74
<b>DIS.N</b>	Walt Disney Company	257 590	21,93
<b>Peer Mean</b>			37,98
<b>Industry Mean</b>			34,55

Source: Author's processing using (Finance Yahoo, 2020) and (Eikon Thomson Reuters, 2020)



It is notable that Netflix and its main competitor Amazon are above the rest in the peer and the industry mean, however Netflix is on the first place with P/E as of 31.12.2019 102,75 (Figure 17).

Thus, it seems that investors are ready to pay for investment in Netflix's shares the higher price, comparing to the peer group.

**Figure 17. P/E overview of Netflix and its peers in comparison to peer and industry mean**



Source: (Eikon Thomson Reuters, 2020)

However, it might have the opposite meaning, that the Netflix's shares are overvalued. The conclusion about Netflix value and the meaning of P/E will be presented further in the thesis.

The author would like to mention, that the comparative of Netflix's financial ratios with its peers will not give the view of the reality. All its competitors have different types of business model, thus additional sources of revenue. For example, Amazon is one of the biggest retailers in the United States and all over the world, as well as the hugest provider of cloud computing services. Disney is a huge corporation which earns starting with movie production and ending with entertainment parks (Disney Land) or retail licensed sales (1st place in the world ranking with nearly \$55 billion in revenue) (Licenseglobal.com, 2020). Google is famous for its Internet search engine and cloud computing. Thus, Netflix has a single product and only one source of revenue oppositely to its competitors. Netflix's competitors do not do segment disclosures in their annual reports, that's why it is impossible to calculate competitors' revenues in SVoD segment and further compare with Netflix performance.

The author of the thesis calculated possible yearly gross revenues based on the number of subscribers and the price of the basic plan subscription (Table 8). Netflix has the highest results (connected with the higher subscribers' base). However there is no available information about competitors' spending, this, in turn, does not allow the author to compare Netflix's net income in SVoD sector with competitors' net income.

**Table 8. Possible revenue from sales for Netflix and its peers**

In thousands	Netflix	Amazon	YouTube	Disney
No of subscribers	167 000	112 000	20 000	57 000
Basic plan price p/year	\$107,88	\$107,88	\$143,88	\$77,88
Revenues p/year	<b>18 015 960</b>	<b>12 082 560</b>	<b>2 877 600</b>	<b>4 439 160</b>

Source: Author's processing using companies' data

To analyze Netflix's competitive position, Porter's Five Forces analysis was chosen and is presented below (Porter, 2004)(Figure 18).

### ***Porter's Five Forces Analysis***

#### *Threat of potential entrants (5 - High)*

Threat of potential entries is at high level as barriers to entry are very low, especially for companies which are already operating in the industry.

#### *Power of buyers (5 - High)*

Power of buyers is very high, as industry is not price sensitive, all companies have approximately the same price for the equal package of services. As most of the providers operate based on the monthly fee, it is easy for customers to switch from one provider to another with no costs. Thus, customers can easily choose the provider and change it in case of any level of dissatisfaction. The main factor for buyers' chose of the provider is the quality of the content.

#### *Power of suppliers (Moderate - 3)*

As of today the power of suppliers is declining due to the extension of the share of the original content produced. Thus, the amount of the licensed content is going to decline as well as the suppliers' power. However, there are remaining contracts with service providers (cloud computing, storage capacities, etc.), who can influence Netflix's performance.

#### *Industry rivalry (High - 5)*

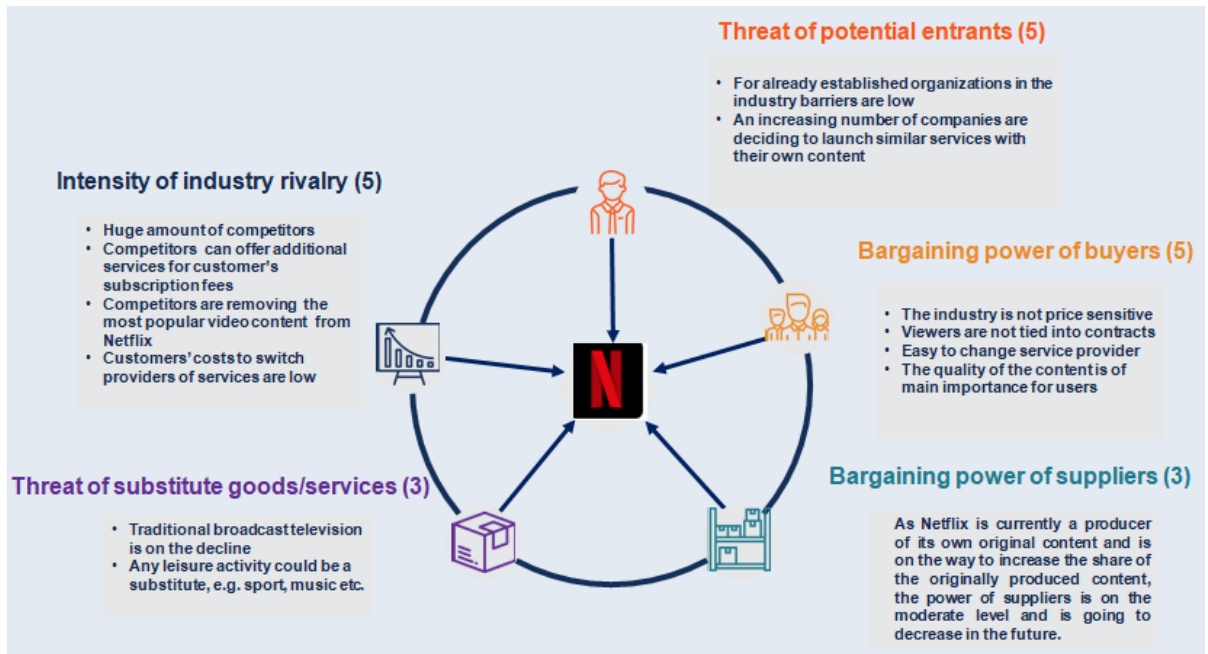
The industry of SVoD is very competitive. There is plenty amount of sustainable companies in the industry, moreover new are appearing due to the mergers and acquisitions. Netflix's competitors offer their customers additional free services for the same fee (e.g. Amazon) or they are removing the most popular content from Netflix (e.g. *Friends* is on HBO GO now).

#### *Threat of substitute (Moderate - 3)*

The threat of substitute of Netflix's product by other product types is on the moderate level. Original broadcast TV is becoming less popular nowadays, especially among young generation. Moreover, original broadcast TV is more expensive comparing to streaming

services. However, there is a risk of substitute for other leisure activities such as sports, cinemas, theatres, traveling.

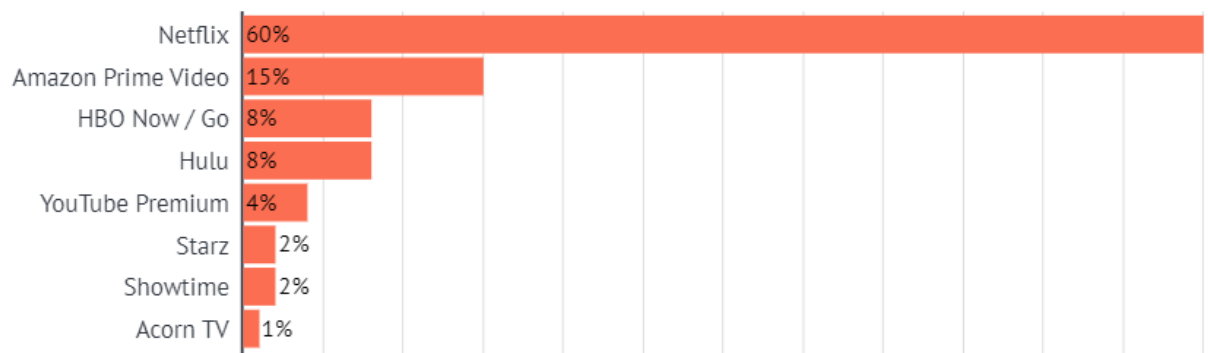
**Figure 18. Porter's Five Forces Analysis**



Source: Author's processing

As it is described above, the high quality of the produced content is one of the main factors influencing customers' preferences towards the SVoD provider. The research of Dick (2019) clarified the answer on the following question: *"Which one of the following streaming services offers the best selection of original content?"* Results are presented in the figure below. Netflix is the sector leader with four times higher results than its main competitor Amazon has, and even eight or ten times higher results than other competitors have. Thus, Netflix is the sector leader in terms of quality and attractiveness of its content library, which, in turn, gives Netflix impressive competitive advantage.

**Figure 19. Results of customers' survey regarding the quality of original content among SVoD providers**



Source: (Dick, 2019)

## 5.2 Product portfolio

Regarding product differentiation Netflix is a single product brand. The only product it offers to the customers is its video content. Thus, Netflix is the only one company in the market of SVoD with a single product in its portfolio. Amazon, Google, Disney, and even other smaller competitors have diversified portfolios and a wide range of products and services. Even though one can say that having single product is riskier, less profitable and has fewer opportunities, the author believes that exactly this makes Netflix "stand out from the crowd."

First of all Netflix can improve its economies of scale. It can be applied by using fewer resources and having fewer costs comparing to multiple product companies. Thus, Netflix even is not in the advertising business. For such a company as Netflix, who has a tremendous data base of customers and can advertise for millions of people all over the world, it probably could be a good source of revenue. However, the management's strategy is to focus on the single product. During the Netflix's Q4 2019 Earnings Interview (Youtube, 2020) Reed Hastings pointed out that *"We've got a much simpler business model, which is just focused on streaming and customer pleasure."*

Furthermore, single product model can help Netflix 1) to protect its worldwide known brand and 2) to have singular focus on its product and thus, improve its quality.

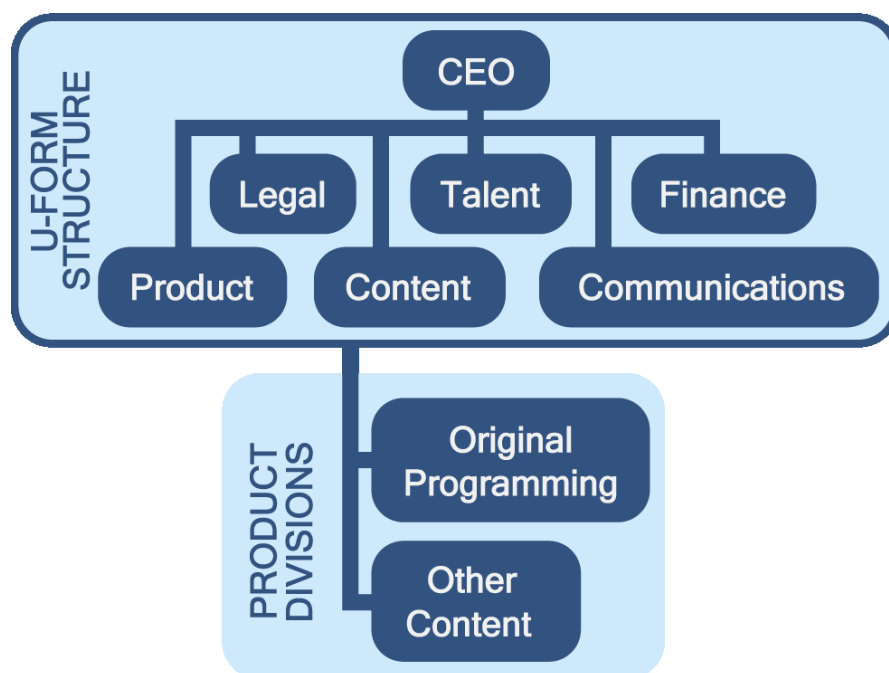
## 6 CORPORATE GOVERNANCE

### 6.1 Netflix's Organizational Structure

Netflix has U-Form organizational structure and seven main functional groups: CEO, Legal, Talent (HR), Finance, Product, Content and Communications. Thus, all the main business Netflix's executives directly report to the CEO (Figure 20).

Regarding products, Netflix has two types: original and licensed content. The operating regional division used to be within Netflix inclusive 3Q 2019: domestic and international. However, since 4Q 2019 the company operates as one operating segment with four equal operating regions (UCAN, LATAM, EMEA, APAC). Netflix reports operating results in the financial statements as one operating segment with regional disclosures in the Notes.

Figure 20. Netflix's Organizational Structure



Source: Author's processing using information from (Rancord Society, 2020)

### 6.2 Netflix's Corporate culture overview

Netflix has unique Corporate culture with the core philosophy - "*people over process.*" (Jobs.netflix.co., 2020). Feedback and disagree openly are two of the main

approaches in Netflix's Corporate culture. Netflix invests time and funds to develop that kind of professional relationship when employees can speak openly and not be afraid. This is the environment of trust to your employer. Moreover, there are lots of internal policies which are common only for Netflix and here are just some of them:

- the vacation policy sounds "take vacation." Opposite to other companies, there are no rules about the vacation and there is no defined amount of vacation days. This is again about trust. Netflix trusts its employees, who acts in Netflix's best interest.
- shared database with all Netflix's information and documents. Every employee has the access to this database and the possibility to make comments.
- there are no compensation handcuffs in order to stay in the company, and employees are totally free to leave Netflix when they want to do so.

Thus, Netflix has strong Corporate culture where the main strengths are Netflix's prosperity and Netflix's employees' well-being and confidence.

### **6.3 Inclusion and Diversity**

*"It takes diversity of thought, culture, background, and perspective to create a truly global storytelling platform."* (Jobs.netflix.co., 2020).

Netflix is a global company, with both a diverse member base and diverse employees. Netflix's employees are from diverse backgrounds, cultures and perspectives. Netflix is an equal-opportunity employer, no matter your skin color, ethnicity, culture, religion, gender, sexual orientation or personal beliefs are. Moreover employees' inclusion is of high importance for Netflix. The main goal is to create an environment where people, despite their differences, can contribute to Netflix at their highest level and where their differences can make a positive difference for Netflix.

### **6.4 Corporate Social Responsibility**

Every year, Netflix is publishing the report, which covers environmental, social and governance performance called ESG Report. Sustainability Accounting Standards Board (SASB) framework differs depending on the industry of production. Netflix is using as a benchmark SASB guideline for the "Internet & Media Services" and "Media & Entertainment" industries.

Netflix's members use energy from the very moment they connect to the network (94 000 MWh in 2019) and it could be called the direct use of energy. Moreover, there is a huge amount of energy consumed indirectly by mean of providers of storage capacities for the

Netflix's network, for example Google Cloud and Amazon Web Services. The usage of indirect energy in 2019 was 357 000 MWh.

To be environmentally responsible Netflix supports international renewable energy projects in more than 20 countries (e.g. Brazil, Canada, India, Mexico, UK) and in 15 states of the United States of America (e.g. Alaska, Georgia, New York, Oklahoma, Texas). In its offices Netflix is reducing the use of paper and practice donating of excess food. Moreover, Netflix uses the strongest instrument - its content (e.g. Our Planet—featuring David Attenborough and supported by the World Wildlife Fund) - to make environmental change in the world and to build awareness around environmental issues, reaching million of people around the world.

Netflix's management strongly believes, that great stories are universal - *"we see "international" as much more than an export market for U.S. content."* (Netflixinvestor.com., 2020).

That means, that Netflix invests in storytelling production all over the world. Netflix's content is subtitled and dub in more than 40 languages, in turn allowing people all over the world to explore different cultures and even languages.

However, using CSRHub which provides CSR/ESG Ranking of companies all over the world, it is possible to say that, Netflix is significantly below its competitors (Table 9, Figure 21).

**Table 9. CSR/ESG Ranking of Netflix and its competitors.**

Company name	CSR/ESG Ranking
<b>Netflix</b>	39 (low)
<b>Google</b>	94 (very high)
<b>Amazon</b>	67 (high)
<b>Walt Disney Company</b>	89 (very high)
<b>HBO GO</b>	91 (very high)

Source: Author's processing using data from (Csrhub.com., 2020)

**Figure 21. CSR/ESG Ranking Scale from CSRHub**



Source: (CSRHub - Information for Netflix, Inc., 2020)

### 6.5 Corporate Reputation

Since 2005 Reputation Institute has developed a RepTrack ranking in order to analyze company's corporate reputation using seven parameters: "products and services," "innovation," "workplace," "governance," "citizenship," "leadership," and "performance." (Rankingthebrands.com., 2020).

For example, in 2019 Reputation Institute released the annual Global RepTrack 100 study relying on calculations after surveying more than 230 000 people from among the general public in five countries.

Starting with the history of RepTrack since 2005, Netflix appeared in the ranking only in 2017, however it has tremendous growth (Table 10) and occupying currently 9<sup>th</sup> place in Top 10 most reputable companies worldwide (Figure 22).

**Table 10. Netflix's Global RepTrack Ranking in 2017-2019.**

	RepTrack ranking	Change
<b>2019</b>	9	15
<b>2018</b>	24	16
<b>2017</b>	40	-

Source: Author's processing using (Rankingthebrands.com., 2020)

**Figure 22. Netflix is on the 9th place in Top 10 most reputable companies worldwide**



Source: (Rankingthebrands.com., 2020)



### 6.6 Netflix's Shareholders' Base

Netflix's shares are publicly traded on the NASDAQ stock exchange under the ticker symbol NFLX.O. Shares outstanding as of 31.12.2019 is 437 779 thousands with a price per share in the amount of \$329,98.

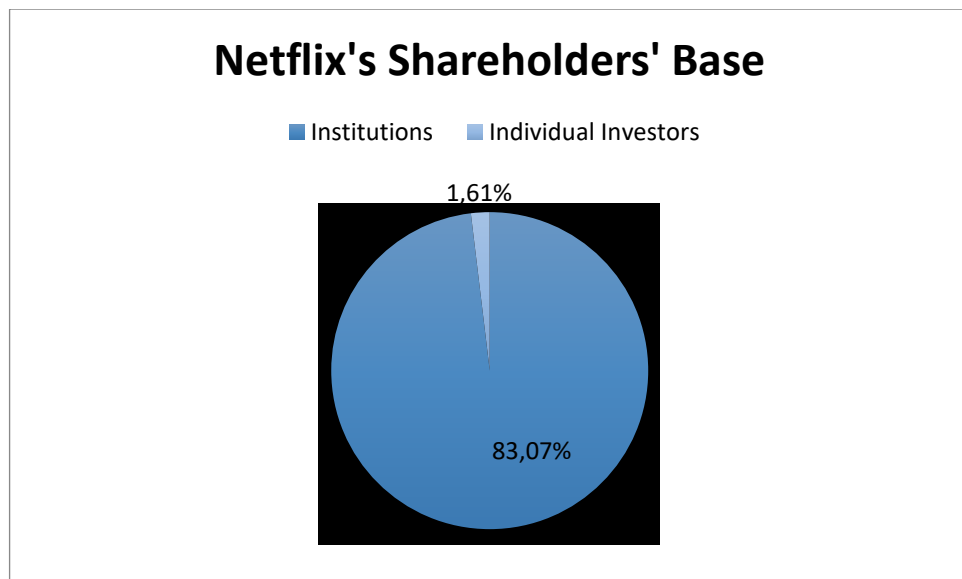
Below Netflix's Top Five shareholders are presented (Table 11). Netflix's shareholders are mostly institutions (Figure 23).

**Table 11. Netflix's Top Five Shareholders**

Shareholder	% of ownership
Capital Research Global Investors	8,66%
The Vanguard Group, Inc.	7,61%
Fidelity Management & Research Company	4,62%
T. Rowe Price Associates, Inc.	4,58%
BlackRock Institutional Trust Company, N.A.	4,17%

Source: Author's processing with information from (Money.cnn.com., 2020)

**Figure 23. Netflix's Shareholders' Base**



Source: Author's processing with information from (Money.cnn.com., 2020)

## 6.7 Netflix's Board of Directors (staggered board)

Netflix has staggered Board of Directors, where all directors are independent (excluding Reed Hastings) in the appliance with the applicable rules of the SEC and the listing standards of the NASDAQ Stock Market. A staggered board is a board that consists of directors grouped into classes who serves terms of different lengths (Staggered Board, 2020). Netflix's directors are grouped into three classes Class I, Class II and Class III with expiring terms 2021, 2022 and 2020 respectively. The staggered board approach can be viewed as a positive factor in corporate governance, as it lends itself to the execution of a company's long term strategic plan.

Netflix's Board has three standing committees: the Compensation Committee, the Audit Committee and the Nominating and Governance Committee. The Compensation Committee reviews and approves all forms of compensation to be provided to the executive officers and directors of the company. The Audit Committee engages the company's independent registered public accounting firm, reviews the company's financial controls, evaluates the scope of the annual audit, reviews audit results, consults with management and the company's independent registered public accounting firm prior to the presentation of financial statements to stockholders and, as appropriate, initiates inquiries into aspects of the company's internal accounting controls and financial affairs. The Nominating and Governance Committee reviews and approves candidates for election and to fill vacancies on the Board, including re-nominations of members whose terms are due to expire, and reviews and provides guidance to the Board on corporate governance matters. The author performed the overview and analysis of Netflix's Board of Directors and Senior Executive Management (APPENDIX P I, APPENDIX P II).

## 6.8 Netflix's approach to Corporate Governance

Netflix has a unique approach to corporate governance. The main idea is to incorporate two main practices: attendance of the members of the Board on monthly and quarterly senior management meetings and access of all Board members to the unique company's shared database.

The Board members' attendance of management meetings leads to direct communication with all 90 executives of Netflix. Moreover, the shared database with all Netflix's financial data deepen members of the Board into the company's current situation with the ability to ask clarifying questions to the author of the statement or numbers. One of

the Board members is embraced with this unique approach to the Corporate Governance: *"Reed's belief is that a competent and honest executive team knows dramatically more about what's going on in the company than a board, and so the board's involvement should be at very strategic levels. ...For a board to function well in that regard, it has to know a lot about the company."* (Larcker and Tayan, 2018).

Thus, the main Netflix's idea in corporate governance is the transparent sharing of information and close and productive intersection of the Board and executive management.

## **6.9 Related party transactions**

Due to the fact that related transactions can be a threat to company's operations and sustainability, Netflix has a written policy concerning the review and approval of related party transactions. In order to identify whether the transaction is between related parties, there is an internal process which includes payments overview and analysis of the relationship between the parties. This process is strictly regulated and after identification of such related party transactions, it goes to the overview and approval of the Netflix's Audit Committee in order to avoid a conflict-of-interest.

## 7 INVESTMENT RISKS

Nowadays it is challenging to analyze risks and one of the effective overall summaries can be made by constructing a risk matrix. Investment risks are highly depended on geography, industry and product type of the target company as is stated by theoreticians. The author believes, that the secret of successful risk identification and assessment is individuality (geography, industry and product type, future targets, previous experience) and relevance in the timeframe (geopolitical situation, world economy and trends, interrelations between all participants in the surrounding economies).

During the research, the key Netflix's risks were analyzed and the individual Risk Matrix was created (Figure 24). The Risk Matrix shows the probability of occurrence of company's risks and their impact.

The most crucial risks are the risk of competition and intellectual property right risk. Any events regarding these risks could adversely affect company's performance and results of operations. Due to the Netflix's nature of business, it is of crucial importance to protect intellectual property rights and avoid any violation of the rights and any possibility of illegal use of the company's intellectual property.

The target company could be influenced a lot by macroeconomic conditions, so the probability is high with the moderate level of impact on the company's performance.

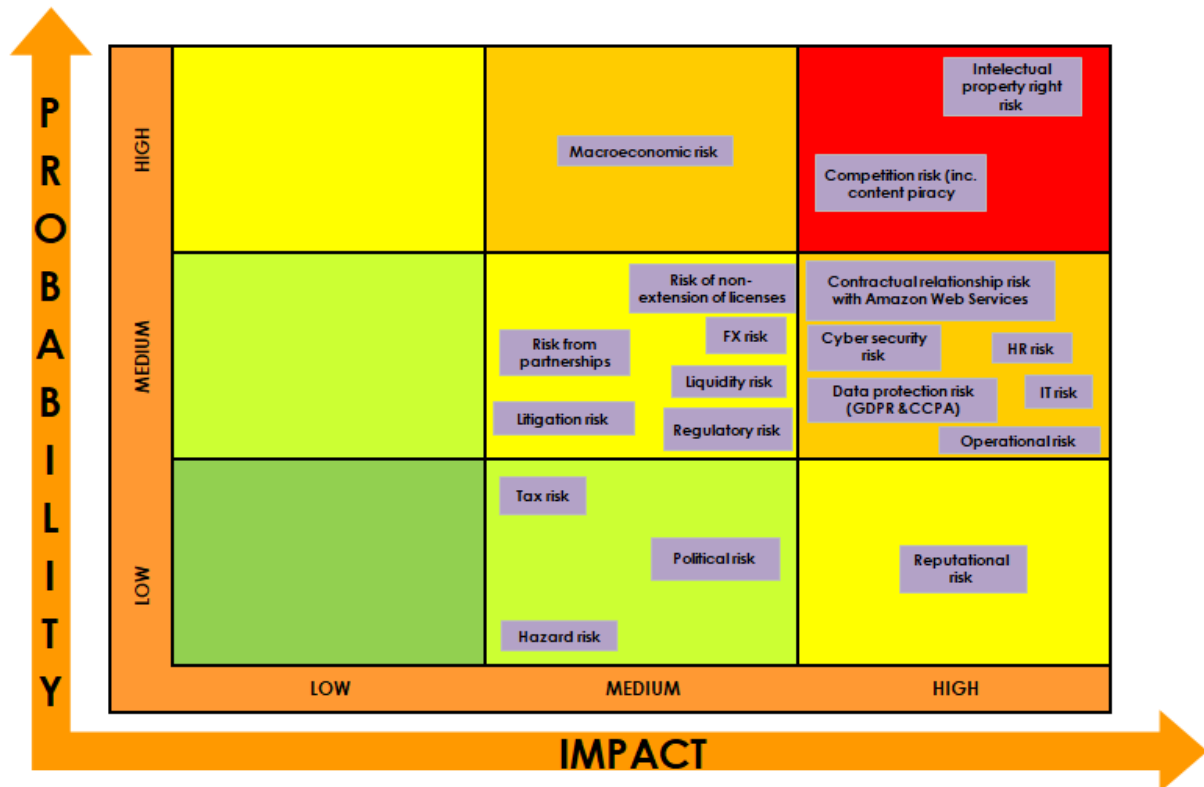
Netflix is highly dependent on the contractual relationship with Amazon Web Services as it is provided by "cloud" computing services. Amazon Web Services provides Netflix with storage capabilities and data processing. There is the risk of any contractual discrepancies which can adversely affect Netflix's performance and results of the operations. Moreover, Amazon Web Services and Netflix are competitors in the retail sector. Even though the risk of using by AWS its operations in order to gain competitive advantage is not highly probable (due to the litigation side of the issue), however it is still the risk for Netflix.

Some portion of Netflix's content is licensed content, that's why the inability of the company to extend the contractual relationship with the owners of the content, could adversely impact Netflix's financial position.

Another risk with high impact and medium probability is operational risk, namely the probable inability of Netflix to take a competitive advantage, produce high quality content with attractive pricing resulting in subscribers' growth, which in turn can increase company's revenues. Managing and mitigating cyber security risk, HR, IT and data

protection risks are of the high importance for the sustainability and profitability of the company.

Figure 24. Netflix's Risk Matrix



Source: Author's processing

## **8 FINANCIAL STATEMENTS ANALYSIS AND REVENUE PREDICTION FOR THE PERIOD 2020-2024**

### **8.1 Financial statements analysis**

In order to understand historical and current position of the company, analysis of financial statements was conducted, namely balance sheet and income statement for the period 2015-2019. Both horizontal and vertical analyses were performed (Robinson, 2015).

During the retrospective analysis of the Balance sheet, there were noticed no significant changes in all line items except one - current content assets. After analyzing the annual report 10-K, it was found that since 2019 the reclassification took place and current content assets item was fully reclassified as non-current content assets. For example, in 2019 current content assets are \$0 and non-current content assets are \$24 504 million, compared to \$5 151 and \$14 951 million respectively in 2018 (APPENDIX P III.). During 2015-2019 company had stable growth in assets, liabilities and shareholder's equity as well as in revenue and expenses. The line items' percentage of the base, both in the balance sheet and income statement, did not change except current and non-current content assets described above.

It is worth noting that due to this reclassification the number of current assets decreased dramatically while the number of non-current liabilities increased, which in turn led to the negative net working capital since 2019. Moreover, based on these changes, the projection of current assets and current liabilities was performed for 2020-2024 which in turn led to the projected negative net working capital.

### **8.2 Revenue prediction for the period 2020-2024**

Due to the fact that Netflix's revenue is splitted relatively in the same proportions from domestic and international markets, prediction of revenue for the next 5 years (2020-2024) was performed considering total revenue of the company without splitting for geographical areas.

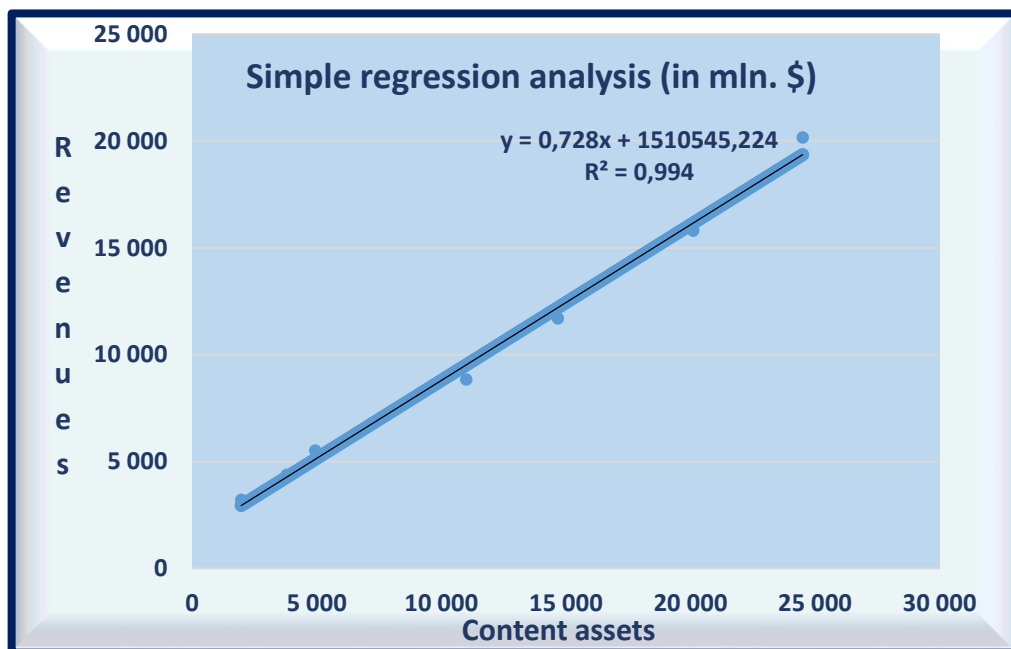
In order to predict Netflix's revenue, simple regression analysis with a single X variable was conducted. Considering the Netflix's business model, its strategy and high dependency on the high quality original content, "content assets" were chosen as independent X variable. Netflix has been a sector leader for a long period of time and even despite increasing competition, it still remains the leader. Thus, considering author's strategic analysis above, it is obvious, that content assets are of vital importance for Netflix

profitability. It is one of the strongest instruments to keep its subscribers' base and moreover to expand it.

For the regression analysis company's data from 2011 till 2019 were chosen. This is due to the significant changes such as expansion to Canada, Latin America and Caribbean until 2011 and expansion into the European market starting from 2012. Until 2011 Netflix launched streaming service and became to be available on the Xbox 360, Blu-ray disc players, TV set-top boxes, on the PS3, Internet connected TVs and other Internet connected devices, on the Apple iPad and the iPhone, as well as the Nintendo Wii. Furthermore, the significant growth in the share price started from 2011.

The created Model is of high quality (Table 12) and shows the statistical significance of the X variable and of the Model in general. Using the linear regression function  $y = 0,728x + 1510545,224$  (Figure 25), the revenue prediction was conducted, in turn, estimating the constant growth rate for content assets in the amount of 30% within the period of prediction (2020-2024) (Table 13). The author made an estimate of 30% growth for Netflix within predicted period based on conducted fundamental analysis and using historical growth trends. The author believes, that despite growing competition, Netflix will be able to expand its customer base and revenues accordingly by mean of increasing content assets (Netflix's content library).

**Figure 25. Regression analysis - interrelationship between Netflix's content assets and revenue**



Source: Author's estimates

Table 12. Regression statistics

Regression Statistics	
R Square (R <sup>2</sup> )	0,994
Significance F	0,000000006
P-value for X variable	0,000949
P-value for intercept	0,000000
Observations	9
Sum of residuals	0
Mean value of residuals	0
Durbin-Watson test (result - no evidence for autocorrelation of residuals)	1,367

Source: Author's processing

Table 13. Estimates of content assets and revenues for the period 2020F-2024F

In thousands \$	2020F	2021F	2022F	2023F	2024F
<b>Content assets</b>	31 855 937	41 412 718	53 836 534	69 987 494	90 983 742
<b>Revenue</b>	24 713 523	31 674 416	40 723 577	52 487 487	67 780 569

Source: Author's estimates



## 9 VALUATION

As it is overviewed in the chapter above, there are four main techniques, which rely either on income, market, asset or economic profit approach for business valuation.

As of today business and economic environment have changed dramatically due to the COVID-19 (declared as pandemic on 11th March 2020) lockdown. Thus, in the current situation the market approach valuation could lead to very bias results due to the high volatility of the market. The asset approach valuation doesn't consider self-developed intangibles and the goodwill of a company, which in turn is in the contradiction with the nature of Netflix's business. Thus, in the current situation and under the high influence of COVID-19 and its consequences the author preferred income and economic profit approaches, namely DCF and EVA (News.bloombergtax.com., 2020).

### 9.1 DCF (Discounted Cash Flow) Valuation

Using above estimated Revenue for the period 2020-2024 the forecast of Balance sheet and Income statement items was performed. The starting point of the forecast is the percentage amount of Content assets out of Total assets based on the percentage in previously analyzed financial statements for the period 2015-2019. Within 2015-2019 Content assets are 75% out of Total assets, thus this ratio and previously estimated amount of Content assets were used to estimate Total assets for the period 2020-2024.

Based on the percentage of the item in financial statements 2015-2019, all items on the Balance sheet (APPENDIX P IV) and Income statement (APPENDIX P V) for the period 2020-2024 were estimated.

In order to calculate company's value using a DCF valuation approach it is needed to estimate the set of key components described in the previous chapter, namely EBIT (Earnings before Interest and Tax), NOPAT (Net Operating Profit After Tax), D&A (Depreciation and Amortization), NWC (Net Working Capital) and its changes from period to period, CAPEX (Capital Expenditures) and its changes from period to period, FCFF (Free Cash Flow to the Firm) and WACC (Weighted Average Cost of Capital).

#### 9.1.1 Discount factor (WACC) calculation

In order to estimate present value (PV) of the company, its series of cash flows and terminal value should be discounted for discount factor, namely Weighted Average Cost of Capital (WACC).

$$WACC = (E/V) * R_E + (D/V) * R_D * (1-T_C) \quad (16)$$

where

E/V - weight of equity in capital;

D/V - weight of debt in capital;

R<sub>E</sub> - cost of equity;

R<sub>D</sub> - cost of debt;

T<sub>C</sub> - corporate tax rate.

As it is stated by professor Aswath Damodaran (2012) the market values of debt and equity should be used rather than book values in order to estimate the cost of capital.

In order to calculate the weight of equity and weight of debt in the company's capital, market value of capital was calculated (shares outstanding\*share price) resulting in the amount of \$157 017 million. Due to the lack of information and accordingly impossibility of market debt value calculation, the book value was used.

Then D/V and E/V were calculated, thus it's equal 8% and 92% respectively.

The bias of this calculation will be eliminated further in the thesis by means of iterations.

In order to calculate cost of equity, CAPM (Capital Asset Pricing Model) was used, which states the following:

$$R_E = R_f + \beta_M * [R_M - R_f] \quad (17)$$

where

R<sub>E</sub> - expected return on equity;

R<sub>f</sub> - risk-free rate;

[R<sub>M</sub> - R<sub>f</sub>] - market risk premium;

β<sub>M</sub> - systematic risk (market risk).

To calculate risk-free rate, interest rates for 10 years US bonds were collected for 2019 (monthly) and then the average interest rate was calculated, resulting 2,08 % (Table 14).

**Table 14. Risk-free rate calculation**

10 Y US Bond interest rate for 2019	
January	2,63 %
February	2,73 %
March	2,41 %
April	2,51 %
May	2,14 %
June	2,00 %
July	2,02 %
August	1,50 %
September	1,68 %
October	1,69 %
November	1,78 %
December	1,92 %
<b>R<sub>f</sub> (average)</b>	<b>2,08 %</b>

Source: Author's processing using (Treasury.gov., 2020)

Risk premium ( $[R_M - R_f]$ ) and market risk ( $\beta_M$ ) indicators were used from the professor Aswath Damodaran calculations. As Netflix is the company which operates in every region throughout the world, it was assumed by the author, that the average global market risk premium ( $[R_M - R_f]$ ) and the average global market risk ( $\beta_M$ ) can more precisely contribute to the calculation of the expected return on equity (cost of equity). The beta coefficient is levered and the average one for the entertainment industry.

Below calculation of the cost of equity is presented (Table 15).

**Table 15. Calculation of the cost of equity using CAPM**

CAPM	01.01.2020
Risk premium ( $[R_M - R_f]$ )	4,44 %
Risk free rate ( $R_f$ )	2,08 %
Levered Beta ( $\beta_M$ )	1,31 %
<b>Cost of Equity</b>	<b>7,90 %</b>

Source: Author's processing using (People.stern.nyu.edu., 2020)

Cost of debt was calculated from the average Long-term debt and Interest expenses and resulting 6,11 % (Table 16).

**Table 16. Calculation of the cost of debt**

<b>COST OF DEBT</b>	<b>01.01.2020</b>
<b>Total Long-term debt (average) in thousands \$</b>	12 559 659
<b>Total Interest expense in thousands \$</b>	-767 558
<b>Cost of Debt</b>	<b>6,11 %</b>

Source: Author's processing using Netflix's data

The tax rate for the company was assumed considering above mentioned retrospective analysis of the financial statements and resulting 7,5%.

Thus, the Cost of Capital was calculated and resulting 7,72%. (Table 17).

**Table 17. Calculation of the cost of capital (WACC)**

<b>WACC</b>	<b>01.01.2020</b>
<b>R<sub>E</sub></b>	7,90 %
<b>R<sub>D</sub></b>	6,11 %
<b>D/V</b>	8 %
<b>E/V</b>	92 %
<b>T<sub>C</sub></b>	7,5 %
<b>Cost of Capital</b>	<b>7,72 %</b>

Source: Author's processing

### 9.1.2 FCFF calculation

To calculate FCFF (Free cash flow to the firm) it is crucial to correctly adjust Earnings before Interest and Tax (EBIT) (Table 18).

**Table 18. FCFF calculation process**

<b>FCFF (Free Cash Flow to the Firm)</b>
<b>+ EBIT *(1-T<sub>C</sub>)</b>
<b>+ D&amp;A</b>
<b>- CAPEX</b>
<b>- change in NWC</b>

Source: (Pinto, 2015)

EBIT calculation was proceeded by adding back to Net Income Interest and Tax Expenses. D&A expenses were estimated based on the yearly change of the PP&E (Property, Plant and Equipment) and the percentage amount in PP&E (Table 19).

**Table 19. Calculation of D&A expenses for the period 2020F-2024F**

In thousands \$	2020F	2021F	2022F	2023F	2024F
<b>D&amp;A</b>	188 860	265 314	364 705	493 913	661 883

Source: Author's estimates

Since CAPEX is not the line item in the financial statements, these expenditures were calculated for analyzed 5 years (2015-2019) as the sum of yearly changes in PP&E and D&A. (Table 20).

**Table 20. CAPEX expenses for the period 2015A-2019A**

In thousands \$	2019A	2018A	2017A	2016A	2015A
<b>CAPEX</b>	167 362	110 123	83 392	72 228	31 792

Source: Company's data

Based on historical amounts and the forecasted Balance sheet items for 2020-2024, CAPEX for the projected period was calculated assuming 30% yearly growth and can be seen in the table below.

**Table 21. Calculation of CAPEX expenses for the period 2020F-2024F**

In thousands \$	2020F	2021F	2022F	2023F	2024F
<b>CAPEX</b>	217 571	282 842	367 694	478 003	621 403

Source: Author's estimates

NWC (Net Working Capital) was calculated as the difference between current assets and current liabilities. Then for FCFE calculations the yearly change in NWC was considered (Table 22).

**Table 22. Calculation of changes in NWC for the period 2020F-2024F**

In thousands \$	2020F	2021F	2022F	2023F	2024F
<b>Change in NWC</b>	1 446 537	637 119	828 254	1 076 731	1 399 750

Source: Author's estimates

After all the components are calculated separately, it is possible to calculate FCFE for the forecasted period 2020-2024. The results are in the table below.

Table 23. Calculation of FCFF for the period 2020F-2024F

In thousands \$	2020F	2021F	2022F	2023F	2024F
+ EBIT $*(1-T_c)$	2 953 565	3 785 475	4 866 960	6 272 889	8 100 597
+ D&A	188 860	265 314	364 705	493 913	661 883
- CAPEX	-217 571	-282 842	-367 694	-478 003	-621 403
- change in NWC	-1 446 537	-637 119	-828 254	-1 076 731	-1 399 750
<b>FCFF</b>	<b>1 478 317</b>	<b>3 130 829</b>	<b>4 035 716</b>	<b>5 212 068</b>	<b>6 741 326</b>

Source: Author's estimates

Further, the expected cash flows should be discounted using the cost of capital (WACC), resulting in finding present value of the expected cash flows of the company (Table 24).

Table 24. Calculation of discounted cash flows for the period 2020F-2024F

In thousands \$	2020F (t=1)	2021F (t=2)	2022F (t=3)	2023F (t=4)	2024F (t=5)
<b>FCFF</b>	<b>1 478 317</b>	<b>3 130 829</b>	<b>4 035 716</b>	<b>5 212 068</b>	<b>6 741 326</b>
$1/(1+WACC)^t$	0,9283	0,8618	0,8000	0,7427	0,6895
<b>Discounted FCFF</b>	<b>1 372 368</b>	<b>2 698 147</b>	<b>3 228 716</b>	<b>3 870 993</b>	<b>4 647 943</b>

Source: Author's estimates

According to the DCF valuation approach the net value of the company equals to the sum of the discounted (present value) expected cash flows and discounted (present value) terminal value minus company's debt. A terminal growth rate indicates at what extend the company is going to grow in perpetuity. Normally it should be in line with inflation rate in the long-run, but should not exceed historical GDP growth rate. Based on the overview of inflation rate and GDP growth rate in the previous chapter, the author assumed perpetual growth for the company in the amount of 3% (terminal growth rate). Thus, it is possible to calculate terminal value of the company as well as the present value of the terminal value (Table 25).

Table 25. Calculation of terminal value and its present value

<b>Expected FCFF</b>	6 741 326
<b>WACC</b>	7,72%
<b>Growth rate (g)</b>	3%
<b>Terminal value</b>	142 820 467
<b>PV of terminal value</b>	<b>98 470 446</b>

Source: Author's estimates

Now it is possible to calculate net value of the company (Table 26).

**Table 26. Calculation of net company's value**

<b>Sum of discounted FCFF</b>	15 818 167
<b>PV of terminal value</b>	98 470 446
<b>Debt</b>	- 12 559 659
<b>Net company's value</b>	<b>101 728 954</b>

Source: Author's estimates

The net company's value equals \$101 729 million.

### 9.1.3 Adjusted capital structure and iterations

As it was previously discussed in the thesis, the market value of debt and equity should be used in order to calculate debt and equity weights in the company's capital and cost of capital. It is quite straightforward to determine market value of equity for publicly traded companies: shares outstanding\*share price = market capitalization. However, it could be challenging to calculate market value of debt. In case of the target company, it is not possible to calculate market value of debt due to the lack of information about issued Notes. This problem could be overcome by means of iterating process. Iterations are the chain of integrated formulas, where the information moves freely between cash flows and cost of capital moves. (Patena, 2010). As a result, the adjusted capital structure can be found. The valuation using iterations is going backwards, meaning that the problem of the cost of capital dependency on the financial structure could be overcome.

Thus, the author performed iterations using Microsoft Excel software in order to find adjusted capital structure for the target company and respectively perform valuation. The adjusted cost of capital equals to 7,63% (comparing to previous 7,72%). The capital structure also was adjusted and resulting 12,21% of debt versus 87,79% of equity (comparing to previous 8% versus 92%). As a result the adjusted company's net value is \$102 882 million (Table 27).

**Table 27. i-DCF calculation (iterations)**

	2020F	2021F	2022F	2023F	2024F	Perpetuity
D/V	12,21%	11,40%	10,79%	10,27%	9,86%	9,56%
E/V	87,79%	88,60%	89,21%	89,73%	90,14%	90,44%
D / E	13,91%	12,86%	12,09%	11,44%	10,93%	10,57%
$R_D * (1 - T_c)$	5,65%	5,59%	5,71%	5,65%	5,61%	5,61%
$R_E$	7,90%	7,90%	7,90%	7,90%	7,90%	7,90%
WACC	<b>7,63%</b>	<b>7,64%</b>	<b>7,66%</b>	<b>7,67%</b>	<b>7,67%</b>	<b>7,68%</b>

In thousands \$	2020F	2021F	2022F	2023F	2024F	Perpetuity
FCFF	1 478 317	3 130 829	4 035 716	5 212 068	6 741 326	6 741 326
Company's value	<b>115 441</b>	<b>122 766</b>	<b>129 010</b>	<b>134 861</b>	<b>139 992</b>	
	<b>995</b>	<b>752</b>	<b>884</b>	<b>923</b>	<b>577</b>	<b>143 995 356</b>
- Debt	12 559 659	12 559 659	12 559 659	12 559 659	12 559 659	12 559 659
Net company's value	<b>102 882</b>	<b>110 207</b>	<b>116 451</b>	<b>122 302</b>	<b>127 432</b>	
	<b>336</b>	<b>093</b>	<b>225</b>	<b>264</b>	<b>918</b>	<b>131 435 697</b>

Source: Author's processing

## 9.2 EVA (Economic value added) Valuation

In order to value the company with EVA valuation approach, EVA and WACC should be calculated.

WACC was calculated in the section above (Table 17), thus the cost of capital will be used in the amount of 7,72% .

### 9.2.1 NOPAT calculation

To calculate company's value using an EVA valuation approach it is needed to estimate the set of key components described in the previous chapter, namely NOPAT (Net Operating Profit After Tax) and C (Capital Invested).

$NOPAT = EBIT * (1 - T_c)$  and was calculated for the forecasting period in the previous chapter. The results are presented in the table below.

**Table 28. Calculation of NOPAT for the period 2020F-2024F**

In thousands \$	2020F	2021F	2022F	2023F	2024F
EBIT	3 193 037	4 092 399	5 261 569	6 781 490	8 757 388



T <sub>c</sub>	0,0750	0,0750	0,0750	0,0750	0,0750
<b>NOPAT</b>	<b>2 953 565</b>	<b>3 785 475</b>	<b>4 866 960</b>	<b>6 272 889</b>	<b>8 100 597</b>

Source: Author's estimates

### 9.2.2 Calculation of Capital invested

The next step is to calculate Capital invested for the forecasting period. According to professor Aswath Damodaran (2012), the book value of equity could be used in order to calculate Capital invested. Even though during WACC calculation the market value of equity was used, there is no contradiction between this two calculations, as any company in order to generate value, should earn more than its market value cost of capital.

Thereby the Capital invested will be calculated as following:

$$\text{Capital invested} = \text{Total liabilities and equity} - \text{non-bearing interest liabilities}$$

(18)

Calculation results for Capital invested for the period 2020F-2024F (Table 29) are below.

**Table 29. Capital invested for the period 2020F-2024F**

In thousands \$	2019A	2020F	2021F	2022F	2023F	2024F
<b>C</b>	<b>17 322 980</b>	<b>20 387 800</b>	<b>26 504</b>	<b>34 455</b>	<b>44 791</b>	<b>58 229 595</b>
			<b>140</b>	<b>382</b>	<b>996</b>	

Source: Author's processing

Now it is possible to calculate EVA for the forecasting period. Even though in basic formula for EVA computation, the invested capital ( $\text{NOA} = \text{C}$ ) should be considered at the point of time, while calculating EVA in order to discount it for company's valuation process, Capital invested should be used for the previous period ( $t-1$ ). *"The capital invested that is used to compute EVA in future periods should be estimated by adding the reinvestment in each period to the capital invested at the beginning of the period."* (Damodaran, 2012, 878).

Thus, the following formula was used:

$$\text{EVA}_t = \text{After-tax operating income}_t - \text{Cost of Capital} * \text{Capital Invested}_{t-1}$$

(19)

Below are the results of EVA calculation (Table 30).

**Table 30. Calculation of EVA for the period 2020F-2024F**

In thousands \$	2020F	2021F	2022F	2023F	2024F
<b>NOPAT</b>	2 953 565	3 785 475	4 866 960	6 272 889	8 100 597
<b>WACC</b>	0,0772	0,0772	0,0773	0,0773	0,0772
<b>C</b>	17 322 980	20 387	26 504	34 455	44 791 996
		800	140	382	
<b>EVA</b>	<b>1 616 095</b>	<b>2 211 396</b>	<b>2 818 191</b>	<b>3 610 795</b>	<b>4 641 180</b>

Source: Author's estimates

Company's value using EVA approach equals to the sum of discounted EVA (Table 31) for the forecasting period and present value of the terminal value minus company's debt.

**Table 31. Calculation of discounted EVA for the period 2020F-2024F.**

In thousands \$	2020F (t=1)	2021F (t=2)	2022F (t=3)	2023F (t=4)	2024F (t=5)
<b>EVA</b>	1 615 169	2 211 396	2 818 191	3 610 795	4 641 180
<b>1/(1+WACC)<sup>t</sup></b>	0,9283	0,8618	0,8000	0,7427	0,6895
<b>Discounted EVA</b>	<b>1 499 412</b>	<b>1 905 780</b>	<b>2 254 653</b>	<b>2 681 731</b>	<b>3 199 955</b>

Source: Author's estimates

As it is explained above in this chapter, for the terminal value calculation the author assumed perpetual growth for the company in the amount of 3% (terminal growth rate). Thus, it is possible to calculate terminal value of the company as well as the present value of the terminal value (Table 32).

**Table 32. Calculation of terminal value and its present value**

<b>Expected EVA</b>	4 641 180
<b>WACC</b>	7,72%
<b>Growth rate (g)</b>	3%
<b>Terminal value</b>	98 327 168
<b>PV of terminal value</b>	<b>67 793 645</b>

Source: Author's estimates

Now it is possible to calculate net value of the company (Table 33).

**Table 33. Net company's value calculation**

<b>Sum of discounted EVA</b>	11 541 531
<b>PV of terminal value</b>	67 793 645

C	17 322 980
<b>Net company's value</b>	<b>96 658 156</b>

Source: Author's estimates

The net company's value equals \$96 658 million.

### 9.2.3 Adjusted capital structure and iterations

As it was previously discussed in the thesis, the problem of the cost of capital dependency on the financial structure could be overcome using iterations. In case with EVA valuation process, iterations were performed as well as in case with DCF valuation.

Thus, the author performed iterations using Microsoft Excel software in order to find adjusted capital structure for the target company and respectively perform valuation. The adjusted cost of capital equals to 7,49% (comparing to previous 7,72%). The capital structure also was adjusted and resulting 18,05% of debt versus 81,95% of equity (comparing to previous 8% versus 92%). As a result the adjusted company's net value is \$99 454 million (Table 35).

**Table 34. i-DCF calculation (iterations)**

	2020F	2021F	2022F	2023F	2024F	Perpetuity
D/V	18,05%	16,95%	16,02%	15,23%	14,60%	14,14%
E/V	81,95%	83,05%	83,98%	84,77%	85,40%	85,86%
D / E	22,03%	20,41%	19,07%	17,97%	17,10%	16,46%
$R_D * (1 - T_c)$	5,65%	5,59%	5,71%	5,65%	5,61%	5,61%
$R_E$	7,90%	7,90%	7,90%	7,90%	7,90%	7,90%
<b>WACC</b>	<b>7,49%</b>	<b>7,51%</b>	<b>7,55%</b>	<b>7,56%</b>	<b>7,57%</b>	<b>7,58%</b>

In thousands \$	2020F	2021F	2022F	2023F	2024F	Perpetuity
EVA	1 615 169	2 211 396	2 818 191	3 610 795	4 641 180	4 641 180
<b>Company's value</b>	<b>82 131 027</b>	<b>86 670 860</b>	<b>90 966 725</b>	<b>95 015 388</b>	<b>98 585 425</b>	<b>101 403 570</b>

Source: Author's processing

**Table 35. Net company's value calculation**

<b>Sum of discounted EVA</b>	11 541 531
<b>PV of terminal value</b>	70 589 496

<b>C</b>	17 322 980
<b>Net company's value</b>	<b>99 454 007</b>

Source: Author's processing

### 9.3 Results and recommendations

Thus, as a result of the thesis, Netflix's value was calculated using the two most common approaches, namely DCF and EVA.

In the table below there are the results.

**Table 36. Netflix's net value according to DCF and EVA methods**

In thousands \$	DCF	EVA
<b>Netflix's net value</b>	<b>102 882 336</b>	<b>99 454 007</b>

Source: Author's estimates

First of all the author would like to point out, that despite theoretical statement, that DCF and EVA results should be equal (Damodaran, 2012), the results of calculations are with a difference in the amount of \$3 428 million. This could be due to the limitations of the research which will be discussed further. The input values as NOPAT and WACC for both calculations were the same. So, the main difference appeared due to the author's estimates of key components while computing future FCFF, such as D&A expenses, CAPEX and changes in NWC. This bias could be due to the lack of the information and the absence of some disclosures in company's publicly available reports as well as the forecasting risk. Moreover, the author did not have access to company's data, management and employees to be able to acquire valuable information about company's operations. Also, the accounting reclassification of the current content assets which took place in 2019 could have resulted in biased results, as it influences NWC, which in turn influences FCFF calculation.

Despite the difference between calculations, both results are positive, meaning that company is generating surplus value for its shareholders.

To be more attractive for investors, debtors and other stakeholders, company can create appraisal file showing its potential, which, in turn, will result in more investments.

Even though both valuation approaches are reliable and of wide use in real life, the author rely more on the EVA valuation results. There is still the room for uncertainties and estimate error, however, EVA calculation is more straightforward in comparison to DCF. DCF approach includes the estimates not only for future cash flows, moreover for D&A

expenses, CAPEX and changes in NWC. As a result, it could lead to higher bias of the results. Oppositely, EVA is straightforward method requiring only future NOPAT estimates and Capital invested.

Thus, the author would like to conclude with the company's value in the amount of \$99 454 million. The market capitalization of Netflix is \$157 018 million, meaning that company is overvalued. Market capitalization is the market value of the company showing how much investors are ready to pay for the company's shares, and it doesn't necessarily describes the intrinsic value of the company. Professor Aswath Damodaran (2012) notes, that there are several ways to reduce the bias in the process of company valuation and one of it is *"to avoid taking strong public positions on the value of a firm before the valuation is complete."* (Damodaran, 2012, 2). This step is very important in business valuation, due to the fact that a huge portion of decisions precedes the actual valuation, which in turn can lead to bias.

The author of the thesis believes in the results obtained from EVA valuation approach and estimates that despite the huge potential, Netflix's is overvalued.

To increase company's EVA and respectively company's value, there are mainly two ways: 1) to increase revenues or 2) to decrease capital costs.

Netflix is still heavily expanding to the global market, increasing its market share and accordingly revenues. Moreover, Netflix is on its way to reduced costs due to the transition to in-house production. The author's recommendation is to follow this strategy, as in the following years it can increase company's value.

Cost of capital (WACC) is the mixture of company's cost of debt and cost of equity. Thus, the main goal, in order to increase EVA, is to find optimal company's capital structure. Debt financing is naturally cheaper as it is less risky and results in tax relief, namely creates tax shield. However, it doesn't mean that the whole capital of the company should be financed with debt, because significant increase in debt, will accordingly lead to increased interest payments, the volatility of dividend payments and as the result increase in the financial risk to shareholders. Finally, this will lead to increase in the cost of equity. As the earlier performed valuation showed, Netflix's capital is financed with 8% of debt and 92% of equity. The author assumes, that this capital structure is quite expensive for the company and recommends Netflix's management to adjust capital structure which, in turn, will increase company's value.

## 10 COVID-19

2020 started with unexpected and frightening COVID-19 which on 11th March 2020 was declared as a pandemic. It is obvious that everyone was influenced by the consequences of COVID-19 and the lockdown started all over the globe. Isolation, quarantine, inability of the most of the people living their common life resulted in a massive increase in the amount of Netflix's subscribers. Thus, in Q1 2020 Netflix has 15 766 thousands of new subscribers, which in turn nearly 65% higher than the same period in 2019 and 80% higher than the previous period (Q4 2019). All this happened as people all over the world should entertain themselves during the pandemic. The viewing statistics for some Netflix's shows increased dramatically. Thus the documentary "Tiger King" was watched by 65 million of subscribers and the original movie "Spenser Confidential" by 85 million. Even though this numbers are inspiring, author of the thesis believes that this rapid growth in subscribers' base could be temporary.

As now uncertainty about the future for every company in every industry and every country, as well as for every individual is very high, and future is pretty vague, the author did not consider subscribers' growth for the long-term perspective and all estimates within thesis and the valuation was performed not considering the influence of the COVID-19 lockdown on the Netflix subscribers' base. Moreover, it's worth mentioning, that due to the global lockdown, most of the Netflix production was frozen. It might have a negative impact of company's profitability in the future. In author's view, assessment and analysis of COVID-19 influence on Netflix might be performed in some period of time, when the situation becomes more certain for all participants of the market and when the outcome is possible to measure or calculate.

## 11 INVESTMENT SUMMARY

The author issued SELL recommendation on Netflix, Inc. with a target price of \$227,18 using EVA valuation approach (Figure 26). As it is stated by theoreticians (Hitchner, 2011), the valuation should be performed in a certain point in time. The result of the appraisal process is as of 31.12.2019. The target price presents a 31% upside and implies a 120,75 P/E. Thus, regarding the results of the valuation Netflix's high P/E indicates that its shares are overvalued.

**Figure 26. Investment summary for Netflix, Inc.**

Recommendation:	<b>SELL</b>
<b>Netflix, Inc. (NFLX.O)</b>	
Target Price	<b>\$227,18</b>
Last close	<b>\$329,98</b>
Downside	<b>31%</b>
Market Cap	<b>\$157 017 973 000</b>
Shares Outstanding	<b>\$437 779 000</b>
P/E	<b>102,75</b>

Source: Author's estimates

## CONCLUSION

The main aim of the thesis was to conduct appraisal process for Netflix. To do so, the thesis was divided in two main parts: theoretical and practical. The first part presents the theoretical framework of the business valuation. The author performed literature review regarding business valuation topic. The basis of the valuation was described. The author described main standards and premises of value, as well as their differences and their importance in the business valuation process. Moreover, main valuation approaches were discussed and several classifications of valuation methods were described. The author has chosen two methods in order to conduct appraisal process for Netflix, namely DCF (Discounted cash flow) and EVA (Economic value added). These two methods were described in details in the theoretical part of thesis, as well as required inputs. The researched selected methods of business valuation were used in the practical part of the thesis. The author conducted strategic analysis of Netflix. Strategic analysis of business is very complex process requiring analysis of the company and its stakeholders from many different perspectives, as well as industry analysis and global trends. Thus, the author analyzed target industry and current trends, as well as industry's potential. Macroeconomic analysis and global trends analysis were performed. Understanding of Netflix's competitive position was reached by mean of worldwide known Porter's Five Forces analysis. Thus, five main forces influencing Netflix performance were analyzed, namely 1) Threat of potential entrants; 2) Power of buyers; 3) Power of suppliers; 4) Industry rivalry; 5) Threat of substitute. The overall description of the business model, company's vision and company's strategy were overviewed as well as its approach to corporate governance. The author applied the knowledge in risk management area in order to conduct risk analysis for Netflix. As a result the self-created Risk Matrix was proposed.

As a result of strategic analysis, the author was able to estimate some Netflix's indicators. Based on this, revenue prediction for the period 2020-2014 was conducted. Then the author was able to define inputs for selected valuation models and to perform calculations. As a result, Netflix's intrinsic value was estimated. Moreover, the author discussed the results and gave some recommendation for target company. In case of positive results of valuation, the company could use them to attract more investors, debtors or other stakeholders. Based of the appraisal performed by the author, the recommendation regarding Netflix stocks is SELL. Thus, the results can help the company to analyze its performance,



probably revise its capital structure and come out with the financial decision which, in turn, will increase Netflix's value and accordingly value for its shareholders.

The author of the thesis was not able to ignore the impact of COVID-19 on the company's performance and on the globe as a whole. Thus, the brief overview regarding the global pandemic and health crisis, as well as their possible influence on Netflix and its operations, were discussed.

## LIMITATIONS OF THE RESEARCH

*"Managers and investors alike must understand  
that accounting numbers are the beginning,  
not the end, of business valuation."*

Warren E. Buffett  
(Schmidlin,2014,159)

The author's assumptions and performed Models and calculations can be applied only to Netflix. Every appraisal process is highly "individual", thus valuation of another company should start from the very beginning with "individual" input.

Moreover, the research and calculations which were conducted have limitations which could have resulted in either vague or biased results of the valuation. Thus, the cost of equity (CAPM) was calculated based on global average values and average for the industry, retrieved from professor Aswath Damodaran calculations. Even though this source of information is reliable, it could have resulted in some bias in the cost of equity estimates, due to the usage of the average values.

To calculate the final value of the company cost of debt calculated based on book values was used, not market values. Thus, it could lead to bias in the results.

Even though Netflix has mandatory 10-K annual reporting as well as quarterly 10-Q reporting, not all needed information regarding company's operations, assets, liabilities and equity, revenue and expenses is disclosed (which is not in contradiction with SEC requirements). Furthermore, it is assumed that the company's financial statements contain reliable and truthful information about the company's financial position and results of operations. Moreover, there is a lack of information regarding competitors' operations, what makes impossible to calculate some required indicators in order to perform more valuable competitors' analysis.

*"The models that we use in valuation may be  
quantitative, but the inputs leave plenty  
of room for subjective judgments."*

Aswath Damodaran  
(Damodaran,2012,2)

Many of the key components of the valuations presented in the thesis are author's estimates and could have subjective influence on the results. Thus, there is the forecasting

risk (estimation risk), which means that the possible errors in the cash flow projections, can lead to incorrect decisions (Ross, 2013).

Moreover, there are two main categories of uncertainties: macro- and -microeconomics. It should be taken into account, that the business is highly affected by these two factors and there is no assurance that in the future, it will not affect the target either with good or bad output.

## SUGGESTIONS FOR FUTURE RESEARCH

As a finishing point of the thesis author would like to give a suggestion for further studies in the area of business valuation.

Business valuation is a very complex and tough topic, becoming more popular and widely used under different circumstances. There is astounding amount of theoretical knowledge and practical experiences regarding valuation. However, there is an abundance of misconceptions about valuation. Moreover, the process and the results of valuation can be manipulated in a number of ways. Thus, before performing the appraisal process, the analyst should deeply research the theoretical background.

Appraisal process as a whole and its results will vary depending on the business, company's business model, core products and services and other bunch of specifics. Thus, it is extremely important for the appraiser to conduct strategic analysis of the target company on the high level and then accurately choose the approach to value and valuation methods according to business specifics.

There could be various incentives for appraisal, however in some circumstances financial decisions might be done. This is one more factor proving that valuation should be performed in the most precise way.

As it is discussed above, to do so the appraiser should consider tremendous amount of things. The theoretical and practical studies are from different authors and in different sources and sometimes have varying information.

Thus, the author's suggestion is to create a so-called *Manual* or *Road Map* basically for inexperienced appraisers. This Manual should be short guide to valuation process, however including most of the misconceptions and all the specifics from most of the valuable resources regarding the topic of business valuation. It should include guidance from the very first step till the very last. In author's view, the Manual should be created in the interactive format for better navigation through it. Most of the Manual may consist of compact interactive tables, smart diagrams and graphics. Moreover, the website and the application could be launched. Thus, interactive content such as short videos can be used as well. In author's view this could help young and inexperienced researches to learn faster and to show better performance in business valuation. However, the creation of the proposed Manual is the topic for further research.

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**LIST OF ABBREVIATIONS**

APAC	Asia-Pacific
AWS	Amazon Web Services
C	Capital invested
CAPEX	Capital Expenditure
CAPM	Capital Asser Pricing Model
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COGS	Cost of goods sold
COVID-19	Corona virus disease
CSR	Corporate Social Responsibility
D&A	Depreciation and Amortization
DCF	Discounted Cash Flow
DVD	Digital Versatile Disc
EBIT	Earnings before interest and tax
EMEA	Europe, Middle East, and Africa
ESG	Environmental, Social and Governance
EVA	Economic value added
FCF	Free cash flow
FCFE	Free cash flow to equity
FCFF	Free cash flow to the firm
GDP	Gross domestic product
HR	Human Resources
INC	Incorporated
LATAM	Latin America
MWh	Megawatt-hour
NASDAQ	Stock exchange
NOPAT	Net operating profit after tax
NWC	Net working capital
P/E	Price-to-earnings ratio
PESTEL	Political, Economic, Social, Technological, Environmental and Legal
PP&E	Property, plant and equipment
PV	Present value
Q1	1 <sup>st</sup> quarter of the year
Q4	4 <sup>th</sup> quarter of the year
SASB	Sustainability Accounting Standards Board
SVoD	Subscription video on demand
SWOT	Strengths, weaknesses, opportunities, and threat
UCAN	United States of America and Canada
US	United States of America
WACC	Weighted average cost of capital

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## **APPENDICES**

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**APPENDIX P VI. Horizontal analysis of Balance sheet for the period 2015-2019**

In thousands \$	2019A	2018A	2017A	2016A	2015A	%Δ				
	31.12.2019	31.12.2018	31.12.2017	31.12.2016	31.12.2015	2019- '18	2018- '17	2017- '16	2016- '15	2019- '15
<b>Cash and cash equivalents</b>	5 018 437	3 794 483	2 822 795	1 467 576	1 809 330	32%	34%	92%	-19%	177%
<b>Short-term investments</b>	0	0	0	266 206	501 385	0%	0%	-100%	-47%	-100%
<b>Current content assets, net</b>	0	5 151 186	4 310 934	3 726 307	2 905 998	-100%	19%	16%	28%	-100%
<b>Other current assets</b>	1 160 067	748 466	536 245	260 202	215 127	55%	40%	106%	21%	439%
<b>Total current assets</b>	<b>6 178 504</b>	<b>9 694 135</b>	<b>7 669 974</b>	<b>5 720 291</b>	<b>5 431 840</b>	<b>-36%</b>	<b>26%</b>	<b>34%</b>	<b>5%</b>	<b>14%</b>
<b>Non-current content assets, net</b>	24 504	14 951	10 371	7 274 501	4 312 817	64%	44%	43%	69%	468%
	567	141	055							
<b>Property and equipment, net</b>	565 221	418 281	319 404	250 395	173 412	35%	31%	28%	44%	226%
<b>Other non-current assets</b>	2 727 420	910 843	652 309	341 423	284 802	199%	40%	91%	20%	858%
<b>Total assets</b>	<b>33 975</b>	<b>25 974</b>	<b>19 012</b>	<b>13 586</b>	<b>10 202</b>	<b>31%</b>	<b>37%</b>	<b>40%</b>	<b>33%</b>	<b>233%</b>
	<b>712</b>	<b>400</b>	<b>742</b>	<b>610</b>	<b>871</b>					
<b>Current content liabilities</b>	4 413 561	4 681 562	4 173 041	3 632 711	2 789 023	-6%	12%	15%	30%	58%
<b>Accounts payable</b>	674 347	562 985	359 555	312 842	253 491	20%	57%	15%	23%	166%
<b>Accrued expenses and other liabilities</b>	843 043	481 874	315 094	197 632	140 389	75%	53%	59%	41%	501%

<b>Deferred revenue</b>	924 745	760 899	618 622	443 472	346 721	22%	23%	39%	28%	167%
<b>Total current liabilities</b>	<b>6 855 696</b>	<b>6 487 320</b>	<b>5 466 312</b>	<b>4 586 657</b>	<b>3 529 624</b>	<b>6%</b>	<b>19%</b>	<b>19%</b>	<b>30%</b>	<b>94%</b>
<b>Non-current content liabilities</b>	3 334 323	3 759 026	3 329 796	2 894 654	2 026 360	-11%	13%	15%	43%	65%
<b>Long-term debt</b>	14 759	10 360	6 499 432	3 364 311	2 371 362	42%	59%	93%	42%	522%
	260	058								
<b>Other non-current liabilities</b>	1 444 276	129 231	135 246	61 188	52 099	1018%	-4%	121%	17%	2672%
<b>Total liabilities</b>	<b>26 393</b>	<b>20 735</b>	<b>15 430</b>	<b>10 906</b>	<b>7 979 445</b>	<b>27%</b>	<b>34%</b>	<b>41%</b>	<b>37%</b>	<b>231%</b>
	<b>555</b>	<b>635</b>	<b>786</b>	<b>810</b>						
<b>Common stock</b>	2 793 929	2 315 988	1 871 396	1 599 762	1 324 809	21%	24%	17%	21%	111%
<b>Accumulated other comprehensive loss</b>	-23 521	-19 582	-20 557	-48 565	-43 308	20%	-5%	-58%	12%	-46%
<b>Retained earnings</b>	4 811 749	2 942 359	1 731 117	1 128 603	941 925	64%	70%	53%	20%	411%
<b>Total stockholders' equity</b>	<b>7 582 157</b>	<b>5 238 765</b>	<b>3 581 956</b>	<b>2 679 800</b>	<b>2 223 426</b>	<b>45%</b>	<b>46%</b>	<b>34%</b>	<b>21%</b>	<b>241%</b>
<b>Total liabilities and stockholders' equity</b>	<b>33 975</b>	<b>25 974</b>	<b>19 012</b>	<b>13 586</b>	<b>10 202</b>	<b>31%</b>	<b>37%</b>	<b>40%</b>	<b>33%</b>	<b>233%</b>
	<b>712</b>	<b>400</b>	<b>742</b>	<b>610</b>	<b>871</b>					

Source: Author's processing

**APPENDIX P VII. Vertical analysis of Balance sheet for the period 2015-2019**

In thousands \$	2019A	2018A	2017A	2016A	2015A	%				
	31.12.2019	31.12.2018	31.12.2017	31.12.2016	31.12.2015	2019	2018	2017	2016	2015
<b>Cash and cash equivalents</b>	5 018 437	3 794 483	2 822 795	1 467 576	1 809 330	15%	15%	15%	11%	18%
<b>Short-term investments</b>	0	0	0	266 206	501 385	0%	0%	0%	2%	5%
<b>Current content assets, net</b>	0	5 151 186	4 310 934	3 726 307	2 905 998	0%	20%	23%	27%	28%
<b>Other current assets</b>	1 160 067	748 466	536 245	260 202	215 127	3%	3%	3%	2%	2%
<b>Total current assets</b>	<b>6 178 504</b>	<b>9 694 135</b>	<b>7 669 974</b>	<b>5 720 291</b>	<b>5 431 840</b>	<b>18%</b>	<b>37%</b>	<b>40%</b>	<b>42%</b>	<b>53%</b>
<b>Non-current content assets, net</b>	24 504 567	14 951 141	10 371 055	7 274 501	4 312 817	72%	58%	55%	54%	42%



<b>Property and equipment, net</b>	565 221	418 281	319 404	250 395	173 412	2%	2%	2%	2%	2%
<b>Other non-current assets</b>	2 727 420	910 843	652 309	341 423	284 802	8%	4%	3%	3%	3%
<b>Total assets</b>	<b>33 975 712</b>	<b>25 974 400</b>	<b>19 012 742</b>	<b>13 586 610</b>	<b>10 202 871</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Current content liabilities</b>	4 413 561	4 681 562	4 173 041	3 632 711	2 789 023	13%	18%	22%	27%	27%
<b>Accounts payable</b>	674 347	562 985	359 555	312 842	253 491	2%	2%	2%	2%	2%
<b>Accrued expenses and other liabilities</b>	843 043	481 874	315 094	197 632	140 389	2%	2%	2%	1%	1%
<b>Deferred revenue</b>	924 745	760 899	618 622	443 472	346 721	3%	3%	3%	3%	3%
<b>Total current liabilities</b>	<b>6 855 696</b>	<b>6 487 320</b>	<b>5 466 312</b>	<b>4 586 657</b>	<b>3 529 624</b>	<b>20%</b>	<b>25%</b>	<b>29%</b>	<b>34%</b>	<b>35%</b>
<b>Non-current content liabilities</b>	3 334 323	3 759 026	3 329 796	2 894 654	2 026 360	10%	14%	18%	21%	20%
<b>Long-term debt</b>	14 759 260	10 360 058	6 499 432	3 364 311	2 371 362	43%	40%	34%	25%	23%
<b>Other non-current liabilities</b>	1 444 276	129 231	135 246	61 188	52 099	4%	0%	1%	0%	1%
<b>Total liabilities</b>	<b>26 393 555</b>	<b>20 735 635</b>	<b>15 430 786</b>	<b>10 906 810</b>	<b>7 979 445</b>	<b>78%</b>	<b>80%</b>	<b>81%</b>	<b>80%</b>	<b>78%</b>
<b>Common stock</b>	2 793 929	2 315 988	1 871 396	1 599 762	1 324 809	8%	9%	10%	12%	13%

<b>Accumulated other comprehensive loss</b>	-23 521	-19 582	-20 557	-48 565	-43 308	0%	0%	0%	0%	0%
<b>Retained earnings</b>	4 811 749	2 942 359	1 731 117	1 128 603	941 925	14%	11%	9%	8%	9%
<b>Total stockholders' equity</b>	<b>7 582 157</b>	<b>5 238 765</b>	<b>3 581 956</b>	<b>2 679 800</b>	<b>2 223 426</b>	<b>22%</b>	<b>20%</b>	<b>19%</b>	<b>20%</b>	<b>22%</b>
<b>Total liabilities and stockholders' equity</b>	<b>33 975</b>	<b>25 974</b>	<b>19 012</b>	<b>13 586</b>	<b>10 202</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
	<b>712</b>	<b>400</b>	<b>742</b>	<b>610</b>	<b>871</b>					

Source: Author's processing

**APPENDIX P VIII. Horizontal analysis of Income Statement for the period 2015-2019**

In thousands \$	2019A	2018A	2017A	2016A	2015A	%Δ				
	31.12.2019	31.12.2018	31.12.2017	31.12.2016	31.12.2015	2019-'18	2018-'17	2017-'16	2016-'15	2019-'15
<b>Revenue</b>	<b>20 156 447</b>	<b>15 794 341</b>	<b>11 692 713</b>	<b>8 830 669</b>	<b>6 779 511</b>	<b>28%</b>	<b>35%</b>	<b>32%</b>	<b>30%</b>	<b>197%</b>
Cost of revenue	12 440 213	9 967 538	8 033 000	6 029 901	4 591 476	25%	24%	33%	31%	171%
Marketing	2 652 462	2 369 469	1 436 281	991 078	824 092	12%	65%	45%	20%	222%
Technology and development	1 545 149	1 221 814	953 710	852 098	650 788	26%	28%	12%	31%	137%
General and administrative	914 369	630 294	431 043	577 799	407 329	45%	46%	-25%	42%	124%
<b>Operating income</b>	<b>2 604 254</b>	<b>1 605 226</b>	<b>838 679</b>	<b>379 793</b>	<b>305 826</b>	<b>62%</b>	<b>91%</b>	<b>121%</b>	<b>24%</b>	<b>752%</b>
Interest expense	-626 023	-420 493	-238 204	-150 114	-132 716	49%	77%	59%	13%	372%
Interest and other income (expense)	84 000	41 725	-115 154	30 828	-31 225	101%	136%	-474%	199%	369%
Income before income taxes	2 062 231	1 226 458	485 321	260 507	141 885	68%	153%	86%	84%	1353%
Provision for (benefit from) income taxes	195 315	15 216	-73 608	73 829	19 244	1184%	121%	-200%	284%	915%
<b>Net income</b>	<b>1 866 916</b>	<b>1 211 242</b>	<b>558 929</b>	<b>186 678</b>	<b>122 641</b>	<b>54%</b>	<b>117%</b>	<b>199%</b>	<b>52%</b>	<b>1422%</b>

Basic (in USD per share)	\$ 4,26	\$ 2,78	\$ 1,29	\$ 0,44	\$ 0,29	53%	116%	193%	52%	1369%
Diluted (in USD per share)	\$ 4,13	\$ 2,68	\$ 1,25	\$ 0,43	\$ 0,28	54%	114%	191%	54%	1375%

Source: Author's processing

**APPENDIX P IX. Vertical analysis of Income Statement for the period 2015-2019**

In thousands \$	2019A	2018A	2017A	2016A	2015A	%				
	31.12.2019	31.12.2018	31.12.2017	31.12.2016	31.12.2015	2019	2018	2017	2016	2015
<b>Revenue</b>	<b>20 156 447</b>	<b>15 794 341</b>	<b>11 692 713</b>	<b>8 830 669</b>	<b>6 779 511</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
Cost of revenue	12 440 213	9 967 538	8 033 000	6 029 901	4 591 476	62%	63%	69%	68%	68%
Marketing	2 652 462	2 369 469	1 436 281	991 078	824 092	13%	15%	12%	11%	12%
Technology and development	1 545 149	1 221 814	953 710	852 098	650 788	8%	8%	8%	10%	10%
General and administrative	914 369	630 294	431 043	577 799	407 329	5%	4%	4%	7%	6%
<b>Operating income</b>	<b>2 604 254</b>	<b>1 605 226</b>	<b>838 679</b>	<b>379 793</b>	<b>305 826</b>	<b>13%</b>	<b>10%</b>	<b>7%</b>	<b>4%</b>	<b>5%</b>
Interest expense	-626 023	-420 493	-238 204	-150 114	-132 716	3%	3%	2%	2%	2%
Interest and other income (expense)	84 000	41 725	-115 154	30 828	-31 225	0,4%	0,3%	1%	0,3%	0,5%
Income before income taxes	2 062 231	1 226 458	485 321	260 507	141 885	10%	8%	4%	3%	2%

Provision for (benefit from) income taxes	195 315	15 216	-73 608	73 829	19 244	1%	0,1%	1%	1%	0,3%
<b>Net income</b>	<b>1 866 916</b>	<b>1 211 242</b>	<b>558 929</b>	<b>186 678</b>	<b>122 641</b>	<b>9%</b>	<b>8%</b>	<b>5%</b>	<b>2%</b>	<b>2%</b>

Source: Author's processing

#### APPENDIX P X. Estimates of the Balance Sheet items for the period 2020-2024 (Forecast)

In thousands \$	2020F	2021F	2022F	2023F	2024F
	31.12.2020	31.12.2021	31.12.2022	31.12.2023	31.12.2024
Cash and cash equivalents	6 371 187	8 282 544	10 767 307	13 997 499	18 196 748
Other current assets	1 274 237	1 656 509	2 153 461	2 799 500	3 639 350
<b>Total current assets</b>	<b>7 645 425</b>	<b>9 939 052</b>	<b>12 920 768</b>	<b>16 796 999</b>	<b>21 836 098</b>
Non-current content assets, net	31 855 937	41 412 718	53 836 534	69 987 494	90 983 742
Property and equipment, net	849 492	1 104 339	1 435 641	1 866 333	2 426 233
Other non-current assets	2 123 729	2 760 848	3 589 102	4 665 833	6 065 583
<b>Total assets</b>	<b>42 474 583</b>	<b>55 216 957</b>	<b>71 782 045</b>	<b>93 316 659</b>	<b>121 311 656</b>
Current content liabilities	6 795 933	8 834 713	11 485 127	14 930 665	19 409 865

Accounts payable	849 492	1 104 339	1 435 641	1 866 333	2 426 233
Accrued expenses and other liabilities	849 492	1 104 339	1 435 641	1 866 333	2 426 233
Deferred revenue	1 274 237	1 656 509	2 153 461	2 799 500	3 639 350
<b>Total current liabilities</b>	<b>9 769 154</b>	<b>12 699 900</b>	<b>16 509 870</b>	<b>21 462 831</b>	<b>27 901 681</b>
Non-current content liabilities	5 096 950	6 626 035	8 613 845	11 197 999	14 557 399
Long-term debt	17 839 325	23 191 122	30 148 459	39 192 997	50 950 896
Other non-current liabilities	849 492	1 104 339	1 435 641	1 866 333	2 426 233
<b>Total liabilities</b>	<b>33 554 920</b>	<b>43 621 396</b>	<b>56 707 816</b>	<b>73 720 160</b>	<b>95 836 208</b>
Common stock	3 397 967	4 417 357	5 742 564	7 465 333	9 704 932
Retained earnings	5 521 696	7 178 204	9 331 666	12 131 166	15 770 515
<b>Total stockholders' equity</b>	<b>8 919 662</b>	<b>11 595 561</b>	<b>15 074 230</b>	<b>19 596 498</b>	<b>25 475 448</b>
<b>Total liabilities and stockholders' equity</b>	<b>42 474 583</b>	<b>55 216 957</b>	<b>71 782 045</b>	<b>93 316 659</b>	<b>121 311 656</b>

Source: Author's estimates

**APPENDIX P XI. Estimates of the Income Statement items for the period 2020-2024 (Forecast)**

In thousands \$	2020F	2021F	2020F	2023F	2024F
	31.12.2020	31.12.2021	31.12.2022	31.12.2023	31.12.2024
<b>Revenue</b>	<b>24 713 523</b>	<b>31 674 416</b>	<b>40 723 577</b>	<b>52 487 487</b>	<b>67 780 569</b>
Cost of revenue	15 252 762	19 548 906	25 133 892	32 394 376	41 833 003
Marketing	3 252 145	4 168 154	5 358 967	6 907 024	8 919 498
Technology and development	1 894 484	2 428 091	3 121 780	4 023 576	5 195 910



General and administrative	1 121 094	1 436 866	1 847 368	2 381 021	3 074 771
<b>Operating income</b>	<b>3 193 037</b>	<b>4 092 399</b>	<b>5 261 569</b>	<b>6 781 490</b>	<b>8 757 388</b>
Interest expense	-767 558	-983 750	-1 264 801	-1 630 167	-2 105 143
Interest and other income (expense)	102 991	132 000	169 711	218 736	282 469
Income before income taxes	2 528 471	3 240 649	4 166 479	5 370 060	6 934 714
Provision for (benefit from) income taxes	239 473	306 924	394 609	508 601	656 790
<b>Net income</b>	<b>2 288 998</b>	<b>2 933 725</b>	<b>3 771 870</b>	<b>4 861 458</b>	<b>6 277 923</b>

Source: Author's estimates

#### APPENDIX P XII. Overview of Netflix's Board of Directors

Name	Years of Affiliation	Position	Class/Term Expiration	Independency	Affiliations
<b>Richard Barton</b>	18	Director and Member of the Audit Committee	Class I/2021	Yes	- Co-founder and former President, CEO and board director of Expedia; - Co-founder and former CEO of Zillow; - Former Zillow's executive chairman;

						<ul style="list-style-type: none"> <li>-Co-founder and former non-executive chairman of Glassdoor;</li> <li>-Venture partner at Benchmark from 2005 till 2018;</li> <li>-Has served on public companies boards such as Qurate, Artsy, Zillow Group;</li> <li>-Holds a B.S. in General Engineering: Industrial Economics from Stanford University.</li> </ul>
<b>Rodolphe Belmer</b>	2	Director and Member of the Compensation Committee	Class I/2021	Yes		<ul style="list-style-type: none"> <li>- Former CEO of Canal + Group;</li> <li>-CEO of Eutelsat since 2016;</li> <li>-Board member of Brut;</li> <li>-Graduated of France’s HEC business school.</li> </ul>
<b>Mathias Döpfner</b>	2	Director	Class III/2020	Yes		<ul style="list-style-type: none"> <li>-Chairman and CEO of Axel Springer SE in Berlin since 2002;</li> <li>-Member of the Board of Directors of Warner Music Group;</li> <li>-Holds honorary offices at the American Academy, the American Jewish Committee, the Federation of German Newspaper Publishers (BDZV) and the European Publishers Council (EPC);</li> <li>-Studied Musicology, German, and Theatrical Arts in Frankfurt and Boston.</li> </ul>

<b>Timothy Haley</b>	22	Director and Chair of the Compensation Committee	Class II/2022	Yes	<ul style="list-style-type: none"> <li>- Co-founder and former Managing Director of Redpoint Ventures;</li> <li>- Former President of Haley Associates;</li> <li>- Former Managing Director of Institutional Venture Partners;</li> <li>- Serves on the board of directors of several private companies;</li> <li>- Holds a B.A. from Santa Clara University.</li> </ul>
<b>Reed Hastings</b>	23	Director, Founder and CEO	Class III/2020	No	<ul style="list-style-type: none"> <li>- Co-founder of Netflix;</li> <li>- Founder of Pure Software;</li> <li>- Board member of Facebook;</li> <li>- Former board member of Microsoft;</li> <li>- Is currently on the board of several educational organizations;</li> <li>- Served on the California State Board of Education from 2000 to 2004;</li> <li>- Holds BA from Bowdoin College and MSCS in Artificial Intelligence from Stanford University.</li> </ul>
<b>Jay Hoag</b>	21	Lead Director, Member of the Compensation Committee and Chair of the Nominating &	Class III/2020	Yes	<ul style="list-style-type: none"> <li>- Former Netflix's director since 1999;</li> <li>- Co-founder of Technology Crossover ventures;</li> <li>- Former member of the board of directors of TripAdvisor, Zillow Group Inc., Electronic Arts Inc.;</li> <li>- Holds an M.B.A. from the University of Michigan and a B.A. from Northwestern University.</li> </ul>

Governance  
Committee

<b>Leslie Kilgore</b>		Director and Member of the Audit Committee	Class II/2022	Yes	<ul style="list-style-type: none"> <li>- Former Chief Marketing Officer from 2000 till 2012;</li> <li>- Former Director of Marketing for Amazon.com Inc.;</li> <li>- Former brand manager for the Procter &amp; Gamble Company;</li> <li>-Serves on board of Nextdoor, Pinterest and Medallia;</li> <li>- holds an M.B.A. from the Stanford University Graduate School of Business and a B.S. from The Wharton School of Business at the University of Pennsylvania.</li> </ul>
<b>Ann Mather</b>	10	Director and Chair of the Audit Committee	Class II/2022	Yes	<ul style="list-style-type: none"> <li>- Serves on the boards of Google, Arista Networks, Airbnb and Glu Mobile Inc;</li> <li>- Former Executive Vice President and Chief Financial Officer of Pixar;</li> <li>- Former Senior Vice President of Finance and Administration of one of Walt Disney Company divisions.</li> </ul>
<b>Ambassador Susan Rice</b>		Director and Member of the Nominating & Governance Committee	Class II/2022	Yes	<ul style="list-style-type: none"> <li>- Currently is Contributing Opinion Writer for the New York Times;</li> <li>- Serves on the board of the Bureau of National Affairs, Inc. (Bloomberg BNA);</li> <li>- Former director of the National Security Council staff;</li> <li>- Former US Permanent Representative to the United Nations.</li> </ul>

<b>Brad Smith</b>	5	Director and Member of the Nominating & Governance Committee	Class I/2021	Yes	<ul style="list-style-type: none"> <li>- Currently is President of Microsoft Corporation;</li> <li>- Holds a BA in international relations and economics from Princeton University and a JD from Columbia University School of Law.</li> <li>- Former lecturer of international law and economics at the Graduate Institute of International Studies in Geneva.</li> </ul>
<b>Anne Sweeney</b>	5	Director and Member of the Compensation Committee	Class I/2021	Yes	<ul style="list-style-type: none"> <li>- Co-founder and former Chairman and CEO of the FX Networks;</li> <li>- Former President of Disney Channel;</li> <li>- Former holder of senior roles in 21st Century Fox and Viacom;</li> <li>- Holds a BA from The College of New Rochelle and an Ed. M. from Harvard University.</li> </ul>

Source: Author's processing using Netflix's data

### APPENDIX P XIII. Netflix's Senior Executive Management

Name	Years of Affiliation	Position	Affiliations
<b>Reed Hastings</b>	23	Founder and CEO	<ul style="list-style-type: none"> <li>- Co-founder of Netflix;</li> <li>- Founder of Pure Software;</li> <li>- Board member of Facebook;</li> </ul>

			<ul style="list-style-type: none"> <li>- Former board member of Microsoft;</li> <li>- Is currently on the board of several educational organizations;</li> <li>- Served on the California State Board of Education from 2000 to 2004;</li> <li>- Holds BA from Bowdoin College and MSCS in Artificial Intelligence from Stanford University.</li> </ul>
<b>David Hyman</b>	18	Chief Legal Officer	<ul style="list-style-type: none"> <li>- Former General Council of Webvan;</li> <li>- Practiced law at Morrison &amp; Foerster in San Francisco and Arent Fox in Washington, DC;</li> <li>- Holds JD and Bachelor’s degrees from the University of Virginia.</li> </ul>
<b>Jackie Lee-Joe</b>	1	Chief Marketing Officer	<ul style="list-style-type: none"> <li>- Former CMO of BBC Studios;</li> <li>- Former Skype's Global Director for Audience, Entertainment Marketing &amp; Broadcast Media;</li> <li>- Has over 20 years of marketing experience with leading media, technology and telecoms companies (e.g. Virgin Mobile, Orange, Carphone Warehouse);</li> <li>- Holds degrees from the University of Sydney and the University of New South Wales.</li> </ul>
<b>Jessica Neal</b>	14	Chief Talent Officer	<ul style="list-style-type: none"> <li>- Former Head of HR at Coursera;</li> </ul>

			<ul style="list-style-type: none"> <li>- Former Chief People Officer at Scopely;</li> <li>- Serves on the board of directors of the Association for Talent Development.</li> </ul>
<b>Spencer Neumann</b>	1	Chief Financial Officer	<ul style="list-style-type: none"> <li>- Former CFO at Activision Blizzard's;</li> <li>- Former CFO and executive vice president of Global Guest Experience of Walt Disney Parks and Resorts;</li> <li>- Former executive vice president of ABC Television Network;</li> <li>- Former CFO of Walt Disney Internet Group;</li> <li>- Serves as a member of the national board of directors of Make-A-Wish America;</li> <li>- Holds a BA degree in economics and M.B.A. degree, both from Harvard University.</li> </ul>
<b>Greg Peters</b>	12	Chief Product Officer	<ul style="list-style-type: none"> <li>- Former vice president of consumer electronics for Macrovision Solutions Corp.;</li> <li>- Held positions in Mediabolic Inc., Red Hat Network and Wine.com;</li> <li>- Serves on the board of 2U Inc.;</li> <li>- Holds a degree in physics and astronomy from Yale University.</li> </ul>
<b>Ted Sarandos</b>	20	Chief Content Officer	<ul style="list-style-type: none"> <li>- Was named one of Time Magazine's 100 Most Influential People of 2013;</li> <li>- Serves on the board of Exploring The Arts (a non-profit focused on arts);</li> <li>- Serves on the Film Advisory Board for the Tribeca and Los Angeles Film Festivals;</li> </ul>

			<ul style="list-style-type: none"> <li>- Is an Executive Committee Member of the Academy of Television Arts &amp; Sciences;</li> <li>- Is an American Cinematheque board member;</li> <li>- Has produced or executive produced several award-winning and critically acclaimed documentaries and independent films.</li> </ul>
<b>Rachel Whetstone</b>	2	Chief Communications Officer	<ul style="list-style-type: none"> <li>- Former Senior Vice President of Communications &amp; Public Policy for Google and Uber;</li> <li>- Former Vice President of Communications for Facebook;</li> <li>- Spent half of the career working as a policy advisor for the UK Conservative Party;</li> <li>- Is a graduate of Bristol University.</li> </ul>

Source: Author's processing using Netflix's data