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Netflix – Is it a House of Cards?

Investment thesis

- Netflix has revolutionised the online viewing experience through its live Internet streaming which offers subscribers close to unlimited content, available instantly on any Internet-connected device.
- In July 2011 the company's share price ended a meteoric run-up to nearly $300/share, falling 80% to $60/share by the year's end on the back of a management decision to increase prices and split Netflix into two businesses (Qwikster [DVD] and Netflix [streaming]). This led to a price increase of c. 60% for anyone who decided to subscribe to both, resulting in a massive exodus of subscribers.
- Subsequent to the share price drop and wide criticism over this poorly conceived decision, CEO Reed Hastings pulled the plug on the company's Qwikster plans and made one apology after another. By January 2012 Netflix started delivering good news again with subscriber numbers growing, announcements regarding original content and 4Q12 results (released in January 2013) which saw the company posting a profit.
- Following two consecutive quarterly earnings reports where the company managed to be profitable once again (its 1Q13 results again surprised on the upside), Netflix now seems to be at the top of its game with the share price rocketing (up 135.2% YTD). The robust growth in subscriber numbers (29.2mn paid subscribers in the US – a 2mn quarterly increase) for 1Q13 has also buoyed the share together with popular original programming and new licensing deals.
- Although the company's share price has run significantly and is currently trading at a very high P/E, we think Netflix is an compelling stock with exceptionally high growth potential. However its main (if not only) way to achieve the required growth is by increasing its subscriber base while at the same time retaining current members. There is a massive potential market and Netflix has been adding at least 5mn subscribers p.a. (a number to which very few, if any, media companies can lay claim). If we annualise the 1Q13 new subscriber number then total new subscriber additions for the year can potentially be 12.2mn. With a subscription rate of $7.99/month it's certainly also a consumer value proposition. Hasting has indicated that Netflix is targeting 90mn subscribers in the US alone, although he didn't give a timeframe. The share price closed at $217.74 on Thursday, representing a astronomical one-year forward P/E of c. 92x. The company should post excellent EPS growth on the back of explosive subscriber growth over the next few years as its international expansion strategy starts generating profit instead of just burning cash and as subscriber growth in the US takes off. However even If company earnings increase at the rate of Bloomberg consensus EPS forecasts then the P/E will unwind to a still-expensive 15.1x by 2018 (in five years time).
- We think Netflix is a very compelling story but it clearly looks expensive on a valuation basis, As a *caveat* we note that Netflix is not a stock for the risk-averse investor (or the faint-hearted) despite the company having some compelling fundamentals. Although we still cant recommend this share as a buy due to its extremely high valuation (on the medium-term earnings outlook), it's certainly a share to keep an eye on, and a significant pullback may create an entry point for this strong growth story.

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Global Ideas is a newsletter published four times a week (Monday, Wednesday-Friday) and available only to clients of Investor Campus and Anchor Capital. The key objective of this newsletter is to provide ideas for investment in the global investment universe.

We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watch-list, which is continually reviewed and updated.

Contacts

Anchor Capital reception	**011 591 0677**	**Trading Desk**	**012 665 3461**
Investment/ Sales	mnyoung@anchorcapital.co.za	General Enquiries	info@anchorcapital.co.za
Brokerage/ Trading	fswart@anchorcapital.co.za	Newsletter Enquiries	newsletters@anchorcapital.co.za

Netflix's metrics are as follows:

Spot ($)	217.74
Mkt Cap $bn	12.2
12M trailing P/E	316.16
12M fwd P/E	92.99
10 Average P/E	88.0
FYE	31-Dec
P/Book Ratio	15.07
12M fwd DY	0

Source: Bloomberg, Anchor Capital

Netflix's forecasts are as follows:

Netflix							
December y/e	2012	2013F	2014F	2015F	2016F	2017F	2018F
EPS ($)	0.31	2.05	3.94	6.77	7.73	10.94	14.45
% growth		561%	92%	72%	14%	42%	32%
DPS	0	0	0	0	0	0	0
P/E	702.4x	106.2x	55.3x	32.2x	28.2x	19.9x	15.1x
DY		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Share price, $	217.74						
12M Fwd P/E	93.0x						

Source: Bloomberg, Anchor Capital

What it does:

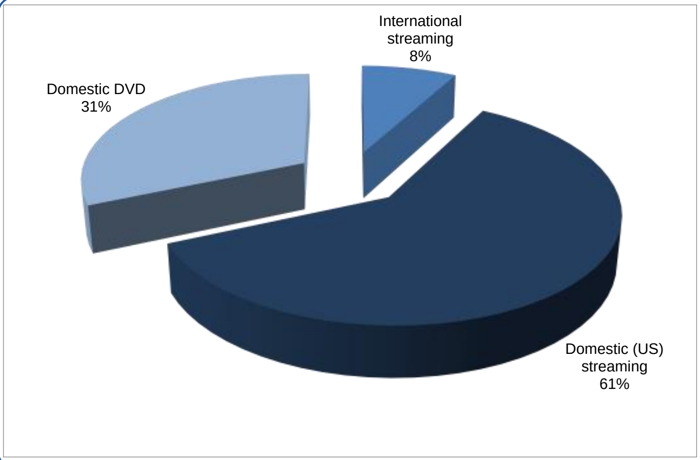
Netflix is a US-based provider of on-demand internet streaming media. Netflix's services are available in over 40 countries including Canada, UK, Ireland, Sweden, Denmark, Norway and Finland. The company also offers a flat rate DVD-by-mail service in the US. Netflix started its subscription-based digital distribution service in 1999 and by 2009 the company was offering a collection of 100,000 titles on DVD and had surpassed 10mn subscribers. Netflix now has more than 36mn members globally. For a low subscription rate of $7.99/month in the US, Netflix members can watch as much as they want, anytime, anywhere and on nearly any Internet-connected device (there will also be a family streaming plan available soon which will allow users to stream to four devices at a time for $12/month). Members are able to play, pause and resume watching, all without commercials.

Business segments:

Netflix is divided into three business segments. These are:

- **Domestic streaming** - The Domestic streaming segment provides its US subscribers with access to a range of exclusive, non-exclusive and original content delivered to any Internet-connected device (Smart TVs, PCs, Macs, gaming consoles, mobile devices, smartphones etc.).
- **International streaming** – Internationally, Netflix's service is now available in over 40 countries outside the US and it has indicated it believes international markets will be a significant source of growth and cash flow in the long term. As a result it is currently strategically investing internationally.
- **Domestic DVD** – Netflix launched its Domestic DVD business in 1999 with DVD-by-mail subscription plans. However, as technology changed and consumer preference shifted, the company has seen subscribers move away from DVD rental and towards its streaming video content.

FY12 contribution to revenue by business segment:



Source: Company reports, Anchor Capital

Background:

Netflix initially offered viewers the option of a DVD rental service that delivered movies and TV shows right to your doorstep, then there was the ability to download movies to your computer and now this option has evolved into streaming video. Streaming video allows anyone with a fast-enough Internet connection to watch video instantly on any Internet-connected device. Companies offering streaming video (such as Netflix, Hulu, Amazon, iTunes etc) have a library of videos available for streaming and when a user selects a video to watch, the company compresses the video and sends it over the Internet in a continuous stream of data, so that the video can be played in real time.

History:

Netflix was founded in 1997 by Marc Randolph and Reed Hastings with the idea coming from Hastings when he had to pay $40 in overdue fines after returning a movie past its due date. The original Netflix website was launched in 1998 with only 30 employees and a limited variety of options available for rent. Initially it had a more traditional, online pay-per-rental model but in September 1999 Netflix introduced the monthly subscription concept and in early 2000 it dropped the single-rental model. Since then the company has built its reputation on flat-fee unlimited rentals without due dates, late fees, shipping and handling fees, or per title rental fees. On 29 May 2002, Netflix initiated an IPO selling 5.5mn shares at $15.00/share and, after incurring substantial losses during its first few years, posted its first profit in FY03, earning $6.5mn on revenue of $272mn. In September 2010 Netflix launched their stream-only service in Canada, their first expansion into international markets. A year later Netflix completed the launch of streaming-content services in Latin America by launching in the Caribbean, Mexico, Central and South America. In 2012 the company launched its service in the UK and Ireland, Norway, Denmark, Sweden and Finland.

Share price performance:

Netflix's share price has phenomenal volatility over the past five years or so, moving from $50 in 2010 to around an all-time high of $298.73 in July 2011, then down to $54 in 2012 before rocketing back up to an YTD high of $243.40 in early May this year. Despite having gained a whopping 133% YTD, Netflix's share price is currently still trading 24.5% below its highest level of $298.73.

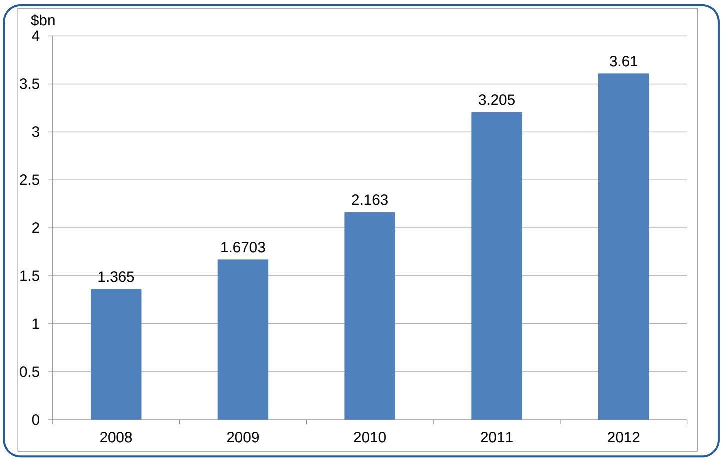
Netflix share-price performance June 2003 to date (USc):

Source: TimBukOne, Anchor Capital

1Q13 results

Netflix's 1Q13 earnings and rapidly increasing subscriber numbers beat Wall Street expectations (one reason why the share price performed so well following the results – up 24.4% on the day), with the company reporting net income of $3mn in 1Q13 (or $0.05/share), up from a loss of $5mn in 1Q12 (or $0.08/share). On an adjusted basis, profit came in at USc31/share, while revenue came in at $1.02bn (up 17.7% YoY and 8.3% from 4Q12) - the highest in its corporate history. Looking ahead Netflix guided for 2Q13 net income of $14mn-$29mn or (between USc23 and USc48/share). According to the company it added 3.05mn streaming members globally in the quarter, with 2.03mn coming from the US and the other 1.02mn coming from international markets. The profit contribution per streaming paid member increased to $1.59, a complete reversal of its -$1.24 in the year-ago quarter.

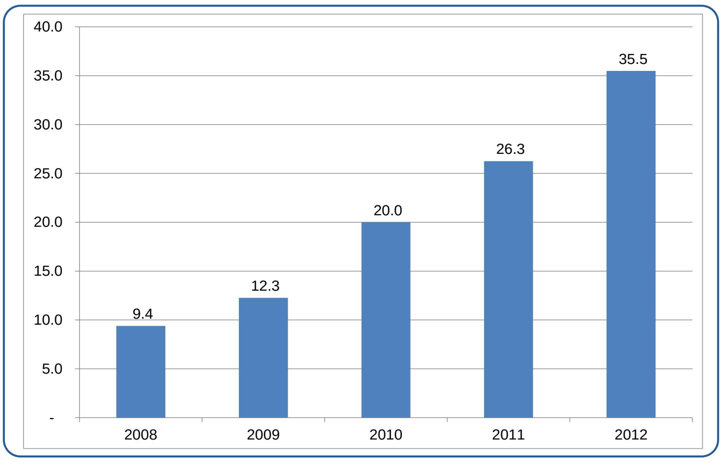
Netflix revenue growth, 2008-2012



Source: TimBukOne, Anchor Capital

The market was also impressed by the total streaming subscriber growth in 1Q13 and the almost 10mn subscribers added over the past four quarters. The company also said that 4bn hours were streamed during 1Q13, highlighting how its subscriber base is increasingly using Netflix for most of their viewing.

Netflix Subscriber growth, 2009- 2012:



Source: TimBukOne, Anchor Capital

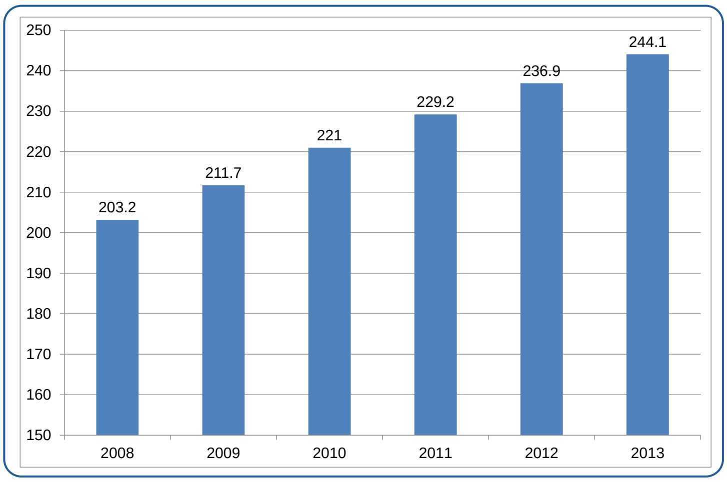
On the negative side its domestic DVD segment dropped to 7.98mn subscribers in 1Q13 from 8.22mn in 4Q12 but this is to be expected as more and more subscribers move to the content streaming option. It should also be highlighted that internationally Netflix was still losing money in streaming, thus eroding the company's total profit margin growth.

Key drivers:

The following are what we believe to be the key growth drivers for Netflix going forward:

Exceptional subscriber growth: Netflix's 1Q13 results showed that the company added more than 2mn US subscribers (and 1mn in foreign markets) in the quarter. On top of that it reached 4bn hours of streaming viewing over the past quarter with a recent *BTIG* study showing that the average US Netflix subscriber watched 87 minutes of Netflix per day, putting Netflix ahead of many US cable networks as one of the most watched services. An important indicator of Netflix's upward trajectory is the company's 29.2mn paid US subscribers. This number surpasses HBO which is the US' number-two premium television channel with 28.7mn subscribers (an *SNL Kagan* estimate as HBO doesn't release subscriber data). Netflix is already increasing its membership base rapidly and at the same time it is also increasing the profitability of its membership base. Subscriber churn is low. Ahead of the release of its original series such as House of Cards, Netflix had cautioned that the significant subscriber uptake of its streaming service could just as quickly reverse as subscribers cancel the service once they have watched the show they signed up for. However this did not happen - rather Netflix has been able to hold onto subscribers as the vast majority of people who sign up for a free trial in order to watch a series have thus far stayed. Growth in streaming subscribers is also being driven by the trend of accessing media over the Internet, increased broadband penetration and growth in connected devices. The option of having a near endless supply of movies and TV shows immediately available is a very attractive proposition in the digital age. In a February presentation Hasting indicated that their goal is to reach 90mn subscribers in the US alone. In the presentation, he identified HBO (and its HBO Go service) as Netflix's primary competitor, estimating that HBO had approximately 30mn subscribers and then reasoned by extrapolation that Netflix, due to its lower $7.99/month cost, deeper library and ability to be viewed on more devices, should be able to achieve two to three times HBO's size. According to the US census the US has about 120mn households of which Netflix has c. 30% as subscribers. There is thus significant upside potential for Netflix in terms of subscriber growth and it follows that if Netflix is able to gain a further 30% of US households it will allow the company to position itself to better negotiate future licencing agreements (cost saving) and it will also become a serious competitor to cable providers such as Time Warner and Comcast.

US internet usage, mn:



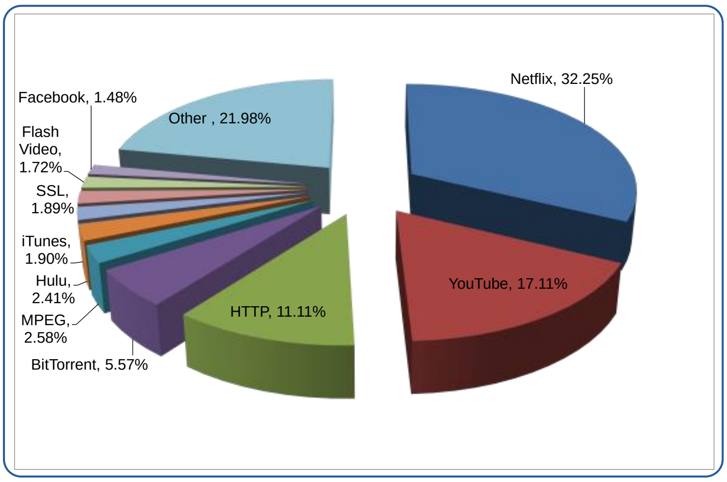
Source: Sandvine

Affordability: According to the Federal Communications Commission (FCC) the average price of basic cable in the US in 2012 was $54.77/month. This is significantly higher than what Netflix charges ($7.99/month) with Netflix having the added benefit of instant access to nearly endless content as well as being able to watch whenever and wherever you want. With innovative ideas such as so-called binge-viewing (where a whole original series is made available at once) and with more and more content moving towards the streaming format it is very likely that Netflix's business model could replace cable and even traditional TV viewing in the future.

First-mover advantage: Although Netflix is facing competition from the likes of Amazon, Hulu and iTunes the company has thus far leveraged it first-mover advantage to expand rapidly and we believe this will continue with Netflix outpacing its competitors in terms of subscriber growth. The company has been a trailblazer for a subscription Internet streaming service and what was initially an add-on to its existing DVD-by-mail rental service has ballooned into a groundbreaking way of watching television with huge customer take-up. Netflix also offers significantly more titles (thanks to exclusive deals with major Hollywood studios such as Walt Disney) than any of its competitors and added to that it has invested in original content which has proven very popular with its current subscriber base and has also resulted in significant take-up from new subscribers.

Increased mobile penetration: According to the latest *Sandvine* report Netflix remains the biggest source of North American web traffic, accounting for c. 33% during peak periods. Although the company has held this position for a few years now (and 2012 data saw it decrease by a fraction of a percent), *Sandvine* notes that what is more significant is that Netflix's North American mobile data usage share almost doubled from 2.24% to 3.98% in the past 12 months. *Sandvine* believes this number will increase going forward and that longer-form video as a whole will become more commonplace on mobile networks throughout North America. Although watching TV episodes and movies on a mobile device may not be ideal it is becoming increasingly viable for a lot of consumers as smartphones increase in size, tablets become more commonplace and the consumer is able to catch up with their favourite show or movie anywhere, anytime.

Top-10 online video downstream sources in North America

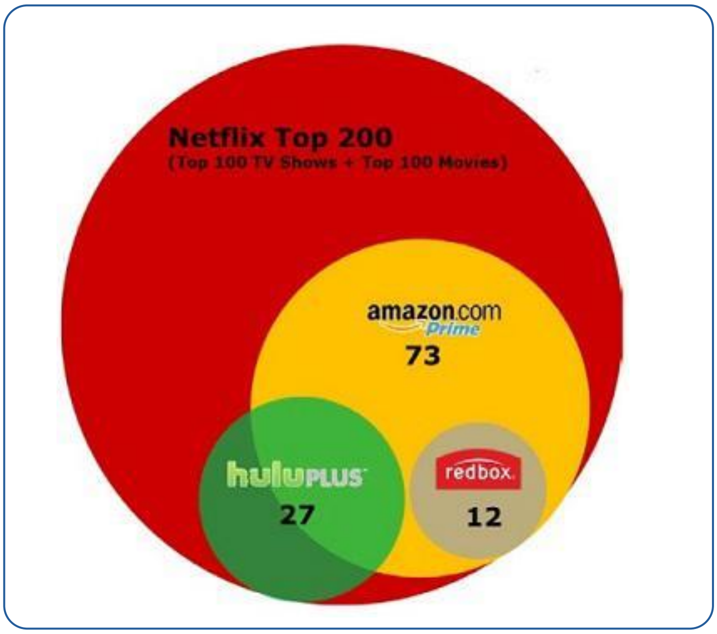


Source: Sandvine

Original content: In February, Netflix unveiled a novel way of experiencing television viewing when it released all the episodes of its original series House of Cards at once (so-called binge viewing) as opposed to an episode at a time, as is traditional on a television network. Although the company provided few statistics around the costs (estimated at $100mn) associated with bringing it first original programming to subscribers, it did provide a bullish assessment of the endeavour saying that "the strong viewing across all our markets gives us faith in our ability to create global content brands in a cost-effective, efficient way,..". Netflix also attributed its strong 1Q13 results in part to the exposure its service received around House of Cards, saying that the launch of the show and the related marketing activities provided a "halo effect on our entire service". In April the company debuted another original series (horror thriller 'Hemlock Grove'), which it said was viewed by more Netflix members globally on its first weekend than was House of Cards. In May the research firm *NetBase* indicated that Netflix's original series appear to be picking up traction in the social sphere with buzz soaring ahead of the 26 May debut of the fourth season of Arrested Development (AD), to three times the levels for House of Cards. The company has high hopes for the show with Netflix CFO David Wells saying recently that the passionate, built-in fan base for AD could tip the balance for the company's 2Q13 net subscriber adds to be higher than the year-ago period. Netflix's continued commitment to increasing its original (exclusive) content (it has already identified six more series), and the greater satisfaction with content will invariably lead to more subscribers signing up. The company has indicated that original programming may be driving better subscriber numbers and, at the very least, reducing subscriber churn.

Agreements with major Hollywood studios: In August 2010, Netflix announced it had reached a five-year deal worth c. $1bn to stream movies from Paramount, Lionsgate and MGM. In December 2012, Netflix and The Walt Disney Company announced an exclusive multi-year US subscription television service agreement for the first run of Walt Disney Studios animated and live-action movies. New titles from Disney, Walt Disney Animation Studios, Pixar, Marvel Studios and Disney Nature would be available from Netflix in 2016, while classic Disney titles were made available to Netflix immediately and direct-to-video new releases were made available in 2013. Disney also shut down its own web movie service (Disney Movies Online) on 31 December last year and has also been trying to sell, together with its partners in the venture, Hulu (Disney has a 30% controlling share in the company). On 14 January Netflix also signed an agreement with Time Warner subsidiaries Turner Broadcasting and Warner Bros. Television to distribute their content. These deals underline the fact that Netflix is the premier streaming content provider and by deciding to sign exclusive content agreements with Netflix it also shows the faith companies like Walt Disney have in Netflix.

Netflix top-200 titles — overlap with other services:



Source: Netflix

Ever-expanding broadband penetration: At the end of 2011, US Internet penetration stood at close to 80% with around 237mn Internet users. Internet penetration is on the increase and many more people are shifting to high-speed broadband connections. This growth in broadband subscriptions will also drive demand for consumption of video over the Internet. This trend will continue to benefit Netflix as there is still room for broadband penetration to grow (both in the US and internationally). According to the company there are 600mn broadband households and 6bn mobile phones globally - a huge pool of potential subscribers. People now also have multiple devices (smartphones, tablets, gaming consoles, etc.) connected to the Internet, which are easy to use, mobile and quick. Streaming is the future of television and the streaming video industry can only grow with Netflix well-positioned to ride this growth wave.

Targeted advertising: In an interview with *The Hollywood Reporter*, Netflix Chief Content Officer Ted Sarandos spoke of algorithms the company uses to study their subscribers' viewing habits. For example in the case of House of Cards, Sarandos said that the director, David Fincher, cut seven different trailers, focusing on various aspects of the show, whether it was female characters, Kevin Spacey, politics etc. These targeted trailers were then made available to a specific subscriber on the user interface (UI), what the subscriber saw was based on that subscriber's demographic as well as what that particular subscriber was watching recently. It would thus seem that Netflix has an advertising advantage over traditional television networks and cable allowing them to specifically target individuals according to that person's likes and dislikes. It follows that Netflix will use this type of subscriber data when making decisions on what programming to pursue and what might not be worth the effort (or the cost).

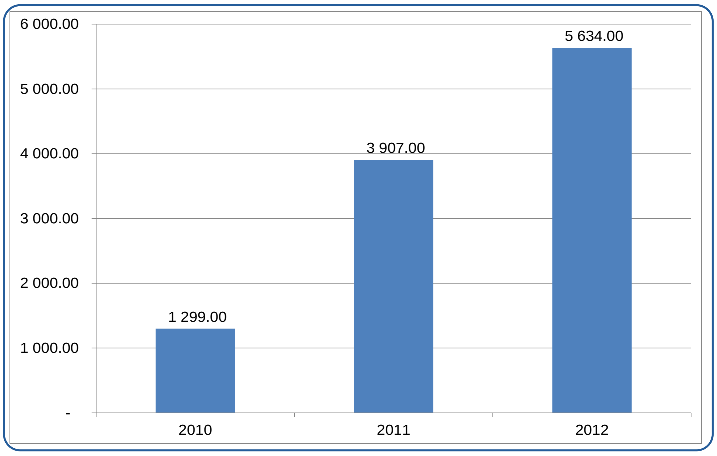
An improved user experience: Netflix has outlined new initiatives to improve the user's experience including the launch of Profiles which will provide personalised recommendations to different members of a household, utilising social media platforms for better content discovery by its members and a new player for Smart TVs and set-top boxes for faster playback. The company has also announced a new subscription option for bigger families which allows four simultaneous streams for $11.99/month (vs the $7.99/month option which allows for two subscribers). The diverse content and the on-demand means of distributing its content is putting Netflix at a significant advantage over networks and cable channels.

Risks:
Below we highlight the possible risk factors facing Netflix:

Competition: Companies like Hulu and Amazon are in direct competition with Netflix. Hulu offers a similar subscription rate to Netflix at $7.99/month although it also includes commercials in its programming, while Amazon's Prime Instant Video costs $79/year. Hulu has about 4mn subscribers and far less content, paling in comparison with Netflix both in terms of subscriber base and content. As mentioned press reports have been swirling around a possible Hulu sale and in early June it was reported that Satellite operator DirecTV and two other bidders offered more than $1bn apiece to buy Hulu. Amazon has also started producing original content and recently made the first episodes of potential series available online allowing subscribers to decide which of these pilots will make it to a series. Potential competition also lurks in the form of YouTube which recently announced its foray into the streaming content space (albeit on a much smaller scale than Netflix).

Content costs: Netflix licences most of its content from movie studios and other companies and new licensing agreements are leading to immense cost pressures. The studios are motivated to ask for increased content prices or not renew current contracts, as they have other outlets to sell their catalog content. Content price inflation and non-renewal of contracts can negatively impact Netflix along with the fixed price and long-term nature of these contracts which create significant amounts of content obligations. Even if subscriber additions do not live up to expectations, Netflix will still have to keep on paying these fixed costs. The company's content acquisition costs (as a percentage of revenue) have already skyrocketed from c. 21% in 2011 to more than 40% in 2012. Netflix is also facing significant content payments over the next few years, including for its exclusive agreement with Walt Disney (starting with 2016 theatrical releases). In future bidding up of content prices by rival streaming companies (Amazon, Hulu, iTunes) could also increase content costs which would impact Netflix's profitability and in turn affect the share price performance. If this happens the company will have to raise subscription rates which in turn could result in subscriber churn. Of course the counter-argument here is that these investments are necessary for subscriber growth to continue and Netflix's margins should improve as the fixed content costs are spread over a larger revenue base. Netflix hasn't shied away from spending to keep its subscribers hooked, stating recently that its content advantage was the biggest driver of US streaming subscriber growth in 1Q13.

Total streaming content obligations ($mn):



Source: Netflix

Expiry of licences: In April 1,800 titles were pulled from Netflix because the company's licensing agreements (with Universal, Warner Bros and MGM) expired. The US media dubbed this the Great Netflix Purge and Streamageddon. It resulted in such bad publicity for the company that its share price declined 2.6% on the day. Although this is far from being a significant threat it did result in Netflix sending out statements to argue that it's all part of the "churn" and that it has always been subject to letting some licensing deals expire while signing new ones. In May the company went even further saying that it has decided not to announce when any titles on its service will be removed.

Netflix availability on competitor platforms: Netflix is currently available on several platforms such as Apple TV, iPad, Microsoft Xbox etc and the company could be impacted if these companies decide to start charging more for Netflix to use their platforms.

The pirate viewer and piracy in general: According to *Bloomberg*, up to 10mn users could be streaming Netflix's video service without paying. The company currently doesn't actively restrict the number of PCs, tablets, phones etc. that can use one account or the number of people who can sign in although it does limit each account to playing two video streams simultaneously. An option for Netflix is to limit the number of people or computers that share one account or charging extra, for example, if someone at school in another city uses his/her parents' account. *Goldman Sachs* highlights that tightening up of sharing would help sales and a pricing or policy change could boost revenue per subscriber by 5% in 2014, accelerate new signups and increase profit margins. However, Netflix has insisted they will not be raising prices as the company was badly burned in the 3Q11 fiasco when it lost 800,000 domestic customers due to a 60% increase in the cost of its combined streaming and DVD-by-mail service to $15.98/month (from $9.99).Piracy of copyrighted material easily available on torrent sites could also potentially have an impact on subscriber growth.

Sporting events and news: Currently Netflix doesn't stream sporting events and also isn't planning on doing so in the near future. Competitors like HBO offer a significant number of exclusive (and live) sporting events which is a very attractive proposition for the sport-loving subscriber. Online services like Netflix will also struggle to compete with regular and pay-tv channels as it does not offer news coverage.

Investor expectations: As is the case with Apple it would seem that investor expectations remain so high for Netflix that one has to consider how long the company will be able to keep the market surprised on the upside. In early June the company's share price lost 6% on the back of reports that its long-awaited (and highly touted) original series, AD Season 4 had disappointed – Netflix had made no presentation on viewership numbers but purely based on perception the company's share price dropped.

Conclusion:

Netflix has over 36mn subscribers globally and the share has a market cap of $12.2bn. If we value the share based on the number of current subscribers then the value is $336 per subscriber or just over 3x the annual revenue generated per subscriber. The company added 3.05mn subscribers in total in 1Q13 and if we annualise this number it can potentially translate into 12.2mn new subscriber additions for the year (FY13). At that growth rate the total subscriber numbers could easily reach the 90mn US subscriber target set by Hastings in about five years' time and exceed that target internationally (see table below). Extrapolating that to what the company's market cap could be in five years if we multiply the revenue per subscriber number ($336) with total US subscribers in five years we get to a market cap of c. $30.3bn – nearly three times its current size.

According to the *Associated Press* even before signing the Disney deal (which some analysts estimate cost between $300 and $350mn) Netflix owed $5bn in Internet video licensing fees during the next five years, including $4.5bn which is due before the end of 2015 - Netflix's annual revenue in FY12 totaled about $3.6bn. However, although that is quite a hefty bill if Netflix manages to accelerate subscriber growth and reaches the goal of 90mn subscribers in the US by 2017 it should easily be able to pay this amount. Netflix's announcement of family packages that may be repriced in the $12/month range also has the potential to increase its earnings. All in all it would seem that the company has made all the right moves recently as its decision to generate its own content (and stream a whole series at once) have gotten the market (and its subscribers') seal of approval while it currently has licensing deals in place with most of the major players in Hollywood, offering the largest variety of streaming content available. It is also important to note that Netflix seems to have the ability to deliver, manage and create content profitably - thus putting to rest investor concerns that costs would spiral out of control.

Fortunately for Netflix consumers want increased control over what they watch and when they watch it. This, together with a plethora of tablets and mobile devices which allow the user to watch online content, will further spur Netflix's growth. Streaming is the future of television and Netflix is at the cutting edge of Internet TV, providing subscribers with an easy, convenient and inexpensive way to watch their favourite television shows or movies anywhere, anytime. Competitors Amazon and Hulu have quite a bit of catching up to do (although Amazon's deal this week with Viacom will be a huge boost for the company) and Netflix's first-mover advantage, excellent distribution network and user interface as well as the fact that its subscriber base is increasingly (4bn hours streamed in 1Q13) using Netflix for a growing share of their viewing, makes the company the current market leader (by far) in terms of streaming content.

Although Netflix is trading at an extremely high 12M fwd P/E of 93x it also has a growth strategy where it is making short-term investment decisions (i.e. expensive overseas expansion, new original content, licensing agreements) that may prove costly at the moment as it dampens profitability and creates a high P/E ratio, but once the company reaches the required subscriber base Netflix (together with its shareholders) should be richly rewarded (albeit in the long-term). The effect of the company's current investment decisions on earning are also coming through in Bloomberg consensus forecasts which show an astronomical EPS growth rate of c. 562% from FY12 to FY13 while for FY14, expected earnings are $3.84, growing 92% over FY13, and for FY15 EPS is forecast to grow at 72%. The key for Netflix to increase its profitability is in how many customers it will have five years down the line. Looking at current Bloomberg EPS forecasts gives us a forward P/E for FY14 and FY15 of around 55x and 32x, respectively. This moves down to a still-high 15.1x P/E five years out — the time by which Netflix should have exceeded 100mn subscribers globally.

Netflix growth forecasts:

	EPS ($)	EPS growth, %	P/E, x	Total subscribers, mn	Total subscriber growth, %
2012	0.31		702.4	33.25	
2013F	2.05	562.3	106.1	45.45	36.7
2014F	3.94	91.8	55.3	57.65	26.8
2015F	6.77	71.9	32.2	69.85	21.2
2016F	7.73	14.2	28.2	82.05	17.5
2017F	10.94	41.5	19.9	94.25	14.9
2018F	14.45	32.1	15.1	106.45	12.9

Source: Bloomberg estimates, Anchor Capital

Note total subscriber growth is Anchor Capital estimates

The company is offering consumers a unique value-proposition and is a market game-changer, which we think will allow it to grow at a pace most other companies can only dream of emulating. We expect Netflix to expand their subscriber base by c. 37% in 2013 with certain Wall Street pundits even pegging subscriber growth at over 100mn worldwide by the end of 2018. Without a doubt Netflix faces a huge global addressable market and growth trends seem to be in its favour. However, despite all the positive noises around growth surrounding the stock and the extremely favourable prospects, we still can't recommend this share as a buy. This is on the basis of an extremely high valuation on the medium-term earnings outlook, but it's certainly a share to keep an eye on, and a significant pullback in the share price may create an entry point for investors into this strong growth story. As the company states in a summary of its manifesto: "Over the coming decades and across the world, Internet TV will replace linear TV. Apps will replace channels, remote controls will disappear, and screens will proliferate. As Internet TV grows from millions to billions… - Streaming is the future of television …".

Marco de Matos

The business of money: Global asset management and stockbroking

The business of knowledge: Financial education, information and valuation services

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