

The path to financial truth.

# EVA Analysis of Netflix (NFLX)



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evaDimensions 

Financial intelligence for finding alpha

# NETFLIX INC

NFLX | \$5.7B mkt. cap.

Internet & Catalog Retail

$$PRV_{it} = (P-R)/V = \text{Intrinsic/Actual}$$

## 93 Performance Score (P) Higher is better

### 88 P1 Profitability Financial strength in generating a return on capital over the full cost

	NFLX	25th	50th	75th	% Industry
EVA Margin (EVA/Sales)	10.0%	-3.8%	-1.2%	4.1%	88
EVA Spread (EVA/Capital)	40.3%	-6.1%	-2.8%	4.8%	93

### 93 P2 Trend The growth rate in the firm's economic profit (its EVA)

	NFLX	25th	50th	75th	% Industry
EVA Momentum (vs Cap)	24.5%	-5.4%	0.9%	3.1%	86
3 Year Trend (ΔEVA/Cap)	18.0%	0.1%	1.5%	6.8%	92
Last Quarter (ΔEVA/Cap)	24.2%	-4.2%	-0.4%	2.7%	88

## 60 Risk Score (R) Lower is better

### 59 R1 Volatility Variability in stock price and the EVA profit margin

	NFLX	25th	50th	75th	% Industry
Stock Price Volatility	70%	41%	56%	64%	81
EVA Margin Variability	0.9%	1.5%	2.9%	4.8%	7

### 41 R2 Vulnerability Leveraged, negative cash flow firms are suspect

	NFLX	25th	50th	75th	% Industry
Free Cash Flow Rate	-1%	13%	3%	-4%	67
Op Cash Gen Return	126%	126%	79%	33%	25
Total Debt/Total Capital	37%	12%	23%	39%	71
Total Debt/EBITDAR	0.3	0.3	0.7	1.2	35

## 40 Valuation Score (V) Lower is better

### 76 V1 Wealth Ratios Valuation multiples to book capital (as adjusted)

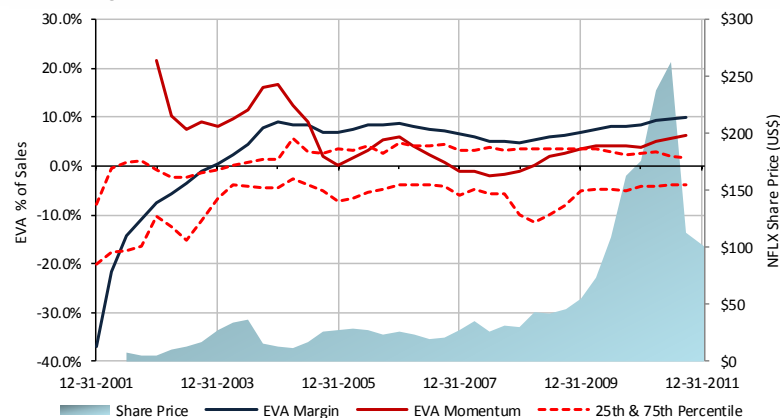
	NFLX	25th	50th	75th	% Industry
MVA Margin	158%	-6%	42%	153%	76
MVA Spread	482%	-12%	63%	317%	80

### 13 V2 Wealth Multiples Valuation multiples to cash flow, earnings, EVA

	NFLX	25th	50th	75th	% Industry
EBITDAR Multiple	3.7	3.7	7.9	11.3	24
NOPAT Multiple	15.7	18.1	27.0	49.4	14
Future Growth Reliance	19%	35%	61%	84%	12

Date	Share Price	PRVit Score (vs Market)	Industry Median	PRVit Score (vs Industry)
24-Jan-12	\$92.67	89	51	<b>PAS : 4</b> <b>93</b>
Sell 0-19	Underweight 20-39	Hold 40-59	Overweight 60-79	Buy 80-100

EVA Margin vs. Share Price

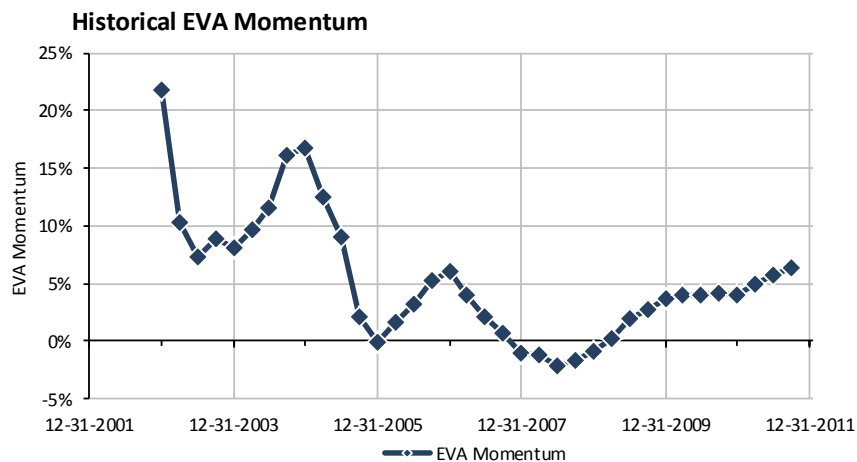
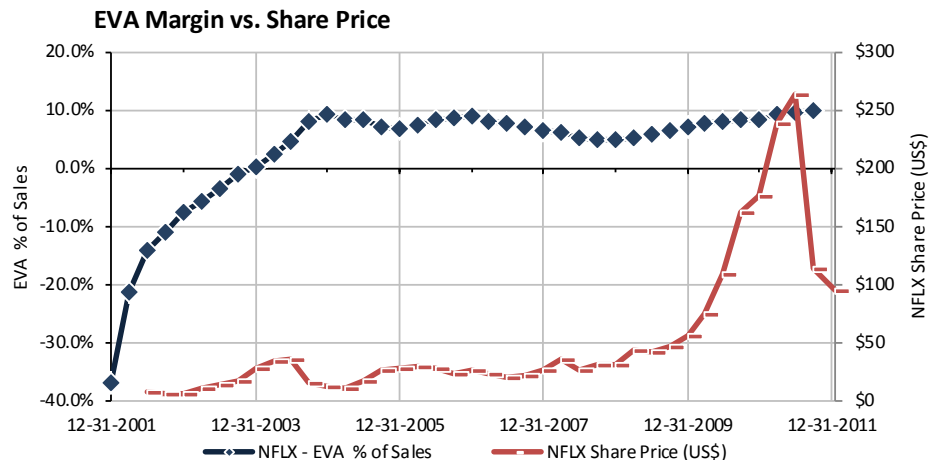


**Conclusion: Shares have fallen from peak levels, yet EVA Momentum continues to rise. Performance remains robust while valuation and risk are reasonable. Embedded expectations also conservative vs. history.**

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NFLX | \$5.7B mkt. cap.

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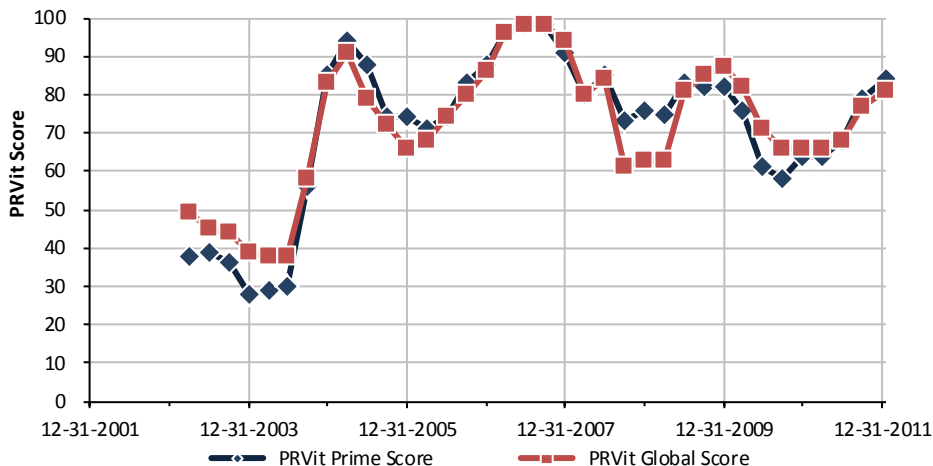
- NFLX's EVA Margin reached 10% in the last quarter – a new high mark.
- The share price rose rapidly as EVA Momentum turned positive in March 2009.
- Although the shares have retraced much of the move in the third quarter of 2011, EVA Momentum continues to climb and this disconnect may present an opportunity.
- Among online retailers, NFLX's EVA Margin is currently in the 88<sup>th</sup> percentile.

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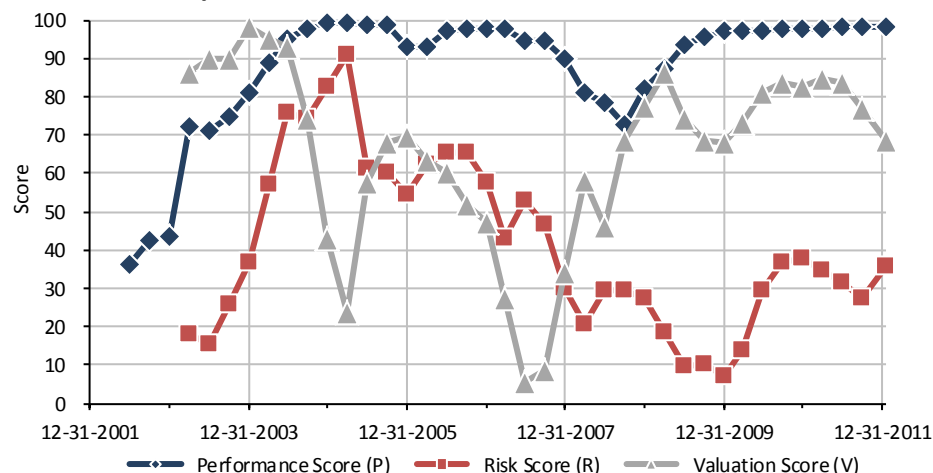
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PRVit Scores

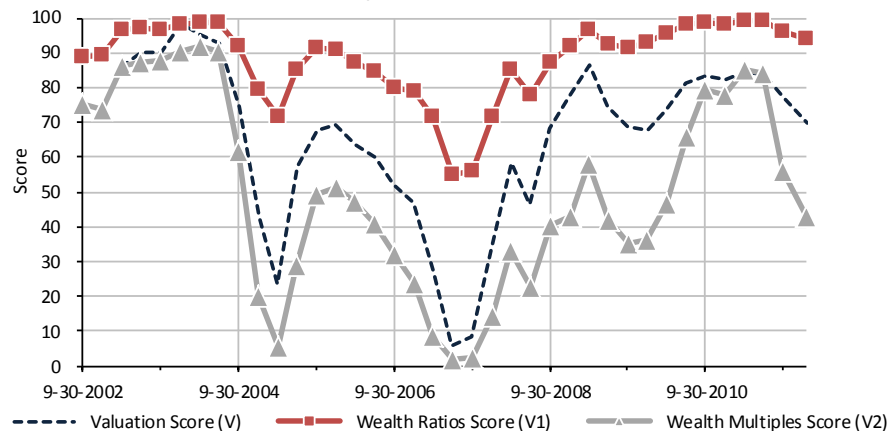


- NFLX's overall PRVit Scores have been climbing since the second half of 2010.
- The high overall score is driven primarily by strong level of performance but had been partially offset by a high current value.
- Wealth Multiples (V2) reached extreme levels in the first half of 2011; risk factors also started to climb in 2010 as variability increased.

PRVit Components



PRVit Valuation Score Components



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	50th Percentile	NFLX Value	2011TFQ3 Percentile	AMZN Value	2011TFQ3 Percentile	EBA Y Value	2011TFQ4 Percentile	CSTR Value	2011TFQ3 Percentile	OSTK Value	2011TFQ3 Percentile
<b>EVA Returns</b>											
Capital Intensity (Avg Capital/Sales)	43%	25%	72	15%	83	117%	28	44%	50	11%	88
EVA Spread (EVA/Capital)	-3.7%	40.3%	95	17.8%	81	11.3%	76	10.8%	76	-13.1%	13
<b>EVA Margins</b>											
Sales Growth Rate	9.3%	45.4%	95	41.6%	76	27.3%	64	27.7%	64	2.4%	13
Cash Operating Costs (% of Sales)	83.5%	48.2%	95	86.3%	38	51.7%	88	78.2%	59	93.5%	5
COGS (Adj) % of Sales	63.8%	63.4%	51	77.5%	12	23.9%	95	69.7%	34	82.7%	5
SG&A (Adj) % of Sales	18.3%	-15.3%	95	8.8%	95	27.7%	15	8.5%	95	10.8%	74
EBITDAR Margin (EBITDAR/Sales)	16.5%	51.9%	95	13.7%	38	48.4%	88	21.8%	59	6.5%	5
Productive Capital Rental Charge (% of Sales)	15.4%	35.4%	10	9.1%	86	32.7%	13	12.5%	74	8.2%	89
Cap Chrg: Working Capital % of Sales	0.7%	-1.6%	95	-0.3%	79	1.0%	38	0.2%	69	0.1%	71
Rent Chrg: Net PP&E Adjusted % of Sales	4.7%	24.8%	5	3.9%	61	12.6%	5	11.3%	5	3.0%	74
Rent Chrg: Intangible Capital AT % of Sales	9.0%	12.3%	32	5.5%	74	19.0%	19	1.1%	95	5.1%	77
EVA Before Tax Margin (EVA/EBT)	1.2%	16.4%	88	4.6%	65	15.7%	87	9.2%	78	-1.7%	32
EVA Effective Tax Rate	35%	37%	31	37%	34	24%	60	41%	24	6%	75
Other EVA (% of Sales)	0.3%	-0.3%	5	0.2%	41	9.2%	95	0.6%	64	0.4%	54
Rent Charge: Goodwill & Sp Items (% of Sales)	1.6%	0.0%	90	0.4%	73	8.0%	22	1.2%	57	0.2%	79
EVA Margin (EVA/Sales)	-1.2%	10.0%	95	2.7%	72	13.2%	95	4.8%	81	-1.4%	48
<b>EVA Momentum</b>											
EVA Momentum (% of Trailing Sales)	0.4%	6.3%	95	0.4%	51	12.9%	95	2.9%	77	-0.6%	33
Implied EVA Momentum 10 Yr (Sales)	0.6%	0.4%	33	1.6%	81	0.7%	54	-0.2%	5	0.3%	18
<b>PRVIt Scores</b>											
PRVIt Score vs. Industry	--	93	--	53	--	93	--	92	--	40	--
PRVIt Score vs. Market (Russell 3000)	--	90	--	54	--	82	--	100	--	37	--
Performance Score (P) vs. Market	--	99	--	85	--	97	--	93	--	39	--
Risk Score (R) vs. Market	--	38	--	37	--	81	--	16	--	2	--
Valuation Score (V) vs. Market	--	55	--	84	--	44	--	17	--	74	--

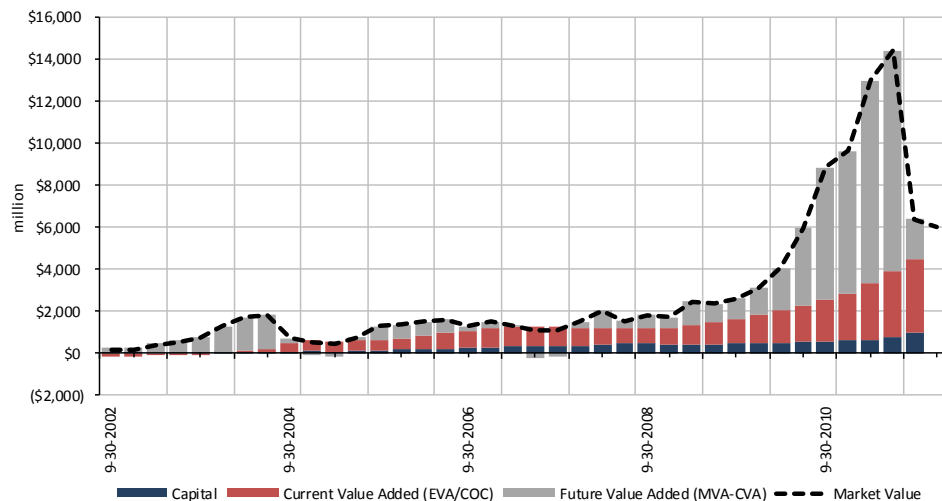
- NFLX has one of the highest overall PRVIt Scores among its peers driven by having the highest Performance Score.
- NFLX's group-leading EBITDAR Margin results having tight cash cost controls and negative working capital helps boost pre-tax EVA Margin.

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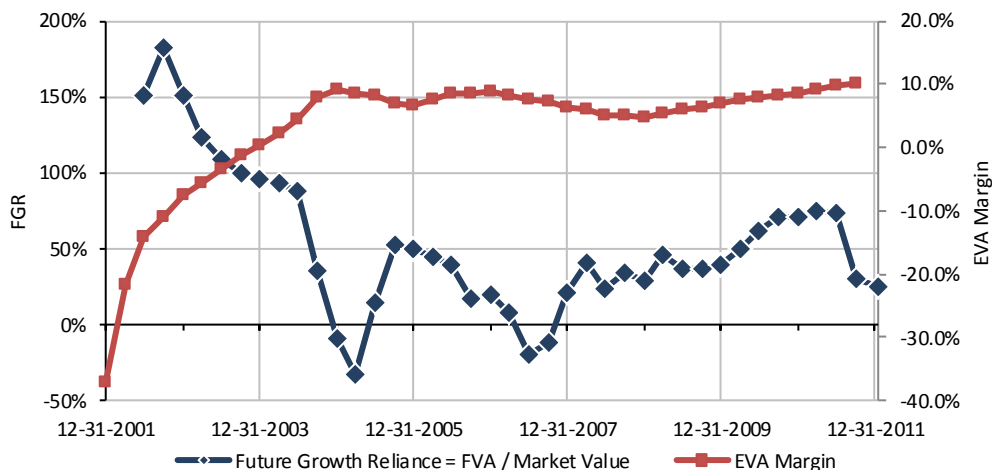
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Future Value Added vs. Market Value

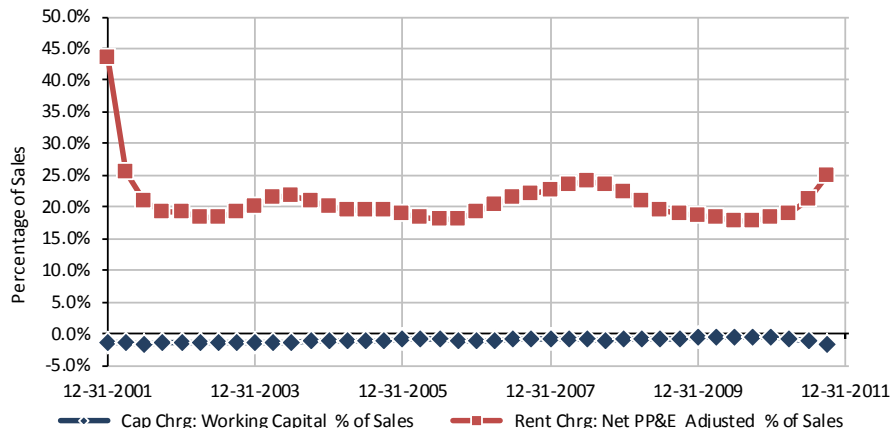


Future Growth Reliance

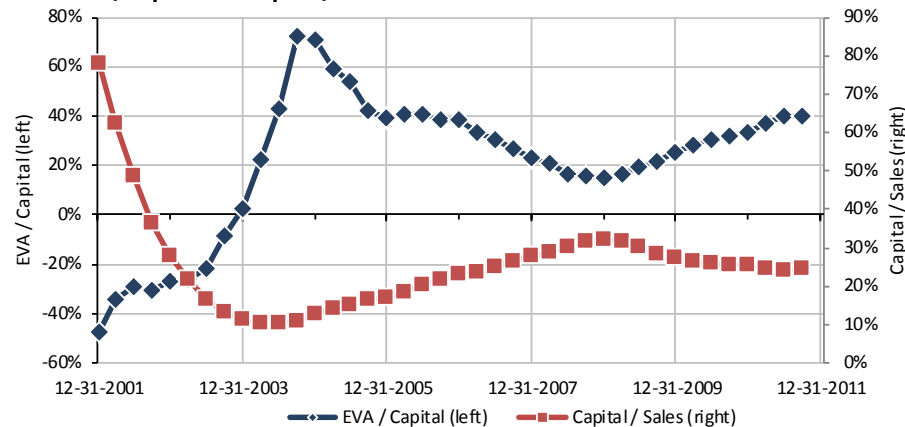


- NFLX's CVA has been gradually increasing over the past few years while capital levels have increased moderately.
- The decline in market value during Q3 2011 directly reduced NFLX's FVA – the amount of future EVA growth being discounted by the market.
- NFLX's future growth reliance (FVA as a % of market value) fell from almost 75% in Q1 2011 to only 25% currently. It is one of the lowest among the high growth internet stocks.
- Despite NFLX increasing its EVA and Current Value Added, the market does not expect the company to continue this path to the same degree – a premise that could lead to upside should NFLX's positive EVA trends remain ongoing.

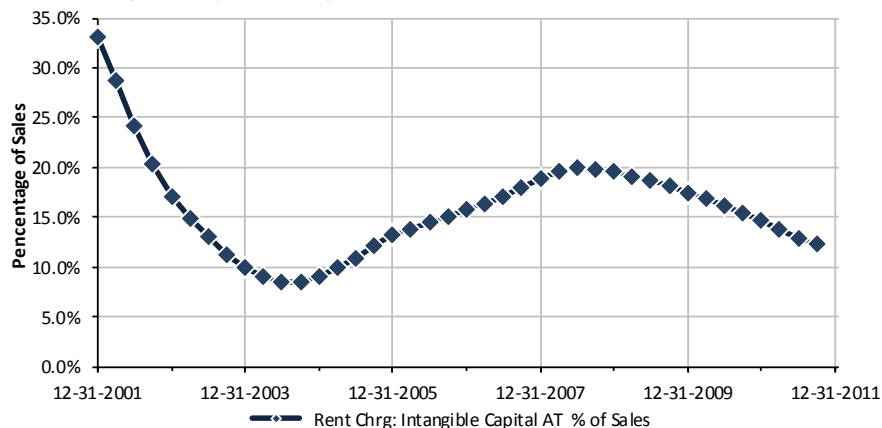
### Working Capital & PP&E Charges as % of Sales



### EVA/Capital vs. Capital/Sales



### Intangible Capital Charges as % of Sales



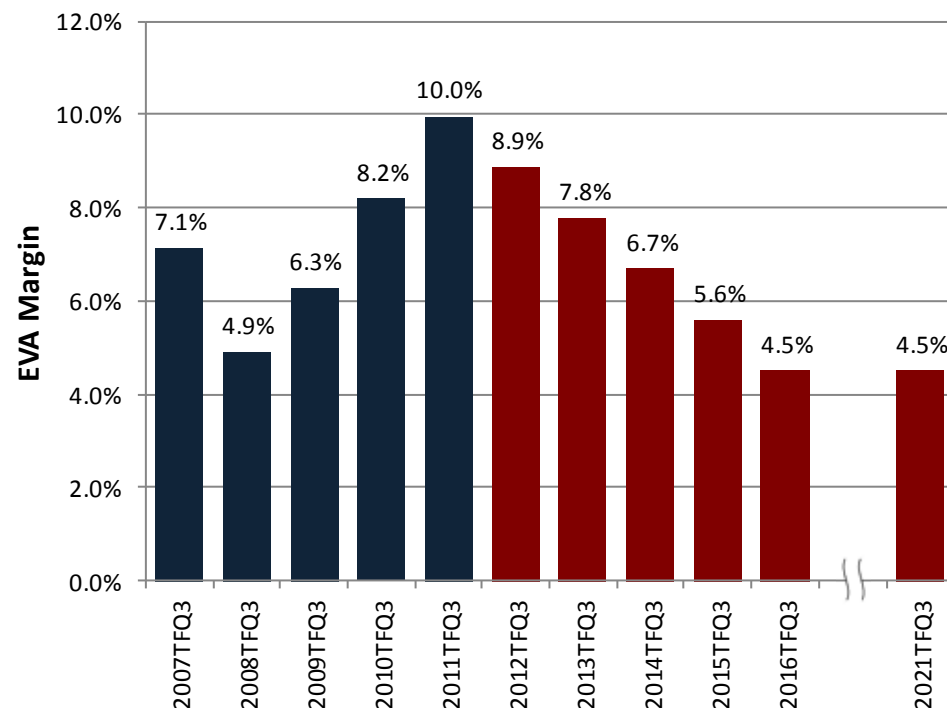
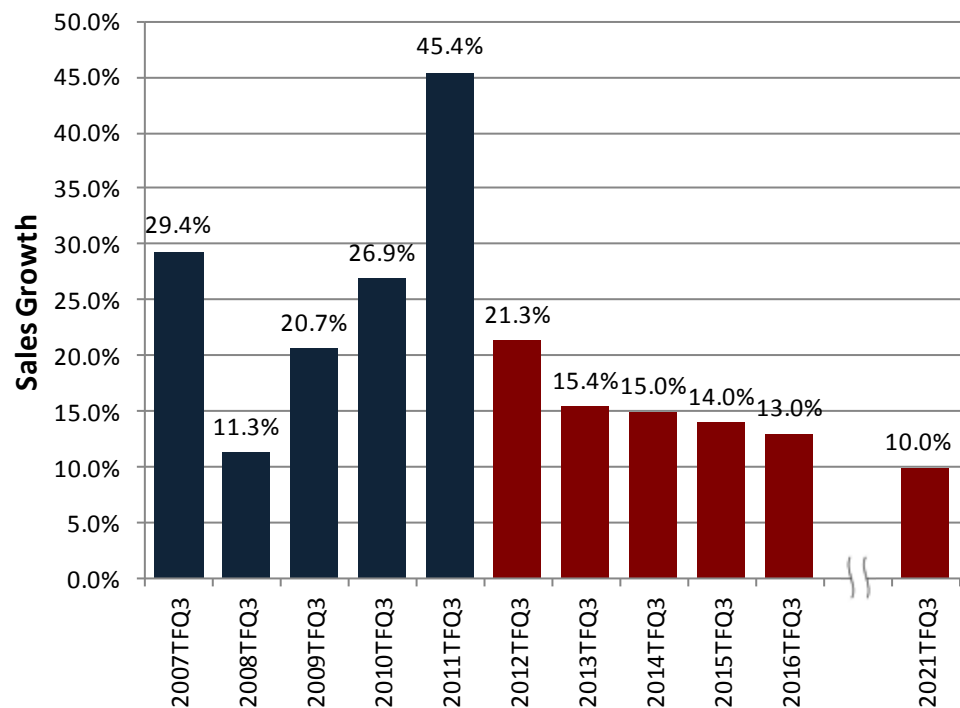
- NFLX benefits from its negative working capital charges.
- Fixed capital charges have risen over the past few quarters and should be monitored.
- Since Q3 2008, NFLX has had its EVA rise while its overall level of capital intensity has fallen. A question might be can EVA Margin levels sustain without this combination of benefits.

EVA Margin and Momentum Summary							
(\$ millions)	2007TFQ3	2008TFQ3	2009TFQ3	2010TFQ3	2011TFQ3	Trend	Notes
<b>Sales</b>	<b>\$1,180.2</b>	<b>\$1,313.9</b>	<b>\$1,585.3</b>	<b>\$2,011.2</b>	<b>\$2,924.9</b>		<b>25.5% CAGR</b>
<b>Sales Growth Rate</b>	<b>29.4%</b>	<b>11.3%</b>	<b>20.7%</b>	<b>26.9%</b>	<b>45.4%</b>		
Cash Operating Costs % of Sales	51.8%	52.2%	54.7%	54.9%	48.2%		-90bp per year avg. decline
<b>EBITDAR Margin</b>	<b>48.2%</b>	<b>47.8%</b>	<b>45.3%</b>	<b>45.2%</b>	<b>51.9%</b>		+90bp per year avg. increase
Cap Chrg: Working Capital % of Sales	-0.9%	-1.0%	-0.7%	-0.6%	-1.6%		
Rent Chrg: Net PP&E Adjusted % of Sales	22.1%	23.6%	18.8%	17.8%	24.8%		Most volatile figure on EVA income stmt.
<b>EVA From Operations Margin</b>	<b>27.0%</b>	<b>25.3%</b>	<b>27.2%</b>	<b>28.0%</b>	<b>28.7%</b>		
Rent Chrg: Intangible Capital AT % of Sales	18.0%	19.8%	18.1%	15.4%	12.3%		-142bp per year avg. decline
<b>EVA Before Tax Margin</b>	<b>9.0%</b>	<b>5.4%</b>	<b>9.1%</b>	<b>12.5%</b>	<b>16.4%</b>		
EVA Effective Tax Rate EVA Tax/EVA Before Tax	37.1%	33.5%	36.2%	37.0%	37.2%		
Other EVA % of Sales	1.5%	1.3%	0.5%	0.3%	-0.3%		
<b>EVAxGW&amp;SI Margin</b>	<b>7.2%</b>	<b>4.9%</b>	<b>6.3%</b>	<b>8.2%</b>	<b>10.0%</b>		
Rent Chrg: Goodwill & Special Items % of Sales	0.0%	0.0%	0.0%	0.0%	0.0%		
<b>EVA Margin</b>	<b>7.1%</b>	<b>4.9%</b>	<b>6.3%</b>	<b>8.2%</b>	<b>10.0%</b>		+70bp per year avg. increase
<b>EVA Momentum ΔEVA/Trailing Sales</b>	<b>0.7%</b>	<b>-1.7%</b>	<b>2.7%</b>	<b>4.1%</b>	<b>6.3%</b>		

- NFLX has improved its EBITDAR Margin over the past several years through better management of its cash operating costs.
- NFLX has become more efficient with working capital and intangible capital which has been a tailwind for EVA Margin.
- The net result has been a 70 bps per annum increase in EVA Margin over the past several years.



## Sales Growth and EVA Margin Expectations Embedded in Current Share Price



- Using consensus sales estimates for TFQ 2012 – 2013 (and assuming a decline in sales growth from 15% to 10% thereafter), the market is currently pricing in NFLX’s long-run EVA Margin to fall 550 bps to 4.5% in 2016 and beyond.