Netflix Inc NFLX (NAS) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
331.18 USD	386.00 USD	193.00 USD	675.50 USD	Very High	Narrow	Stable	Standard	BB+	Communication Services

Raising Moat Rating to Narrow Based on Intangibles and Network Effect

See Page 2 for the full Analyst Note from 17 Nov 2014

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The primary analyst covering this company does not own its stock.

Research as of 17 Nov 2014
Estimates as of 12 Nov 2014
Pricing data through 05 Jan 2015
Rating updated as of 05 Jan 2015

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

Contents

Investment Thesis 13 Nov 2014

From its origins as a DVD rental by mail service, Netflix has morphed into a pioneer in streaming video on demand and the largest online video provider in the United States. We have raised our economic moat rating to narrow based on intangibles and a network effect resulting from the use of Big Data stemming from the firm's massive subscriber base in the U.S.

Already the largest provider in the U.S., Netflix is expanding rapidly into markets abroad with the belief that its experience and expertise will help overcome any hurdles. The firm has used its scale to construct a massive data set that tracks every customer interaction. It then leverages this customer data to better purchase content and produce original material such as "House of Cards" and "Orange Is the New Black." We believe that this data and ability to leverage will help Netflix to remain the largest provider in the U.S. and enjoy success in many of the newly entered and potential expansion markets across the globe.

While the company uses data to help with the process of selecting new shows to fund, management does not use the data to interfere with the show runners, an important consideration in the competitive market for content. Successful series such as "House of Cards" and "Orange Is the New Black" have a halo effect with not only audiences but also content creators. Netflix's public hands-off stance coupled with the halo effect from its previous investments creates an attractive environment for creators, similar to the reputations enjoyed by HBO and FX (the top two networks by Emmy nominations in 2014), turning Netflix into a preferred platform for show creators and producers.

We expect that the company will continue its overseas expansion and that the segment will generate losses over the next few years. However, we believe Netflix's technical expertise, content library, and brand will overcome most challengers as has already happened in other markets. Also, while we acknowledge the need to create and acquire country-specific content, we note that American pop culture remains popular across the globe and provides Netflix with a deep library for any market.

Vital Statistics

Market Cap (USD Mil)	19,952
52-Week High (USD)	489.28
52-Week Low (USD)	299.50
52-Week Total Return %	-8.8
YTD Total Return %	-3.1
Last Fiscal Year End	31 Dec 2013
5-Yr Forward Revenue CAGR %	23.3
5-Yr Forward EPS CAGR %	46.2
Price/Fair Value	0.86

Valuation Summary and Forecasts

Fiscal Year:	2012	2013	2014(E)	2015(E)
Price/Earnings	319.3	162.9	93.3	61.2
EV/EBITDA	21.4	53.4	30.7	24.4
EV/EBIT	92.0	93.0	47.8	34.7
Free Cash Flow Yield %	-0.4	0.2	1.6	2.1
Dividend Yield %	—	—	—	—

Financial Summary and Forecasts (USD Mil)

Fiscal Year:	2012	2013	2014(E)	2015(E)
Revenue	3,609	4,375	5,508	6,878
Revenue YoY %	12.6	21.2	25.9	24.9
EBIT	50	228	402	553
EBIT YoY %	-87.0	356.8	75.9	37.8
Net Income, Adjusted	17	138	216	328
Net Income YoY %	-92.7	701.8	56.9	52.2
Diluted EPS	0.29	2.26	3.55	5.41
Diluted EPS YoY %	-93.3	677.3	56.9	52.2
Free Cash Flow	-121	-42	233	334
Free Cash Flow YoY %	-183.9	-65.5	-657.4	43.7

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Netflix's primary business is a streaming video on demand service available in the U.S., Canada, Central and South America, and Europe. Netflix delivers original and third-party digital video content to PCs, Internet-connected TVs, and consumer electronic devices, including tablets, video game consoles, Apple TV, Roku, and Chromecast. In 2011, Netflix introduced DVD-only plans and separated the combined streaming and DVD plans, making it necessary for subscribers who want both to have separate plans.

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Morningstar Analysis

Raising Moat Rating to Narrow Based on Intangibles and Network Effect 17 Nov 2014

We have raised our economic moat rating for Netflix to narrow based on intangibles and a network effect resulting from the use of Big Data stemming from the firm's large subscriber base in the U.S. We believe that the company can leverage its rapidly expanding subscriber base and the data set that it creates to better purchase and create content. We also have increased our fair value estimate to $386 from $230. We are more bullish on the opportunity overseas and expect the segment to generate positive operating margin by 2017. Domestically, we expect a slowdown in subscriber growth but increased penetration. While we are impressed by Netflix's execution and opportunity, we would wait for a larger margin of safety before investing.

Already the largest provider in the U.S., Netflix is expanding rapidly into markets abroad with the belief that its experience and expertise will help overcome any hurdles. The firm has used its scale to construct a massive data set that tracks every customer interaction. It then leverages this customer data to better purchase content and produce original material such as "House of Cards" and "Orange Is the New Black." This new content not only strengthens its relationship with its current customers, but also attracts new customers via word of mouth and the halo effect from critical acclaim and award nominations. We believe that this data and ability to leverage will help Netflix to remain the largest provider in the U.S. and enjoy success across the globe. Netflix has also established an attractive environment for show creators, similar to the reputations enjoyed by HBO and FX (the top two networks by Emmy nominations in 2014), turning Netflix into a preferred platform for show creators and producers.

Valuation, Growth and Profitability 13 Nov 2014

We are increasing our fair value estimate to $386 per share from $230, implying a 2015 price/earnings ratio of 71 times. Our valuation model assumes that Netflix's domestic paid streaming subscriber count reaches roughly 58.5 million subscribers in 2018, and we forecast 5.6 million new domestic streaming subscribers in 2015, which implies 44.7 million at year-end. We also assume that the domestic DVD business (the most profitable segment) will lose about 1 million subscribers per year through 2018, which implies a decline from 5.4 million at the start of 2014 to 1.3 million in 2018. We believe the international segment will move to a positive contribution margin by 2017, as recently entered markets such as Europe turn positive. As a result, we expect the international streaming subscriber base to expand to 59 million. We do anticipate that the company will moderate the pace of entry into new markets, but we note that it currently has no presence in Asia, a market with increased interest in consuming media, particularly American-produced fare.

Our domestic subscriber forecast generates 19% average annual revenue growth between 2013 and 2018, as Netflix benefits from charging $8.99 as its base price in the U.S. to all customers in 2016. We also expect the company to begin enforcing its concurrent streaming limits, leading many families to migrate to the $14.99 plan for 4 HD streams. We expect domestic streaming contribution margins to expand to 35.5% in 2018 from 22.6% in 2013 as subscriber and revenue growth is partially offset by rising content costs for both first- and third-party produced content. On the international side, the entry into new markets and increased penetration generates average revenue of 53% through 2018. The company also benefits from a higher average revenue per user in these markets. While we expect contribution margin to remain negative until 2016, we project a 7.0% contribution margin in 2018 for the international streaming segment. Overall, we forecast average revenue growth of 23% for Netflix with operating margin expanding to 11.7% in 2018 from 5.2% in 2013.

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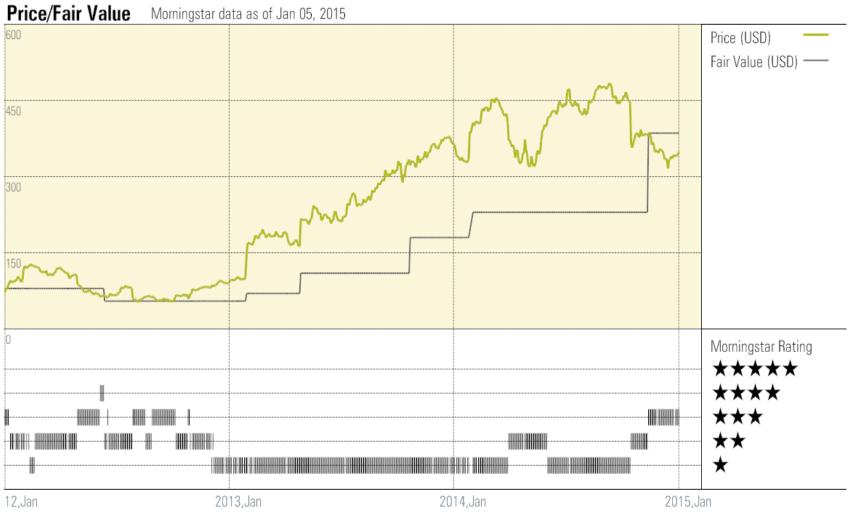

Despite our increased confidence in Netflix's competitive position, the ultimate market for streaming video on demand, the future of digital content delivery, and Netflix's ultimate position in the market remain very difficult to forecast with precision. For these reasons, we assign Netflix's shares a very high uncertainty rating.

Scenario Analysis

Although our fair value estimate reflects what we believe is the most likely long-run fundamental outcome for Netflix, there is a wide range of possible outcomes, considering the unknowns regarding competition in streaming video content and how management will allocate capital outside the U.S. While recognizing the range of possible outcomes, we have contemplated upside and downside cases to frame our base-case fair value estimate.

Our upside scenario assumes that while domestic competition emerges, Netflix accelerates subscriber growth, increasing its domestic paid subscriber count to 66 million by 2018, leading to average annual revenue growth of 22% from 2013 to 2018. The larger subscriber base would provide Netflix with operating leverage to lower content costs and decrease marketing expenses, powering the domestic streaming contribution margin to 37%. We assume international penetration will grow faster, leading to a subscriber base of 65 million and a positive contribution margin by 2016. Our upside scenario assumes a 15% overall operating margin in 2018, resulting in a $545 stock price.

Our downside case assumes Netflix faces heavy competition domestically and achieves less subscriber growth than our base case, ending up with 53 million subscribers by 2018 and leading to average domestic annual revenue growth of 15% through 2018. Increased competition also means Netflix would be face serious pressure on profitability, with a segment contribution margin of only 23% by 2018. We assume the company continues to expand intentionally but achieve much lower penetration. The international segment ends 2018 with 43 million subscribers but still posts a negative contribution margin. As result, the overall operating margin collapses to 2.8%, leading to $88 stock price.

Economic Moat

We assign Netflix a narrow moat rating. Netflix is the largest SVOD provider in the U.S. and is rapidly expanding into select overseas markets. This rapidly expanding subscriber base (over 50 million worldwide) creates a humongous data set that Netflix mines in order to better purchase and create content. This new content not only strengthens its relationship with its current customers, but also attracts new customers via word of mouth and the halo effect from critical acclaim and award nominations.

Through the streaming video delivery method, Netflix tracks every customer interaction, from large (total time spent at Netflix) to minute (whether a user pressed fast forward). This data is aggregated in a massive cloud database housed across multiple data centers worldwide. Netflix can query this information to better understand network and device performance, customer behavior, and content popularity.

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While current and future competitors such as Amazon and Internet access providers could create similar databases, Netflix's data set is and will continue to be significantly larger due to the size advantage of its subscriber base and the amount of time spent on the service. According to the Sandvine Global Internet Phenomena Report, Netflix accounted for 34% of downstream prime-time traffic (the largest source) in North America during the first half of 2014, up from 32% the year before. Both Amazon Video and Hulu were each under 2% over the past 12 months. Even in newer markets such as the U.K. and Ireland, Netflix has quickly become one of the largest sources of downstream traffic (18%, second behind YouTube at 20%), well ahead of the offerings from entrenched players such BT, RTE, and Amazon (between 1% and 3% each). The average Netflix user worldwide now watches more 90 minutes of video per day as overall Netflix streaming has increased 350% since the beginning of 2012.

Netflix leverage this data set across its offerings in multiple ways to derive sustainable competitive advantages. To improve the customer experience, Netflix analyzes data traffic, video performance, and buffering to better understand where data loss and slowdown occurs and route traffic accordingly. The company also examines specific subscriber actions by type of action and device used to formulate better user interfaces and to tweak device-specific applications. The real-time nature of the data provides Netflix with the ability to iterate quicker than traditional user group or beta testing methods. The large number of subscribers using different devices across multiple countries generates a large, growing robust data set that current competitors can't match and new entrants can't easily replicate.

Netflix also leverages its cloud database to help with its content creation and acquisition efforts as well as to run its content discovery engine. The company has long employed its usage data to drive content acquisition by understanding subscriber usage beyond simple rating metrics. The content discovery engine provides recommendations based on a subscriber's previous viewing habits in context with subscribers with similar viewing habits. While growing rapidly as a streaming video provider, the company understood the need to create original content to differentiate its offering. Instead of simply competing with the studios and networks for new pilots, the company draws upon its data to understand the types of shows, directors, and actors that would appeal to its subscribers. An often-cited example of this data is "House of Cards," an adaption of a British miniseries that stars Kevin Spacey and is produced by David Fincher. Netflix noted that Fincher's movies were generally watched from beginning to end, that Spacey's films had performed well, and that the original version was popular with subscribers. The show has proved to be a success with audiences and critics while providing Netflix with substantial positive press and nonsubscriber recognition.

Moat Trend

We think the moat trend for Netflix is stable. While the media environment is highly competitive, consumer demand for content continues to grow. We believe the company will continue to invest in original and acquired content, providing a deep and varied library for subscribers. We do believe that content costs will increase but that Netflix is best positioned to understand the content that current and potential subscribers value and pay accordingly. We expect the company will also continue to invest in original content by partnering with the best production studios in the U.S. and abroad.

While announcements from two major competitors have shaken up the U.S. SVOD market, we believe the potential threat to Netflix has been overstated by the media and investment community. The announcement by Time Warner

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Morningstar Analysis

that HBO will launch its long-demanded stand-alone online offering in 2015 was greeted with widespread acclaim despite an absence of any details. Time Warner management avoiding calling the service HBO Go, the streaming service for current subscribers, and did not provide any details on pricing, content, or the technical underpinnings of the service. Given the emphasis of working with the company's current cable operator partners, we believe that the service will be directly aimed at the 10 million broadband-only households and will be priced to discourage subscribers from abandoning the pay TV bundle. The second major event was the launch of CBS All Access, a SVOD service with linear CBS in select markets for $6.99 per month. Given the selection of shows and availability of prime-time shows one day after viewing, the service appears to be the Tiffany Network's version of Hulu Plus. Given that Hulu Plus only has 6 million paid subscribers, we don't view CBS All Access as a threat to Netflix's model. We actually believe that Netflix and other SVOD providers could be thought of as complementary products for cord cutters, and for those customers still in the pay TV ecosystem, Netflix remains the most robust SVOD provider with the deepest library and the most-desired first-party content.

We also believe large-scale streaming video is difficult and costly to do efficiently and well. Netflix accounts for more than one third of the prime-time downstream traffic in the U.S. and almost 20% in the U.K. and Ireland. Companies like Netflix, Amazon, and Google (YouTube) have years of experience gained from millions of streams served. We believe new linear online television entrants such as Sony and DISH will suffer growing pains that may stifle their growth potential. While some investors may worry about net neutrality and the existence of paid fast lanes, we believe that the cost to Netflix is and will remain minimal since excessive charges could bring the wrath of the Federal Communications Commission down on broadband providers. Also, paid fast lanes may provide an inadvertent benefit to Netflix (and other incumbent providers) by increasing the cost of starting a new service.

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Bulls Say/Bears Say

Bulls Say

- Netflix's internal recommendation software and large subscriber base give the company an edge when deciding which content to acquire in future years.
- TV Everywhere from traditional pay TV distributors has been slow to roll out and largely replicates the linear experience, gifting Netflix with an extended window to remain the leading provider of Internet television in the U.S.
- The FCC may implement strict net neutrality rules in the U.S., limiting the ability of broadband providers to charge Netflix for access.

Bears Say

- The expansion into international markets is unprofitable today, and any material level of profitability may take five or more years to achieve.
- Netflix relies on unlimited bandwidth for its online service, and its subscribers use the largest percentage, by far, of all Internet downstream traffic during peak hours. The move toward paid fast lanes by broadband providers could lower margins if the company cannot pass though price increases.
- Netflix may be overpaying for content due to the presence of Amazon and Hulu. The entry of new competitors may exacerbate the rising cost of content.

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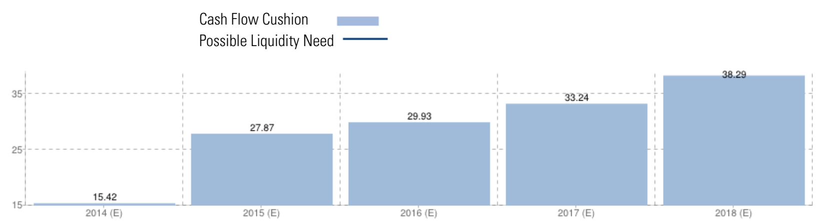
Credit Analysis

Five Year Adjusted Cash Flow Forecast (USD Mil)

	2014(E)	2015(E)	2016(E)	2017(E)	2018(E)
Cash and Equivalents (beginning of period)	1,200	1,804	2,107	2,502	3,061
Adjusted Available Cash Flow	-37	474	577	763	1,041
Total Cash Available before Debt Service	1,164	2,277	2,684	3,265	4,102
Principal Payments	—	—	—	—	—
Interest Payments	-50	-50	-50	-50	-50
Other Cash Obligations and Commitments	-25	-31	-39	-48	-57
Total Cash Obligations and Commitments	-75	-82	-90	-98	-107

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	USD Millions	% of Commitments
Beginning Cash Balance	1,200	265.5
Sum of 5-Year Adjusted Free Cash Flow	2,818	623.2
Sum of Cash and 5-Year Cash Generation	4,019	888.7
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	4,019	888.7
Sum of 5-Year Cash Commitments	-452	—

Credit Rating Pillars–Peer Group Comparison

	NFLX	Sector	Universe
Business Risk	6	5.0	5.2
Cash Flow Cushion	2	7.3	6.0
Solvency Score	5	7.0	4.7
Distance to Default	4	4.6	3.7
Credit Rating	BB+	BBB-	BBB+

Source: Morningstar Estimates

Note: Scoring is on a scale 1-10, 1 being Best, 10 being Worst

Financial Health & Capital Structure

Netflix has $900 million in debt, but nothing due in the near term ($500 million due 2021 and $400 million due 2024). The company recently issued the 2024 notes to fund its heavy investments in content and international growth. The company's weak free cash flow due to this spending is a concern, as we don't see this need decreasing. Netflix does not currently have a share-repurchase authorization and has not repurchased shares since 2010-11 ($259 million). The company also does not pay a dividend. We think these capital-allocation decisions are prudent, given our concerns about the company's liquidity.

Enterprise Risk

As technology improves, more consumers will be able to download content quickly via the Web and play it on their televisions or alternative devices. The cost of licensing content will rise as competitors emerge and bid for content that Netflix desires. The move to more original content adds costs and risks. Netflix's expansion outside the U.S. and Canada could remain unprofitable and drag on cash flow due to different tastes and lower video consumption. The cost to deliver content could increase and the need to pay for fast-lane network access could drag on margins. Network and channel-specific video services could steal subscribers and limit subscriber growth. The increased price rates in the U.S. could limit growth and increase churn when the grandfathering period expires.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
NEIL HUNT	Other Executive Officer	80,786	01 Dec 2014	10,000
LESLIE J. KILGORE	Director	10,028	01 Jul 2014	—
RICHARD N. BARTON	Director	6,343	18 Jun 2014	—
DAVID A. HYMAN	General Counsel/Secretary	5,230	18 Jun 2014	—
MICHAEL N. SCHUH	Director	2,750	31 Oct 2006	—
GREG PETERS	Other Executive Officer	1,870	01 Jul 2014	—
MR. REED HASTINGS	CEO/Chairman of the Board/Co-Founder/Director/President, Director	—	29 Dec 2014	39,150
TAWNI CRANZ	Other Executive Officer	—	09 Sep 2014	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
VA CollegeAmerica AMCAP	3.24	2.21	—	30 Sep 2014
VA CollegeAmerica Growth Fund of America	2.63	0.53	250	30 Sep 2014
VA CollegeAmerica Cap World Gr and Inc	1.89	0.62	370	30 Sep 2014
VA CollegeAmerica Small Cap World	1.57	1.81	-35	30 Sep 2014
VA CollegeAmerica New Economy	1.55	3.20	—	30 Sep 2014
Concentrated Holders				
BSG Prometeo FI	0.03	91.78	15	30 Jun 2014
Prudential Jennison Market Neutral Fund	—	6.52	1	30 Nov 2014
Dynamic Power American Growth Class	0.10	5.07	—	30 Sep 2014
Dynamic Power American Growth Fund	0.14	5.07	—	30 Sep 2014
FMT US Growth Opportunities	0.01	4.98	—	30 Jun 2014

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
Winslow Capital Management, LLC	1.11	0.92	668	30 Sep 2014
Capital Research Global Investors	11.32	1.07	585	30 Sep 2014
D. E. Shaw & Co LP	1.70	0.60	381	30 Sep 2014
Government Pension Fund of Norway - Global	0.71	—	230	31 Dec 2011
Two Sigma Investments LLC	0.36	0.46	211	30 Sep 2014
Top 5 Sellers				
T. Rowe Price Associates, Inc.	7.28	0.43	-513	30 Sep 2014
Icahn Associates Corp	2.34	1.89	-353	30 Sep 2014
Lansdowne Partners Limited Partnership	1.07	2.61	-322	30 Sep 2014
Viking Global Investors LP	1.76	1.92	-259	30 Sep 2014
Citadel Advisors Llc	0.11	0.04	-248	30 Sep 2014

Management 13 Nov 2014

We rate Netflix's stewardship of shareholder capital as standard. Despite some missteps, chairman and CEO Reed Hastings successfully transitioned Netflix from a DVD rental service to the premier streaming video on demand service. Hastings founded Netflix in 1998 and owns about 6% of the company. CFO David Wells and chief content officer Ted Sarandos have long tenures with Netflix with proven records. Hastings and Sarandos have positioned Netflix as a major player in content distribution and now content creation. We respect management's long-term planning and perception, but believe investors still remember 2011's questionable Qwikster decision, a short-lived plan to rebrand and spin off the DVD business from streaming. However, the subsequent performance of the domestic streaming-only business and the cautious manner and messaging of the price increase depict a management team that internalized the lessons from the mistakes of 2011.

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Analyst Notes

Netflix's Third-Quarter Subscriber Growth Disappoints; HBO Emerges as Potential New OTT Competitor 15 Oct 2014
While revenue and EPS beat expectations, Netflix's third-quarter results were disappointing due to lower-than-expected streaming net adds with 0.98 million domestically and 2.04 million internationally, versus guidance of 1.33 million and 2.36 million, respectively. While the management blamed the net add shortfall on increased prices, we maintain our favorable view of management's decision to slowly raise prices. Netflix remains committed to investing in marketing and proprietary content, both of which we believe will offer solid returns. Despite the subscriber misses, the firm continues to build a solid foundation, ending the reporting period with over 50 million global paid streaming subscribers.

Management addressed Time Warner's announcement that HBO would be launching a standalone OTT offering in 2015. The company has apparently expected this move by HBO and believes that the markets in the US and worldwide are large enough for multiple offerings including pay-TV, Amazon Prime, and Hulu.

The company also issued fourth quarter guidance below current expectations. Management guided for a $95 million operating loss for the international segment during the next quarterly reporting period, primarily due to the launch of six European markets (Germany, France, Austria, Switzerland, Belgium, and Luxembourg) in September. Management expects 1.85 million domestic net customer additions in the third quarter, down sharply from a year earlier, and international subscriber growth of 2.15 million, up from 2.15 million, due largely to the additional 66 million addressable homes added via the market expansions in September.

We would caution investors to wait for further details on the HBO OTT offering before turning overly negative as Time Warner did not disclose a launch date, potential content library, or pricing. We also believe that the standalone HBO offering will be packaged to ensure continued positive relationships with the multi-channel distributors. Potential methods could include a price point around or above the current monthly fee for the linear HBO channels (i.e. above the $9 Netflix fee), offering a subset of the HBO library, streaming only original programming, or other methods to keep the cable bundle plus HBO attractive to current subscribers.

Netflix Continues to Build Momentum, but Shares Still Look Rich 21 Jul 2014
Netflix's second-quarter results were slightly above both management's guidance, and our own expectations. The firm continues to build a solid foundation, ending the reporting period with over 50 million global streaming subscribers. We continue to have a favorable view of management's decision to slowly raise prices, though we've already included increases in our expectations. Netflix is also investing in marketing and proprietary content, both of which we believe will deliver solid returns.

We like what Netflix is doing, but we think much of the upside has already been priced into the stock at current levels. The wild card is how quickly - and how successfully - Netflix is able to tick up its prices.

Consolidated revenue grew 25.3% year over year, to $1.34 billion, driven once again by net domestic streaming customer growth. Operating profit expanded to $129.6 million, up from $57.1 million last year, and slightly better than management's $125 million forecast. The operating margin improved about 4 percentage points year over year, to 9.7%, as revenue growth continued to outpace content cost increases. We're encouraged by the continued margin improvement.

While management guided for a $42 million operating loss

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Analyst Notes

for the international segment during the current quarterly reporting period, this expected loss is primarily due to the planned launch of six European markets (Germany, France, Austria, Switzerland, Belgium, and Luxembourg) in September.

At $1.15, diluted earnings per share was up sharply from $0.49 in the year-ago quarter. Management expects 1.33 million domestic net customer additions in the third quarter, up slightly from a year earlier, and international subscriber growth of 2.36 million, up from 1.44 million, due largely to the additional 60 million addressable homes to be added via the market expansion in September. Given the market expansion and number of broadband homes yet to be addressed, Netflix's growth profile remains robust.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2011	2012	2013	*2014* (Forecast)	*2015* (Forecast)	*5-Year Proj. CAGR*
Revenue	*26.5*	48.2	12.6	21.2	*25.9*	*24.9*	*23.3*
EBIT	*-7.0*	35.8	-87.0	356.8	*75.9*	*37.8*	*45.0*
EBITDA	*0.9*	37.7	-59.8	85.3	*56.7*	*25.9*	*34.2*
Net Income	*-5.1*	46.2	-92.7	701.8	*56.9*	*52.2*	*46.2*
Diluted EPS	*-8.6*	46.0	-93.3	677.3	*56.9*	*52.2*	*46.2*
Earnings Before Interest, after Tax	*-26.6*	-47.7	-104.6	-1,742.1	*45.5*	*46.7*	*41.3*
Free Cash Flow	*-141.7*	-75.0	-183.9	-65.5	*-657.4*	*43.7*	—

Profitability	3-Year Hist. Avg	2011	2012	2013	*2014*	*2015*	*5-Year Proj. Avg*
Operating Margin %	*6.2*	12.0	1.4	5.2	*7.3*	*8.1*	*9.0*
EBITDA Margin %	*10.6*	16.7	6.0	9.1	*11.3*	*11.4*	*12.0*
Net Margin %	*3.7*	7.3	0.5	3.1	*3.9*	*4.8*	*5.4*
Free Cash Flow Margin %	*0.1*	4.5	-3.4	-1.0	*4.2*	*4.9*	*5.3*
ROIC %	*9.9*	21.3	-0.9	9.5	*10.2*	*13.2*	*15.2*
Adjusted ROIC %	*9.6*	19.7	0.1	9.1	*9.9*	*12.6*	*14.4*
Return on Assets %	*5.0*	11.6	0.5	2.9	*3.8*	*5.3*	*7.2*
Return on Equity %	*22.1*	50.5	2.5	13.2	*15.0*	*19.2*	*21.2*

Leverage	3-Year Hist. Avg	2011	2012	2013	*2014*	*2015*	*5-Year Proj. Avg*
Debt/Capital	*0.34*	0.38	0.35	0.27	*0.37*	*0.32*	*0.28*
Total Debt/EBITDA	*1.29*	0.75	1.86	1.26	*1.44*	*1.15*	*0.95*
EBITDA/Interest Expense	*17.03*	26.67	10.75	13.66	*12.39*	*15.60*	*21.36*

Valuation Summary and Forecasts

	2012	2013	*2014(E)*	*2015(E)*
Price/Fair Value	1.68	2.05	—	—
Price/Earnings	319.3	162.9	*93.3*	*61.2*
EV/EBITDA	21.4	53.4	*30.7*	*24.4*
EV/EBIT	92.0	93.0	*47.8*	*34.7*
Free Cash Flow Yield %	-0.4	0.2	*1.6*	*2.1*
Dividend Yield %	—	—	—	—

Key Valuation Drivers

Cost of Equity %	10.0
Pre-Tax Cost of Debt %	5.8
Weighted Average Cost of Capital %	8.4
Long-Run Tax Rate %	35.0
Stage II EBI Growth Rate %	15.0
Stage II Investment Rate %	60.0
Perpetuity Year	15

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	1,825	8.7	30.03
Present Value Stage II	3,553	17.0	58.47
Present Value Stage III	15,555	74.3	256.00
Total Firm Value	**20,932**	**100.0**	**344.50**
Cash and Equivalents	1,200	—	19.76
Debt	-500	—	-8.23
Preferred Stock	—	—	—
Other Adjustments	32	—	0.52
Equity Value	**21,664**	**—**	**356.55**
Projected Diluted Shares	61		
Fair Value per Share (USD)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

Netflix Inc NFLX (NAS) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
331.18 USD	386.00 USD	193.00 USD	675.50 USD	Very High	Narrow	Stable	Standard	BB+	Communication Services

Morningstar Analyst Forecasts

Income Statement (USD Mil)
Fiscal Year Ends in December

				Forecast	
	2011	2012	2013	*2014*	*2015*
Revenue	**3,205**	**3,609**	**4,375**	***5,508***	***6,878***
Cost of Goods Sold	2,040	2,652	3,117	*3,737*	*4,520*
Gross Profit	**1,165**	**957**	**1,257**	***1,771***	***2,358***
Selling, General & Administrative Expenses	139	139	180	*253*	*273*
Marketing	381	439	470	*650*	*976*
Technology and development	259	329	379	*465*	*556*
Depreciation & Amortization (if reported separately)	—	—	—	—	—
Operating Income (ex charges)	**385**	**50**	**228**	***402***	***553***
Restructuring & Other Cash Charges	—	—	—	—	—
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	—	—
Operating Income (incl charges)	**385**	**50**	**228**	***402***	***553***
Interest Expense	20	20	29	*50*	*50*
Interest Income	3	0	-3	*2*	*2*
Pre-Tax Income	**369**	**30**	**196**	***354***	***505***
Income Tax Expense	133	13	59	*138*	*177*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	—	—	—	—	—
(Preferred Dividends)	—	—	—	—	—
Net Income	**235**	**17**	**138**	***216***	***328***
Weighted Average Diluted Shares Outstanding	54	59	61	*61*	*61*
Diluted Earnings Per Share	**4.32**	**0.29**	**2.26**	***3.55***	***5.41***
Adjusted Net Income	235	17	138	*216*	*328*
Diluted Earnings Per Share (Adjusted)	**4.32**	**0.29**	**2.26**	***3.55***	***5.41***
Dividends Per Common Share	—	—	—	—	—
EBITDA	**429**	**95**	**277**	***456***	***611***
Adjusted EBITDA	**534**	**215**	**398**	***624***	***786***

Netflix Inc NFLX (NAS) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
331.18 USD	386.00 USD	193.00 USD	675.50 USD	Very High	Narrow	Stable	Standard	BB+	Communication Services

Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Fiscal Year Ends in December

	2011	2012	2013	Forecast 2014	2015
Cash and Equivalents	798	748	1,200	*1,804*	*2,107*
Investments	—	—	—	—	—
Accounts Receivable	—	—	—	—	—
Inventory	—	—	—	—	—
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	1,033	1,493	1,858	*1,858*	*1,858*
Current Assets	**1,831**	**2,241**	**3,059**	***3,662***	***3,965***
Net Property Plant, and Equipment	136	132	134	*168*	*220*
Goodwill	—	—	—	—	—
Other Intangibles	—	—	—	—	—
Deferred Tax Assets (Long-Term)	—	—	—	—	—
Other Long-Term Operating Assets	1,047	1,506	2,091	*2,091*	*2,091*
Long-Term Non-Operating Assets	54	89	129	*129*	*129*
Total Assets	**3,068**	**3,968**	**5,413**	***6,050***	***6,406***
Accounts Payable	86	86	108	*130*	*157*
Short-Term Debt	—	—	—	—	—
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	1,139	1,590	2,046	*2,046*	*2,046*
Current Liabilities	**1,225**	**1,676**	**2,154**	***2,176***	***2,203***
Long-Term Debt	400	400	500	*900*	*900*
Deferred Tax Liabilities (Long-Term)	—	—	—	—	—
Other Long-Term Operating Liabilities	740	1,077	1,346	*1,346*	*1,346*
Long-Term Non-Operating Liabilities	62	71	79	*79*	*79*
Total Liabilities	**2,427**	**3,224**	**4,079**	***4,501***	***4,528***
Preferred Stock	—	—	—	—	—
Common Stock	—	0	0	*0*	*0*
Additional Paid-in Capital	219	302	777	*777*	*777*
Retained Earnings (Deficit)	423	440	552	*768*	*1,097*
(Treasury Stock)	—	—	—	—	—
Other Equity	0	2	4	*4*	*4*
Shareholder's Equity	**642**	**744**	**1,334**	***1,549***	***1,878***
Minority Interest	—	—	—	—	—
Total Equity	**642**	**744**	**1,334**	***1,549***	***1,878***

Netflix Inc NFLX (NAS) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
331.18 USD	386.00 USD	193.00 USD	675.50 USD	Very High	Narrow	Stable	Standard	BB+	Communication Services

Morningstar Analyst Forecasts

Cash Flow (USD Mil)

Fiscal Year Ends in December	2011	2012	2013	*Forecast 2014*	*Forecast 2015*
Net Income	226	17	112	*216*	*328*
Depreciation	44	45	48	*54*	*57*
Amortization	—	—	—	—	—
Stock-Based Compensation	62	74	73	*114*	*117*
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	-19	-30	-22	—	—
Other Non-Cash Adjustments	-4	-8	30	—	—
(Increase) Decrease in Accounts Receivable	—	—	—	—	—
(Increase) Decrease in Inventory	—	—	—	—	—
Change in Other Short-Term Assets	-107	-101	-264	—	—
Increase (Decrease) in Accounts Payable	24	-5	18	*22*	*27*
Change in Other Short-Term Liabilities	92	30	101	—	—
Cash From Operations	**318**	**22**	**98**	***405***	***531***
(Capital Expenditures)	-50	-40	-54	*-88*	*-110*
Net (Acquisitions), Asset Sales, and Disposals	—	—	—	—	—
Net Sales (Purchases) of Investments	-135	-165	-142	—	—
Other Investing Cash Flows	-81	-39	-60	—	—
Cash From Investing	**-266**	**-245**	**-256**	***-88***	***-110***
Common Stock Issuance (or Repurchase)	20	4	125	—	—
Common Stock (Dividends)	—	—	—	—	—
Short-Term Debt Issuance (or Retirement)	—	—	—	—	—
Long-Term Debt Issuance (or Retirement)	198	0	271	*400*	—
Other Financing Cash Flows	44	2	80	*-114*	*-117*
Cash From Financing	**262**	**6**	**476**	***286***	***-117***
Exchange Rates, Discontinued Ops, etc. (net)	—	0	-3	—	—
Net Change in Cash	**313**	**-218**	**315**	***603***	***303***

Netflix Inc NFLX (NAS) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
331.18 USD	386.00 USD	193.00 USD	675.50 USD	Very High	Narrow	Stable	Standard	BB+	Communication Services

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
Company/Ticker	Price/Fair Value	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*
Comcast Corp CMCSA USA	1.24	20.3	*18.5*	*17.5*	8.3	*8.2*	*8.0*	20.8	*19.7*	*16.9*	2.7	*2.7*	*2.6*	2.1	*2.1*	*2.0*
Amazon.com Inc AMZN USA	0.81	675.9	*NM*	*241.8*	44.0	*29.4*	*20.1*	90.1	*47.6*	*32.7*	18.8	*14.6*	*13.8*	2.5	*1.6*	*1.3*
Time Warner Inc TWX USA	1.07	17.7	*19.9*	*19.5*	10.1	*12.4*	*11.6*	19.2	*17.9*	*19.6*	2.0	*2.6*	*2.7*	2.0	*2.5*	*2.4*
Average		238.0	*19.2*	*92.9*	20.8	*16.7*	*13.2*	43.4	*28.4*	*23.1*	7.8	*6.6*	*6.4*	2.2	*2.1*	*1.9*
Netflix Inc NFLX US	**0.86**	**162.9**	***93.3***	***61.2***	**53.4**	***30.7***	***24.4***	**502.3**	***62.9***	***47.4***	**16.5**	***12.9***	***10.6***	**5.0**	***3.6***	***2.9***

Returns Analysis

		ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
Company/Ticker	Last Historical Year Total Assets (Mil)	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*
Comcast Corp CMCSA USA	158,813 USD	10.8	*10.9*	*11.0*	76.2	*93.0*	*98.7*	13.6	*15.2*	*15.0*	4.2	*5.0*	*5.1*	1.4	*1.6*	*1.7*
Amazon.com Inc AMZN USA	— USD	3.7	*-0.1*	*4.0*	4.6	*1.4*	*4.6*	3.0	*-1.9*	*5.8*	0.8	*-0.4*	*1.1*	—	—	—
Time Warner Inc TWX USA	67,994 USD	11.7	*10.6*	*10.0*	27.1	*23.4*	*22.1*	12.4	*14.2*	*13.1*	5.4	*6.1*	*5.4*	1.8	*1.6*	*1.6*
Average		8.7	*7.1*	*8.3*	36.0	*39.3*	*41.8*	9.7	*9.2*	*11.3*	3.5	*3.6*	*3.9*	1.6	*1.6*	*1.7*
Netflix Inc NFLX US	**5,413** USD	**9.5**	***10.2***	***13.2***	**9.1**	***9.9***	***12.6***	**13.2**	***15.0***	***19.2***	**2.9**	***3.8***	***5.3***	—	—	—

Growth Analysis

		Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
Company/Ticker	Last Historical Year Revenue (Mil)	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*
Comcast Corp CMCSA USA	64,657 USD	3.3	*6.3*	*4.3*	11.4	*10.2*	*2.0*	12.1	*18.0*	*5.8*	-150.1	*-241.4*	*13.9*	24.5	*22.1*	*10.0*
Amazon.com Inc AMZN USA	74,453 USD	21.9	*20.4*	*18.1*	10.2	*-104.1*	*-3,496.8*	-781.0	*-168.1*	*-409.5*	-164.6	*184.1*	*46.4*	—	—	—
Time Warner Inc TWX USA	29,795 USD	3.7	*-4.5*	*1.6*	10.2	*-6.6*	*9.0*	14.8	*10.9*	*1.9*	18.0	*159.5*	*-55.3*	10.0	*11.5*	*5.5*
Average		9.6	*7.4*	*8.0*	10.6	*-33.5*	*-1,161.9*	-251.4	*-46.4*	*-133.9*	-98.9	*34.1*	*1.7*	17.3	*16.8*	*7.8*
Netflix Inc NFLX US	**4,375** USD	**21.2**	***25.9***	***24.9***	**356.8**	***75.9***	***37.8***	**677.3**	***56.9***	***52.2***	**-65.5**	***-657.4***	***43.7***	—	—	—

Netflix Inc NFLX (NAS) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
331.18 USD	386.00 USD	193.00 USD	675.50 USD	Very High	Narrow	Stable	Standard	BB+	Communication Services

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

	Last Historical Year Net Income	Gross Margin %			EBITDA Margin %			Operating Margin %			Net Margin %			Free Cash Flow Margin %		
Company/Ticker	(Mil)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
Comcast Corp CMCSA USA	6,823 USD	33.2	*33.4*	*32.7*	33.2	*33.4*	*32.7*	21.0	*21.8*	*21.3*	10.6	*11.5*	*11.4*	10.1	*10.7*	*12.0*
Amazon.com Inc AMZN USA	273 USD	27.2	*28.8*	*30.6*	5.4	*5.2*	*6.4*	1.0	*0.0*	*1.0*	0.4	*-0.2*	*0.5*	2.7	*3.3*	*4.0*
Time Warner Inc TWX USA	3,549 USD	45.5	*42.9*	*45.0*	26.0	*25.2*	*26.7*	23.0	*22.5*	*24.1*	11.9	*12.9*	*12.0*	10.4	*13.7*	*12.3*
Average		35.3	*35.0*	*36.1*	21.5	*21.3*	*21.9*	15.0	*14.8*	*15.5*	7.6	*8.1*	*8.0*	7.7	*9.2*	*9.4*
Netflix Inc NFLX US	**138** USD	**28.7**	***32.2***	***34.3***	**9.1**	***11.3***	***11.4***	**5.2**	***7.3***	***8.1***	**3.1**	***3.9***	***4.8***	**1.0**	***5.8***	***6.1***

Leverage Analysis

	Last Historical Year Total Debt	Debt/Equity %			Debt/Total Cap %			EBITDA/Interest Exp.			Total Debt/EBITDA			Assets/Equity		
Company/Ticker	(Mil)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
Comcast Corp CMCSA USA	47,847 USD	94.4	*85.6*	*76.3*	48.6	*46.1*	*43.3*	8.3	*9.2*	*10.0*	2.2	*2.0*	*1.8*	3.1	*3.0*	*2.8*
Amazon.com Inc AMZN USA	3,191 USD	32.7	*88.3*	*82.8*	24.7	*46.9*	*45.3*	28.4	*26.3*	*18.8*	0.8	*1.8*	*1.2*	4.1	*5.3*	*5.5*
Time Warner Inc TWX USA	20,165 USD	67.4	*75.0*	*78.7*	40.3	*42.9*	*44.0*	6.0	*5.7*	*5.8*	2.6	*2.8*	*2.7*	2.3	*2.4*	*2.5*
Average		64.8	*83.0*	*79.3*	37.9	*45.3*	*44.2*	14.2	*13.7*	*11.5*	1.9	*2.2*	*1.9*	3.2	*3.6*	*3.6*
Netflix Inc NFLX US	**500** USD	**37.5**	***58.1***	***47.9***	**27.3**	***36.7***	***32.4***	**13.7**	***12.4***	***15.6***	**1.3**	***1.4***	***1.1***	**4.1**	***3.9***	***3.4***

Liquidity Analysis

	Market Cap	Cash per Share			Current Ratio			Quick Ratio			Cash/Short-Term Debt			Payout Ratio %		
Company/Ticker	(Mil)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
Comcast Corp CMCSA USA	145,227 USD	0.64	*0.40*	*0.30*	0.74	*0.66*	*0.73*	0.74	*0.66*	*0.73*	0.52	*0.21*	*0.27*	28.8	*29.8*	*31.0*
Amazon.com Inc AMZN USA	139,916 USD	18.79	*32.53*	*37.34*	1.07	*1.25*	*1.25*	0.75	*0.93*	*0.93*	—	—	—	—	—	—
Time Warner Inc TWX USA	69,796 USD	1.98	*3.15*	*2.90*	1.77	*1.85*	*1.65*	1.53	*1.61*	*1.43*	28.21	—	*2.37*	29.1	*27.8*	*31.5*
Average		7.14	*12.03*	*13.51*	1.19	*1.25*	*1.21*	1.01	*1.07*	*1.03*	14.37	*0.21*	*1.32*	29.0	*28.8*	*31.3*
Netflix Inc NFLX US	**19,952** USD	**19.76**	***29.69***	***34.67***	**1.42**	***1.68***	***1.80***	**1.42**	***1.68***	***1.80***	—	—	—	—	—	—

Research Methodology for Valuing Companies

Components of Our Methodology

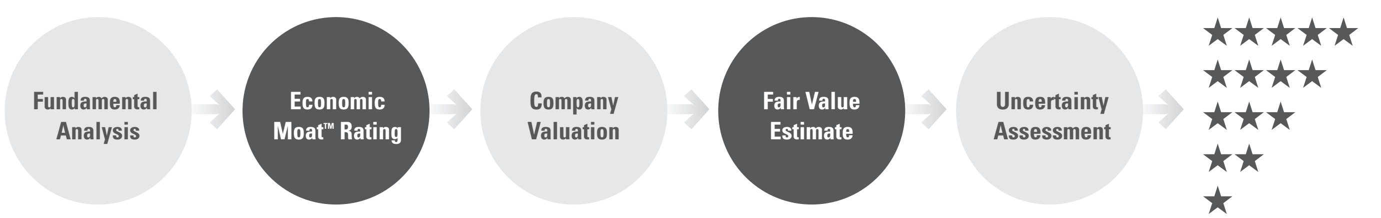
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

Morningstar Research Methodology for Valuing Companies



Fundamental Analysis	Economic Moat™ Rating	Company Valuation	Fair Value Estimate	Uncertainty Assessment	Morningstar Rating
Analyst conducts company and industry research: ► Financial statement analysis ► Channel checks ► Trade-show visits ► Industry and company reports and journals ► Conference calls ► Management and site visits	Strength of competitive advantage is rated: None, Narrow, or Wide Advantages that confer an economic moat: **High Switching Costs** (Microsoft) **Cost advantage** (Wal-Mart) **Intangible assets** (Johnson & Johnson) **Network Effect** (Mastercard) **Efficient Scale** (Lockheed Martin)	Analyst considers past financial results and focuses on competitive position and future prospects to forecast future cash flows. Assumptions are entered into Morningstar's proprietary discounted cash-flow model.	Analyst uses a discounted cash-flow model to develop a Fair Value Estimate, which serves as the foundation for the Morningstar Rating for stocks.	The analyst then evaluates the range of potential intrinsic values for the company and assigns an Uncertainty Rating: Low, Medium, High, Very High, or Extreme. The Uncertainty Rating determines the margin of safety required before we would recommend the stock. The higher the uncertainty, the wider the margin of safety.	The current stock price relative to Morningstar's Fair Value Estimate, adjusted for uncertainty, determines the Morningstar Rating for stocks. The Morningstar Rating for stocks is updated each evening after the market closes.

Research Methodology for Valuing Companies

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

* Please contact a sales representative for more information.

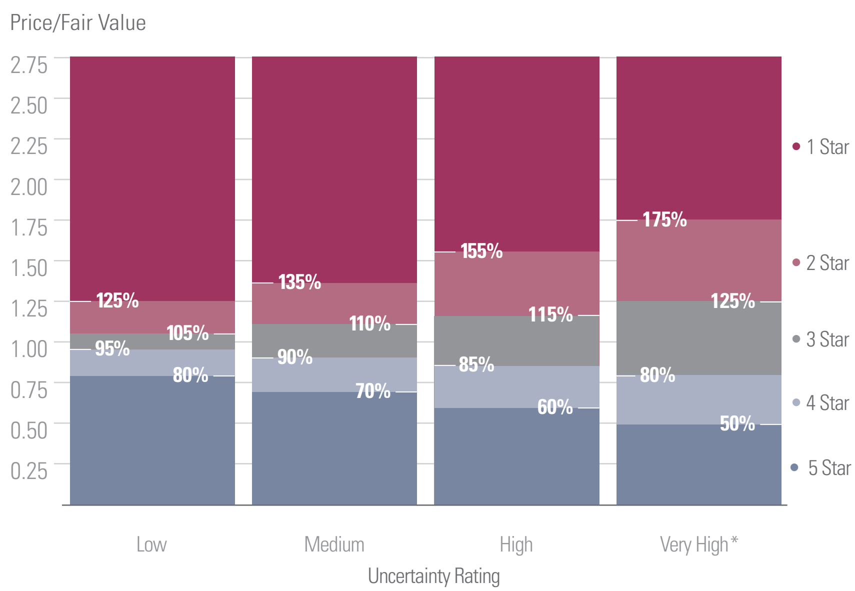
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Morningstar's Approach to Rating Corporate Credit

- Offers a proprietary measure of the credit quality of companies on our coverage list.
- Encapsulates our in-depth modeling and quantitative work in one letter grade.
- Allows investors to rank companies by each of the four underlying components of our credit ratings, including both analyst-driven and quantitative measures.
- Provides access to all the underlying forecasts that go into the rating, available through our institutional service.

Purpose

The Morningstar Corporate Credit Rating measures the ability of a firm to satisfy its debt and debt-like obligations. The higher the rating, the less likely we think the company is to default on these obligations.

The Morningstar Corporate Credit Rating builds on the modeling expertise of our securities research team. For each company, we publish:

- Five years of detailed pro-forma financial statements
- Annual estimates of free cash flow
- Annual forecasts of return on invested capital
- Scenario analyses, including upside and downside cases
- Forecasts of leverage, coverage, and liquidity ratios for five years
- Estimates of off balance sheet liabilities

These forecasts are key inputs into the Morningstar Corporate Credit Rating and are available to subscribers at select.morningstar.com.

Methodology

We feel it's important to perform credit analysis through different lenses—qualitative and quantitative, as well as fundamental and market-driven. We therefore evaluate each company in four broad categories.

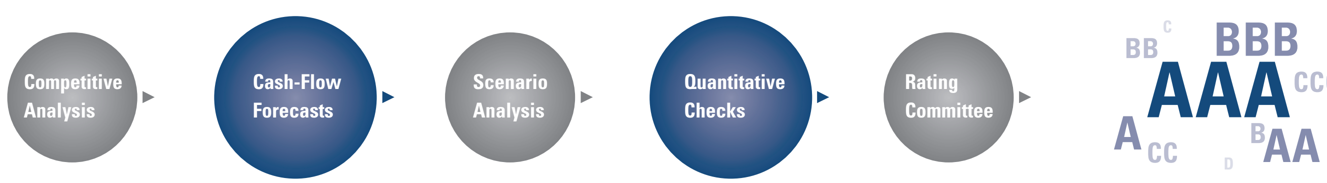
Business Risk

Business Risk captures the fundamental uncertainty around a firm's business operations and the cash flow generated by those operations. Key components of the Business Risk rating include the Morningstar Economic Moat™ Rating and the Morningstar Uncertainty Rating.

Cash Flow Cushion™

Morningstar's proprietary Cash Flow Cushion™ ratio is a fundamental indicator of a firm's future financial health The measure reveals how many times a company's internal cash generation plus total excess liquid cash will cover its debt-like contractual commitments over the next five years. The Cash Flow Cushion acts as a predictor of financial distress, bringing to light potential refinancing, operational, and liquidity risks inherent to the firm.

Morningstar Research Methodology for Determining Corporate Credit Ratings



Competitive Analysis: Analyst conducts company and industry research:

- Management interviews
- Conference calls
- Trade show visits
- Competitor, supplier, distributor, and customer interviews
- Assign Economic Moat™ Rating

Cash-Flow Forecasts: Analyst considers company financial statements and competitive dynamics to forecast future free cash flows to the firm.

Analyst derives estimate of Cash-Flow Cushion™.

Scenario Analysis: Analysts run bull and bear cases through the model to derive alternate estimates of enterprise value.

Based on competitive analysis, cash-flow forecasts, and scenario analysis, the analyst assigns Business Risk.

Quantitative Checks: We gauge a firm's health using quantitative tools supported by our own backtesting and academic research.

- Morningstar Solvency Score™
- Distance to Default

Rating Committee: Senior personnel review each company to determine the appropriate final credit rating.

- Review modeling assumptions
- Approve company-specific adjustments

AAA	Extremely Low Default Risk
AA	Very Low Default Risk
A	Low Default Risk
BBB	Moderate Default Risk
BB	Above Average Default Risk
B	High Default Risk
CCC	Currently Very High Default Risk
CC	Currently Extreme Default Risk
C	Imminent Payment Default
D	Payment Default
UR	Under Review
UR+	Positive Credit Implication
UR-	Negative Credit Implication

Morningstar's Approach to Rating Corporate Credit

The advantage of the Cash Flow Cushion ratio relative to other fundamental indicators of credit health is that the measure focuses on the future cash-generating performance of the firm derived from Morningstar's proprietary discounted cash flow model. By making standardized adjustments for certain expenses to reflect their debt-like characteristics, we can compare future projected free cash flows with debt-like cash commitments coming due in any particular year. The forward-looking nature of this metric allows us to anticipate changes in a firm's financial health and pinpoint periods where cash shortfalls are likely to occur.

Morningstar Solvency Score™

The Morningstar Solvency Score™ is a quantitative score derived from both historical and forecasted financial ratios. It includes ratios that focus on liquidity (a company's ability to meet short term cash outflows), profitability (a company's ability to generate profit per unit of input), capital structure (how does the company finance its operations), and interest coverage (how much of profit is used up by interest payments).

Distance to Default

Morningstar's quantitative Distance to Default measure ranks companies on the likelihood that they will tumble into financial distress. The measure is a linear model of the percentile of a firm's leverage (ratio of Enterprise Value to Market Value), the percentile of a firm's equity volatility relative to the rest of the universe and the interaction of these two percentiles. This is a proxy methodology for the common definition of Distance to Default which relies on option-based pricing models. The proxy has the benefit of increased breadth of coverage, greater simplicity of calculation, and more predictive power.

For each of these four categories, we assign a score, which we then translate into a descriptive rating along the scale of Very Good / Good / Fair / Poor / Very Poor.

Overall Credit Rating

The four component ratings roll up into a single preliminary credit rating. To determine the final credit rating, a credit committee of at least five senior research personnel reviews each preliminary rating.

We review credit ratings on a regular basis and as events warrant. Any change in rating must be approved by the Credit Rating Committee.

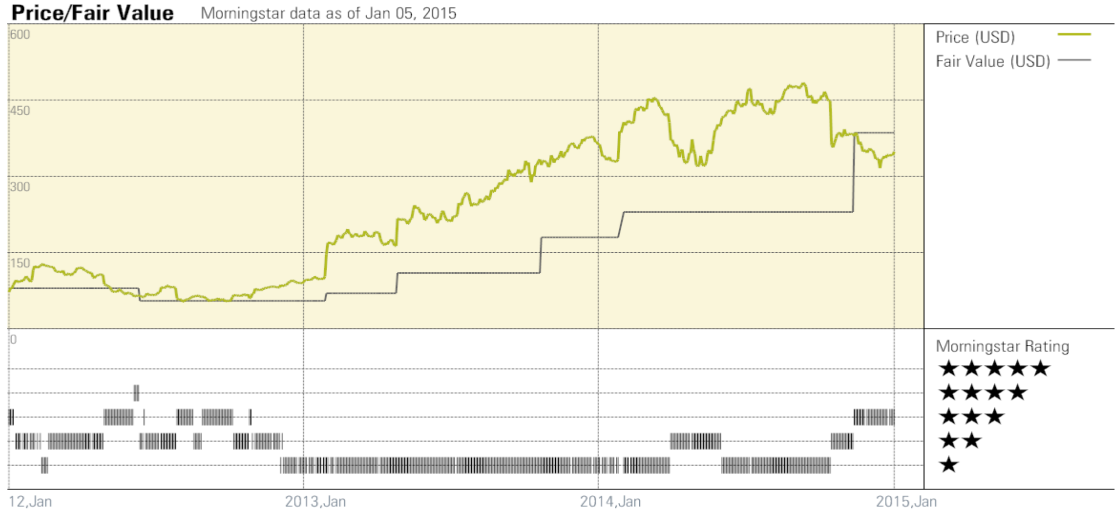
Investor Access

Morningstar Corporate Credit Ratings are available on Morningstar.com. Our credit research, including detailed cash-flow models that contain all of the components of the Morningstar Corporate Credit Rating, is available to subscribers at select.morningstar.com.

Netflix Inc NFLX (NAS) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
331.18 USD	386.00 USD	193.00 USD	675.50 USD	Very High	Narrow	Stable	Standard	BB+	Communication Services

Price/Fair Value Morningstar data as of Jan 05, 2015



The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value.

Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm’s economic moat, 2. Estimate of the stock’s fair value, 3. Uncertainty around that fair value estimate and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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