

Netflix: Growth accelerates strongly

Netflix posted strong Q3CY21 numbers—revenue grew 1.9% QoQ/16.3% YoY to USD7.48bn, in line with Street’s estimate and much ahead of its own guidance. Margin contracted 170bps QoQ to 23.5%, but still much higher than Street’s estimate of 20.9%, while subscriber additions at 4.38mn beat guidance of 3.5mn and came in higher than 2.2mn in Q3CY20. EPS at USD3.19 topped Street’s USD2.56 estimate.

Management highlighted that business growth remains healthy, as it had been throughout the year, with churn at low levels down to prior comparable periods. Retention is healthy and viewing is up. It is focusing on growing margins at roughly 3 percentage points per year on average, on a multi-year basis. Netflix is ‘not rated’.

Expect strongest Q4 content offering

Subscriber additions stood at 4.38mn in the third quarter, much ahead of the company’s forecast of 3.5mn, of which half were from the APAC region. Net paid memberships in Europe of 1.8mn improved significantly versus 188k in Q2 led by several titles. Management expects paid net additions of 8.5mn in Q421 compared with 8.51mn in Q420. For CY21, it is targeting 20% operating margin versus 18% in CY20. Nielsen estimates Netflix is just 6% of US TV screen time, which indicates a long growth runaway. During Q3, it announced an agreement to acquire the Roald Dahl Story company (pending regulatory approval).

Cash flow to be positive in FY22

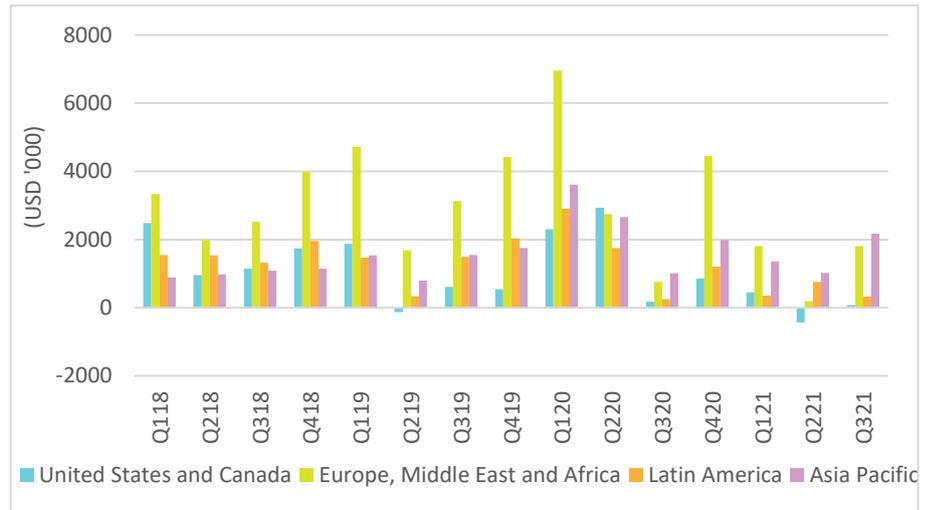
Netflix reported OCF of USD82mn and FCF of -USD106mn. Management anticipates Q4CY21 FCF to be negative owing to ramp-up of production volume and a lower operating margin, but continues to expect full-year FY21 FCF to break even and FY22 FCF to be positive. On balance sheet, Netflix boasts a strong cash position of USD7.6bn. It prioritizes cash for reinvesting in core business and to fund new growth opportunities such as gaming, followed by selective acquisitions. Management has guided for USD7.7bn in revenue for Q4CY21 with a 6.5% operating margin.

Outlook and valuation: Strong content pipeline ahead

Netflix has been a major beneficiary of the pandemic-induced lockdown with subscribers logging onto the app/site in hordes in 2020. It has rebounded strongly in this quarter led by strong content offerings such as *Squid Game* and *Money Heist*. Management expects strongest content offerings in Q4CY21.

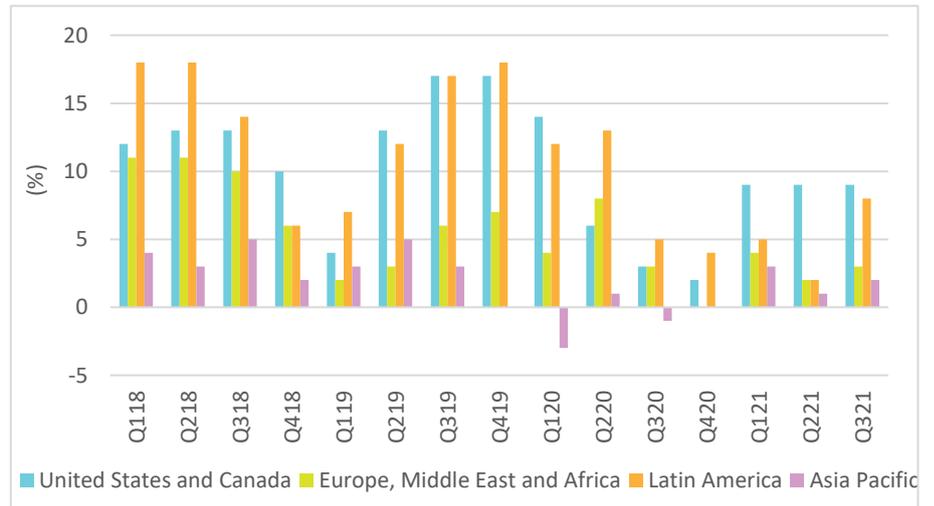
Meanwhile, Netflix faces intense competition from consolidation of Disney/Fox, Discovery/Scripps, Viacom/CBS and Time Warner/AT&T, etc. Even so, its growth is not affected as Netflix is consistently strengthening its library and accelerating content production. We believe disruption in the TMT space will accelerate spending on technology, leading to higher outsourcing, benefiting Indian IT services companies. Netflix is **not rated**.

Exhibit 1: Paid net memberships addition



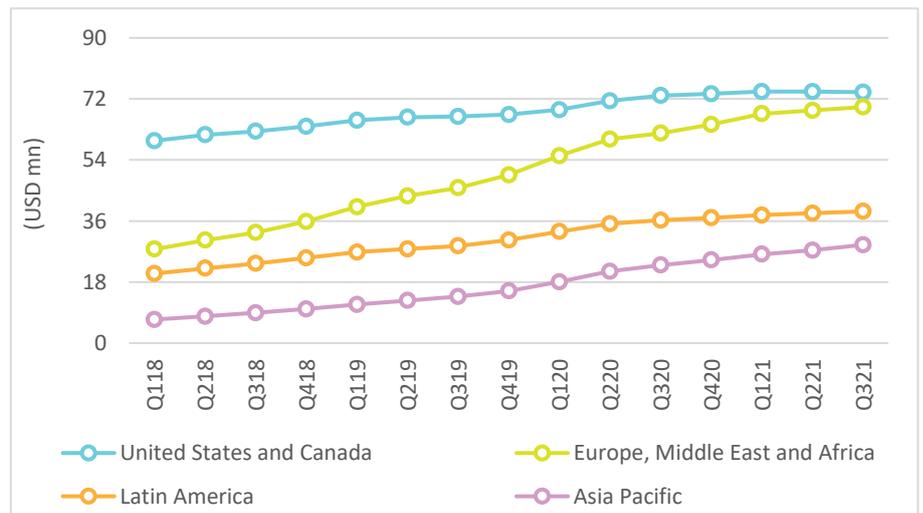
Source: Company, Edelweiss Research

Exhibit 2: Constant currency YoY (%) change



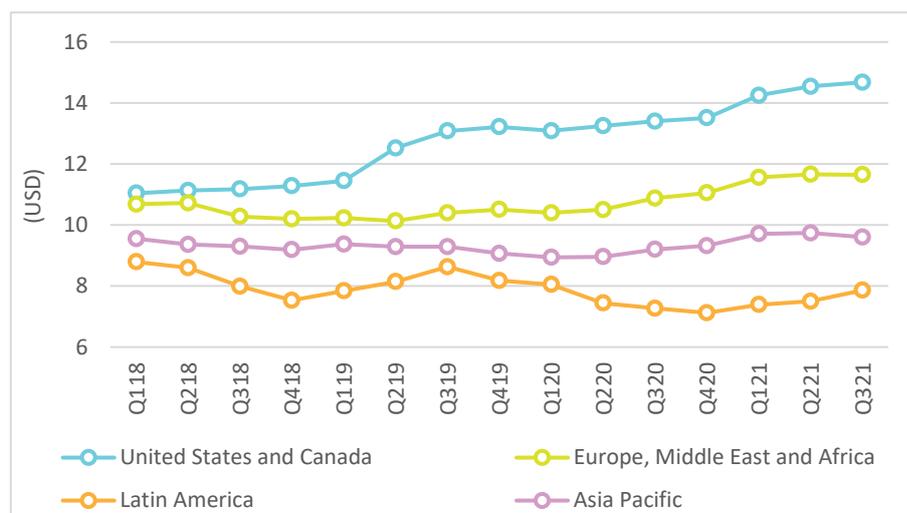
Source: Company, Edelweiss Research

Exhibit 3: Average paying memberships



Source: Company, Edelweiss Research

Exhibit 4: Average monthly revenue per paying membership



Source: Company, Edelweiss Research

Exhibit 5: Quarterly financial snapshot

(in USD mn)	Q3 21	Q3 20	YoY	Q2 21	QoQ
Revenue	7,483	6,436	16.3	7,342	1.9
Cost of Revenue	4,207	3,868	8.8	4,018	4.7
Marketing	636	528	20.5	604	5.3
Technology and Development	564	454	24.3	537	4.9
General and Administrative	322	272	18.5	335	-3.9
Operating Income	1,755	1,315	33.5	1,848	-5.0
Other Income (expense)	-	-	-	-	-
Interest Expense	-190	-197	-3.4	-191	-0.5
Interest and Other Income	96	-256	-137.5	-63	-253.8
Income before Taxes	1,661	861	92.8	1,594	4.2
Provision for Taxes	-212	-71	196.4	-241	-12.0
Net Income	1,449	790	83.4	1,353	7.1
Earnings per share	3	2	83.3	3	7.3

Source: Company, Edelweiss Research

Earnings call: Key highlights

- Management highlighted that the business remained healthy as it had been throughout the year with churn at low levels down prior to the comparable periods. Retention was very healthy and viewing was up. Saw acceleration in growth, which is what management had been hoping for and expecting.
- Few big hits were Squid Game, La casa de papel, Never Have I Ever and He's All That and Chestnut Man and Copenhagen at the end of the quarter.
- For Latin America, the growth was a little bit soft in the quarter. It was primarily the company took some price increases in Brazil in Q3. It's a sort of a short-term slowdown in growth, but good for business. New season of Sintonia and high profile shows will reignite growth going forward.
- The guidance is at 8.5mn paid net adds is essentially in line with the past few years, even pre-COVID.
- Company is matching the PayTV households and plenty of room for growth. Streaming is developing at a great pace.
- Squid game (a unique Korean story), released on September 17, has become the biggest TV show ever.
- Sintonia in Brazil, Chestnut Man right now in Denmark is an enormous success. Spin out version of Call My Agent! from India, the Italian film, The Hand of God, new seasons of Luis Miguel are meant to be hugely impactful as well. Management anticipates greater number of originals in FY22 vs. FY21
- The company is making progress and very excited for the next three to five years to provide spectacular all around experience with gaming options.
- Management believes that the consumer products is really a great way to enhance the relationship with content and fans.
- Revenue growth remains healthy. It is Committed to making those trade-offs growing healthy strategically investing in the business and growing margins at roughly 3 percentage points per year on average, on a kind of on any multi-year basis.
- On October 4, when Facebook experienced a global outage for several hours, its engagement saw a 14% increase during this time period.
- According to Nielsen, Netflix is 6% of TV share in terms of TV time.

Netflix continue to target 20%+ operating margin for the full year 2021, which translates to Q4FY21 operating margin of approximately 6.5% compared with 14% in Q4FY20 mainly due to big content release schedule in Q4.

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