Conquering the Subscription Video on Demand Market

Providentia Capital

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Table of Abbreviations

Abbreviation	Explanation
SVOD	Subscription Video On Demand
OTT	Over The Top
MVPD	Multichannel Video Programming Distributor
CDN	Content Delivery Network
HHI	Herfindahl Hirschman Index
EV	Estimated Value
LTM	Last Twelve Months
NTM	Next Twelve Months
FAANG	Facebook, Amazon, Apple, Netflix And Google
OIBDA	Operating Income Before Depreciation And Amortization
FTC	Federal Trade Commission
USD	United States Dollar
EUR	Euro
AWS	Amazon Web Services
Tech	Technology
R&D	Research and Development
Algo	Algorithm
Mn	Million
Bn	Billion
EMEA	Europe, the Middle East and Africa

Abbreviation	Explanation
APAC	Asia-pacific
INR	Indian National Rupee
UX	User Experience
UI	User Interface
OCA	Open Connect Appliances
ISP	Internet Service Provider
E&M	Evaluation And Management
AVOD	Advertising Video On Demand
YoY	Year On Year
CAGR	Compounded Annual Growth Rate
Ecomm	Electronic Commerce
Pharma	Pharmaceutical
VR	Virtual Reality
AR	Augmented Reality
3D	Three Dimensional
EBITDA	Earnings Before Interest, Tax, Depreciation And Amortization

I. Executive Summary

Should Amazon acquire Netflix?

Amazon should not acquire Netflix

NETFLIX

- The capital market currently **overvalues Netflix by 43.42%**
- Netflix Management is not open to an acquisition which results in a hefty premium
- This premium is not justified by the relatively limited synergies that emerge
- The transaction is not financially feasible and would lead to destruction of wealth

Amazon should acquire ViacomCBS

VIACOMCBS

- The Capital Market severely undervalues ViacomCBS by 80%.
- The owners may be looking to sell, which results in a smaller premium
- The synergies that arise are far more significant than those that arrive with Netflix
- The transaction is financially feasible through a reasonable issue of debt

II. Industry Analysis

Industry Analysis – Segmenting the Industry (1/2)

The Over-the-Top (OTT) Services Industry is the newest major sub-Industry under the Global Entertainment & Media (E&M) Industry umbrella…

Entertainment & Media Industry

Back-end Media Services
Ex. Scripting, Recording, Production Encoding, Distribution etc.

Broadcast Media
Ex. Television, Cable Networks, Movie Halls etc.

OTT Services
Ex. Internet based Music or Video Streaming

Analysis in the Next Slide

Key Definitions

Entertainment & Media Market

E&M Market comprises production, broadcasting and marketing of audio and video content including music, TV, movies, advertising and publishing; it comprises auxiliary services such as cabling and ticketing as well

Over the Top Market

Media companies that offer audio and video content using Over the top (OTT) bypassing cable, broadcast television or telecomm channels; includes Video on Demand, Livestreaming, Game Streaming etc.

Subscription Video on Demand Market

Media companies that offer online video content comprising movies, sitcoms, sports etc. using the OTT model and charge a regular subscription fees for the same.

Industry Analysis – Segmenting the Industry (2/2)

The Subscription Video on Demand (SVOD) Market is a Key Portion of the OTT Industry…

SVODs form a major portion of the OTT market and are supported by numerous auxiliary services such as Distribution and Management.

Mapping the OTT Industry*

Streaming Platforms

Subscription Video on Demand

NETFLIX hulu amazon prime video Disney+

Sports

fubo TV FLOSPORTS

Gaming

eSportsU SLIVER.tv

User Generated Content

YouTube dailymotion

Gaming

twitch mixer

Internet Protocol TV

YUPPTV Tango

Virtual MVPD

PLUTO TV Wherever TV

Multichannel Networks

Tastemade MACHINIMA

Video Management

Digital Rights Management

verimatrix ZEFR

Encoding & Transcoding

BITMOVIN ateme

Video Distribution

IPTV Distribution

netgem amino

Content Delivery Network

Kollective Akamai

Streaming Devices

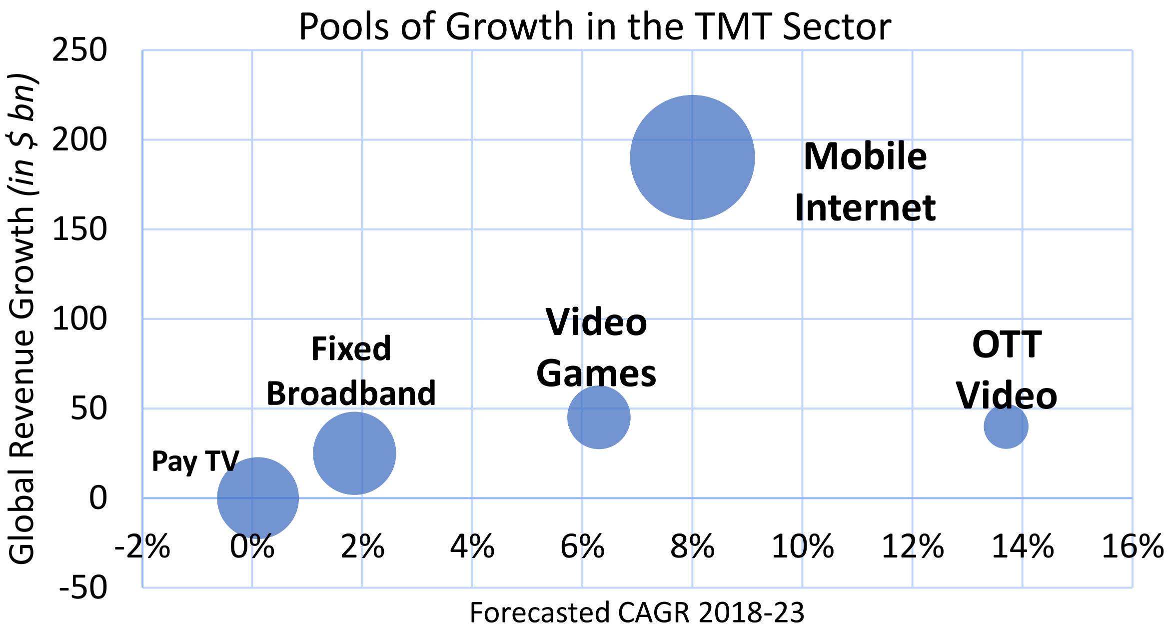
ROKU PLEX

*company list is non-exhaustive

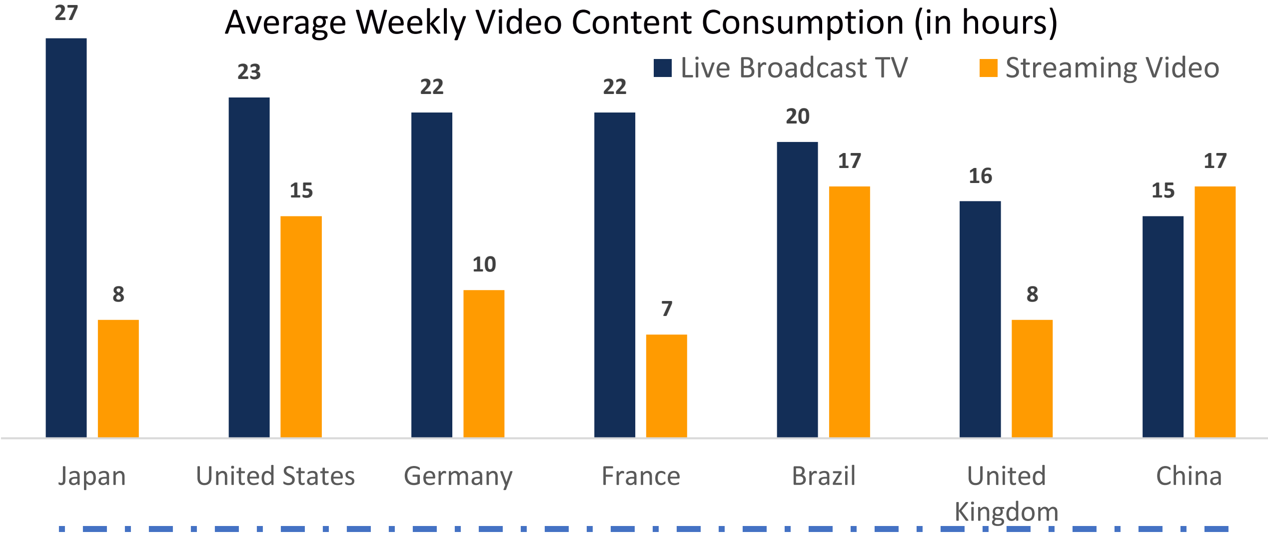
Over-the-Top is Rising to Prominence in the Global E&M Segment

OTT Video is Poised to Attract Higher Investments as it's backed by Data Consumption Growth and Favourable Consumer Patterns…

OTT Video is projected to have the highest CAGR in the TMT Sector…

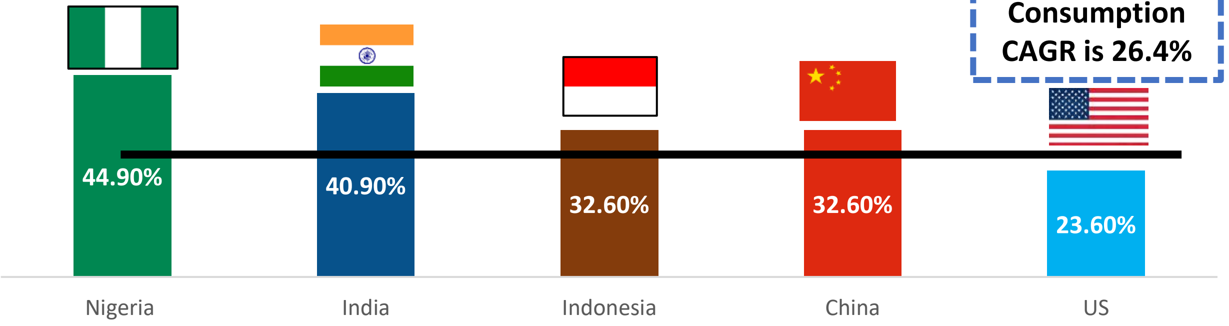


Consumers are Spending more and more Hours Watching Streamed Content…

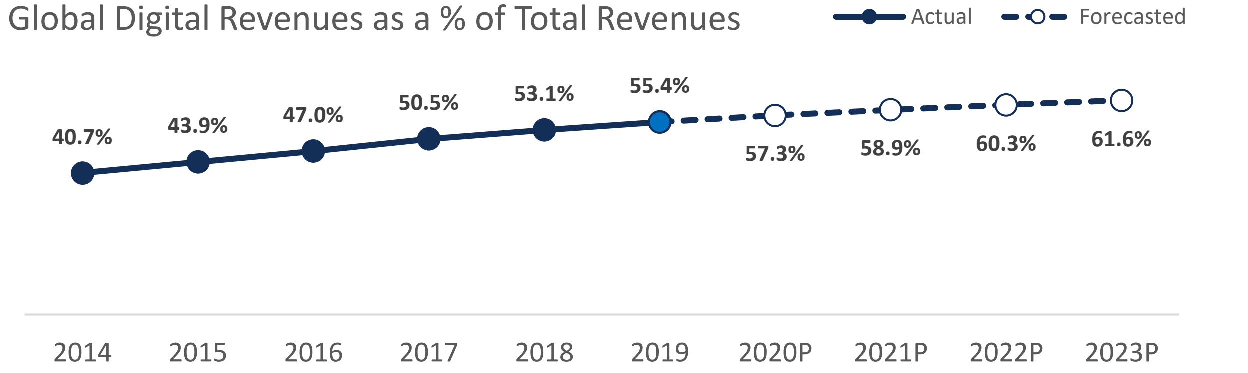


…and Data Consumption is Rising across the Globe (2018-23 CAGR)

Global Data Consumption CAGR is 26.4%



…and with each passing year, Digital Revenues account for a higher percentage of the E&M



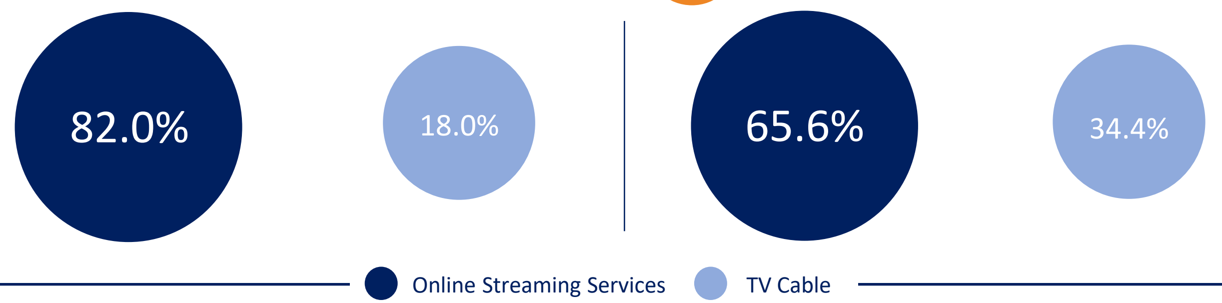
Sources: PwC Global E&M Outlook 2019; Deloitte Digital Trends Survey 2018

SVODs are Changing the Dynamics of the E&M Industry

The USA exemplifies the Changes that the OTTs can bring to the Incumbent Traditional Players…

Majority of American Consumers already prefer Online Streaming over TV Cable…

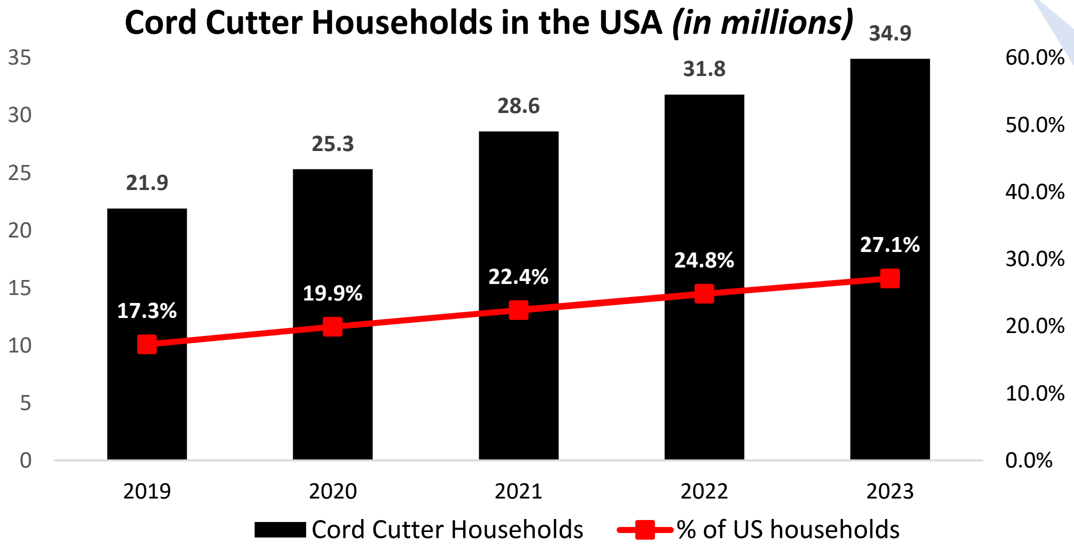
1 Online Streaming Subscribers — **2 TV Cable Subscribers**



1 82% of the US Households surveyed by *Flixed* and *BusinessOfApps* that had both Online Streaming and Cable TV Subscriptions stated that they find Online Streaming content more entertaining than TV Cable content.

2 65.6% of only TV Cable Subscriber Households stated that they would find Online Streaming more entertaining than their TV Cable content.

…and 34.9 million USA Households are expected to "Cut the Cord" to Traditional Cable by 2023 and Switch wholly to OTT Driven Video on Demand Content

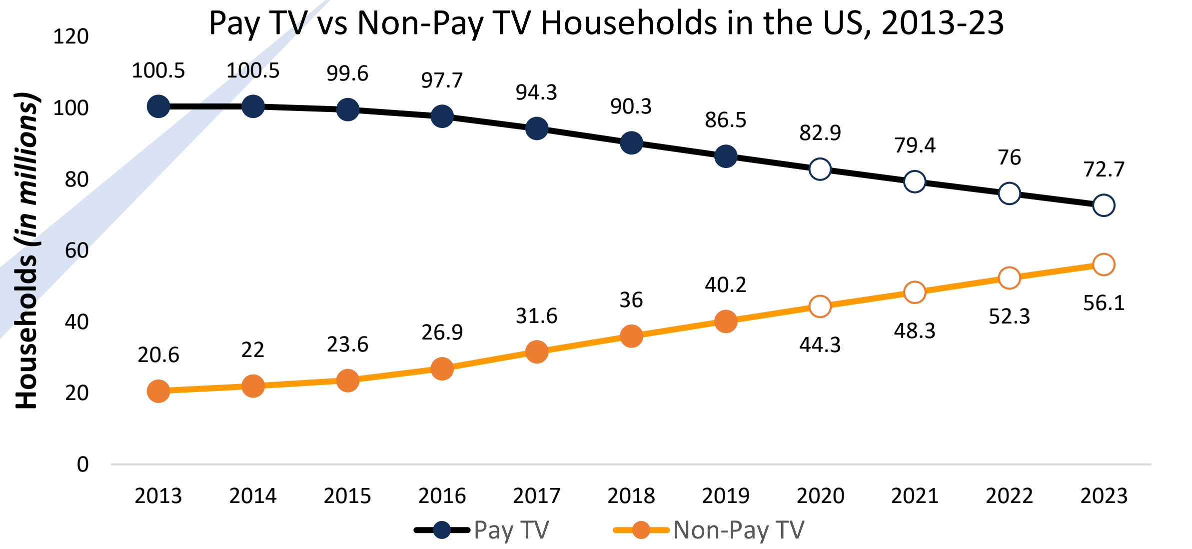


Cord-Cutters: Households that *had* Cable TV but switched wholly to SVODs

Cord-Nevers: Households that never had Cable TV in the first place and have been using SVODs since the beginning.

Sources: Emarketer; BusinessOfApps

Non-Pay TV Households in the US will rise to 56.1 million by 2023, this includes "Cord-Cutters" and "Cord-Nevers", ie new Households that Never had Cable TV



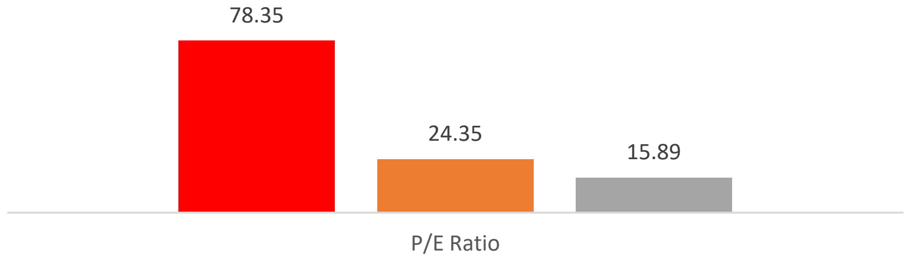
SVODs are Disrupting the Incumbent Media Players

Media and Tech Conglomerates are Launching their own Video OTTs to adapt to the Changing Market and Hop onto the Wealth Creation Bandwagon

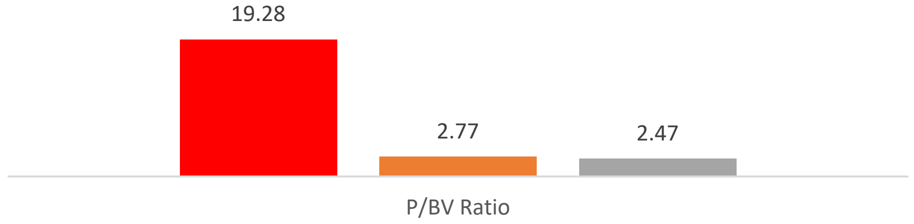
Capital Markets Value SVODs such as Netflix higher than Traditional Media Incumbents such as Disney & Comcast…

■ Netflix ■ Disney ■ Comcast

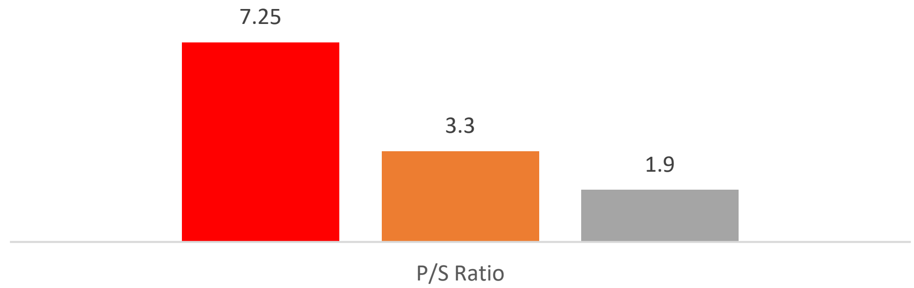
P/E Ratios of Netflix, Disney & Comcast



P/BV Ratios of Netflix, Disney & Comcast



P/S Ratios of Netflix, Disney & Comcast



Netflix was the best performing stock in the S&P 500 for the decade 2010-19 with a whopping return of **4181%** against the index's return of mere 189%, exemplifying that the technology driven SVOD and OTT Industries are highly valued by the Capital Markets.

Seeking Greater Shareholder Wealth, Tech as well as Media Conglomerates have entered the OTT Industry in 2010s or are soon planning to enter…

Conglomerate	OTT Service	Launch Date
Disney	Disney+	12^{th} November 2019 for USA & Canada 12^{th} March 2020 for India 24^{th} March 2020 for UK, Germany, France etc.
WARNER MEDIA	HBO max	May 2020
VIACOMCBS	PLUTO tv	15^{th} April 2020 for Xfinity & Flex Customers; 15^{th} July 2020 for the US
COMCAST NBCUNIVERSAL	peacock	September 2019
amazon	prime video	7^{th} September 2006 for Downloading Purchased Content and 22^{nd} February 2011 for rebranding into an OTT Service
Apple	tv+	1^{st} November 2019

Media Conglomerates   Tech Conglomerates

Content is King – Content is the Valuable Commodity

Media Conglomerates launching their own Video OTTs has lead to Content Wars and Exclusivity

Media Conglomerates pose a Threat to Streamers such as Netflix and Prime Video…

COMCAST

"Netflix will lose one of its most streamed shows, "The Office" to NBC for its new Streaming Service Peacock." – The Verge

peacock

Disney

"Disney will not be renewing its 2016 contract with Netflix that gave the streaming service access to Disney movies including "Pirates of the Caribbean," "The Incredibles 2," "Thor," and several "Star Wars" films." – USC Annenberg Media

Disney+

AT&T

"FRIENDS won't be available on Netflix starting 2020 as it will be available on WarnerMedia (AT&T)'s streaming service HBO MAX from May 2020" – CNBC

HBO max

Note: Map of Disney is not Exhaustive and only covers major Content Assets that may be jointly or wholly owned.

Media Houses have a Large Scale of Operations as they own Gigantic Amounts of Content…

Disney Owns Several Content Assets & Rights

Disney+ has Gained 28.6 million subscribers in its first 90 days and could disrupt Netflix and other Video Streamers if all its Content is put on Disney+

Similarly, Giants such as Comcast and AT&T owned WarnerMedia could also pull off Content for their Streaming Services Peacock and HBO MAX respectively…

Details in Appendix

COMCAST

And much more…

AT&T

WARNERMEDIA

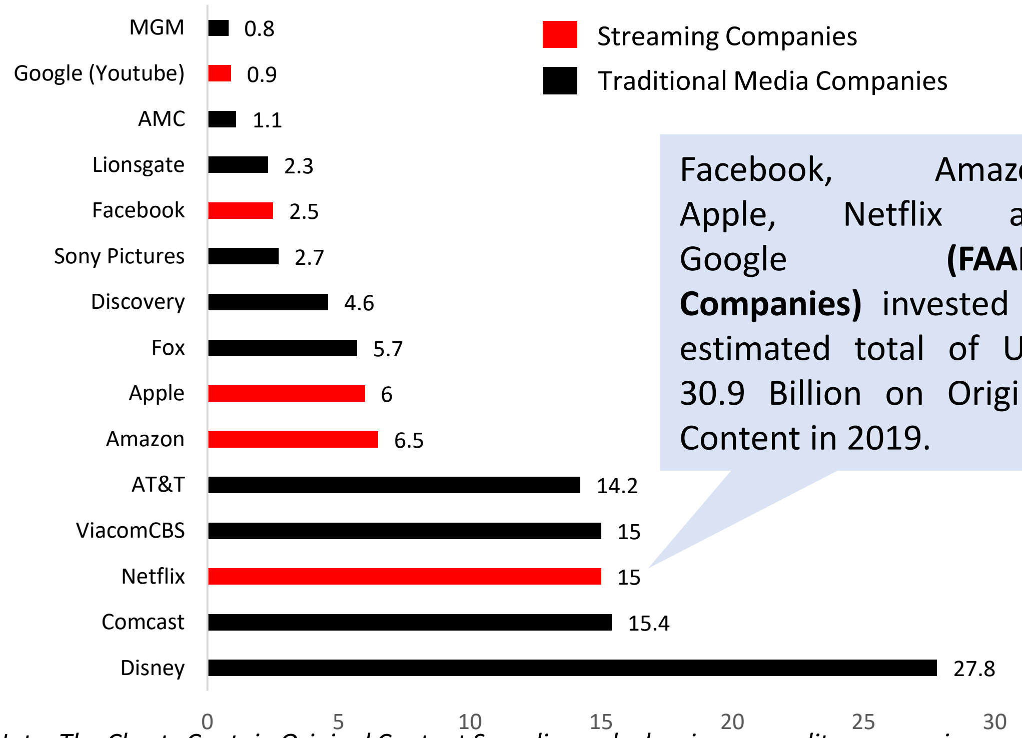
And much more…

Streaming Companies are turning into Content Producers

Media Conglomerates launching their own Video OTTs have Compelled the Streamers to Invest in Content

Streaming Companies are now Investing Heavily into Original Content…

Original Content Spending in 2019 *(in USD billion)*



Facebook, Amazon, Apple, Netflix and Google **(FAANG Companies)** invested an estimated total of USD 30.9 Billion on Original Content in 2019.

Note: The Charts Contain Original Content Spending only; leasing expenditures remain separate

Source: Variety Business Intelligence; Own Analysis

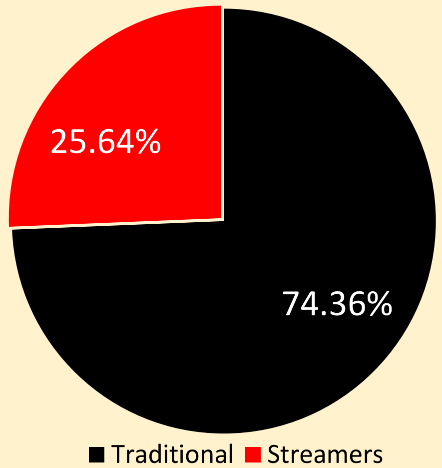
While Disney remains the largest content spender by a huge margin, FAANG Companies have increased their spending as well. Netflix and Amazon are the two largest Streamers among FAANG.

…and are Quickly Becoming a Major Player in the E&M Industry

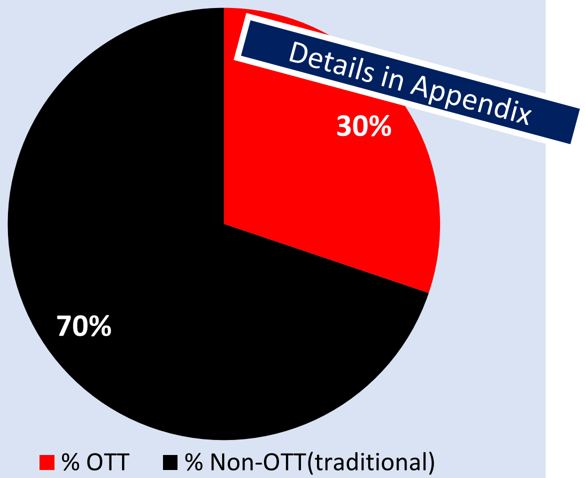
Share in Original Content Expenditure

To put things into Perspective, more than one fourth of all Content Production Investment in 2019 came from Tech Streaming companies.

Percentage of Original Content Expenditure by Streamers



Emmy Nominations - OTT vs Traditional



Share in Emmy Nominations

In 2019, Tech Streaming Companies got 30% of the Emmy Nominations, indicating that they are becoming a major player in the Quality Content Production Market.

The FAANG Spending in Original Content is Driven by Netflix and Amazon which have been producing originals since 2014 to reduce dependence on Traditional Media Companies due to their anticipation of Content Wars by the latter.

III. Company Overview

Amazon is Pivoting into an "Everything" Company

Through Continual Expansion as well as Vertical Integration, the Company wants to Leverage its Scale and Achieve Omnipresence

Delivery Services

amazon hub
amazon restaurants
Fulfilment Systems
key
KIVA Systems
FLEX

Books and Reading

kindle
goodreads.com
Book Rating
AbeBooks
audible
Audio Books
amazon publishing

Entertainment

prime video
amazon game studios
amazon studios
IMDb
Movie Rating
twitch
Game Streaming
music

Cloud Computing

Amazon Gov. Cloud
amazon web services
amazon drive
safaba
VR, AR & 3D Apps
mechanical turk

Payments

amazon payments
Store Card
Prime Rewards

Smart Home

alexa
fire tv stick
ring
fire TABLETS

Shopping

Pill Pack
Pharma
shopbop
souq.com
Arabic Langauge Ecomm
Zappos.com
Fashion
PrimePantry
amazonfresh

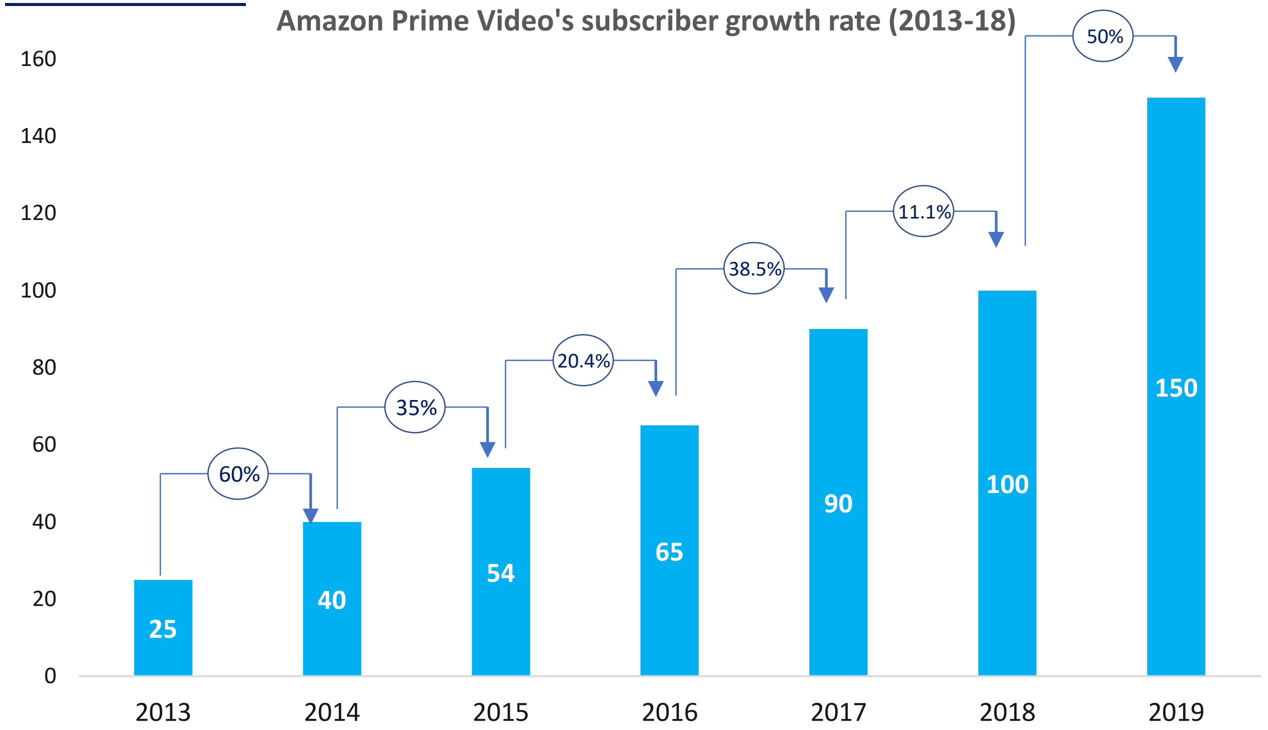
Physical Stores

amazon go
POP-UP
WHOLE FOODS MARKET
amazon 4-star SoHo
books

Amazon's Presence in the Video OTT Market

Prime Video + Twitch = Amazon's Video OTT Presence

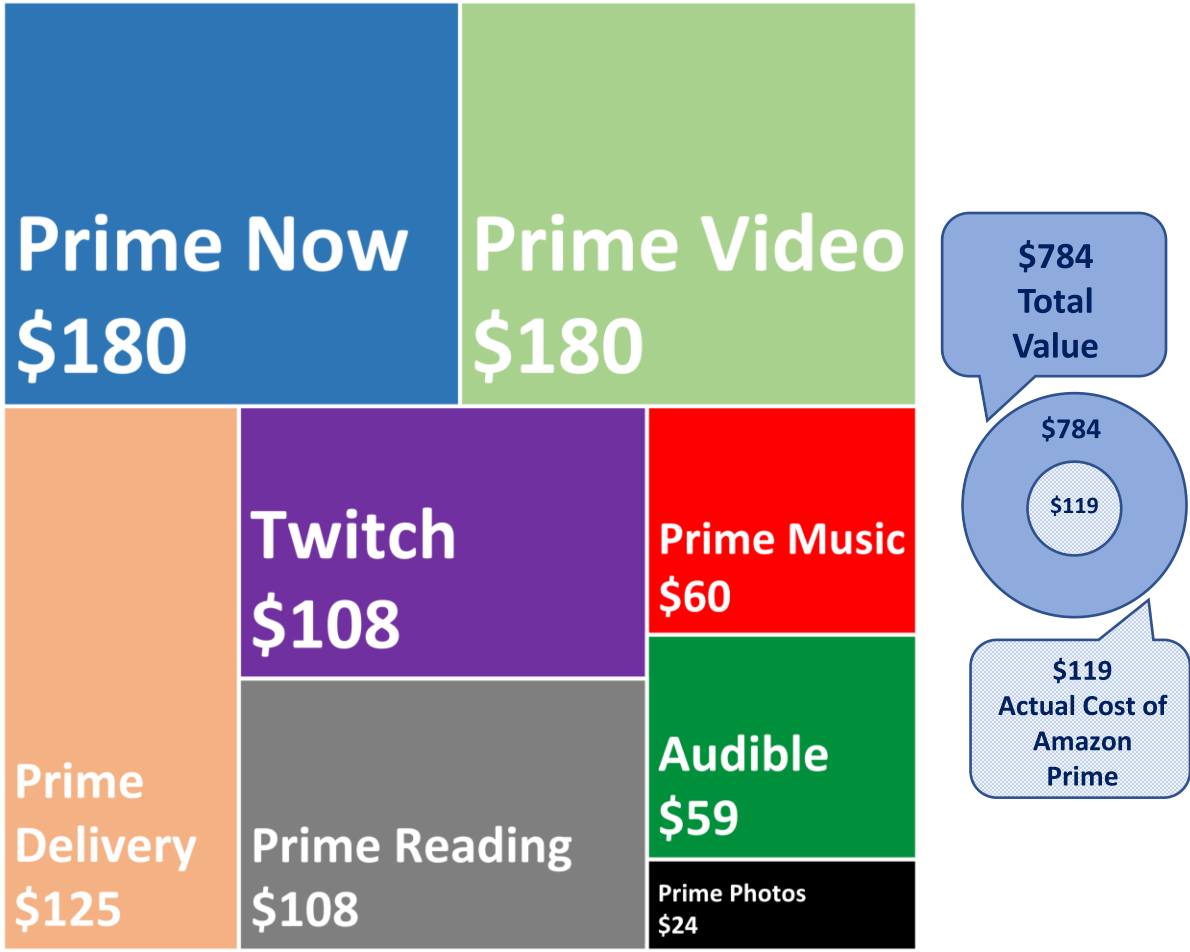
Amazon's Presence in the Video OTT Domain is marked through Prime Video…



In most countries, Prime Video comes bundled with Amazon Prime, a flagship membership programme of the company; Prime Video is also offered separately at relatively reasonable monthly prices in markets such as USA and India

Owing to Bundling, Amazon offers a lot of Value against the Annual Subscription of Prime Membership…

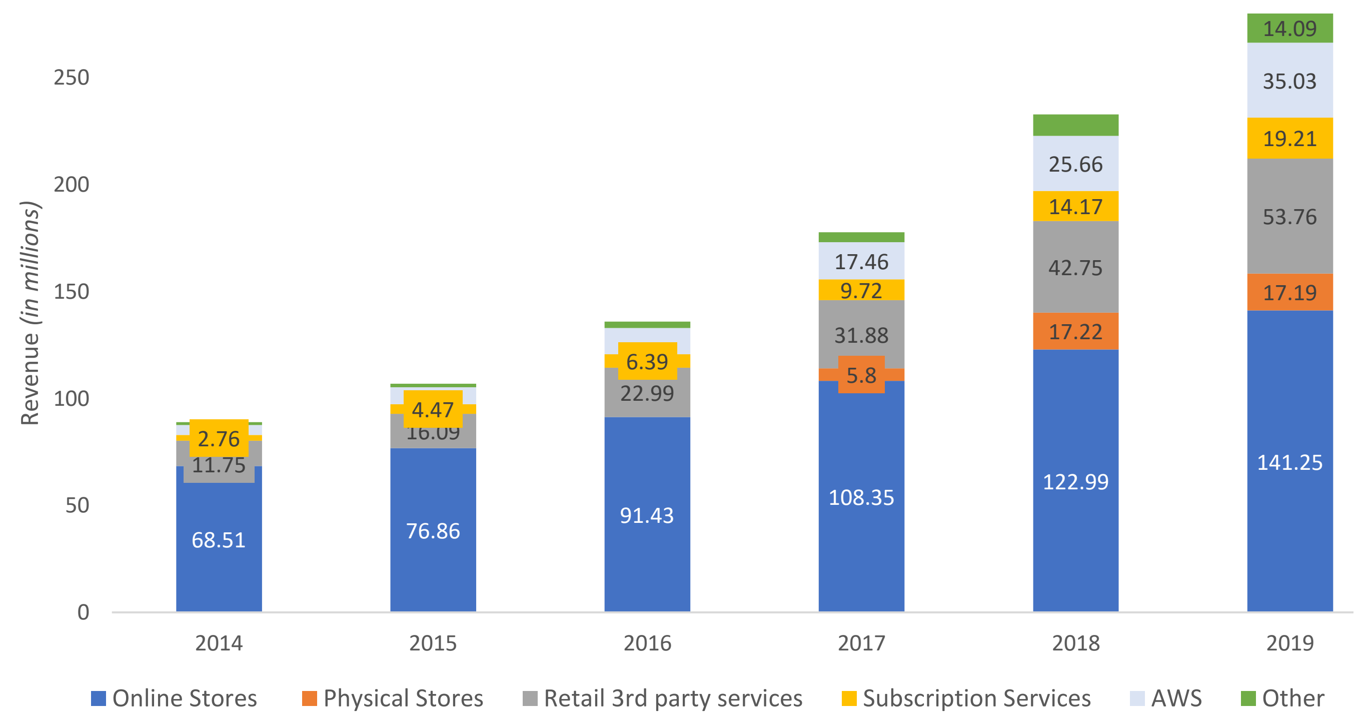
Estimated annual value of Amazon Prime Services.



Executive summary	Industry Analysis	**Company Overview**	Strategic Fit	Financial Analysis	Acquisition Feasibility	Alternative Solution	Conclusion

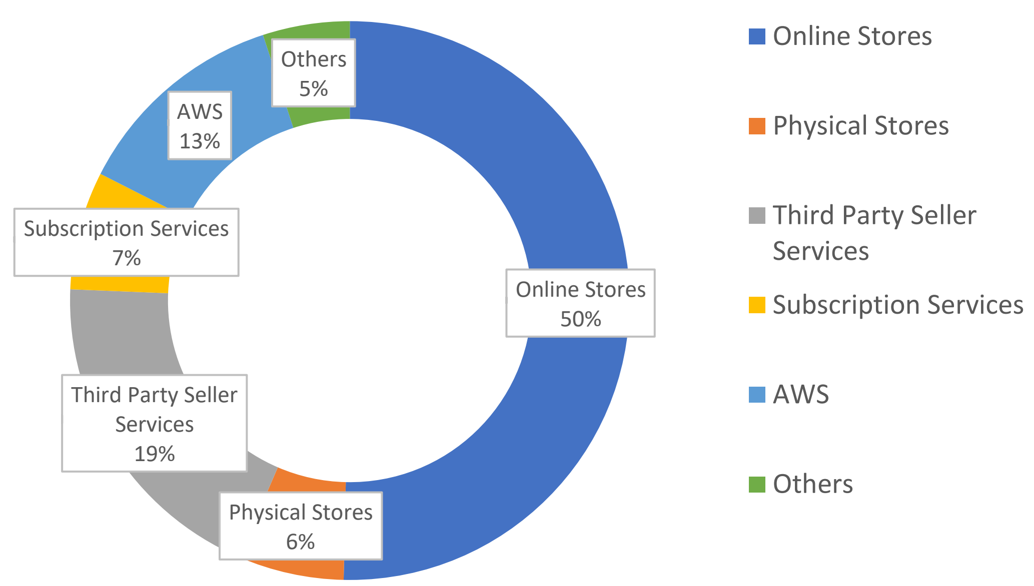
Amazon’s Bundled Subscriptions are a Key Growth Driver

Revenues from Subscription Services, driven by Prime, have risen to USD 19.21 bn in 2019 from USD 2.76 bn in 2014…



Driven by an increase in Prime Subscribers due to expansion of Amazon into mass consumer markets such as India, South Asia and South-East Asia + due to its cost utility, Subscription Revenue has increased consistently since 2014, bringing more customers into the Amazon ecosystem.

In 2019, Subscription Services Constituted 7% of Amazon’s Revenue…

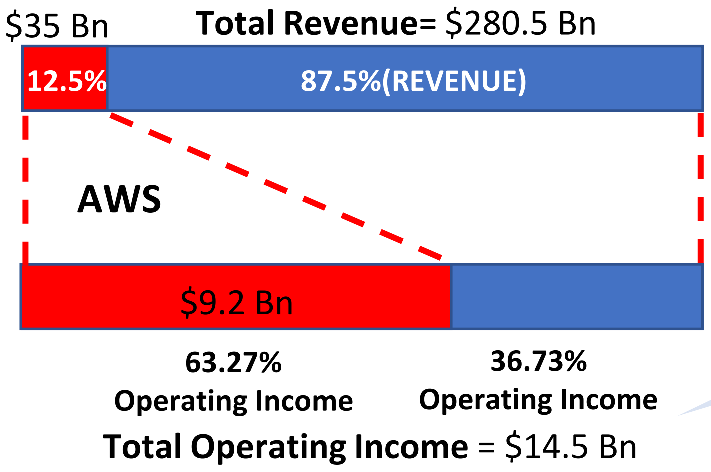


Even though Subscription Services formed only 7% of the Revenue in 2019, they contributing heavily to Online Stores’ revenue as an average Prime Member spends USD 1200 annually as opposed to an average non-Prime Member who spends only USD 500.

Executive summary | **Industry Analysis** | Company Overview | Strategic Fit | Financial Analysis | Acquisition Feasibility | Alternative Solution | Conclusion

Amazon has two Cash Cows in its Business Operations

AWS is Amazon's Cloud Computing Vertical that offers a pay-as-you-use model; it counts some of the world's largest companies, including Video Streamers such as Netflix and Hulu as its clients.



AWS constituted **63.27% of Amazon's Operating Income** despite being only **12.5% of its revenue in 2019**

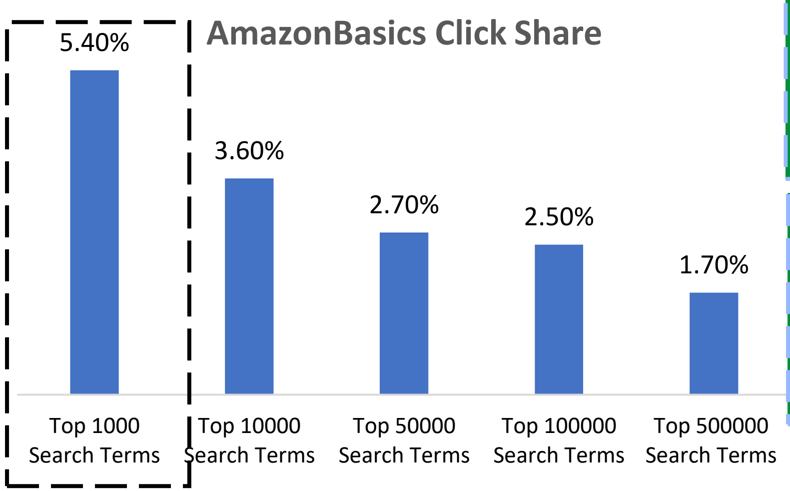
Private Labels

Private Labels are brands that are owned by Amazon and are exclusive to Amazon's ecommerce platform

Future Cash Cow

Over the years, Amazon has launched its own Private Labels encompassing categories such as soft electronics, bags, fashion & apparel, shoes, toys, diapers, cosmetics, consumer goods etc. with the most common of them being Amazon Basics, private labels now contribute ~2% of Amazon's Revenue.

Private Labels may Benefit from Skewed Search Results since Amazon owns the Ecommerce Platform too …



As Alexa's household penetration rises, the smart-assistant may direct consumers to Amazon's Products first, thus creating a huge operational moat.

Through its Ecommerce platform, Amazon has collected years of data on what price/product combinations work best for which consumer, hence providing a technological moat.

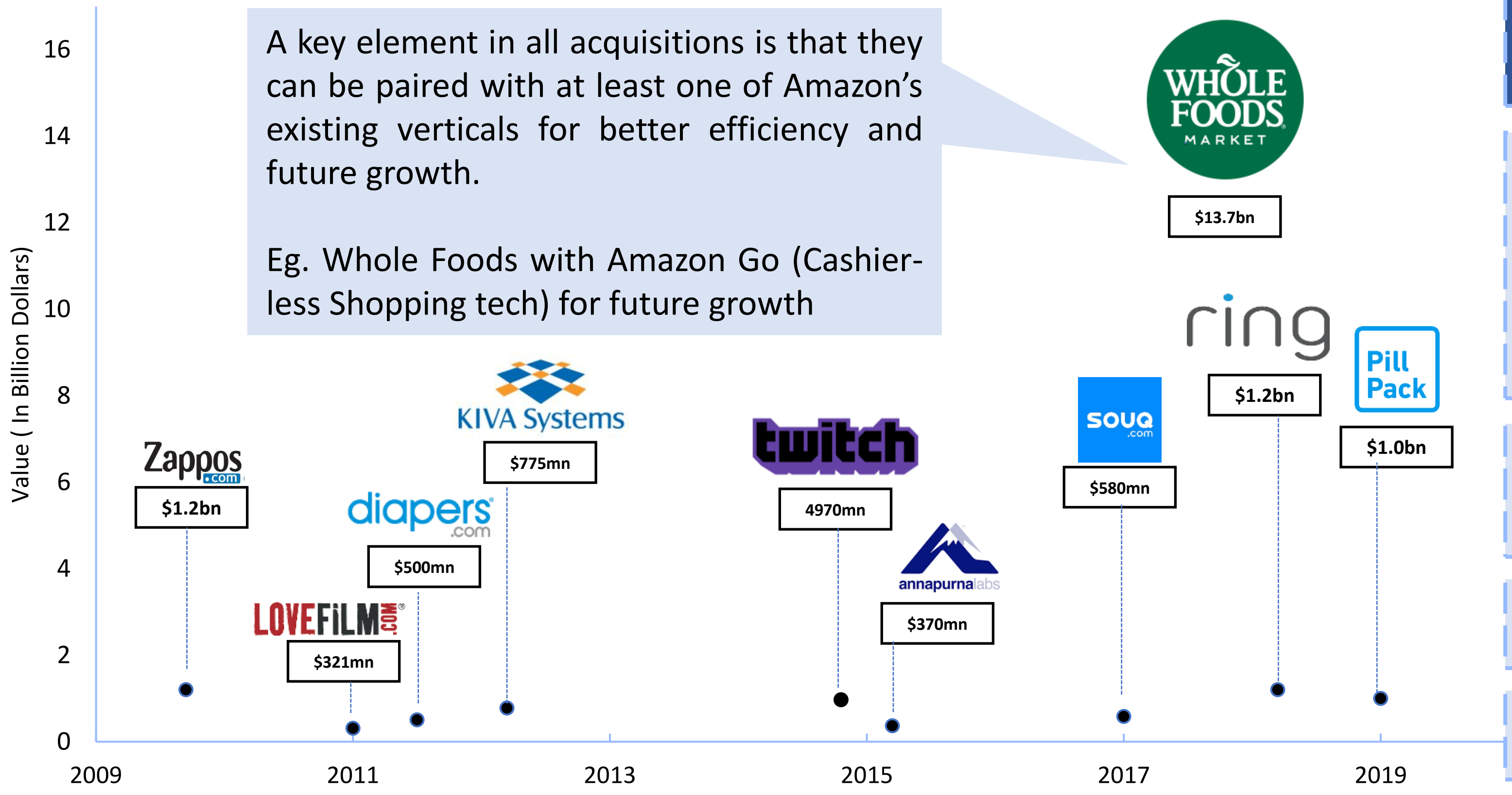
Amazon has its own Methodology of Acquisitions

Similar to other Tech Conglomerates, Amazon too has Indulged in Multiple Acquisitions…

Amazon's Major Acquisitions

A key element in all acquisitions is that they can be paired with at least one of Amazon's existing verticals for better efficiency and future growth.

Eg. Whole Foods with Amazon Go (Cashier-less Shopping tech) for future growth



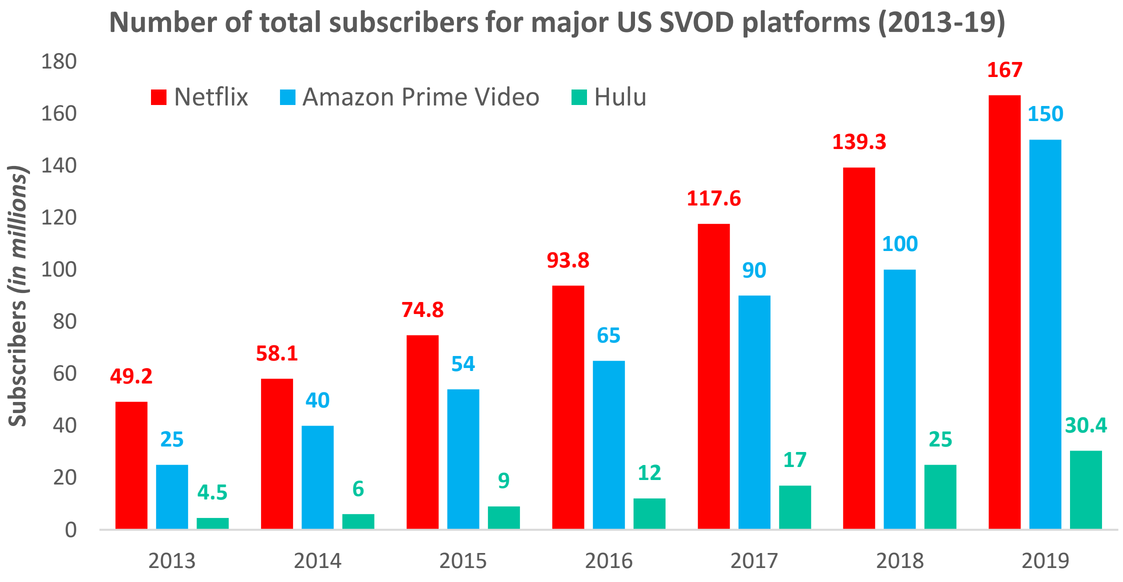
Amazon has generally not participated in horizontal acquisitions ie acquisitions that inorganically increase the market share of the acquirer in a particular market.

Amazon has history indulged in two types of acquisitions

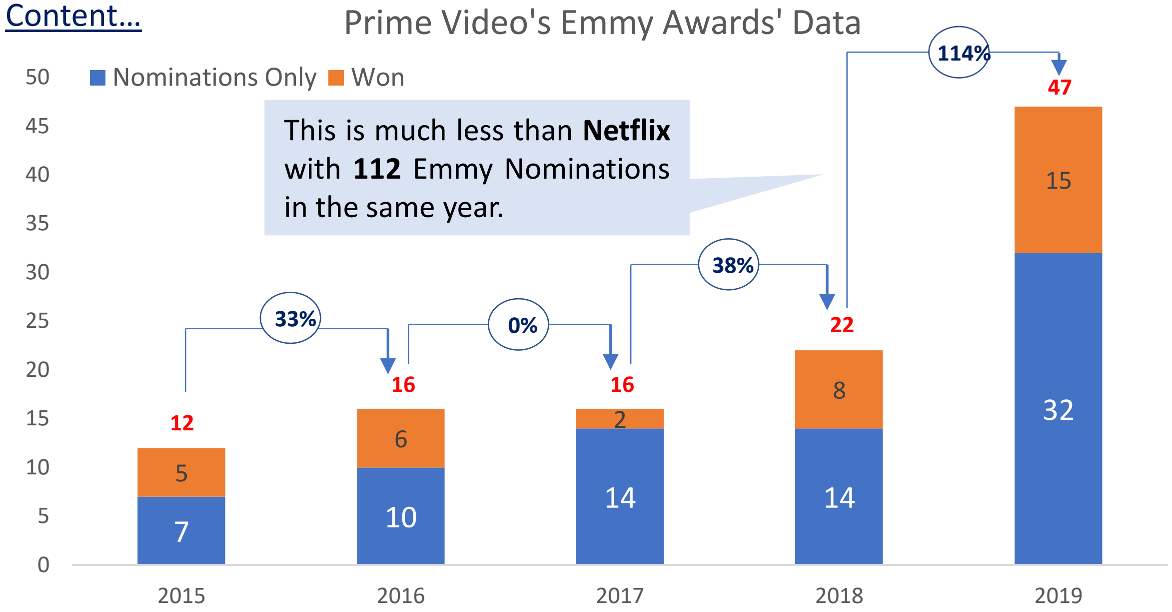
Vertical Integrations & Operational Efficiencies	New Market Entries & Expansions
Acquiring a company to increase the operational efficiency of any one of its existing subsidiaries or core processes and/or to integrate more portions of the value chain	Entering a new market from the scratch in order to expand its presence across business verticals
Eg: Ring; aids efficient deliveries & Alexa's Smart Home Presence	Eg: Whole Foods; aided Amazon's expansion into the Brick & Mortar Food Retail
Eg: Kiva Systems; aids efficient warehouse management	Eg: Twitch; aided Amazon's expansion into Game Streaming
Eg: Lovefilm.com; aids Prime Video through movie ratings	Eg: Annapurna Labs; aids Amazon's AWS through microelectronics and semiconductor manufacturing
Eg: Zappos, Diapers, Souq, Pill Pack; aids Ecomm Operations	

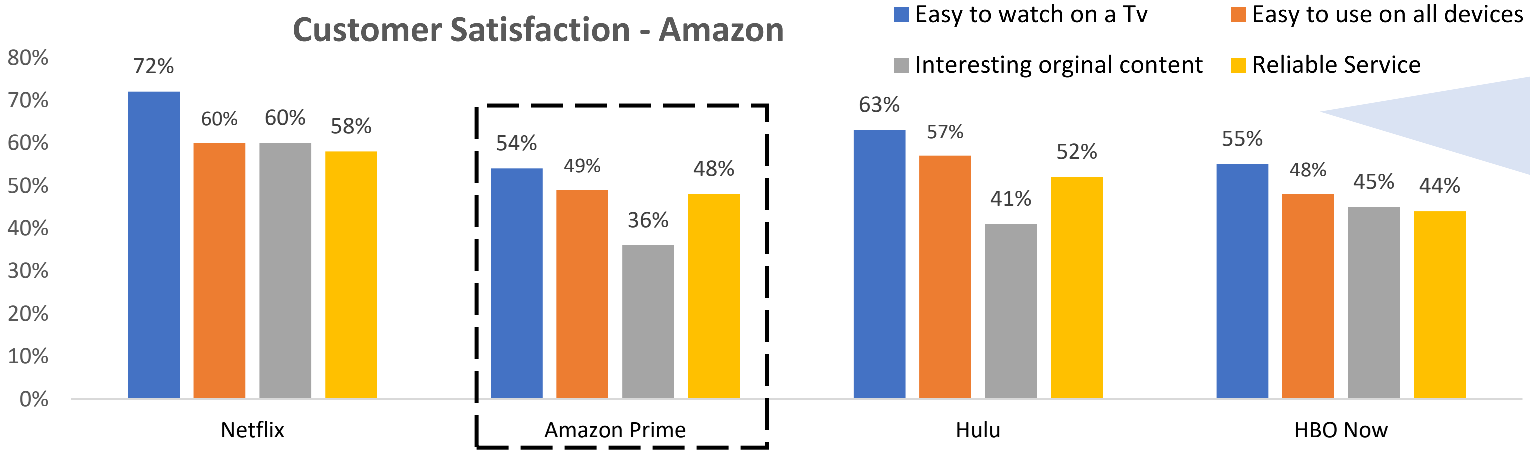
Thus far, Prime Video is second to Netflix

Prime Video still lies behind Netflix in its worldwide Subscriber Base...



Amazon received 47 Emmy Nominations in 2019 due to high Investment in Original Content...





Out of the four major US SVOD Players, Amazon's Prime Video has the lowest Customer Satisfaction rating for Interesting Original Content at a mere 36%

While Amazon has uniquely positioned itself in the Ecommerce, Smart-Home, Logistics, Cloud Computing and other markets, its Video Streaming presence is reliant on Prime Subscriptions for driving growth due to a lack of attractive content collection.

III. Company Overview

Netflix has one of the Largest Footprints on the Digital Ecosystem

How Big is Netflix?

As of 31st December 2019, Netflix commands a whopping 167 million paying members globally with an additional 4 million potential members on free trials; however, **this number is not enough to quantify the sheer size of the streaming behemoth**.

Netflix's huge size can be exemplified using the following figures from Netflix's USA Operations…

54% of US Adults use Netflix.

28% Of Americans have watched Netflix in last one week.

79% of US millennials use Netflix.

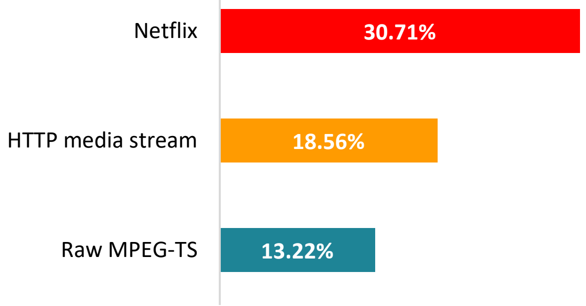
83.2 Million Impressions were received by Stranger Things Season 3 in the USA, the highest amongst all Netflix Originals.

80 Million views were gained by Bird Box, a critically acclaimed Netflix movie in just one month.

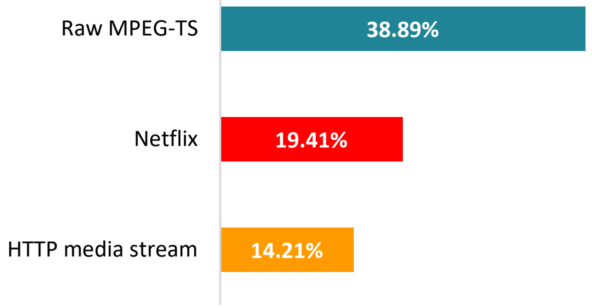
10 Billion hours of Netflix is streamed every month.

Netflix Constitutes a chunk of Downstream & Upstream Traffic Globally…

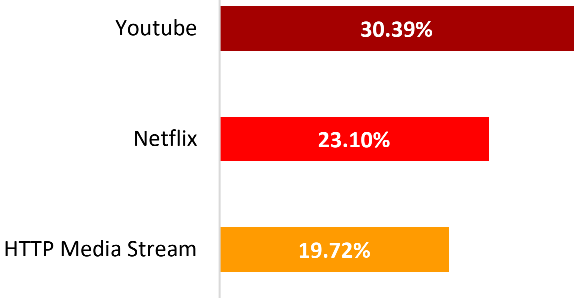
America - Downstream %



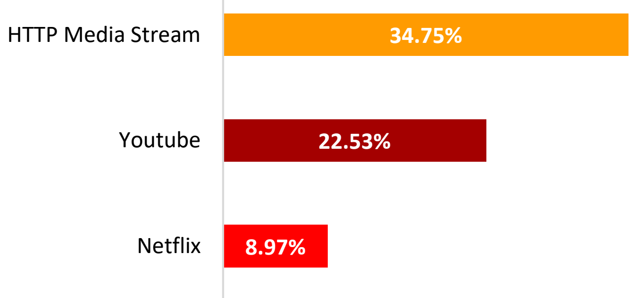
America - Upstream %



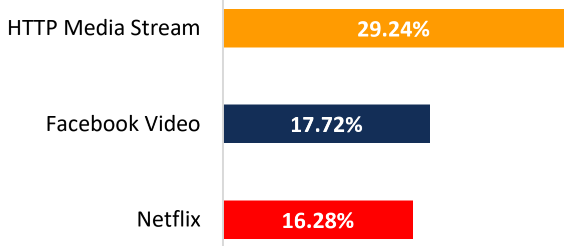
EMEA - Downstream %



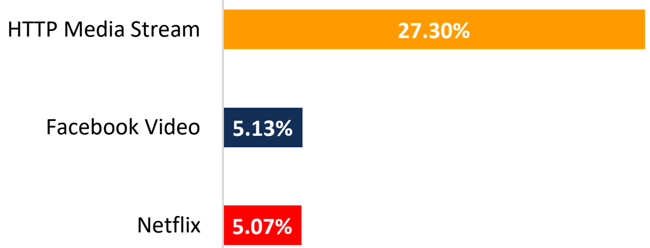
EMEA - Upstream %



APAC - Downstream %

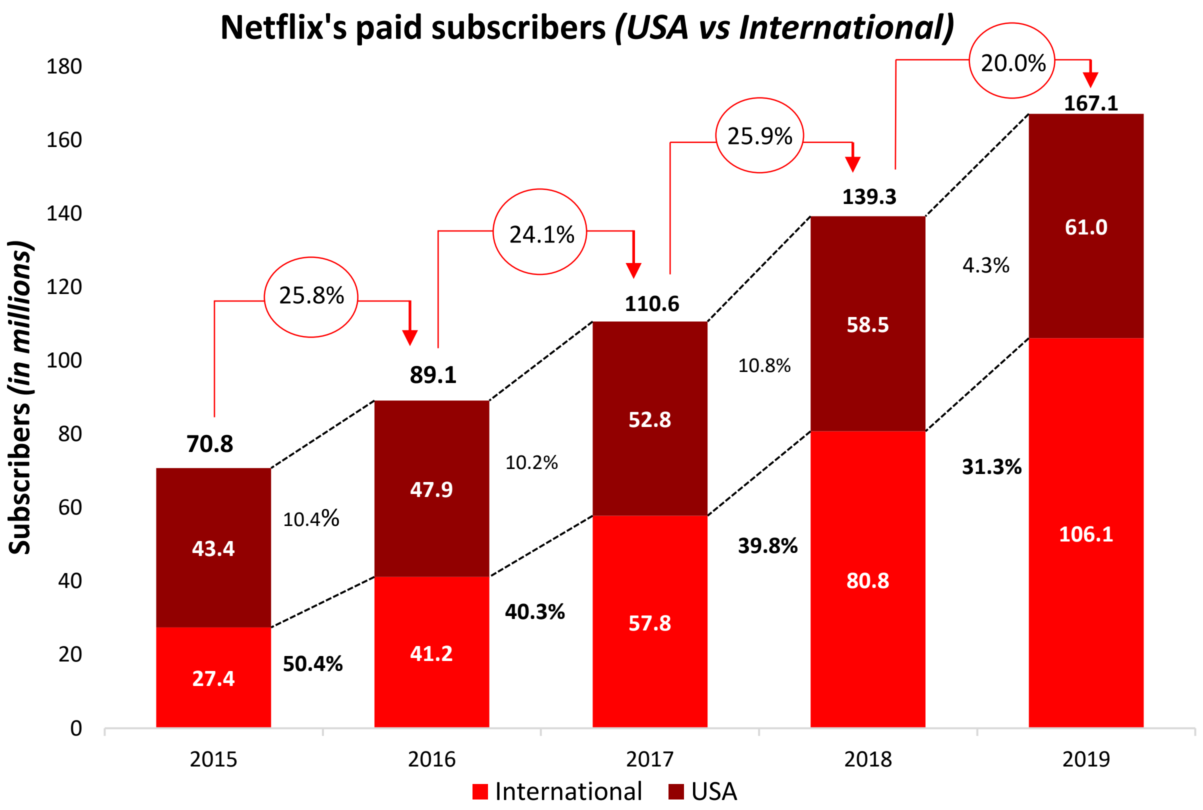


APAC - Upstream %



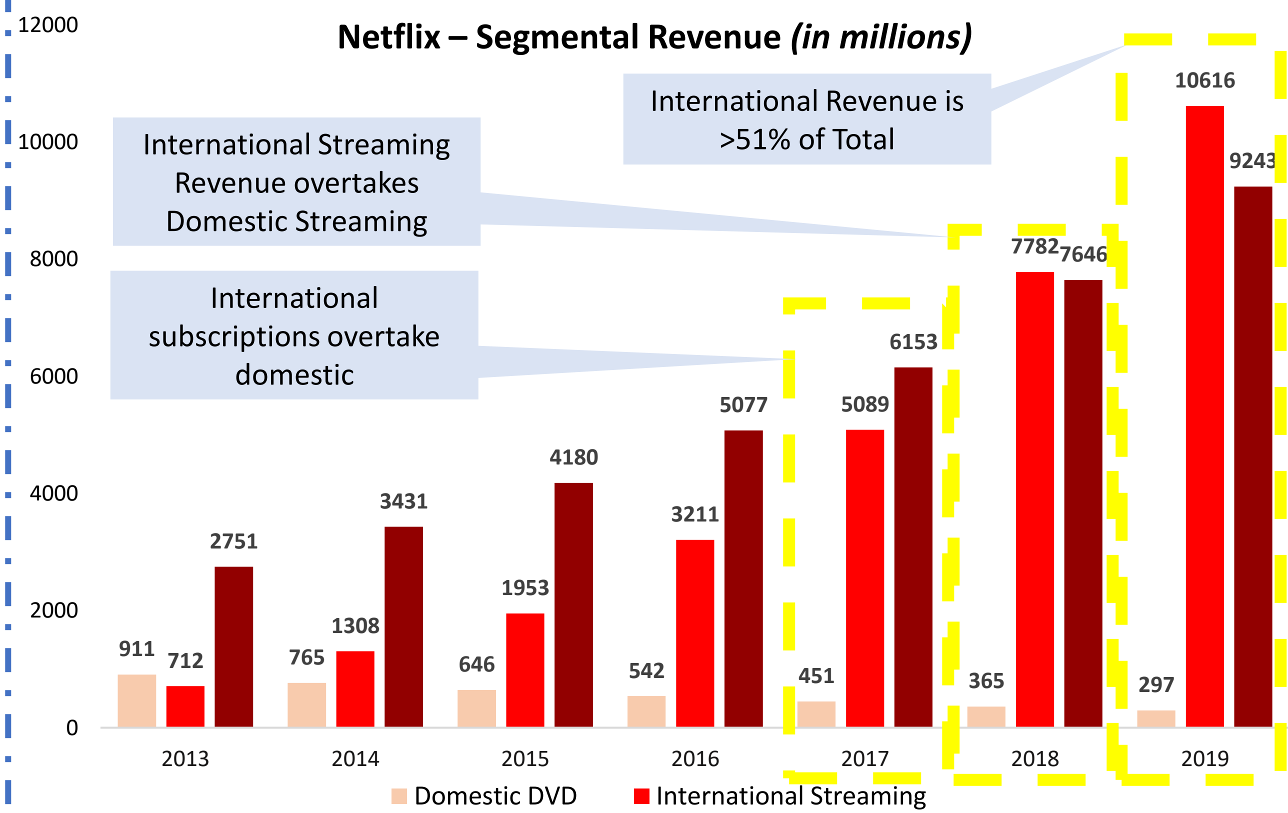
Netflix: Geographical Presence

Despite a Slowdown in Netflix's Domestic Growth, 61 million paid subscribers of the Company still come from the US…



Netflix's International push in 2014 and the subsequent expansion to 130 countries has reaped dividends in the form of the company's Paid Subscriber Growth being driven by the International Markets.

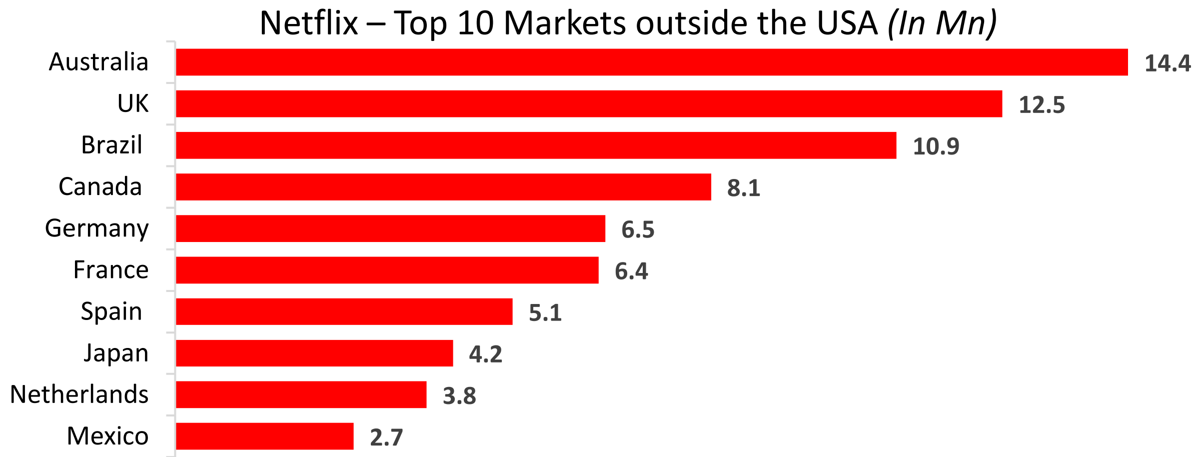
2019 was the first year when the Company's International Revenue exceeded that of the Domestic Market…



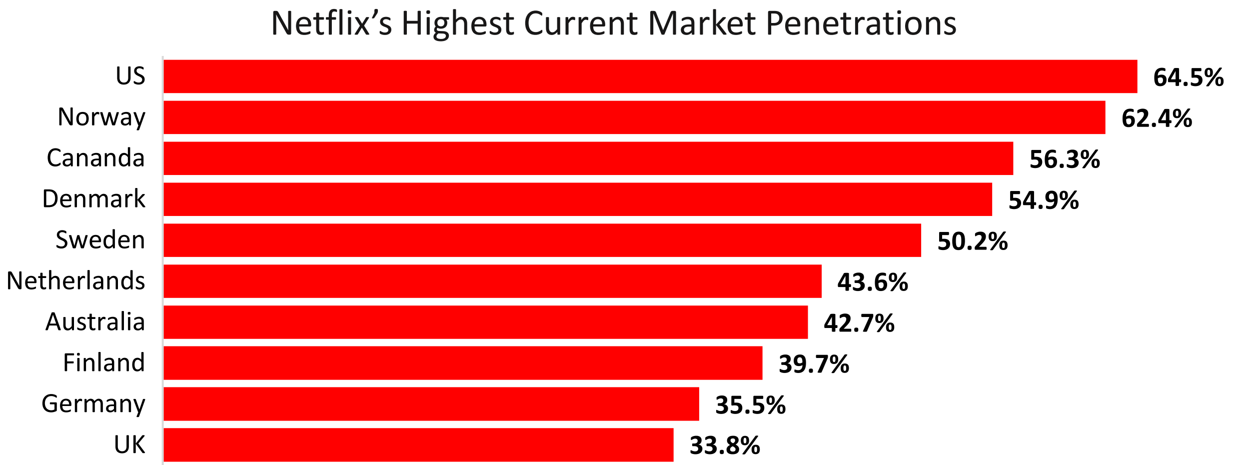
Despite Netflix's International Subscribers exceeding the Domestic in 2017, it was only in 2018 that the International Revenue exceeded that of the Domestic Streaming, a causation of lower ARPUs in Domestic Markets due to penetrative marketing and lower USD price points.

Netflix has been Rapidly Expanding to International Markets

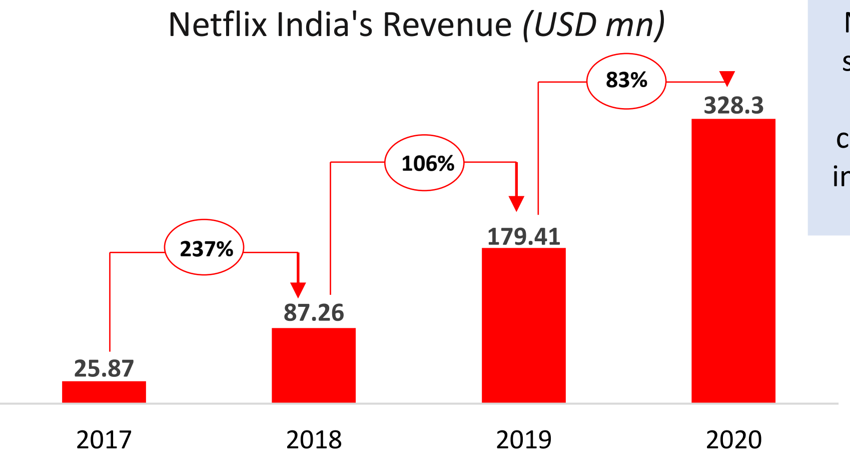
Netflix has gained millions of subscribers across all Continents …



Netflix has penetrated strongly into various Developed Markets…

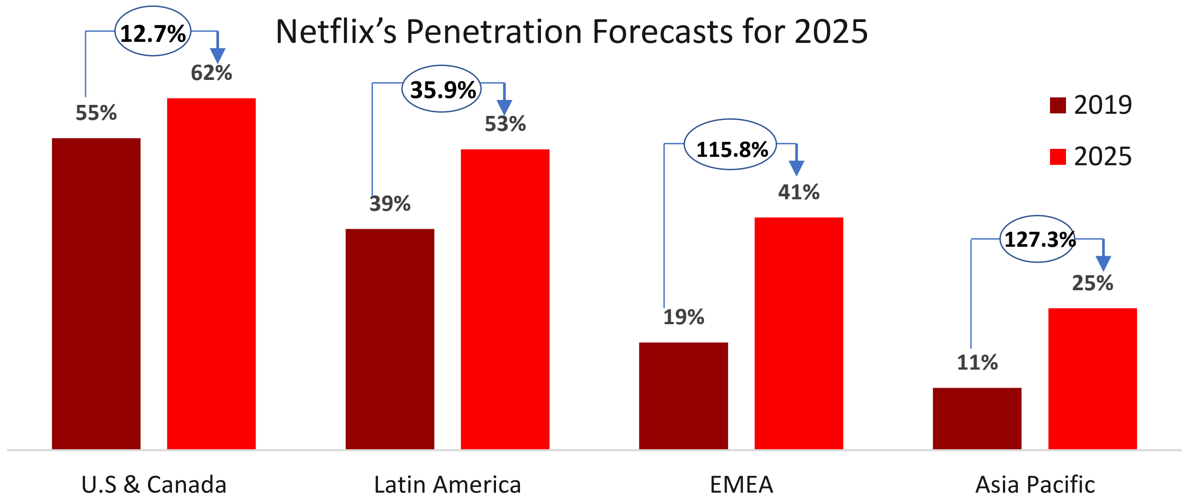


…and has a Specialised INR 200/- (USD 2.7) per Month **Smartphone only Plan** for its Mass Indian Market Penetration Strategy



Netflix CEO Reed Hastings has said that the company aims to have 100 million paying customers in India and plans to invest USD 400 million in Indian Content in 2020.

…and is Expected to more than Double its Penetration in the EMEA & APAC Markets by 2025



Technology forms a Major Part of Netflix's Value Chain

CONTENT
TV Shows,
Movies, Original Content

DreamWorks Studios
Comcast
Discovery Channel
Walt Disney

1 NETFLIX STACK

NETFLIX

amazon web services

Storage on S3

Transcoding on EC2

2 DISTRIBUTION

Adaptive Streaming

NETFLIX Open Connect

Global CDN Partners

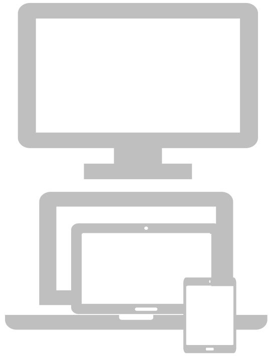
Limelight Networks

Akamai

Level(3) Communications

PLAYBACK

200+ devices
Roku, AppleTV, SmartTVs, iOS devices, Android, Game Consoles, PCs etc.



Analysis in the Next Slide

Tech Backbone of Netflix

1 AWS Tech Stack

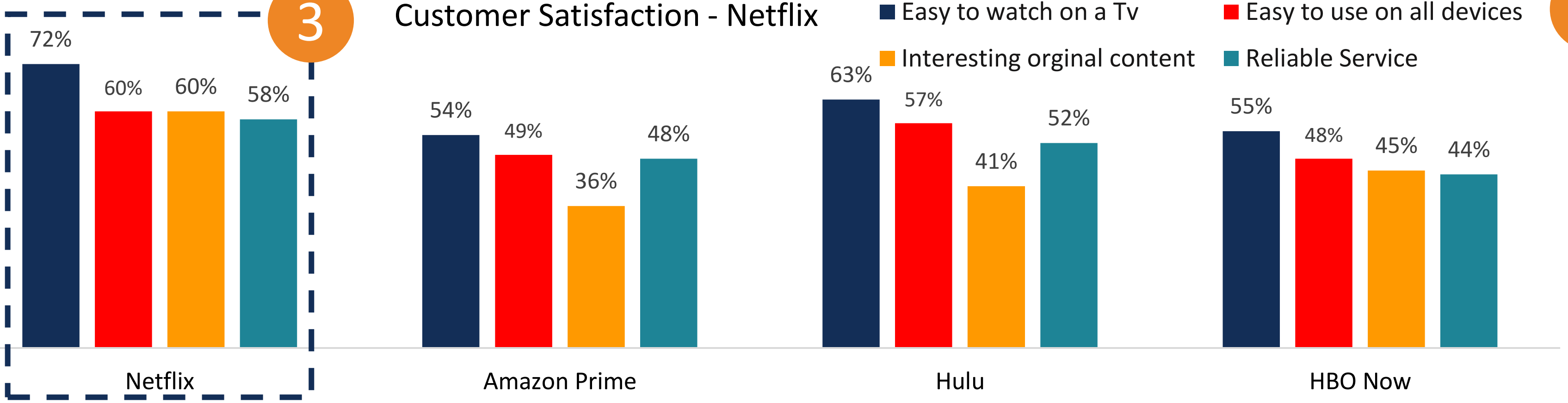
Netflix uses AWS for back-end processes such as Storage, Computational Power, Payment Gateways etc.

2 Tech-Driven Customer Satisfaction

Netflix utilizes its own OCAs which are hardware appliances installed at an ISP's site in order to provide Netflix's traffic demand a dedicated channel to flow through such that it does not have to compete with the other bits of traffic demanded by various internet users.

Additionally, CDN partners such as Akamai provide necessary infrastructure to transmit data seamlessly.

3 Customer Satisfaction - Netflix



3 Tech-Driven Customer Satisfaction

Netflix ranks the highest amongst its competitors on the following three tech-driven metrics:

- Easy to watch on a TV – 72%
- Easy to use on all devices – 60%
- Reliable Service – 58%

Netflix's UI enriches the customer experience and has been one of its drivers of success in the SVOD market. Its recommendation and other algorithms are widely popular.

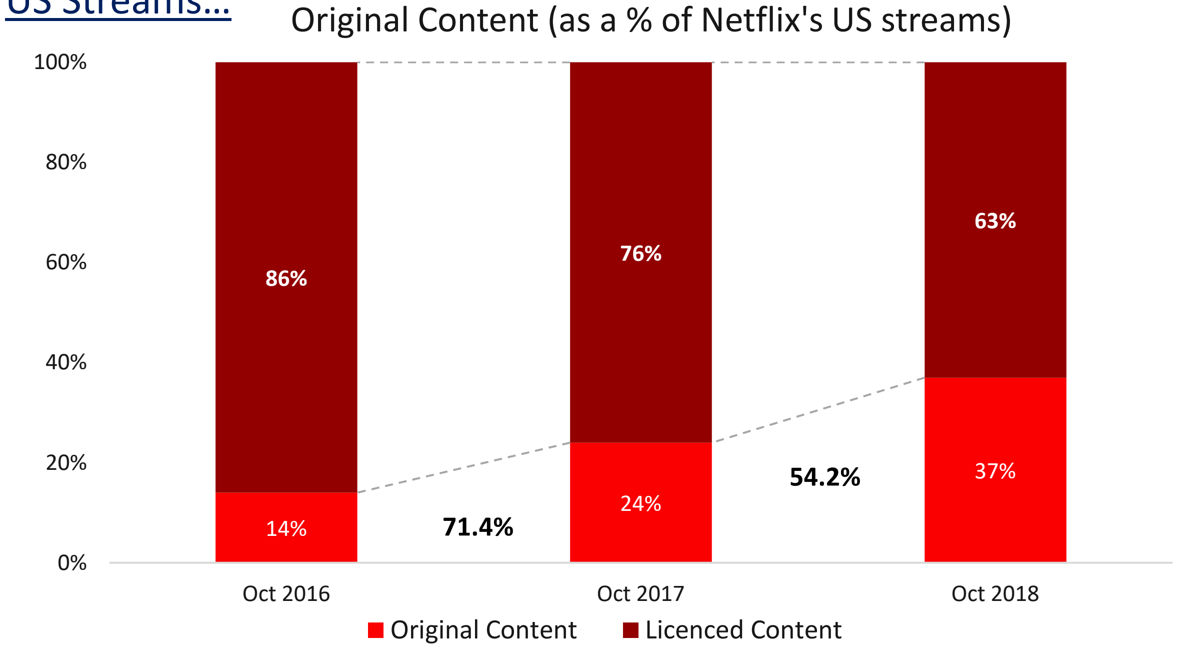
Netflix's Value Chain has a Looming Threat

Launch of Video Streaming Services by the big players in the E&M has put Netflix's business model on threat as the former may not renew their content leasing contracts allotted to Netflix.

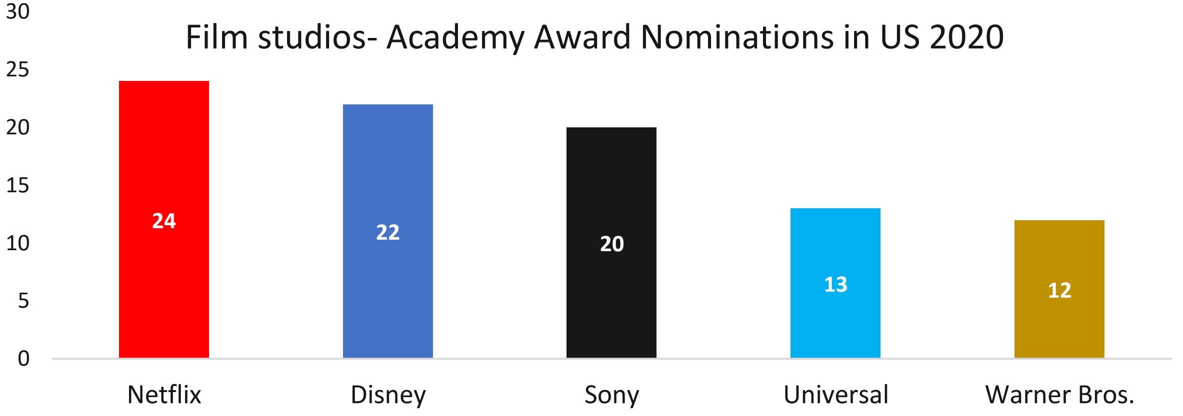
E&M players have began seeing Netflix as a disrupter as it has gained lucrative shareholder values in a relatively short period of time.

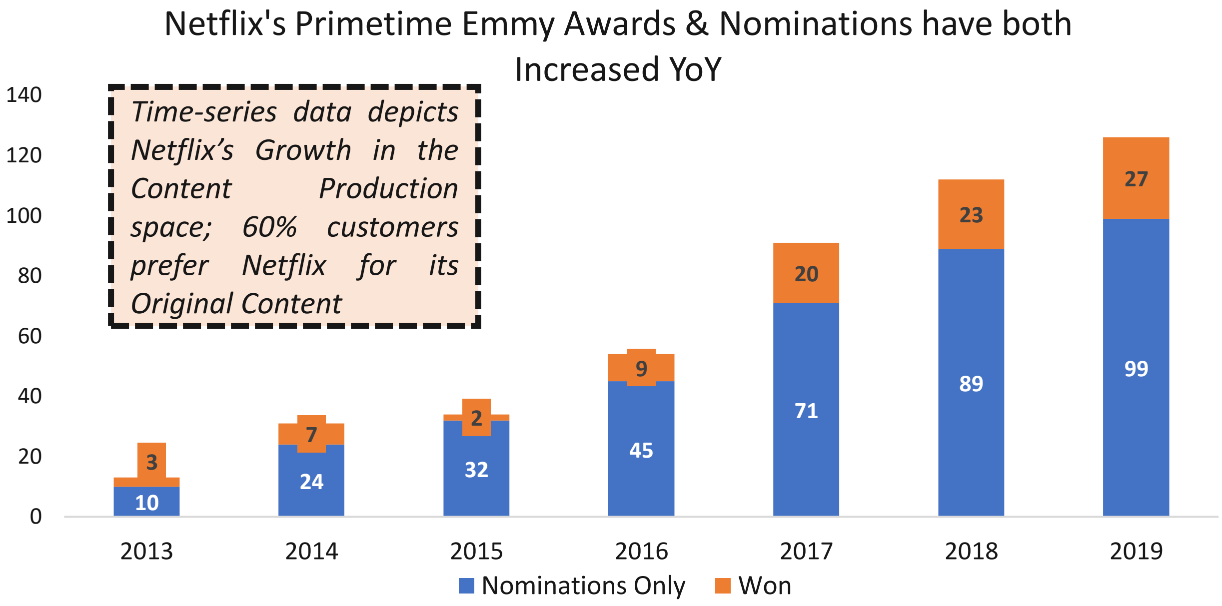
However, by the launch of video streaming services by traditional E&M players, the disruptor (Netflix), is on the cusp of being disrupted.

Original Content now Commands a Higher Percentage of Netflix's US Streams…



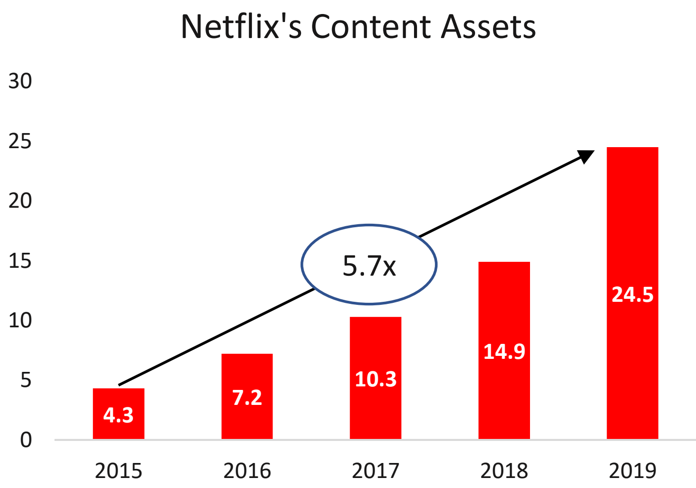
…and Netflix's Originals are Giving the traditional E&M Giants a run for their money

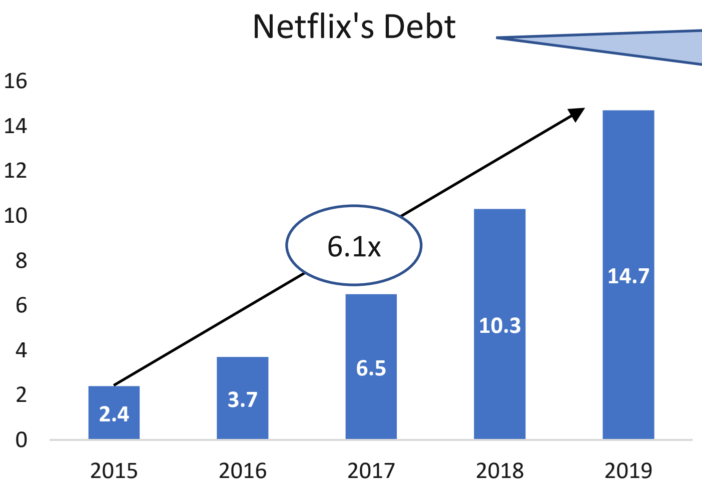




Netflix's Financials are Struggling as it plans to Scale

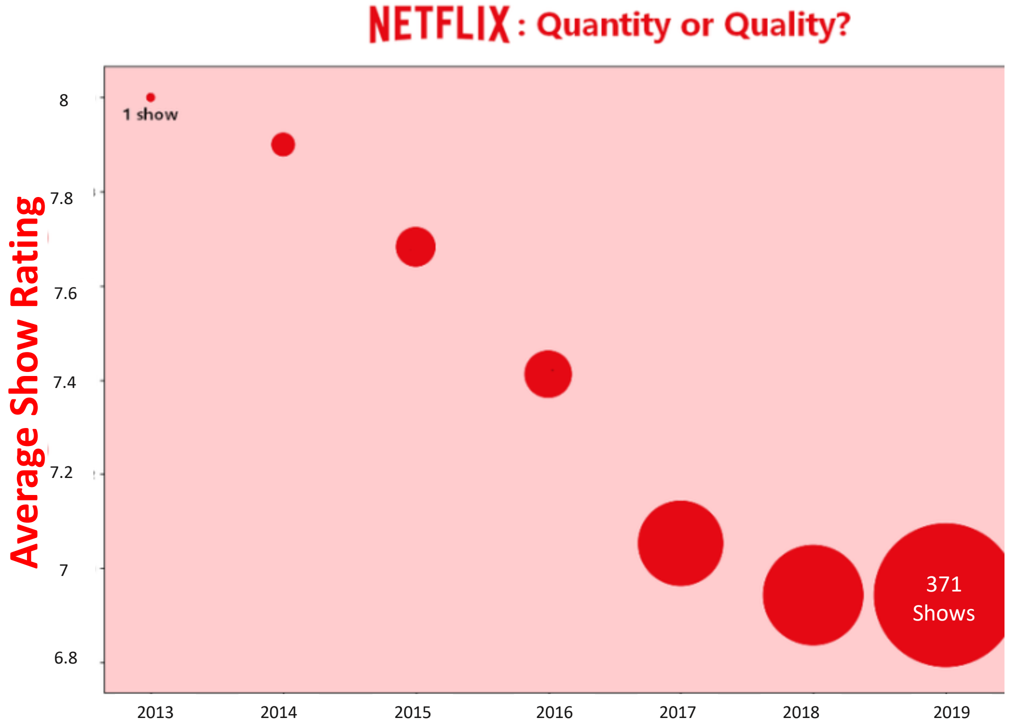
Netflix's Debt has Increased in a correlation of 0.98 to Netflix's Content Assets…



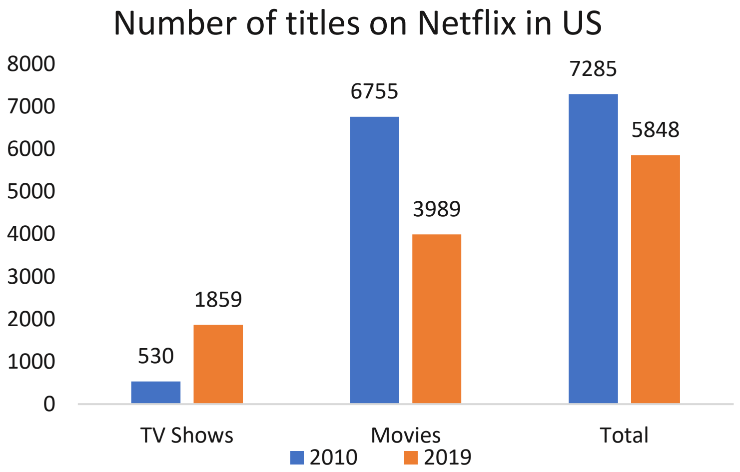


Netflix is projected to spend USD 17.3 bn on Content (Original + Leased) in 2020; most of which comes through debt raises; Netflix's debt to equity ratio has worsened from 1.82 in 2017 to 2.13 in 2019.

From its first original in 2013, Netflix produced a massive 371 shows/documentaries/movies etc. in 2019, however, as it tries to catch a mass audience, its Average Show Rating has declined year on year.



Netflix has been increasing the proportion of TV Shows in its Content Library…



Netflix has over time increased the number of TV shows in its library as it focuses more on more on the customer spending higher amounts of time on the streaming service; Original TV Series also increase customer retention and increase brand loyalty.

IV. Strategic Fit

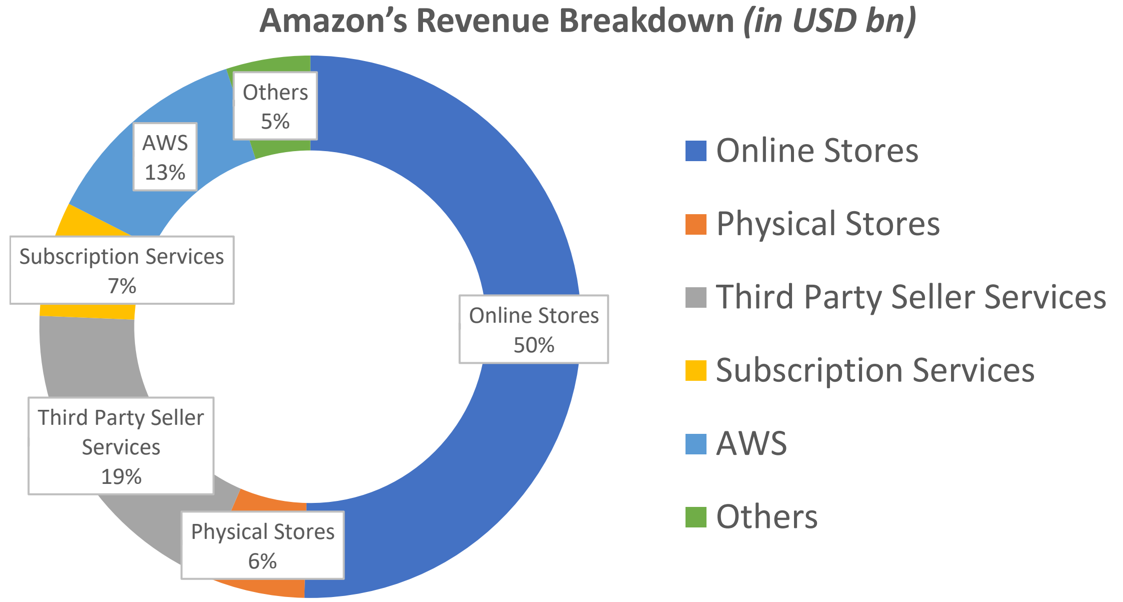
Integrating Netflix and Prime Video post-acquisition

Problems associated with bundling and the aftermath of the same

The Problem with Bundling

- Netflix is a stand alone service, whereas Prime Video is usually sold as part of a bundle
- Pricing the bundled service might be tricky, partly as one is already part of a bundle, and partly because their prices are quite different
- The pricing may also upset the revenue earned from the subscription services which are sold as part of the Amazon Prime Bundle
- Bundling them might dilute the Netflix brand and force users to take on services they don't want

Subscription Services are an important part of Amazon's Revenue…



Source- Statista

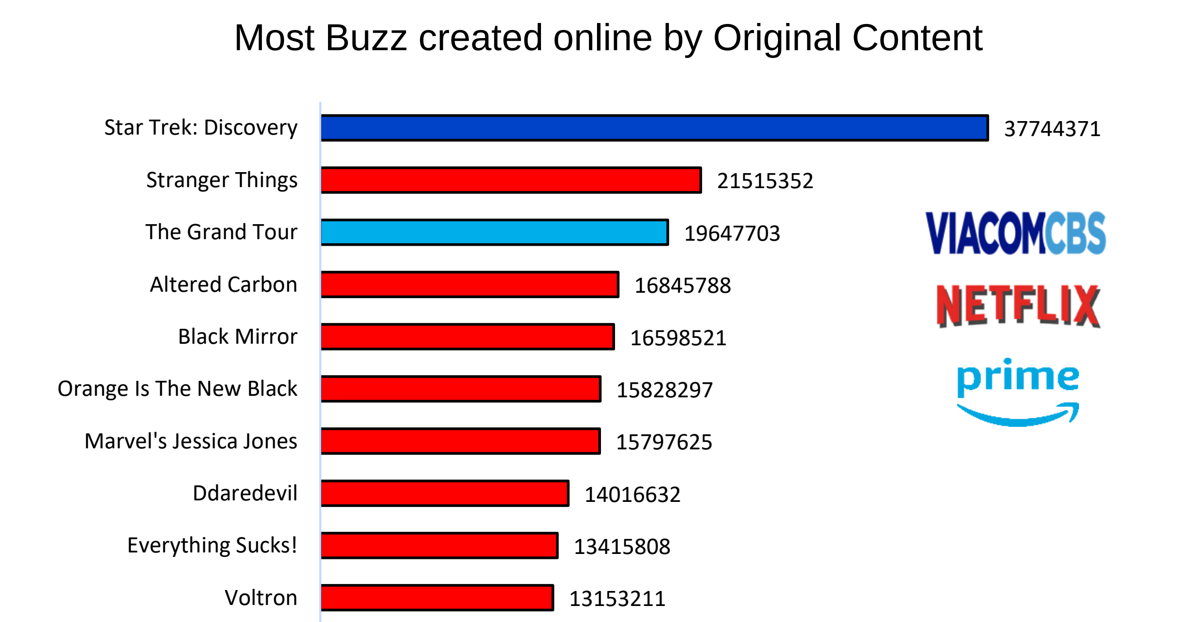
Case: Merging Netflix into Prime Video

Importance of Original Content for the popculture audience

Netflix Originals: A Distinguishing Factor

- Netflix originals are a brand in themselves, and its increasing expenditure on creating originals makes Netflix a big content creator that competes with the likes of HBO
- The ever increasing spending on original content by Netflix shows that the company’s vision is that of a large scale content creator
- In a 2016 study by Cowen and Company, 58% of Netflix users said they subscribe to the service because of its original programs. These are programs that users can’t find anywhere else
- Thus, Netflix’s reputation is not only that of a distributor, but also of a famous producer of popular and acclaimed content

Netflix Originals are a Strong Brand in and of themselves…



Source- Statista

Case: Replacing Prime Video with Netflix in the bundle

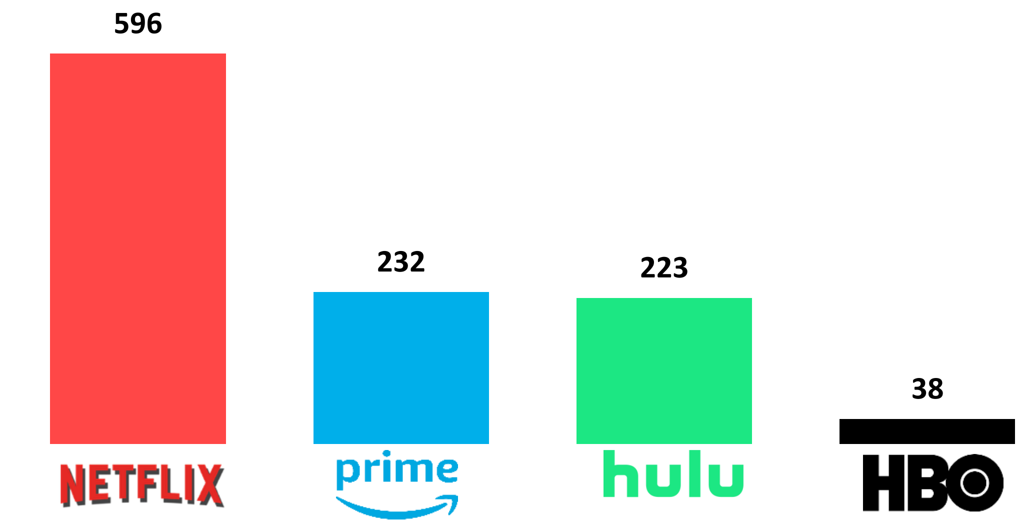
Analysing operational competencies between Prime and Netflix

Would Replacing Prime Video with Netflix work?

- The pricing and product structure is of great importance here. Prime Video does not come just as an individual service but also as a bundle of services as a way to sell more Amazon Prime Subscriptions. Replacing the relatively cheaper Prime Video with Netflix may disrupt the revenue stream all the other subscription services generate, as mentioned previously
- Further, more than half of the Netflix customers exclusively use Netflix as their video streaming medium, which means for them, Netflix is enough in itself and the they are not interested in taking on more services from the bundle

Netflix has Enough Content for most Subscribers…

Certified Number of Fresh Titles on Streaming Services



Source- rottentomatoes

Technology and Development Synergies

Netflix's Spending on Technology and Development is divided into 3 main categories

Watch Recommendation Algorithm

The algorithm is one of the main pillars of Netflix because it allows each member to have a different view of the content that adapts to their interests. Netflix has a pathbreaking algorithm that it continues to grow and develop through offline experiments and online A/B testing

Infrastructure R&D

Netflix continuously works on developing their streaming infrastructure in order to improve the user-experience. They work on minimizing load times, improving visual quality, and reducing interruptions in streaming

Content Valuation and Marketing Research

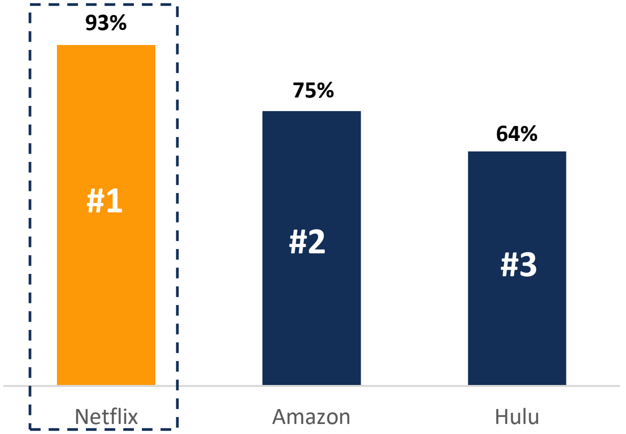
Includes research on the type of content to be produced or licensed, the budget of shows/movies to be produced, and everything regarding the production and efficient release of the content that is produced/licensed. Research in this space also revolves around models that help explore areas of growth, such as geographical locations.

How they stack up

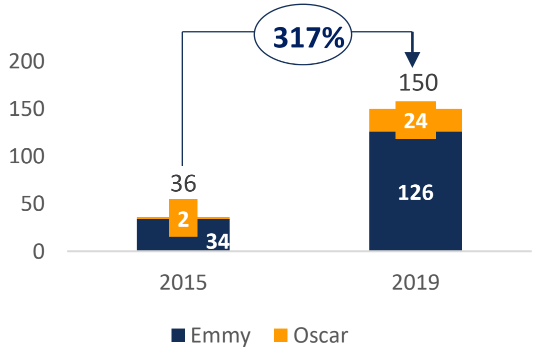
Netflix's best-in-class algorithm and content selection

- More than 80% of the TV shows people watch on Netflix are discovered through the platform's recommendation system.
- Constantly offer incentives for external teams to come in improve or review their algorithm.

Netflix has consistently been the top ranker in customer retention rate. A major factor for this is the algorithm.



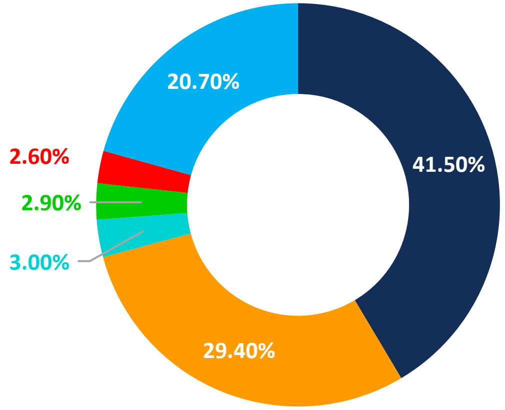
- Netflix's content success has been constantly increasing due to accurate content research.
- Success in content research and valuation is seen through the increase in media awards received



Source- second measure; Source 2- Skyhigh Networks

Amazon Web Services has Great Infrastructure Facilities

- Netflix uses Amazon Web Services for research that includes models, algorithms, analytics, and experimentation to optimize video delivery. This, along with other expenditure on research to improve streaming process makes up a portion of their Tech and Dev. Expenditure
- Amazon Web already provides various solutions to Netflix like using Amazon Kinesis to monitor the communications between all of its applications
- A big part of Netflix's expenditure is on improving infrastructure, which essentially means improvement to their streaming process. Amazon already spends a huge amount in improving very similar infrastructure in order to improve their AWS offerings, and Netflix would no longer need to rely on its own R&D



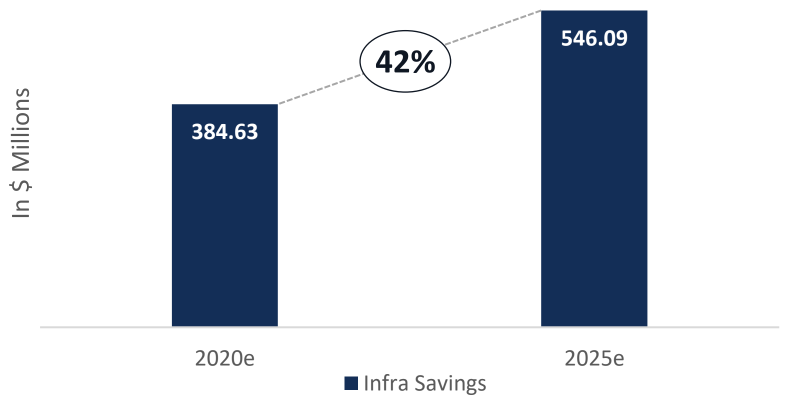
Amazon is already the leading provider of Infrastructure as a solution service through AWS

Quantifying Technology and Development Synergies

Netflix Saves money on infrastructure R&D as they begin to use Amazon's infrastructure

Details in Appendix

Present Value of all Savings = $2.3 billion.



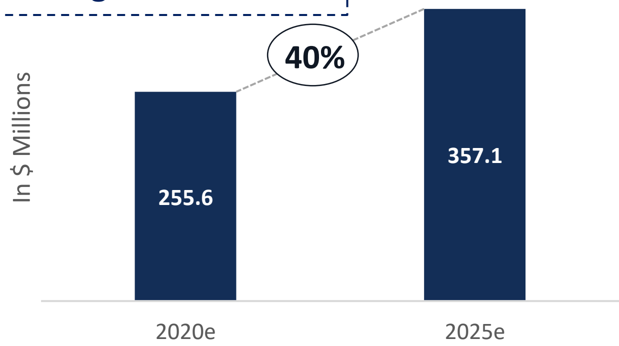
Infrastructural efficiency

- After the acquisition, Netflix will integrate fully into AWS and no longer need to spend on improving infrastructure, since they will essentially have none
- The costs that remain afterwards are a fraction of the infrastructure costs required to integrated the two systems fully and change of ownership of technical expertise (For further details, refer to appendix)

Amazon saves on algorithm and content valuation by leveraging Netflix's capabilities…

Details in Appendix

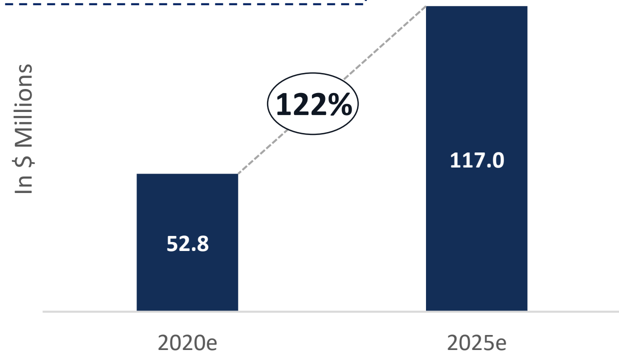
Present Value of all Savings = $1.4 billion



Operational efficiency

- Amazon will benefit from and can use Netflix's expertise in algorithms, as well as their actual algorithm as well
- The only costs that will remain for Amazon in the algorithm department will be integration costs in the few years

Present Value of all Savings = $0.4 billion



Research efficiency

- Amazon can benefit from the content and market research that Netflix is so good at
- With the same sophistication as Netflix, Amazon Studios can be a front runner amongst content creators.

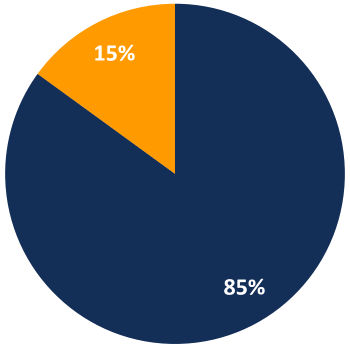
Source- Own Analysis

Leasing expenses

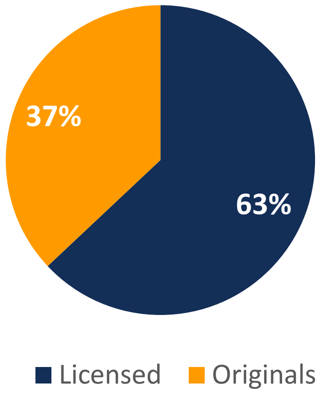
Rapidly increasing Content Expenditure

Details in Appendix

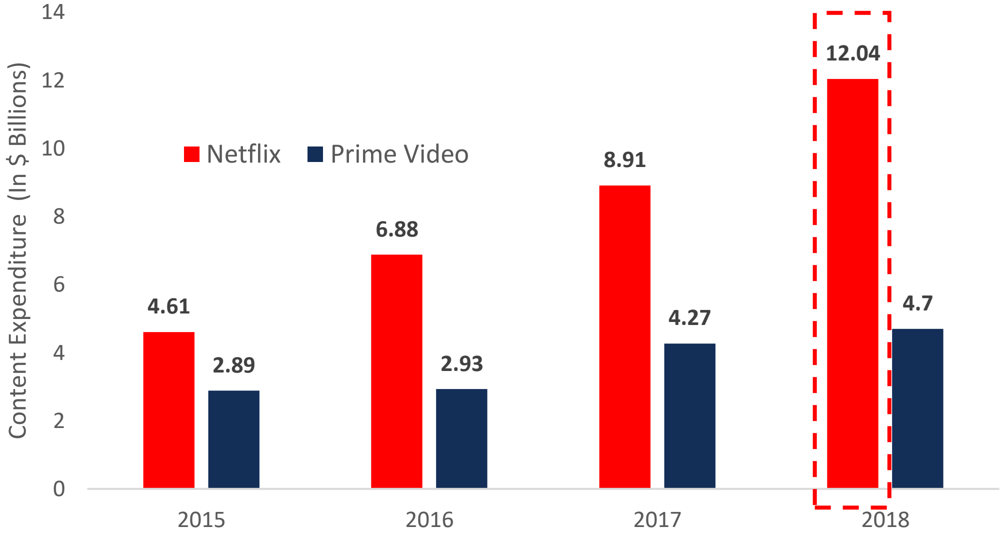
- Expenditure on content is one of the biggest costs that a streaming company bears. In recent years, streaming companies are competing for creating and leasing more shows as the industry becomes content heavy.
- While original content remains something that is treated internally, leasing costs are often dictated by the presence of other big players present in the market
- Some of the most viewed shows on OTT platforms are ones that have been leased from other content creators. Thus, ownership of distribution rights is a major deciding factor for leadership in the industry.



A closer look into the content expenses of Netflix shows a low percentage of expenditure on licensed shows as compared to originals.



- As data shows, people stream more licenced shows than original content on Netflix.
- Even though expenditure on original content has increased, licensed and third party content still remains a driving force.



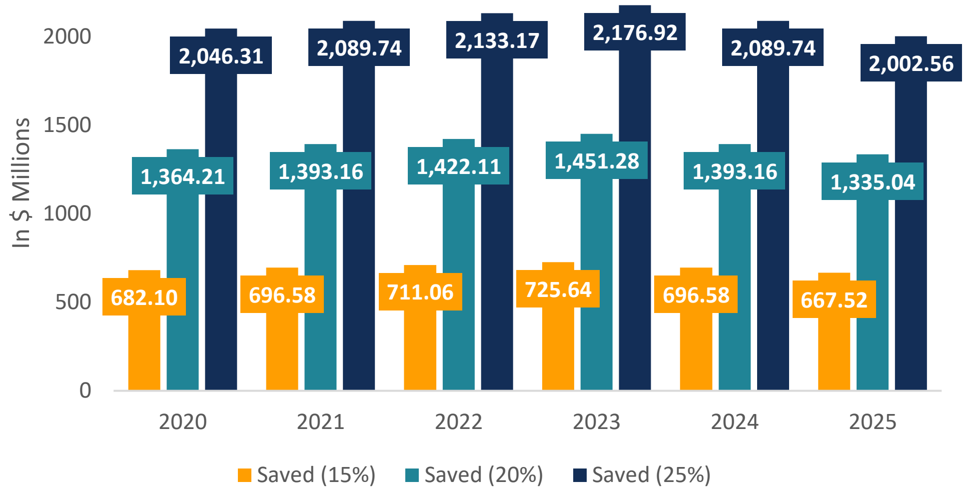
Source : Forbes

Leasing Synergy

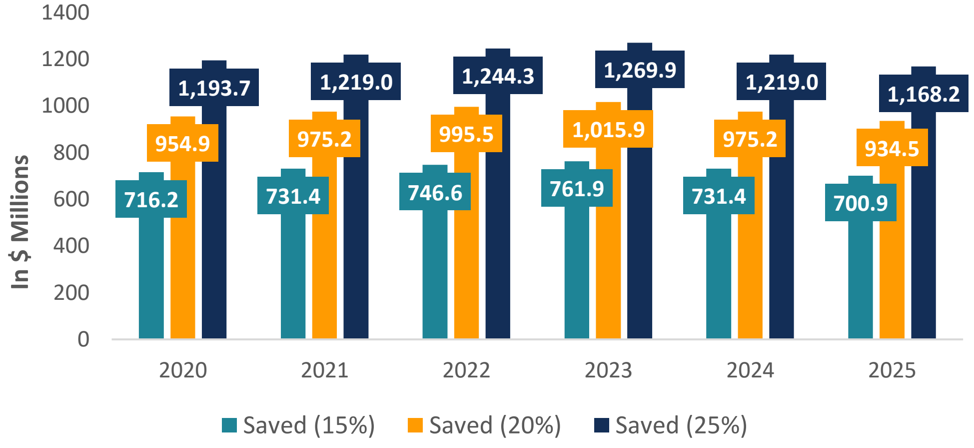
The Bidding Battle

- A combined entity for bidding consisting of Netflix and Amazon would be a big force and would stop the two largest competitors in the market from bidding against each other.
- Popularity, is another factor that affects the result of a bidding war. Netflix-Prime video combined will have a huge subscriber base due to which content creators will not have a problem handing over the rights as it will reach more audiences
- Since companies have limited budget for spending's on licensing content, savings on every deal will be imperative and significantly beneficial
- Leasing expenses for Netflix have been calculated from amortization forecasts, and Amazon prime's expenditure has been estimated by comparison of it's content library with Netflix's
- Thus, three potential savings cases emerge out of this synergy: high savings (25%), standard savings (20%), low savings (15%)

Netflix Savings



Amazon savings

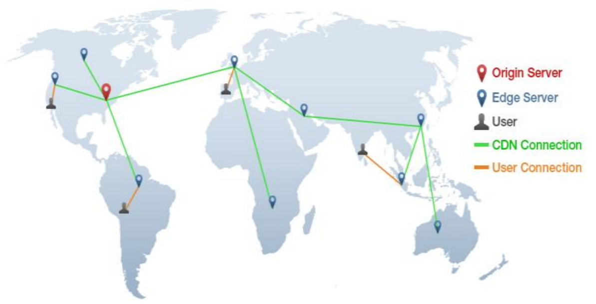


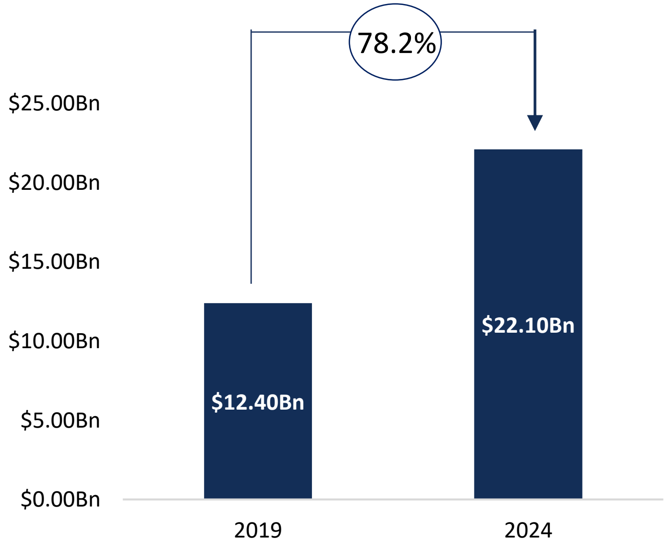
Content Distribution Network

Details in Appendix

CDN Networks

- A CDN or Content Delivery Network is a network of servers distributed across multiple locations, which optimizes data distribution by allowing delivery of data directly to end-users across a wide geography
- Where a traditional set-up would store all the data and content in a single location and deliver to all end users from that location through the ISP's centers, a CDN places multiple edge servers in closer proximity to the end users around the world
- More than 50% of CDN Traffic is video streaming, which is expected to rise to about 80% till 2024





Source- MarketsandMarkets

Strategic Flow

- Netflix uses an interesting strategy to deploy their CDN. In areas of high demand, they provide ISPs with custom-made server hardware in the form of Open Connect Appliances, or OCAs
- The OCAs are used only for Netflix's data stream and allow content to be delivered more directly to customers
- Open connect allows Netflix to control a crucial part of their delivery infrastructure and prevents total reliance on their rivals

Amazon's CDN

- Amazon Cloud Front is AWS's own CDN, which is designed to integrate perfectly with their other products
- The service is already used for OTT video streaming by multiple platforms in different parts of the world, thus it is already used to processing OTT traffic

CDN Synergy – Why it is Limited

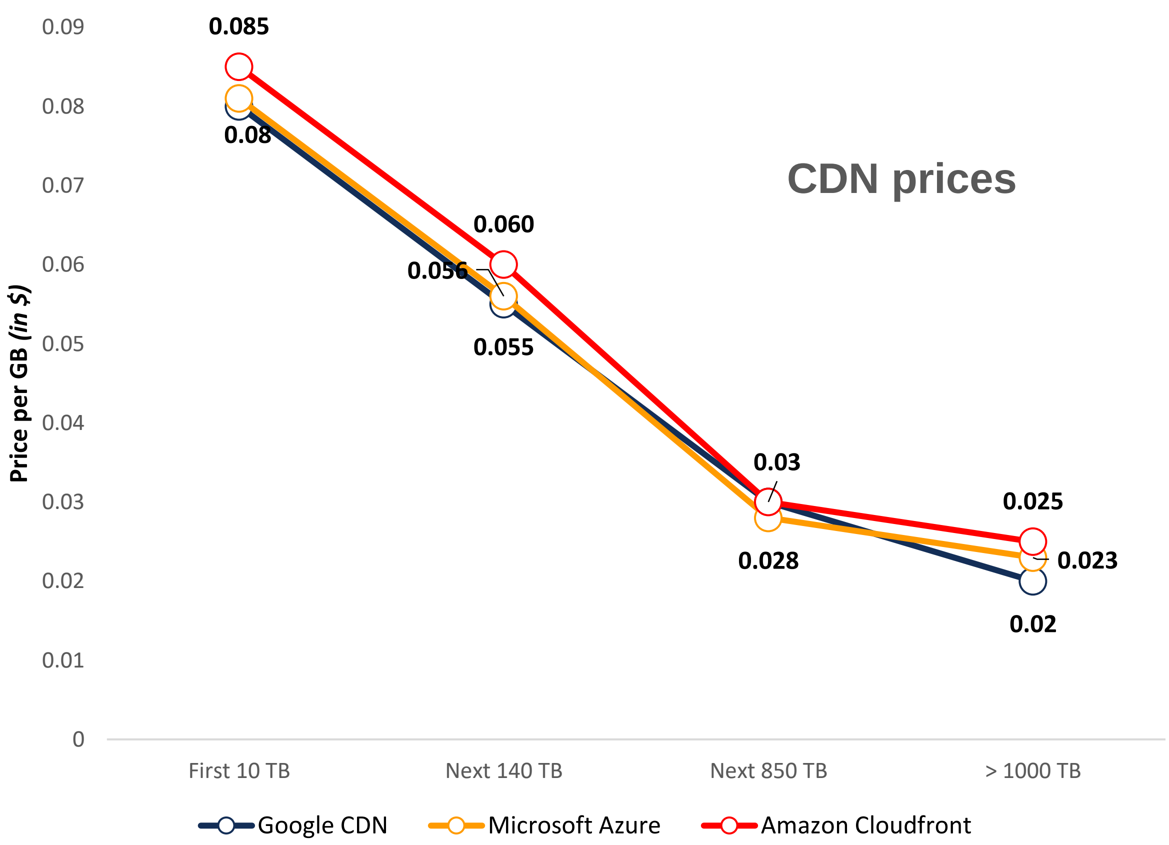
Operational flow post acquisition

- In an ideal post-acquisition scenario, Netflix could be fully integrated into AWS, and would benefit from a simplification of their delivery network and economies of scale in the long run. However, an immediate migration would be a waste of the money already invested into building Open Connect, and so does not make sense unless the Open Connect infrastructure is liquidated.
- **The liquidation of Open Connect would be virtually impossible** due to the following reasons:
  1. Open Connect uses infrastructure that is completely tailor made for Netflix, which means a sale of the appliances would be difficult to a similar OTT provider, and virtually impossible to anyone else
  2. With Netflix and Amazon integrated, no single player would remain who is large enough to require such a large CDN at short notice

Netflix uses Akamai for most of it's CDN needs. Akamai does not keep a fixed price on its CDN service, but it is a fair assumption that it's not significantly different from other service providers

Source – Respective company websites

Cloudfront isn't the Cheapest Option Available



V. Financial Analysis

1

COMPARABLES

Trading and transaction multiples

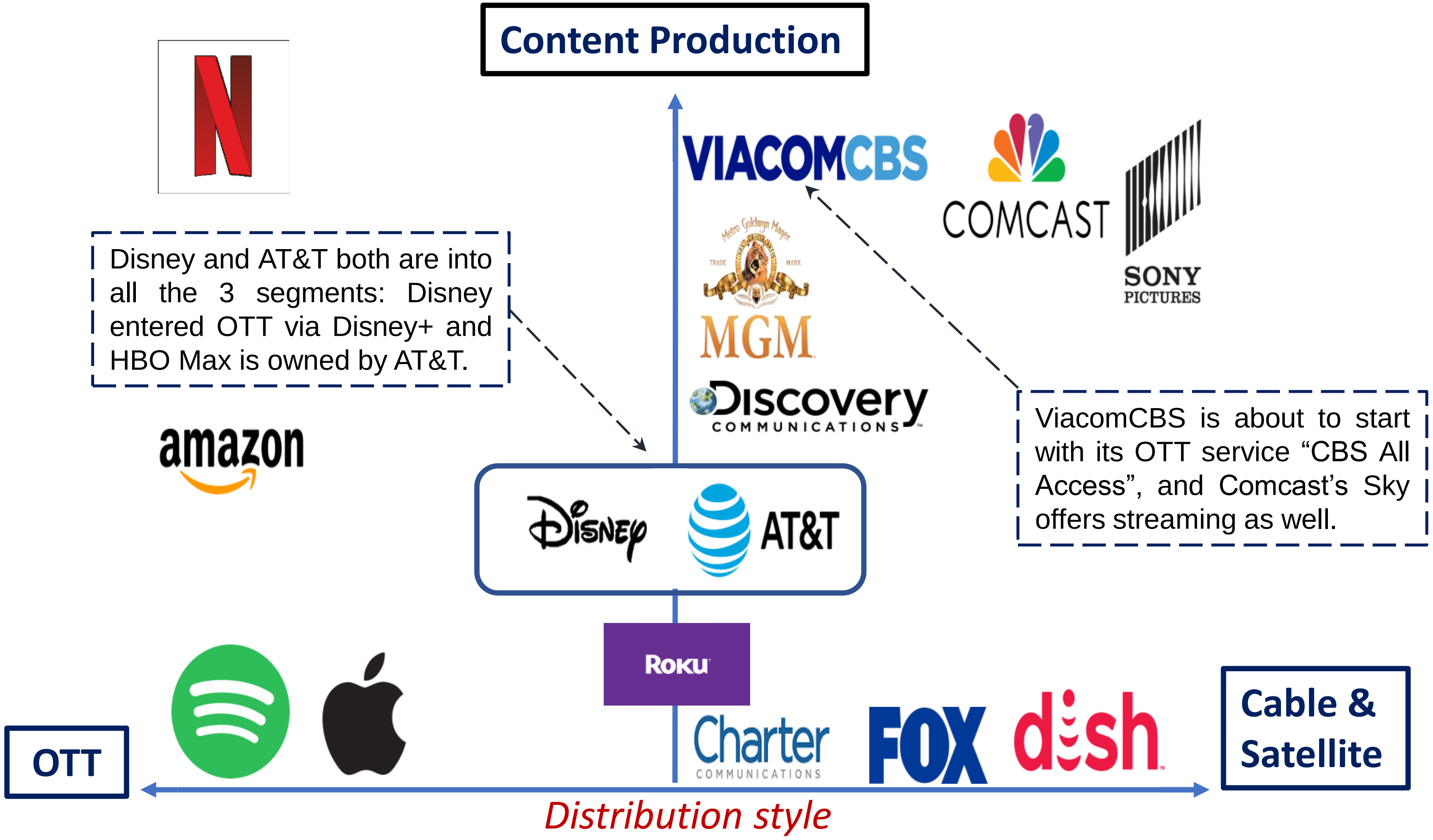
2

DISCOUNTED CASH FLOW

Business case forecasting and DCF

Comparable Universe

We identified peer companies in 3 segments: OTT, Content production (media/production houses) and Cable & Satellite companies (Broadcasting). The logic being: Netflix is big on original content, is an OTT and faces competition from TV cable-satellite networks.



FAANG stocks consist of the 5 biggest American technology companies and have a combined market cap of over 4.1 Trillion USD as of Jan 2020.

It is clear that Netflix can’t be pigeonholed into 1 particular segment, since it is both a producer and a licensor of content. And of course it is a streaming service as well.

Selection of Companies

After analyzing the CAGR, market size, revenue and cost drivers, we come to the conclusion that Cable-satellite is the group that needs to be discarded. The other 3 groups are in contention right now.

	Market size ('19)	Market Size CAGR	Brand relevance	Key Revenue drivers	Key Cost drivers	Decision
Netflix	-	10.51% (2019-'30		• Global subscriber growth rate • Average revenue per user • Demand and quality of content • Internet Penetration	• Licensed content • Original content • Streaming delivery expenses • Tech and Development	
Content Production	USD 2.2 tn	10.4% (2019-'30)		• Global subscriber growth rate ✗ • Average revenue per user ✓ • Demand and quality of content ✓ • Internet Penetration ✗	• Licensed content ✗ • Original content ✓ • Streaming delivery expenses ✓ • Tech and Development ✓	Retained
OTT	USD 81.6 bn	14% (2019-'24)		• Global subscriber growth rate ✓ • Average revenue per user ✓ • Demand and quality of content ✓ • Internet Penetration ✓	• Licensed content ✓ • Original content ✓ • Streaming delivery expenses ✓ • Tech and Development ✓	Retained
TV Cable & Satellite	USD 247 bn	2.7% (2019-'28)		• Global subscriber growth rate ✗ • Average revenue per user ✓ • Demand and quality of content ✗ • Internet Penetration ✗	• Licensed content ✓ • Original content ✗ • Streaming delivery expenses ✗ • Tech and Development ✗	Discarded
FAANG	USD 793 bn	8% (2019-'29)		Each FAANG stock has a peculiar revenue and cost structure and as such the drivers cannot be taken for a group. Since these stocks trade on similar valuation multiples and are similar in terms of size, margins and sector (Technology) , the group is retained for analysis.		Retained

Analysing Peers

We identified Netflix's 5 closest comparables from the universe, which have similar margins as Netflix and are involved in similar business operations: production/licensing and distribution of content through streaming services.

	Relevance to target	EBITDA margin 2020e	EBIT margin 2020e	Net income margin 2020e
Netflix	• Media-services provider and production company headquartered in California. • Specializes in streaming original and licensed content	18%	17%	13%
		Median: 22%	Median:18%	Median: 11%
Disney	• Diversified multinational mass media and entertainment conglomerate. • Owns production houses, film studios and new streaming service Disney+	22%	17%	13%
ViacomCBS	• Formed via the re-merger of CBS Corporation and the second incarnation of Viacom • Involved in film, TV, publishing and media	19%	18%	11%
Comcast	• Second largest broadcasting and cable television company in the world by revenue • Largest Pay/Cable TV company in the US	30%	19%	13%
Amazon	• Tech company with focus on e-commerce, cloud computing, digital streaming and AI • Prime Video is its OTT Streaming segment.	15%	8%	4%
AT&T	• World's largest media company by revenue • Owner of Warner Media, which owns HBO and streaming service HBO Max with Warner Bros.	33%	19%	11%

Source: Capital IQ, Thomson Reuters (Eikon), Factset, Yahoo Finance.

Other criteria

Business
- Nature of operations
- Geography
- Target market

Financial
- Size
- Growth
- Revenue & Cost drivers

Trading Multiples

Trading Multiples suggest Netflix is highly overvalued. NTM multiples are more conservative due to a weakened economic outlook amidst recent tensions.

Peers	NTM EV/Sales	NTM EV/EBITDA	LTM EV/Sales	LTM EV/EBITDA	WEIGHTS Assigned to different comparables
Netflix	7.1x	31.7x	8.6x	59x	
	Weighted Avg: 2.9x	Weighted Avg: 13.4x	Weighted Avg: 3.3x	Weighted Avg: 17.7x	
Disney	3.3x	13x	3.6x	16.8x	5%
ViacomCBS	1.2x	4.9x	1.3x	7.5x	40%
Comcast	2.6x	7.9x	2.7x	8.5x	5%
Amazon	2.9x	17x	3.4x	23.5x	10%
AT&T	2.5x	7.2x	2.5x	7.7x	40%

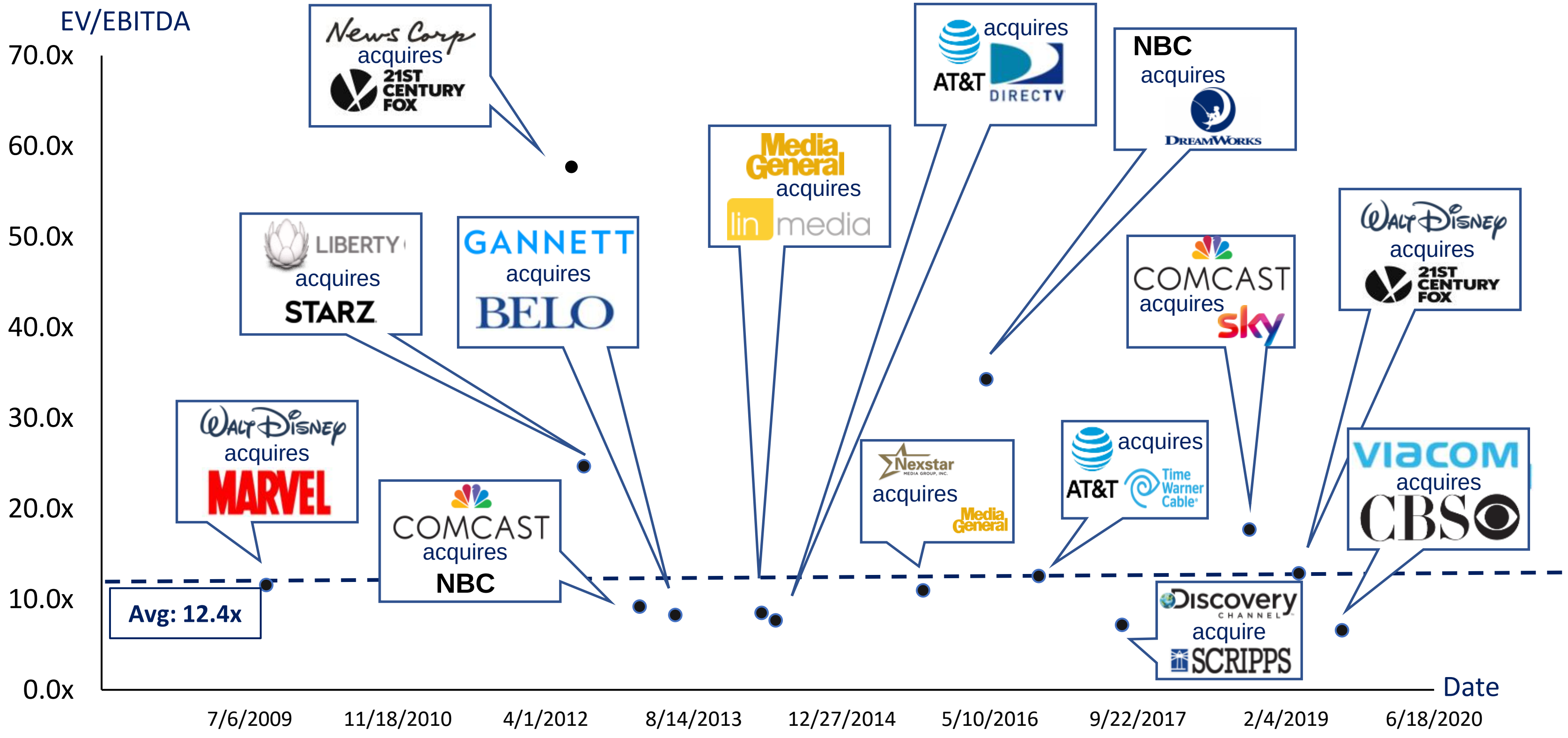
Disney and Amazon have been provided higher weightages since they're Netflix's closest comparables and have similar growth profiles.

Source: Capital IQ, Thomson Reuters (Eikon), Factset, Yahoo Finance.

Precedent Transaction multiples (1/2)

We drilled down to these precedent transactions in the Media and Entertainment industry, which give us an EV/EBITDA multiple of 12.4x. However, we reduce its weight in the Football field analysis.

Precedent Multiples: EV/EBITDA



Source: Capital IQ, MergerMarkets, Bloomberg, NASDAQ, Google Finance.

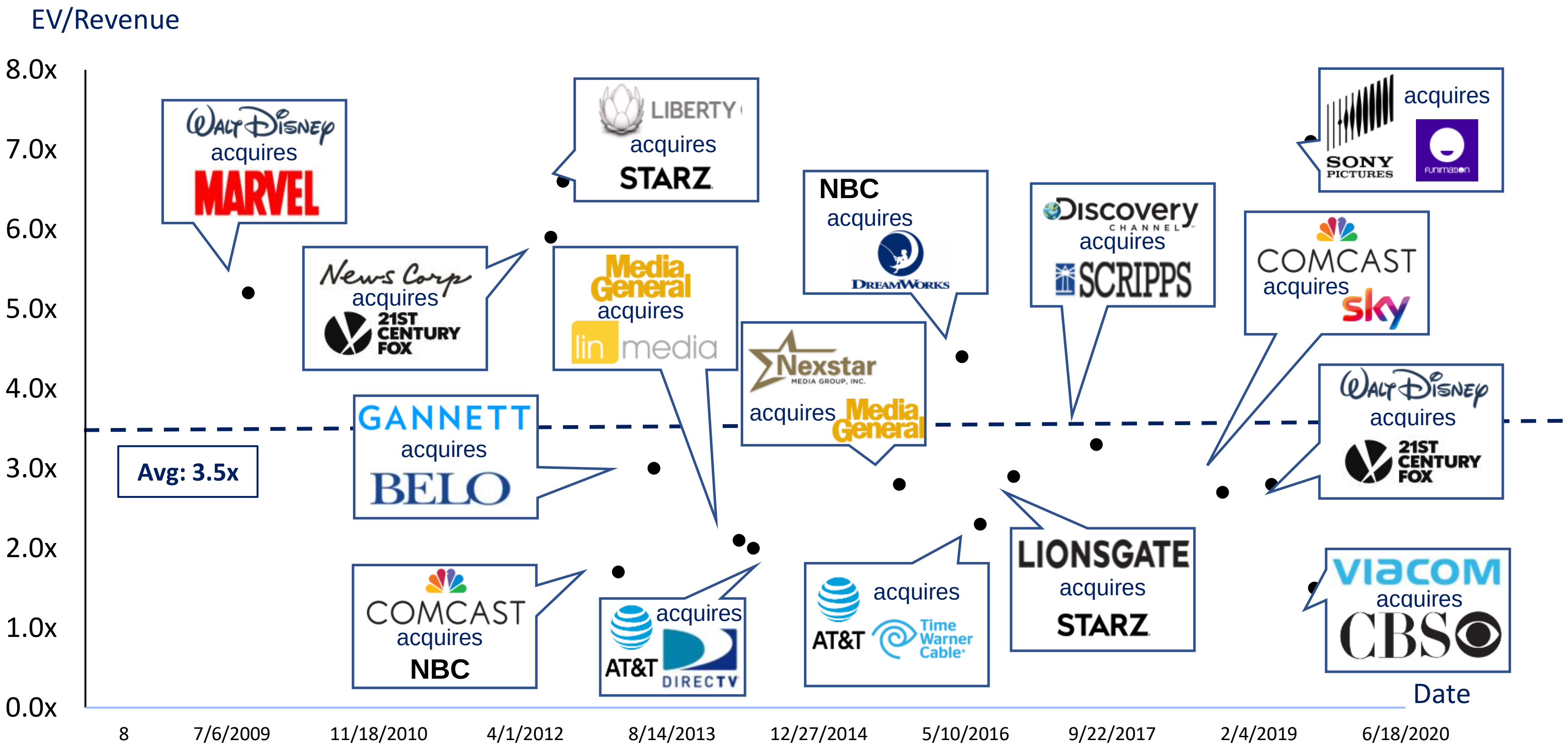
Deal Insights

- The target companies in these transactions are mainly involved in content production, content distribution, programming or in video services and motion pictures.
- In the past 5-10 years, a lot of M&A activity has taken place in the Media and Entertainment industry, resulting in 'The Big 5' owning most of the SVOD companies.
- A few companies such as AT&T, Disney and Comcast have been involved in multiple acquisitions.
- In a few instances, the acquirer has turned the target a few years later. Eg: Media General, NBC.

Precedent Transaction multiples (2/2)

We estimated an EV/Revenue multiple of 3.5x from the same transactions.

Precedent Multiples: EV/Revenue



Source: Capital IQ, MergerMarkets, Bloomberg, NASDAQ, Google Finance.

Conclusion

- These precedent multiples aren't accurate measures to determine Netflix's EV because:

1. The targets didn't operate at the same scale as Netflix.
2. The targets are content producers/distributors, but rarely both (which Netflix is). Moreover they don't operate on an SVOD model.
3. The synergies estimated for Netflix are different than what would've been achieved in these transactions.
4. The premiums varied widely from transaction to transaction.

Overall, precedent transactions are a good way to estimate the implied share price.

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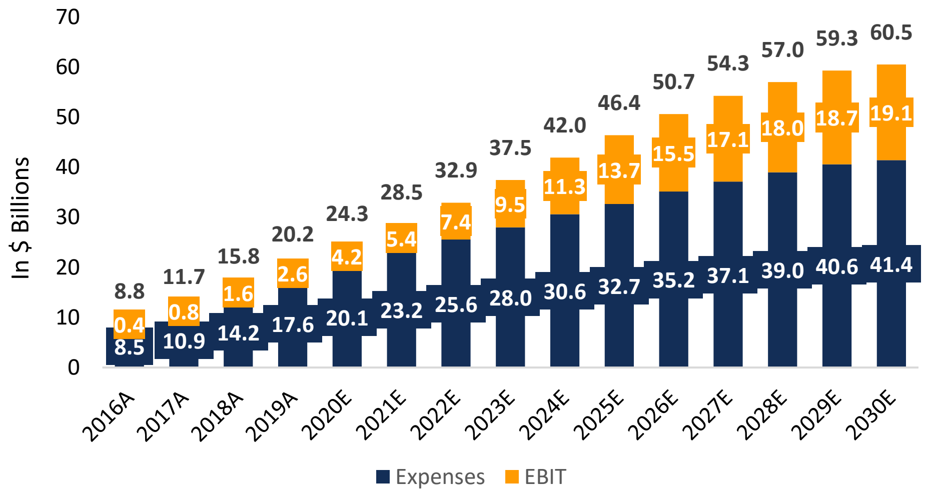
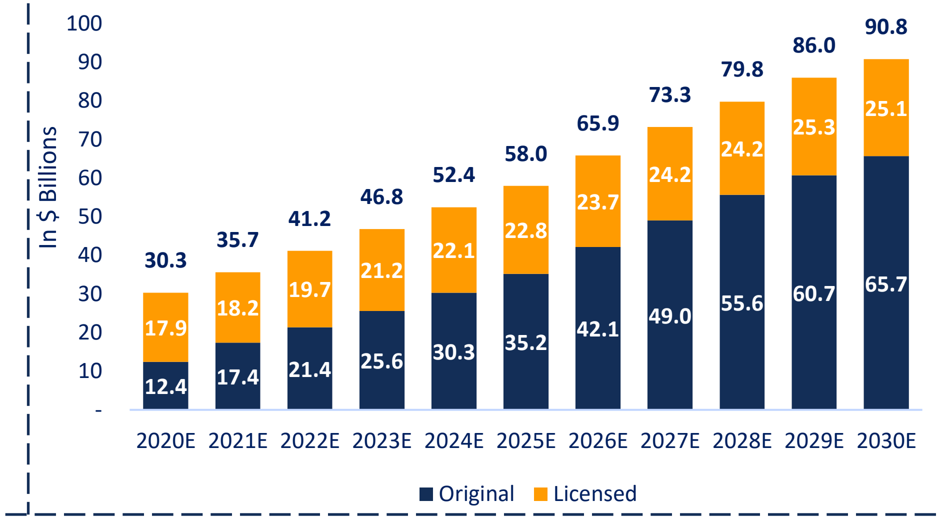
Financial Performance Forecasts

Revenue Projections



- Expenses are expected to mature over the years, while the EBIT show increasing growth.
- Netflix's share of original content is expected to outweigh its licensed content.

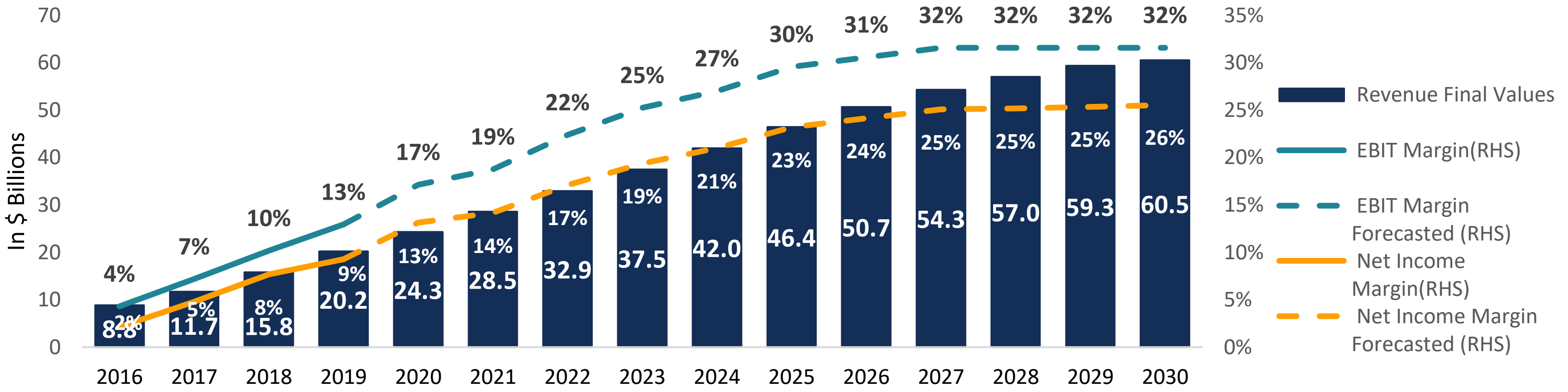
Forecasted Content Assets



Revenue and Margins, 2019-30

- EBIT margins constantly grow until they level at 32% in 2030.
- This is driven by growing subscribers and improving margins.
- EBIT margins are expected to grow at a CAGR of 10%, while Net income margins at 9%.

P&L



Executive summary
Industry Analysis
Company Overview
Strategic Fit
Financial Analysis
Acquisition Feasibility
Alternative Solution
Conclusion

Discounted Cash Flow Analysis: Overview

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In $ 000's	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
EBT	36,16,792	48,11,060	67,82,007	88,43,585	1,07,30,741	1,31,24,101	1,49,14,260	1,65,92,125	1,75,03,724	1,83,21,395	1,88,42,888
Interest	5,40,189	5,40,189	5,81,194	6,09,390	5,96,580	5,89,260	5,67,300	5,34,360	4,89,360	3,98,611	2,56,237
EBIT	**41,56,980**	**53,51,249**	**73,63,202**	**94,52,975**	**1,13,27,321**	**1,37,13,361**	**1,54,81,560**	**1,71,26,485**	**1,79,93,085**	**1,87,20,005**	**1,90,99,124**
[+]Adjustment for operating lease	65,08,338	71,71,544	77,22,205	81,55,842	84,29,399	85,39,593	84,73,328	81,64,065	76,18,427	69,28,739	60,50,485
Adjustment for operating lease(% of Revenue)	*26.82%*	*25.14%*	*23.45%*	*21.77%*	*20.09%*	*18.41%*	*16.73%*	*15.05%*	*13.36%*	*11.68%*	*10.00%*
[-]Cash Taxes (Charged on EBIT)	(7,48,256)	(9,63,225)	(13,25,376)	(17,01,536)	(20,38,918)	(24,68,405)	(27,86,681)	(30,82,767)	(32,38,755)	(33,69,601)	(34,37,842)
[+] D&A	1,59,295	1,61,803	1,58,252	1,62,434	1,28,450	1,49,226	1,52,654	1,64,520	1,91,791	2,03,752	2,33,779
[-] Capex	(2,50,000)	(2,77,000)	(2,77,000)	(2,85,000)	(2,50,000)	(2,69,000)	(2,68,000)	(2,62,000)	(2,66,000)	(2,66,000)	(2,66,000)
[-] Changes in NWC	5,24,448	6,19,608	5,20,166	5,32,923	5,23,306	3,43,049	3,17,221	2,29,641	1,16,998	55,672	(88,625)
[-] Net Content Investment	(1,48,98,714)	(1,65,52,403)	(1,86,87,943)	(2,08,96,588)	(2,29,47,015)	(2,49,44,899)	(2,93,22,586)	(3,17,67,992)	(3,36,61,965)	(3,57,21,000)	(3,65,75,153)
[+] Content Amortization	90,66,690	1,12,24,539	1,31,95,849	1,52,27,923	1,73,25,329	1,94,05,353	2,14,54,985	2,43,65,997	2,71,04,736	2,95,30,911	3,18,21,244
Unlevered FCF	**45,18,781**	**67,36,116**	**86,69,355**	**1,06,48,975**	**1,24,97,873**	**1,44,68,278**	**1,35,02,482**	**1,49,37,948**	**1,58,58,316**	**1,60,82,478**	**1,68,37,010**
Net FCF (Time period adjusted)	**37,65,651**	**67,36,116**	**86,69,355**	**1,06,48,975**	**1,24,97,873**	**1,44,68,278**	**1,35,02,482**	**1,49,37,948**	**1,58,58,316**	**1,60,82,478**	**1,68,37,010**

Terminal Value	
Perpetural Growth	23,20,57,130
EV/EBITDA	23,10,28,190
Average	**23,15,42,660**

The Terminal value is an average of the 2 methods

The market value of debt has been estimated which includes the capitalized value of operating leases

Cost of Equity	
Equity to Total Capitalization	82.84%
Risk Free Rate	1.52%
Equity Risk Premium	6.46%
Levered Beta	1.40
Cost of Equity	**10.59%**

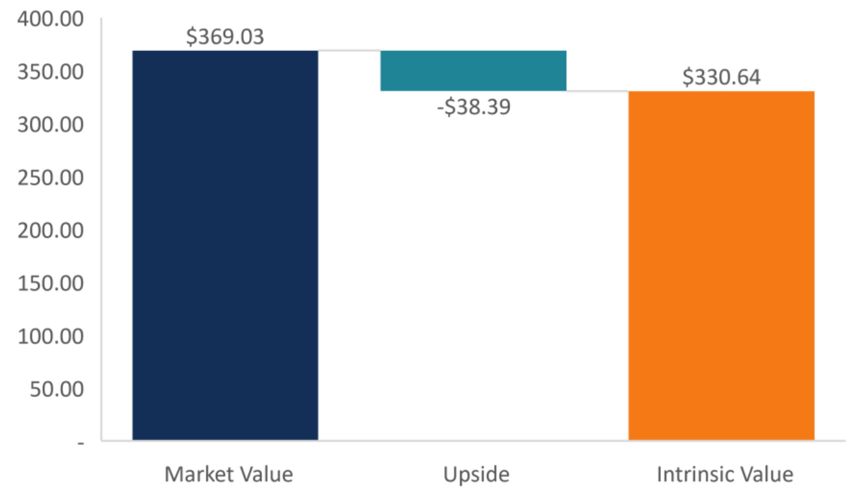
Cost of Debt	
Debt to Total Capitalization	17.16%
Pre tax cost of Debt	4.53%
Tax Rate	18.00%
After Tax Cost of Debt	**3.71%**

WACC = 9.41%

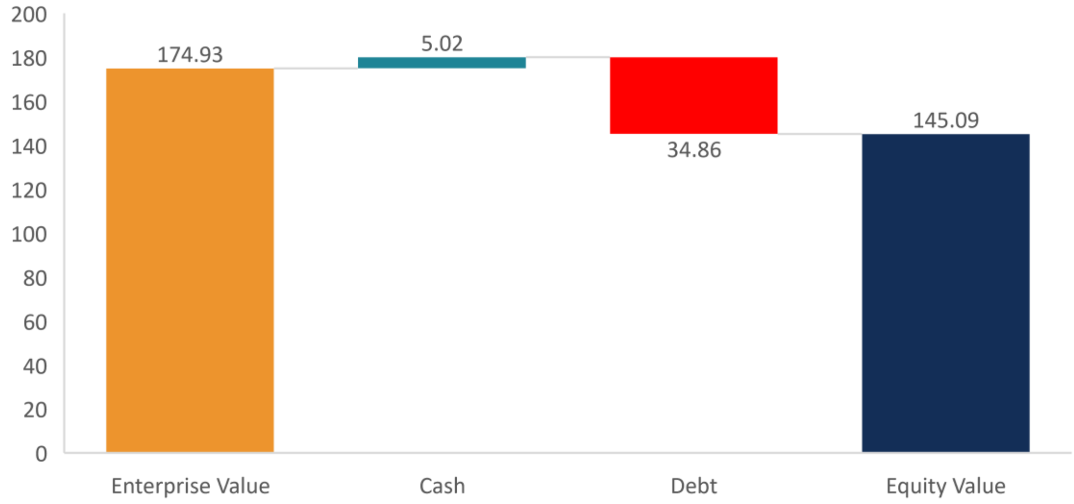
Sensitivity Analysis: Share Price and EV

Netflix's intrinsic DCF share price is 10.5% below the market price; Enterprise value is calculated at a 2.01% perpetual growth rate.

Market Value vs. Intrinsic Value



Enterprise Value to Equity Value



Share Price Sensitivity

Perpetual Growth Rate

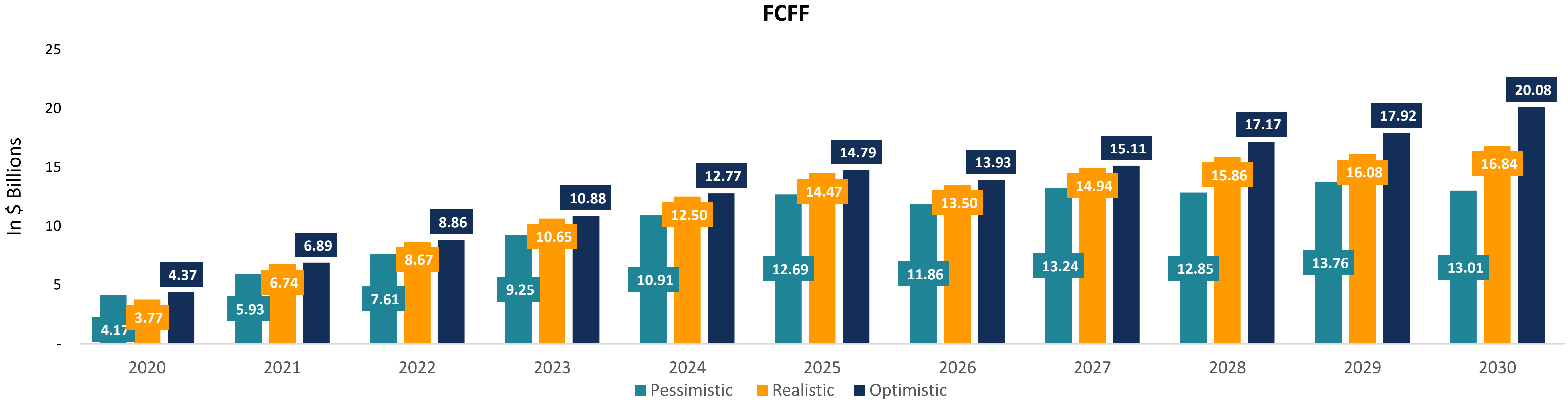
WACC	331	1.01%	1.51%	2.01%	2.51%	3.01%
	7.41%	412	425	441	460	483
	8.41%	359	368	379	391	406
	9.41%	317	323	331	339	349
	10.41%	282	287	292	298	304
	11.41%	252	256	260	264	269

Enterprise Value Sensitivity (in Billions USD)

Perpetual Growth Rate

WACC	175	1.01%	1.51%	2.01%	2.51%	3.01%
	7.41%	211	216	223	232	242
	8.41%	187	191	196	201	208
	9.41%	169	172	175	179	183
	10.41%	154	156	158	160	163
	11.41%	140	142	144	146	148

Sensitivity and Scenario Analysis



Grey Sky Case

Subscriber Growth rate: 14% and declining

ARPU Growth rate: 4% and declining

Realistic Case

Subscriber Growth rate: 15.33% and declining

ARPU Growth rate: 4.4% and declining

Blue Sky Case

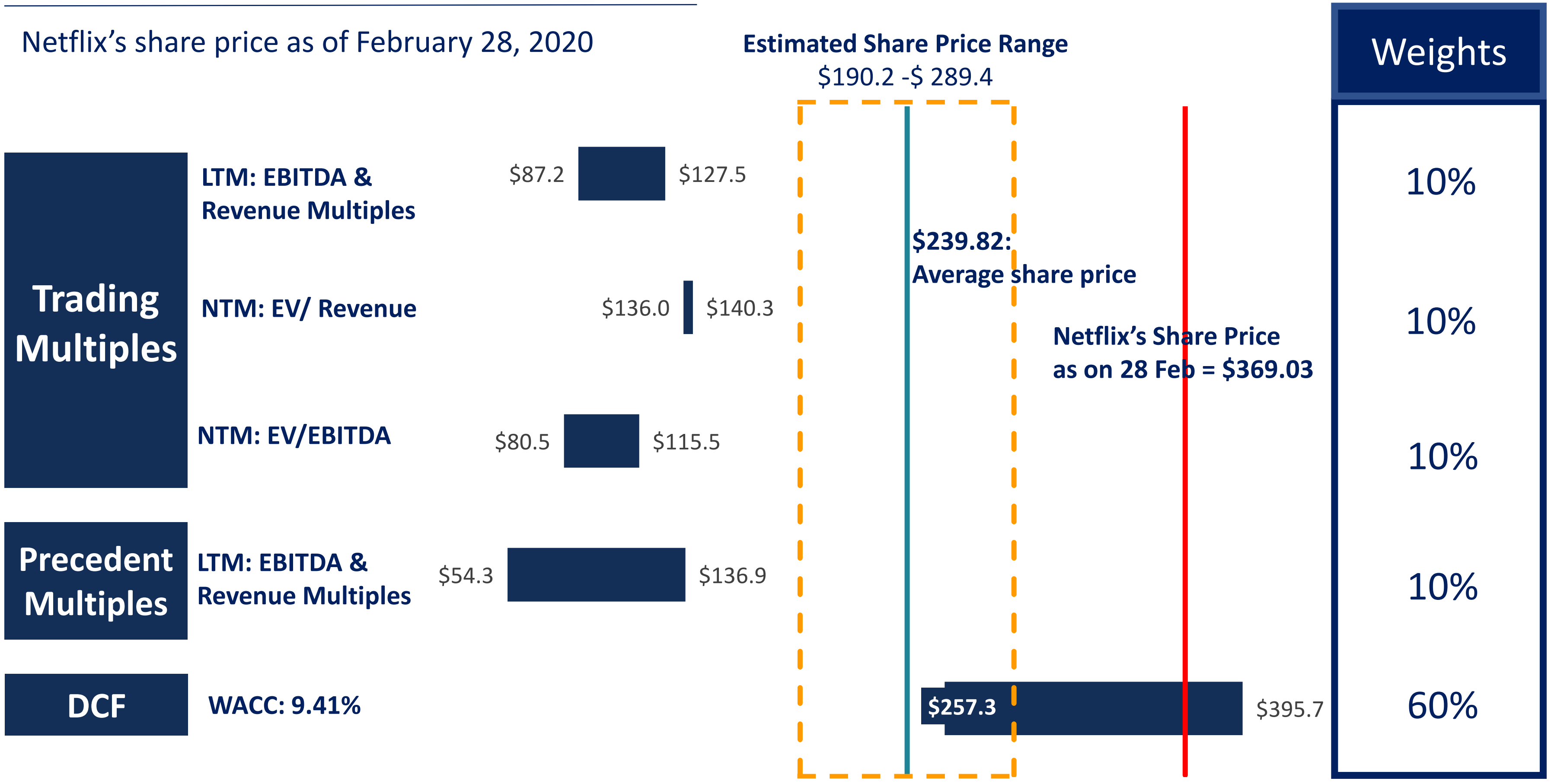
Subscriber Growth rate: 16% and declining

ARPU Growth rate: 5% and declining

Enterprise Value determination

From the 3 methods: DCF, Comparables and Precedents, we arrive at an average share price of $239.82 for Netflix, which translates to an Equity Value of $105.2 Bn and an Enterprise Value of $127 Bn.

Football Field

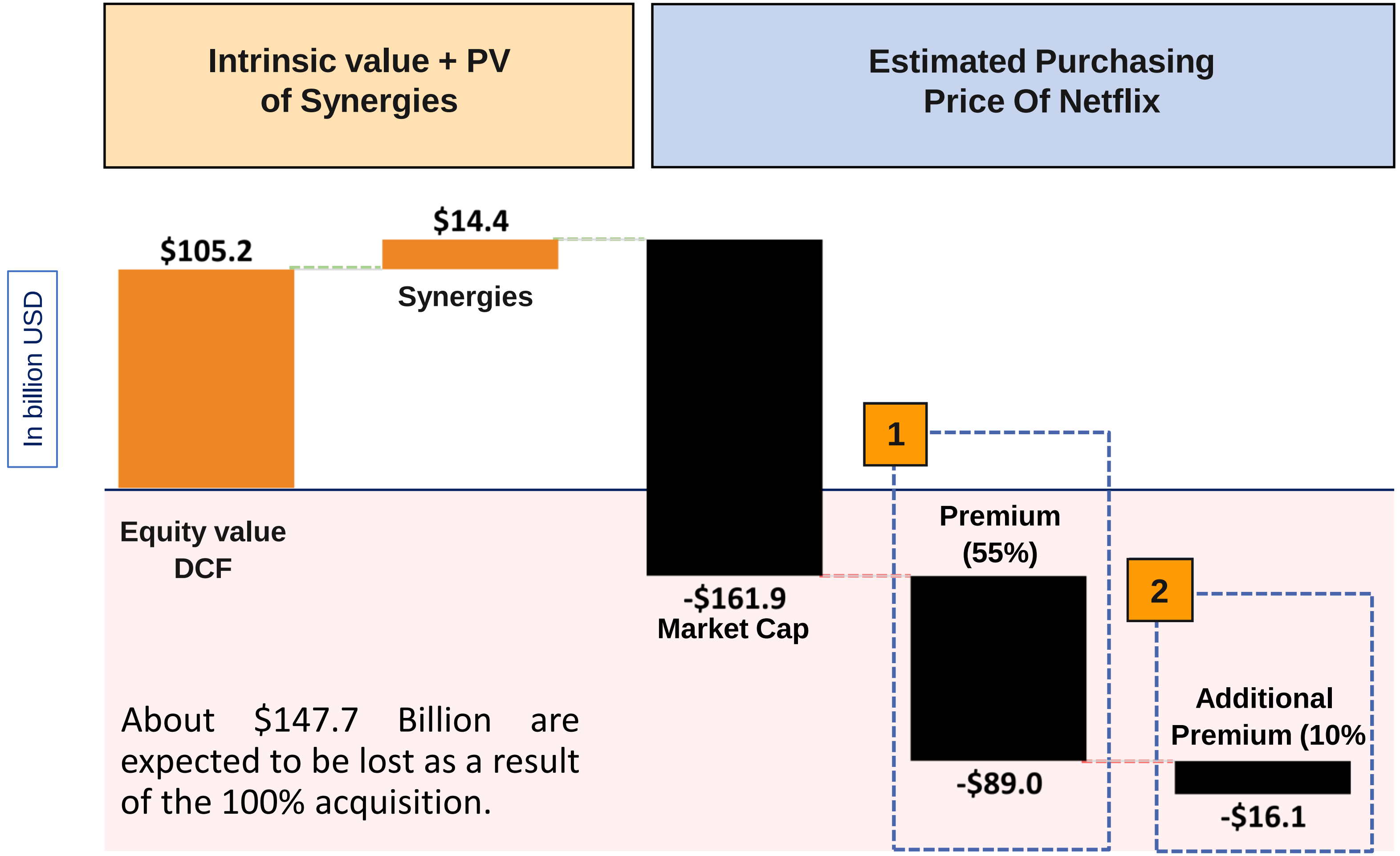


Netflix's intrinsic share price is **35%** below its current market price.

Note: Comparables have been given a less weightage (30%) because as mentioned before, Netflix's position in the industry is unique and it doesn't have a perfect substitute. Moreover, the growth profiles of comparables are different: some have entered the streaming segment recently while some are not proper SVODs.

Purchase Price vs. Intrinsic Value

Acquiring a 100% stake in Netflix would result in wealth destruction of about USD 147 Bn, which includes the market capitalization plus the premium required to convince Netflix's shareholders to sell their full stake.



Source: Yahoo Finance, Team analysis, Deloitte.

1

Premium:

According to a Deloitte report, the surging takeover activity has contributed to average control premiums from an annual level of 38% in 2016 to as high as **55%** in 2019. The trend has materialized inside and outside the United States.

2

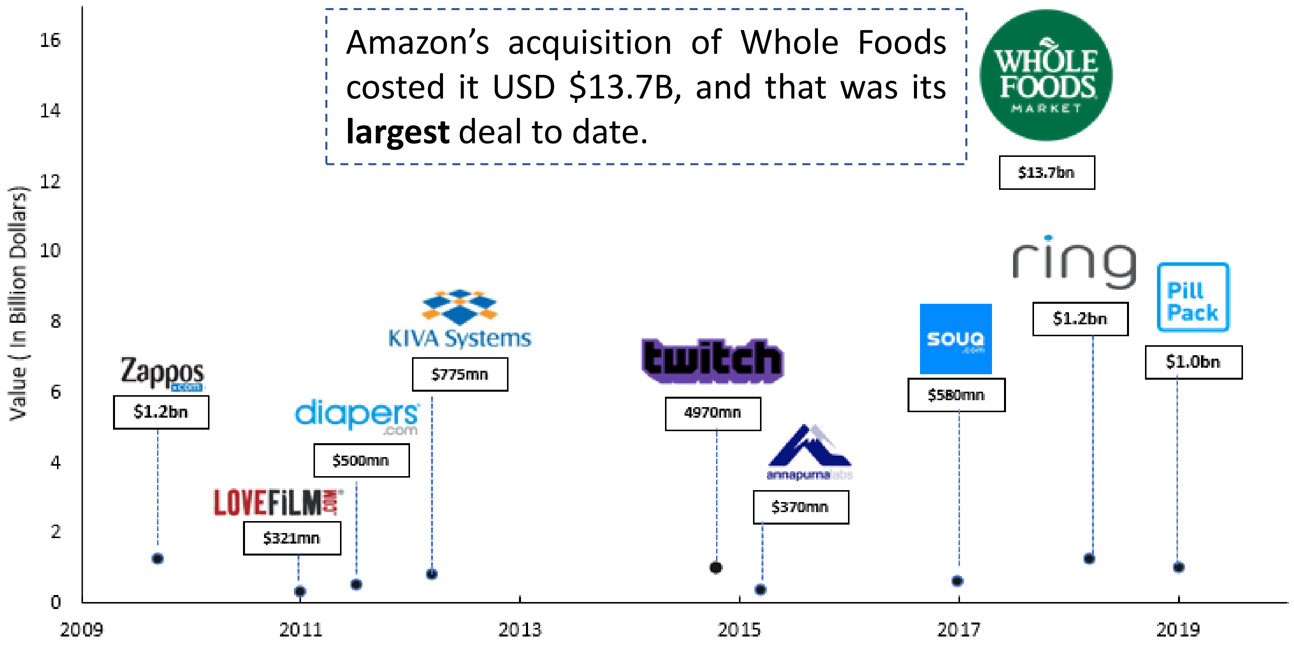
Additional Premium:

The shareholding of Netflix has been fragmented in a 'Poison Pill' form thereby requiring some additional premium to acquire the company. Thus, 10% has been added for that.

VI. Acquisition Feasibility

Amazon’s past acquisitions

It’s true that the past isn’t necessarily the right indicator for the future, but nevertheless, we take a look at Amazon’s transactions in terms of their size and rationale.

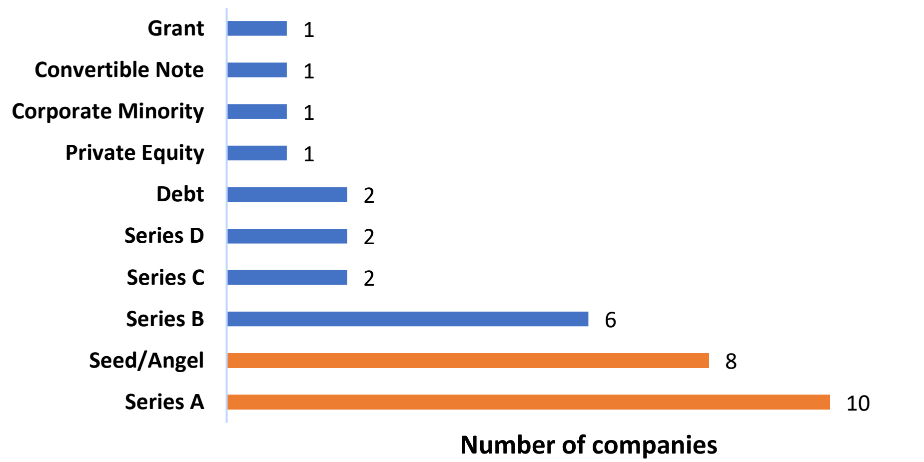


“Amazon is a conservative buyer. They think long term and they don’t get seduced by high-flying valuations…. Amazon is unlikely to overpay for a high-flying, fully baked platform as the basis for the next dreamy business.“ - Nat Burgess, TechStrat

Source: CB Insights

Amazon targets early stage companies for acquisition

Amazon acquisitions ranked by last funding stage, 2010-17



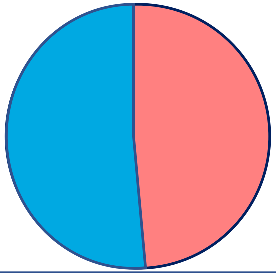
Conclusion

It appears that Amazon isn’t looking for an overvalued and mature stock like Netflix, which would cost them a fortune and not yield significant synergies either.

Why a 51% stake is not feasible

Why not 51%

- Ownership of a majority stake would be quite difficult for the following reasons:
- Ownership of Netflix stock is distributed across multiple institutional and individual investors, with even the largest owner, the Capital Group, holding less than 10%. This leaves a lot of parties to be negotiated with, many of whom might be unwilling to sell
- Netflix has demonstrated an extreme aversion to hostile takeovers. In late 2012, when investor Carl Icahn disclosed a 10% stake in the company, Netflix adopted a ‘Poison Pill’ shareholders rights plan to ensure any further stake would be extremely expensive for Icahn (or anyone else) to acquire. While the plan has since been revoked, it clearly demonstrates the lengths to which the company is willing to go to in order to avoid a takeover



prime 51%

NETFLIX 49%

Sensitive information

- In order to realize synergies from the acquisition, there needs to be a smooth flow of exchange of expertise and research from Netflix.
- Some of these sensitive and important decisions may require a 3/4th majority voting to get passed and many at the company might have an issue with sharing their Secret formulas like the pathbreaking recommendation algorithm
- Thus, in order to realize the synergies, it is important that no such problems take place and a full acquisition is required for smooth control over the process.

Decisions pertaining to areas of sensitive information like trade secrets are decided by special resolutions which require a 3/4th majority.

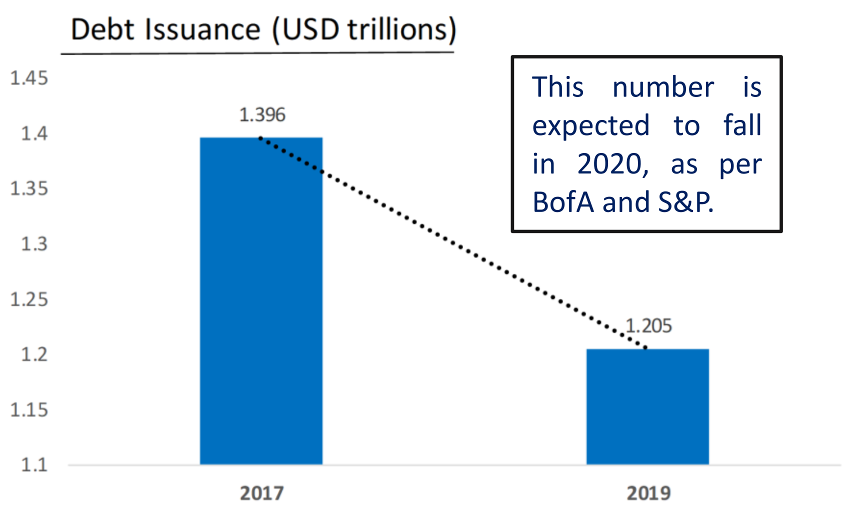
Debt: Why a 100% Stake is not Feasible

A 100% acquisition isn't a viable option in terms of its financial implications; the synergies don't justify the purchasing price.

- Amazon issued 17Bn in debt in 2017 to acquire Whole Foods for 13.7Bn.
- Amazon currently has **55Bn** in cash as of FY19.
- Since its cash is used to fund current liabilities, it has to resort to debt to fund the purchase price of 267Bn.
- Issuing 267Bn in debt would imply that it would be the largest debt issuance of all time.

Cost of Debt implications

- Issuing new debt to the value of **USD 267Bn** results in a **38%** rise in cost of debt.
- This downgrades Amazon's credit rating from A2 to Baa2, i.e., from high quality to medium grade.
- Interest Coverage ratio falls by **55%** of the combined entity after Amazon owns Netflix.



- In 2020 , debt financing for M&A activity is predicted to fall due to political uncertainty regarding the Presidential elections, according to BofA. This makes it harder to take on huge debt.

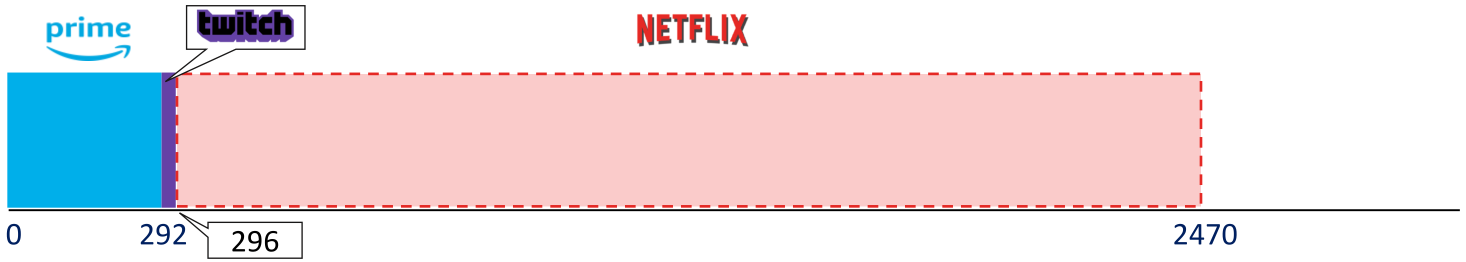
Source: Amazon 10-K, Aswath Damodaran, Thomson Reuters (*Eikon*), CNBC.

Antitrust Regulation

The US Federal Trade Commission (FTC) will interpret this maneuver as Amazon's expansion in the US Video OTT Market

Concentration analysis

Herfindahl-Hirschman index for selected US markets



Three major US Antitrust laws currently prevent the development of monopolies

- **Hart-Scott-Rodino Antitrust Improvements Act, 1976:** states that acquisitions involving companies of a certain size cannot be completed until certain information is provided to the federal government and a specified waiting period has elapsed
- **Clayton Act, 1914:** makes it illegal for one company to purchase the stock of another company if their combination results in reduced competition within the industry at large
- **Sherman Act, 1890:** prohibits new business combinations and stock purchases that lead to the creation of a monopoly

Vertical acquisitions (made to increase the efficiency of organisation) aren't scrutinised as strictly as horizonal acquisitions which are primarily meant for expansion of market share.

Prime Video already operates in the Video OTT segment, this acquisition would be treated as a horizontal acquisition and hence the likelihood of the acquisition falling under the DOJ or the FTC scrutiny is quite high.

Note: Estimates for Amazon Prime Video and Twitch have been calculated on the basis of data available via US Revenue disclosures and the SEZ filings.

The HHI Index

The HHI is a common measure of market concentration and is used to determine market competitiveness, often pre- and post- M&A transactions.

Conclusion

The following acquisition increases the HHI of Amazon by more than 2100 points which is way beyond 200 points, as set by section 5.3 of the Horizontal Merger Guidelines jointly issued by the department and the Federal Trade Commission (FTC).

Other Threats & Hinderances

Cultural and HR obstructions

See next Slide

- Netflix strongly believes in the ideals of creative freedom bestowed upon its content curators in terms of directional and productional flexibility.
- In a survey conducted by Blind, an anonymous professional networking app, 86% of the employees of Netflix were happy at their workplace, the largest share of any company included in the survey. Next in line was Bloomberg.
- Amazon acquiring Netflix may not be the best sign for its employees and work culture when a nine times larger organization acquires the company.

Poison Pill

Details in Appendix

- The management at Netflix have made it very clear they are not interested in being acquired by outsiders, which implies that the takeover at the current stage would have to be a hostile one, with a fragmented shareholder base.
- Ownership of Netflix stock is distributed across multiple institutional and individual investors, with even the largest holding less than 10%. This leaves a lot of parties to be negotiated with, many of whom might be unwilling to sell. The Poison Pill was deliberated curated by Netflix to prevent an acquisition.

Transfer Pricing and Accounting Hinderances

- On the completion of the acquisition, Netflix and AWS become legally related entities, except Netflix Tech stack is supported heavily by the latter, the transactions would come under the ambit of the Transfer Pricing Law
- Amazon has already been imposed with a penalty of €250m for 'illegal tax advantages' in Luxembourg, popularly known as the Death Star of financial secrecy.
- In 2019, despite generating a net income of $11.58 bn, Amazon paid $0 in federal taxes due to various ta breaks. This has been called out by various senators and citizens as blatant Corporate Socialism.
- All these instances aggravate the Andersen effect, which justify the increase in due diligence practiced by auditors on the grounds of pre existing suspicion on certain companies. Amazon can be put on the same radar.

Not Attractive | Very attractive

Source: The Guardian (2018), Amazon's 10K filing - Exhibit 21.1 (2019)

Loss of Creative Freedom

Would Netflix lose their mojo?

- If Amazon wishes to acquire Netflix to capitalize on its content library, it is important to analyze how such an acquisition would impact the way Netflix creates its content.
- Netflix is famous for providing film-makers with full creative freedom, which has been lauded by many directors who have worked with the firm, and the policy has resulted in many critically-acclaimed, award-winning offerings, although it can be quite expensive.
- They have also shown willingness to make risky bets on new ideas and technologies, such as with the revolutionary de-aging technology used in Martin Scorsese's 'The Irishman'. Scorsese has said that he approached multiple financers, but only Netflix was willing to take on the risk.
- While Amazon has also been attempting to attract talent by advertising their willingness to provide freedom, they have not been nearly as successful as Netflix in this regard. Amazon's culture simply doesn't appear as conducive to creative freedom.
- Having made a significant investment in Netflix, it is conceivable that Amazon would stifle this creative and financial freedom, partly by its very nature as a corporate giant, and partly to secure a return, thereby compromising Netflix's ability to do the very thing Amazon needs the most – create high quality content.

THE IRISHMAN was watched by 26,404,081 accounts globally — within its first 7 days on Netflix.

The movie required a huge investment of $159 Million because of the ensemble cast and the Special effects for de-ageing the cast.

VII. Alternative Solution

1

EVALUATING ALTERNATIVES

2

FINANCIAL FEASIBILITY

3

POST-ACQUISITION STRATEGY

Solving Amazon’s Problems

The Content Problem

Invest Further in Own Content

- Amazon can increase its budget for original content and compete for more leases as compared to before.
- As a company, Amazon can afford to spend more than most of their competitors’, and therefore move ahead of them in the given context`

- May not solve the problem of quality, which is what Amazon has been struggling with, as they still would not know what to produce
- Increment to the library would be gradual. It might be too late by the time Amazon catches up to its rivals

Buy a Media Company

- Acquiring a content creator with a history of high quality content would solve Amazon’s problem of deciding what to produce
- Buying a company which owns distribution rights to valuable content would allow Amazon to immediately catch up to its competitors

- Most content creators and media companies are owned by huge conglomerates, who are usually not willing to sell their strategic investments
- Buying out a company with assets like movie studios, TV networks, and content rights may be expensive

Invest in Data Analytics

- Amazon can supplement its content production and acquisition with an investment in data analytics and market research in order to decide what to produce
- This should be done through a 3rd party firm such as Kantar, as despite using data analytics in e-commerce, Amazon has not translated their experience to successful content acquisition

- Here too, the addition to the content library is gradual, and it might simply be too late by the time they can catch up to their rivals
- There is also inherent risk in investing billions into content on the basis of an analysis that lacks a proven track record

Improving the Algorithm

After adding to its library, we feel Amazon should work on improving its recommendations algorithm, as it would help people find shows they actually want to watch, and multiply the returns on the content

DataRobot

Considering Amazon’s lack of success so far, we recommend employing a 3rd party firm like DataRobot Inc. to develop a new algorithm

Finding the Right Creator

Infeasible

Company	Overview	Content	Strategic Feasibility	Financial Feasibility	Verdict
hulu	• A direct competitor to Netflix and Prime Video. • It has been a division of Disney since 2019. • Integrated with Disney's other products, used to stream content from networks and studios owned by Disney.				Lacks the original content, and Disney would be unwilling to sell it, as Hulu offers a strategic advantage in distribution.
abc	• Owns both a film division and a television division with high quality output, although does not own rights to many TV shows. • Management have stated they wish to grow the business, and are not interested in selling.				Even if Disney are willing to sell ABC, the content library may not be sufficient for Amazon.
NBCUniversal	• Large TV and Film library. • Owned by Comcast. • Too large to acquire entirely, divisions not for sale.				More than enough content to win the streaming wars, but not a feasible acquisition.
HBO	• Great original TV content. • Ultimately owned by AT&T. • Investing heavily into launching own streaming service.				Would add to TV content library, but is not likely to be open to acquisition.

Continued

Details in Appendix

Finding the Right Creator

Continued

	Company	Overview	Content	Strategic Feasibility	Financial Feasibility	Verdict	
Feasible	MGM	• Has produced high quality movies and TV shows, but owns the distribution rights to very few. • The owners are rumored to be looking to sell MGM.					A feasible acquisition, but does not bring enough content to the table.
	SONY PICTURES	• Large library of popular TV shows, most of which are already available on OTT platforms. • Owned by Disney, and content from ABC is commonly distributed through Hulu.					Would definitely help expand Amazon's movie library, but it does not appear as though Sony would be willing to sell this division.
	LIONSGATE	• Mainly a film studio, relatively small in terms of output and library. • Smaller market cap (around $1.2 billion). • Some content already on NBC's platform.					Certainly a viable acquisition, but would only go part way in solving Amazon's content problem.
Ideal	VIACOMCBS Analysis on Next Slide	• Formed in December 2019 from the merger of Viacom and CBS. • The firm owns movie production studios and a vast television network. • Report suggests owners may be interested in selling.					Would form a sizeable increment to Amazon's content library, but acquiring a company that is in the process of being restructured may pose challenges.

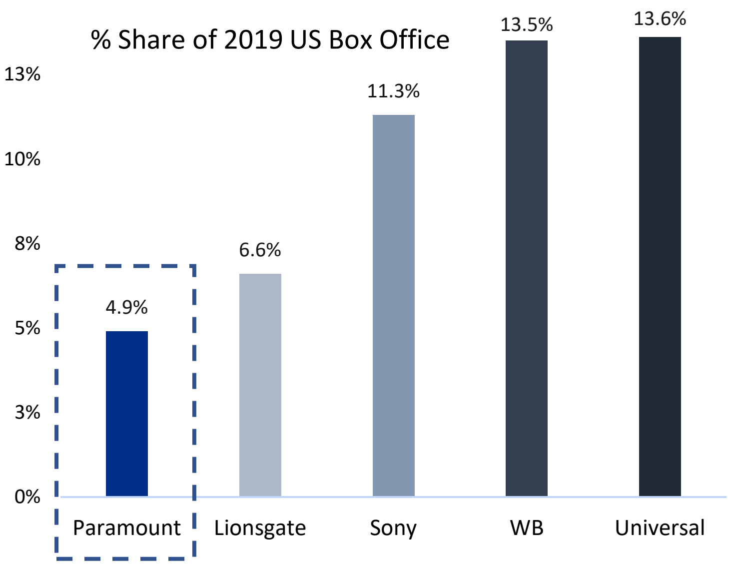
Details in Appendix

ViacomCBS as a Target

Movies

- ViacomCBS owns Paramount Pictures, one of the largest movie studios in the world, with a history of churning out blockbusters
- Paramount has a current theatrical library of close to 400 films including franchises like Mission Impossible, Indiana Jones, Transformers, and Star Trek, which would add considerable value to Amazon's current library

Paramount is one of the largest studios in the world

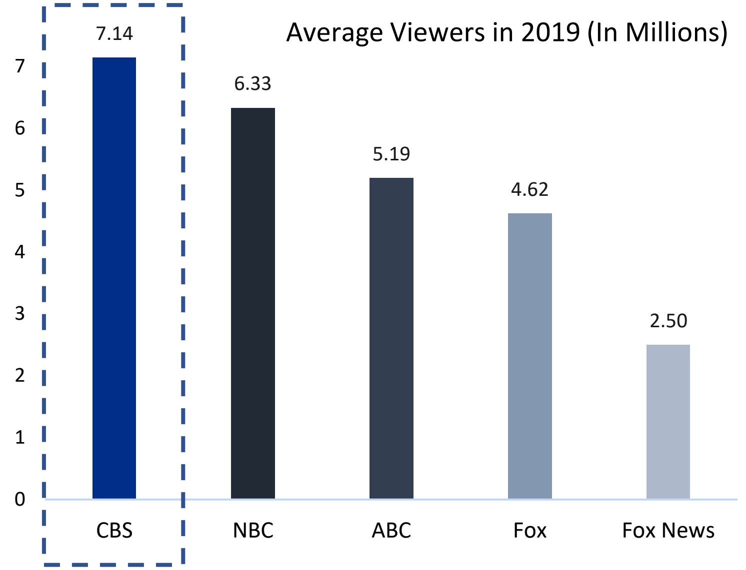


Disney not shown, Source: Box Office Mojo

Television

- CBS is one of the 'Big Three' television networks in the US, and includes not only the numerous CBS-branded channels, but also ones like MTV, Comedy Central and Nickelodeon
- It owns the rights to hundreds of sucesful TV shows and series, including Star Trek: Picard, NCIS, The Big Bang Theory, Mom, etc.

CBS is the largest TV network in the US



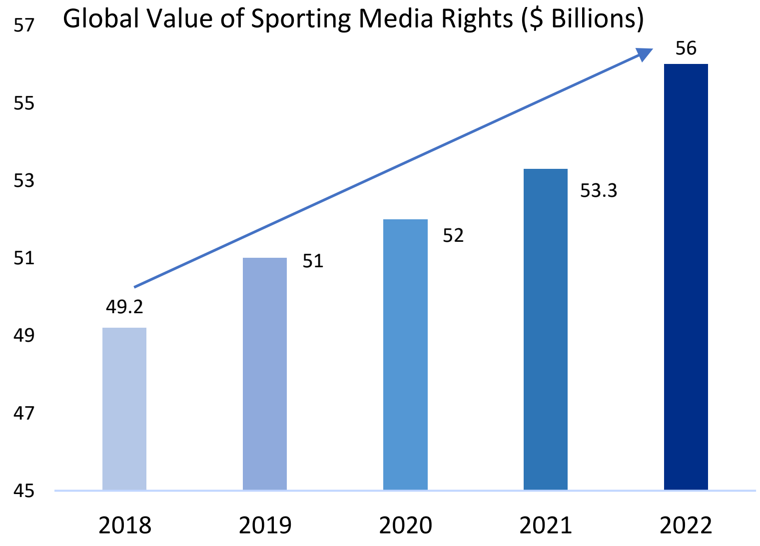
Source: Statista

Details in Appendix

Sports

- Amazon has been trying to enter the sports broadcasting industry for the last few years, and an established cable network like CBS would greatly help the company launch successful bids for rights in the future
- Live sports broadcasting would be an excellent addition to Amazon, and a huge selling point over primary rival Netflix

Sporting Media Rights may be worth over $55 billion by 2022



Source: SportBusiness Global Media Report

ViacomCBS as a Target – Asset Base

OTT Services

Movie Studios and Distribution

Television Assets

Interactive Division

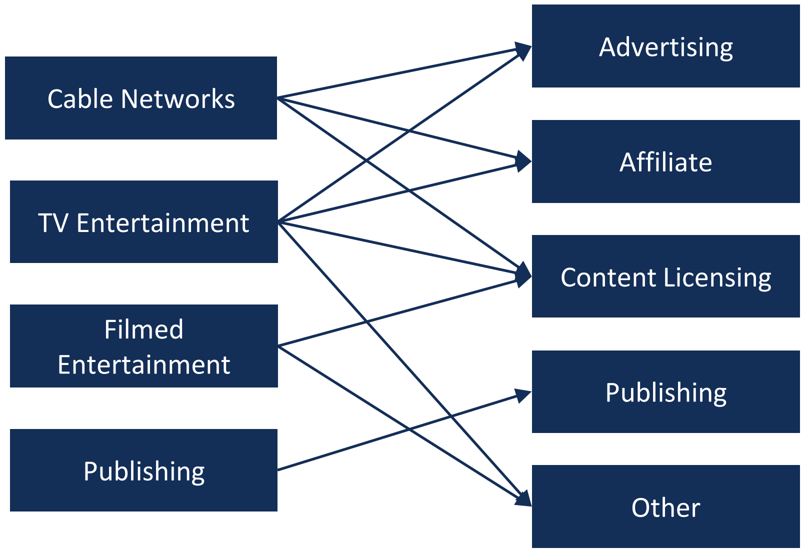
Note: The list of Assets is non-exhaustive.

ViacomCBS as a Target – Revenue Model

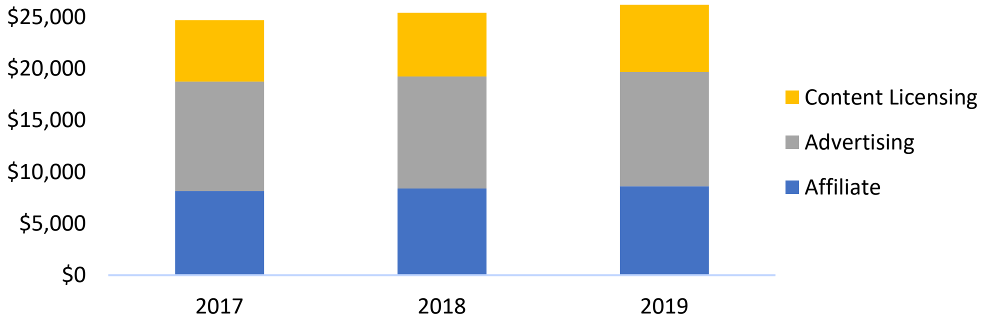
Most of the company's revenue comes from 4 divisions

It is further classified broadly by type

(Arrows are indicative of true breakup)

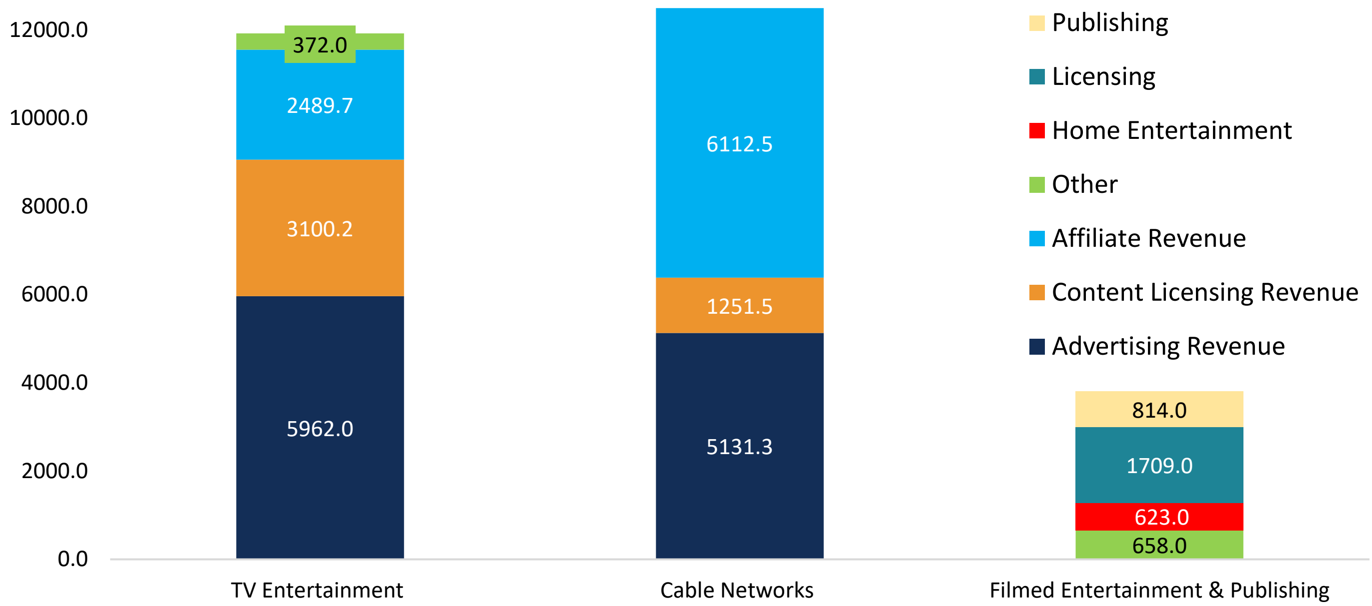


ViacomCBS Revenue by type in $ Million (2019)



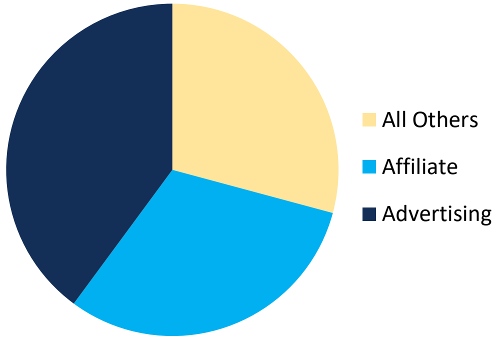
Source: Company Filings and Press Releases

ViacomCBS Revenue by Division and Type in $ Million (2019)



Source: 10k Report

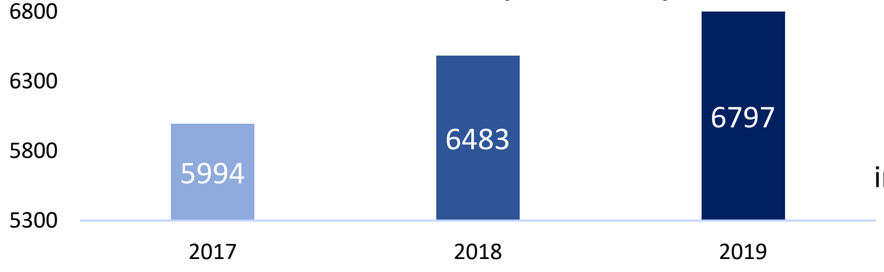
- A majority of the revenues come from selling advertising time on their television broadcasts, and in the form of affiliate revenue
- Affiliate Revenue consists primarily of fees received from MVPDs for carriage of CBS's cable networks and TV stations and fees from TV stations associated with the Network
- Affiliate Revenue also includes subscription fees for Showtime and CBS All Access



ViacomCBS as a Target – Costs and Profit

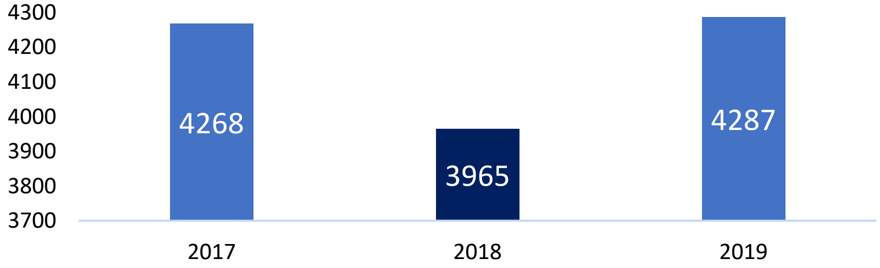
ViacomCBS has 3 main cost drivers

Production Cost ($ millions)



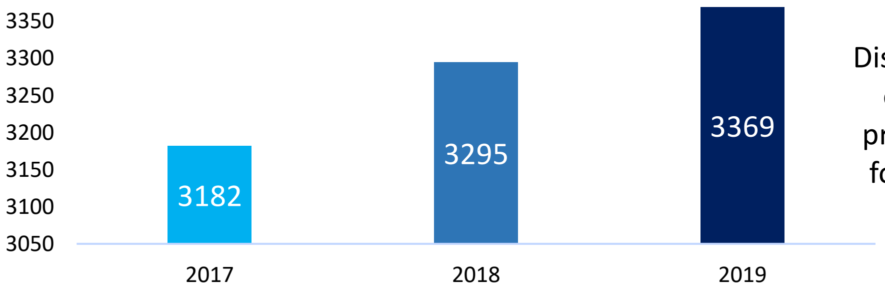
The amortization expenditure on internally-produced content.

Programming Cost ($ millions)



The amortization expenditure on acquired content.

Participation, Distribution, Royalties ($ millions)

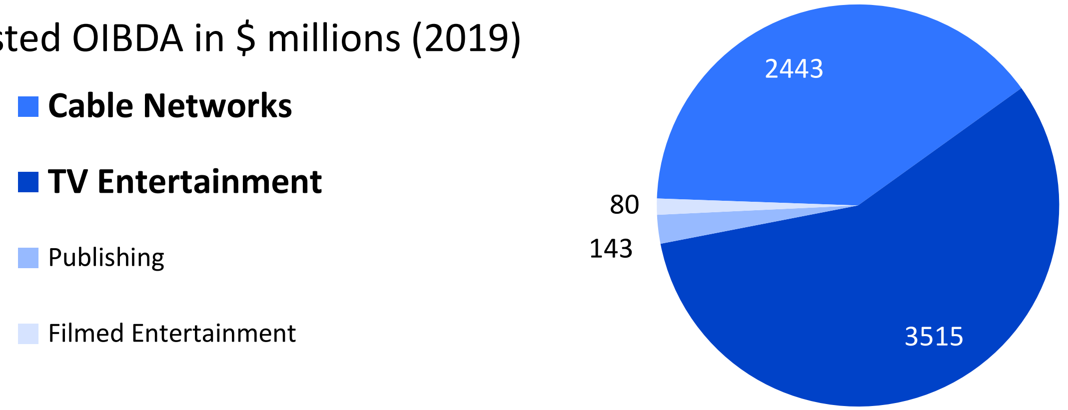


Distribution and residual costs of TV and Film programming, royalties for published content.

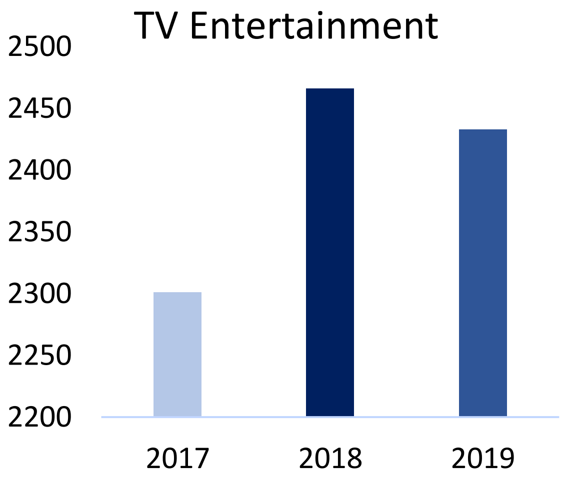
Source: Company Filings and Press Releases

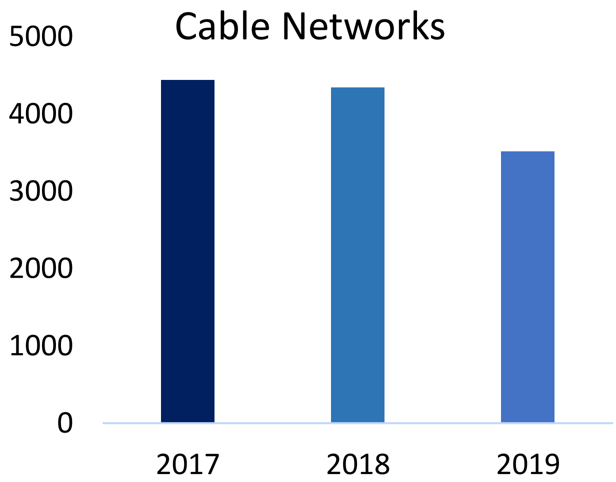
Nearly all its profits come from 2 divisions

Adjusted OIBDA in $ millions (2019)



Adjusted OIBDA in $ millions





VII. Alternative Solution

1

EVALUATING ALTERNATIVES

2

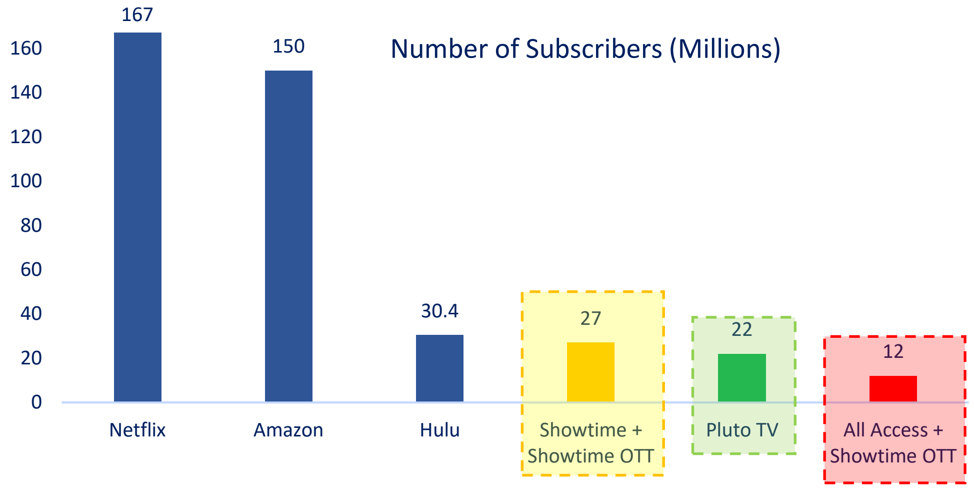
POST-ACQUISITION STRATEGY

3

FINANCIAL FEASIBILITY

Post Acquisition Strategy

CBS All Access and Showtime OTT can be closed



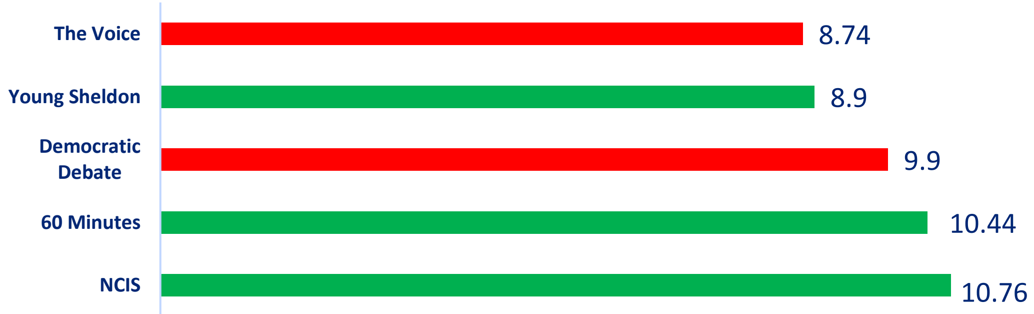
CBS All Access is relatively small in terms of subscriber base. Its operations would be shut down 2021 onwards
All content on CBS All Access would be quickly incorporated into Prime Video and be available to subscribers at no additional cost

While Showtime is fairly successful as a premium cable channel, Showtime OTT has failed to take off
Showtime OTT would be discontinued as an independent service 2021 onwards, and would only be available through Prime Video Channels

All of ViacomCBS' traditional content creation and distribution operations as undertaken by their numerous channels, studios and networks would remain more or less undisturbed, as it is one of the most successful players in multiple industries

ViacomCBS leads the traditional broadcasting segment

3 of the 5 most watched shows on TV in the US right now are on CBS

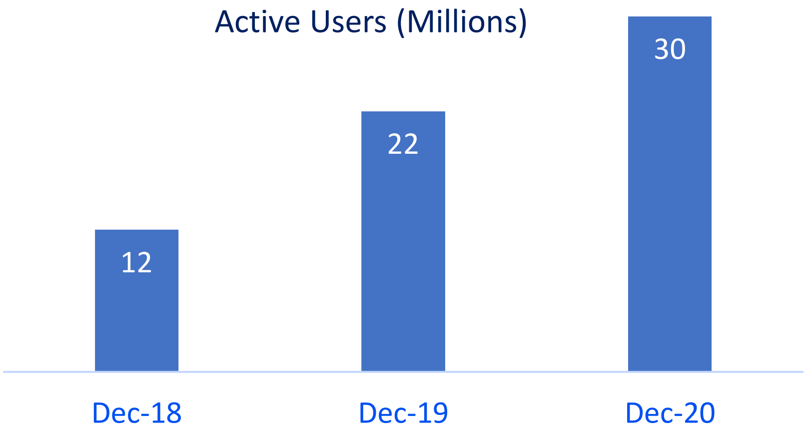


For week ended Mar 15, 2020 **(Viewers in millions)**

Sources: Digitaltrends.com, NCTA.com, Variety.com, Usnews.com Company Filings

Post Acquisition Strategy

PLUTO TV



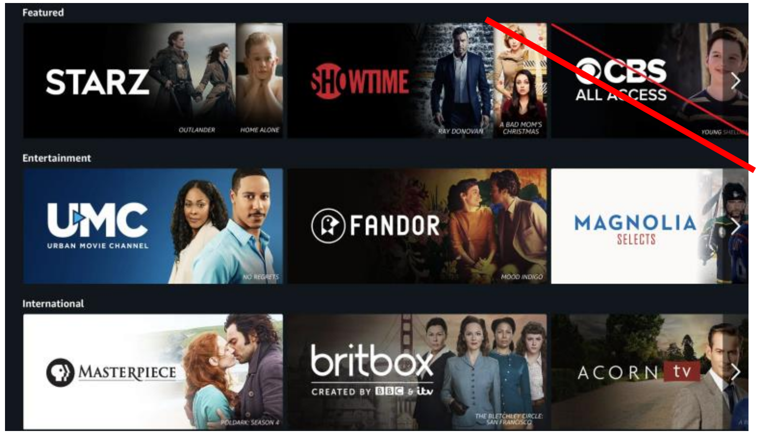
Pluto TV is growing rapidly

Pluto TV's AVOD model may not integrate well with Prime Video. It also has a healthy subscriber count which captures a different segment of the market
Pluto TV acts as a great compliment to a service like Prime Video, and would function independently, as it does now

prime video live

Live feeds of CBS TV channels would be available at no additional cost to subscribers of Prime Video through a new section called 'Prime Video Live', this would include News and non pay-per-view sports feeds

This would not include premium or pay-per view channels, as providing those may disrupt their usual revenue stream significantly. It would also not include channels such as The CW, which are not owned or run entirely by ViacomCBS



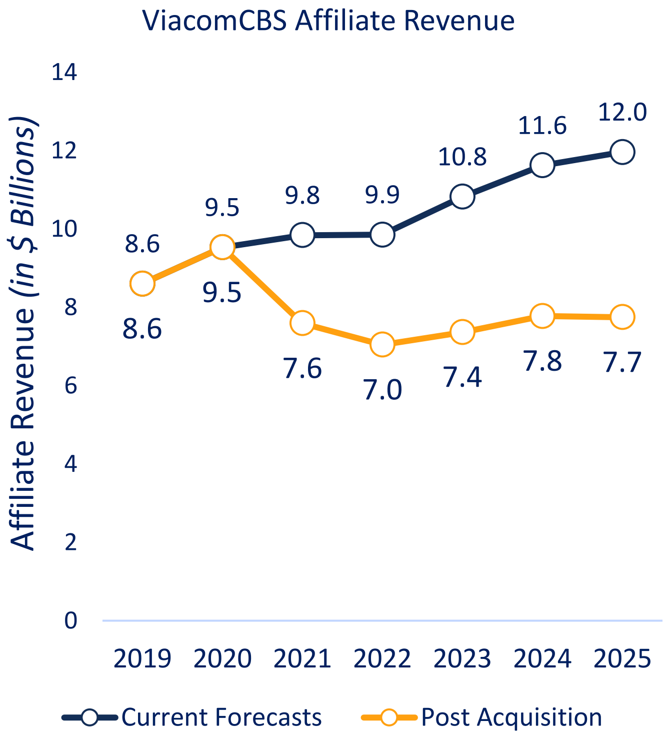
Prime Video Channels would remain unchanged as a service, but those CBS channels now available for free through Prime Video Live would not be on it

Sources: Company Filings, thewrap.com

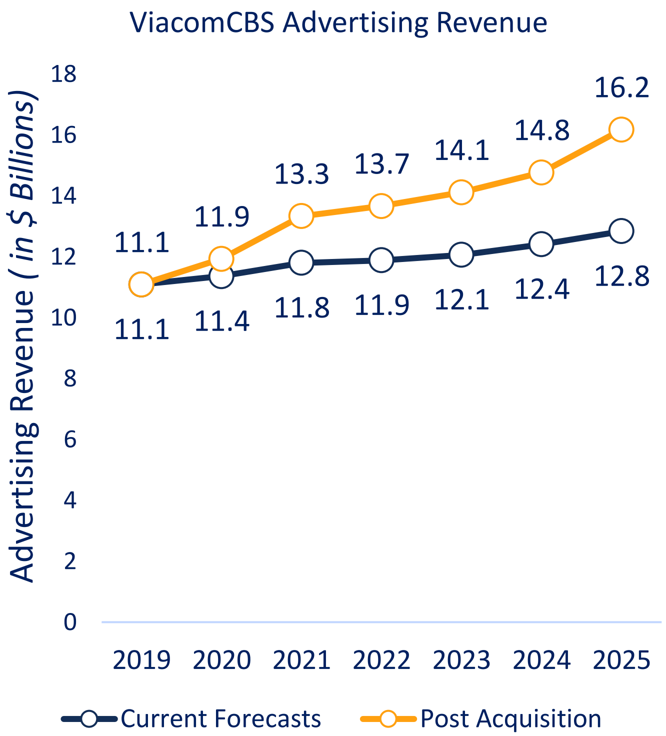
Post Acquisition Strategy – Financial Analysis

The Post Acquisition Strategy will have an impact on the earnings of both firms

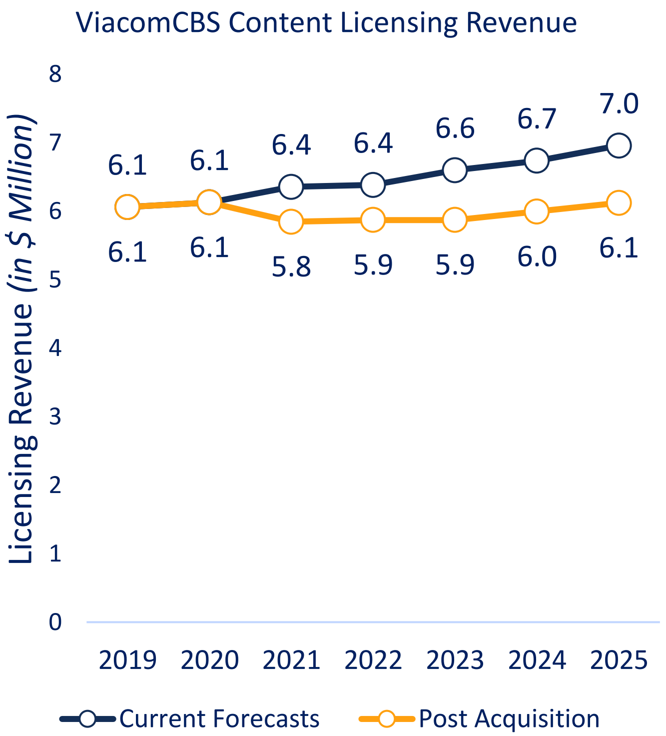
*ViacomCBS will **lose out** on **Affiliate Revenue** due to the **closure** of **CBS All Access and Showtime OTT***



*However, they will **gain advertising revenue** due their channels being broadcasted **to a large audience** through **Prime Video Live***



*ViacomCBS would be more **selective** in leasing its content out to rivalling platforms, so **Licensing Revenues** would **reduce** slightly*

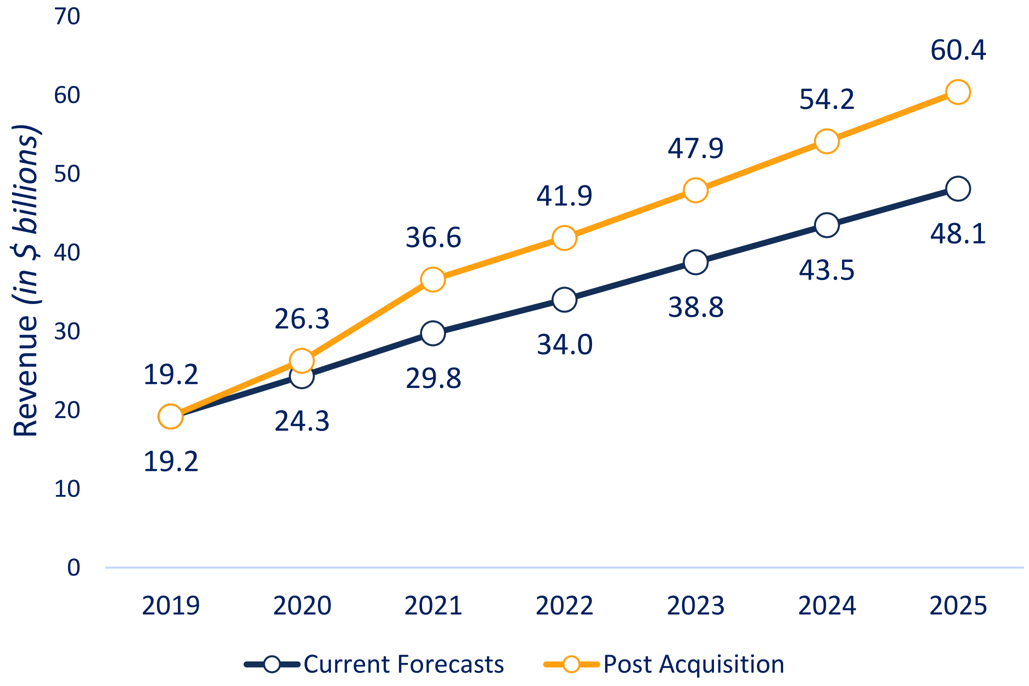


Sources: Company Filings, thewrap.com

Post Acquisition Strategy – Financial Analysis

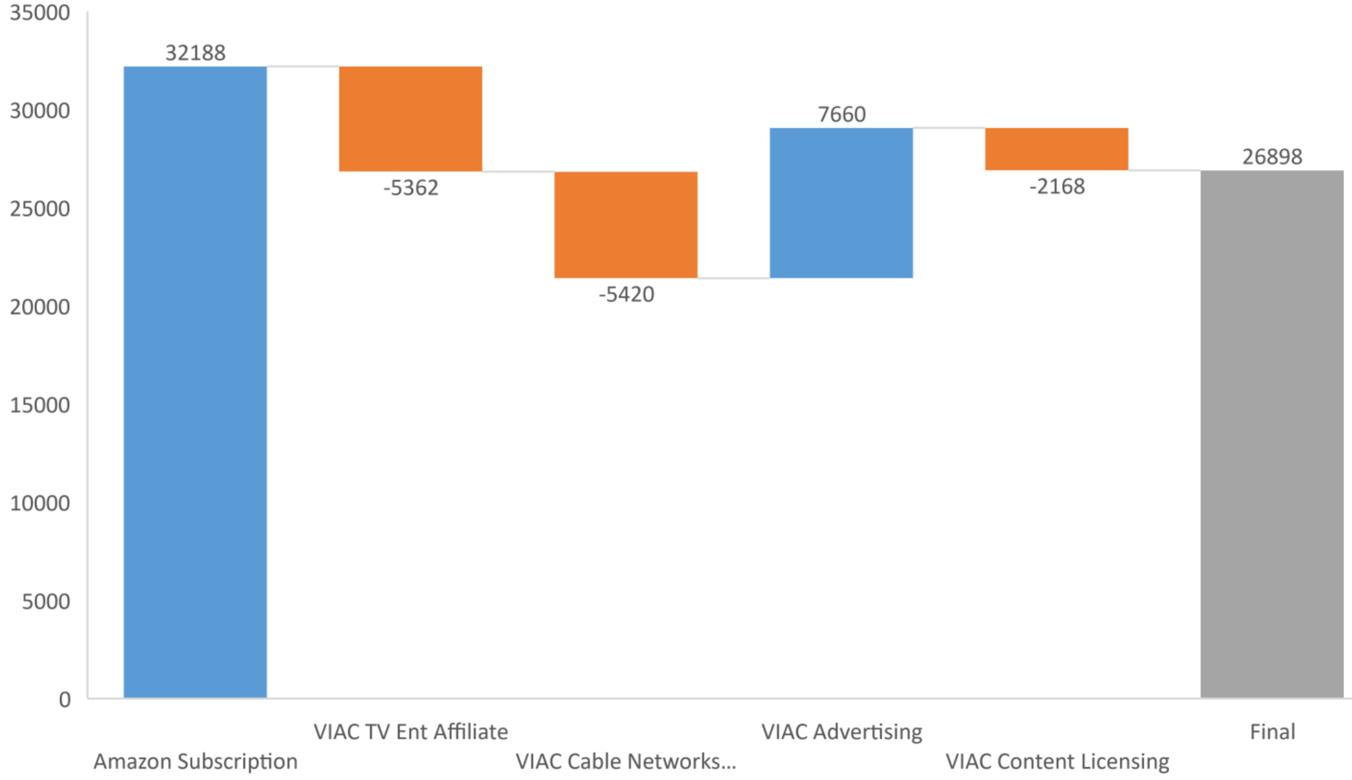
The Post Acquisition Strategy will have an impact on the earnings of both firms

*Amazon would **gain** significantly in terms of **revenue from subscription services***



Overall, we see an increase in revenue when netting out all the sources from both companies

(Discounted Values of Incremental Revenues; USD mn)



Sources: Company Filings, thewrap.com

VII. Alternative Solution

1

EVALUATING ALTERNATIVES

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FINANCIAL FEASIBILITY

Determining the Intrinsic Value of ViacomCBS

ViacomCBS's Discounted Cash Flow Analysis

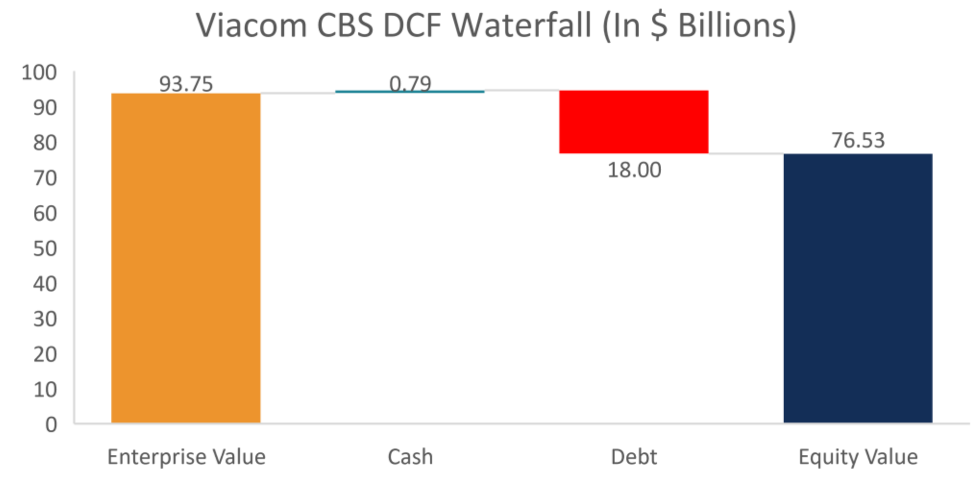
In $ Millions	2020	2021	2022	2023	2024	2025
EBIT	4,964	4,770	4,414	4,399	3,907	3,320
[-] Cash Taxes	993	954	883	880	781	664
EBIAT	**3,971**	**3,816**	**3,531**	**3,519**	**3,126**	**2,656**
[+] D&A	245	317	386	306	330	366
[-] Capex	(380)	(393)	(394)	(412)	(429)	(442)
[-] Changes in NWC	(503)	(93)	(9)	(131)	(121)	(93)
Unlevered FCF	**3,335**	**3,646**	**3,514**	**3,282**	**2,906**	**2,487**
Transaction FCFF	**2,779**	**3,646**	**3,514**	**3,282**	**2,906**	**2,487**

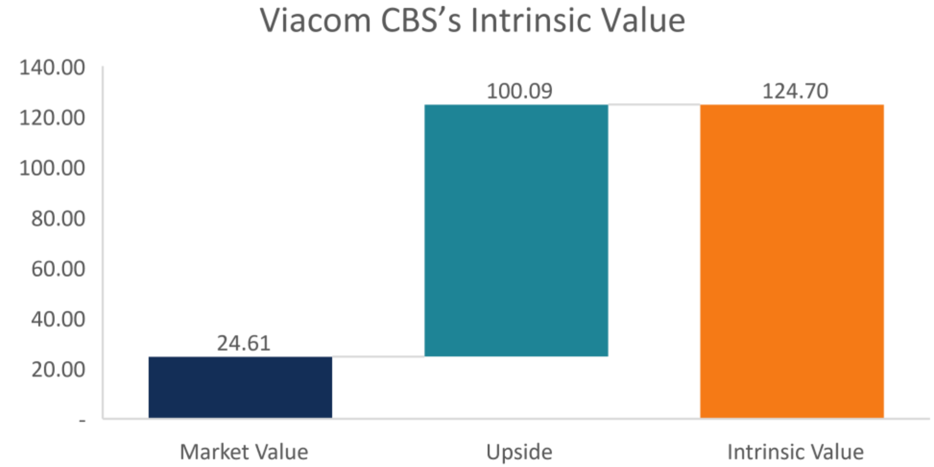
Cost of Equity	
Risk Free Rate	1.52%
Equity Risk Premium	5.20%
Levered Beta	1.59
Cost of Equity	**9.80%**

Cost of Debt	
Pre tax cost of Debt	3.11%
Tax Rate	20.00%
After Tax Cost of Debt	**2.49%**

Capital Structure	
Market value of Debt	22,286
Market value of Equity	15,104
Total Market Value of Capital	37,390
Debt to Total Capitalization	59.60%
Equity to Total Capitalization	40.40%
Debt / Equity	**1.48**

WACC = 5.44%

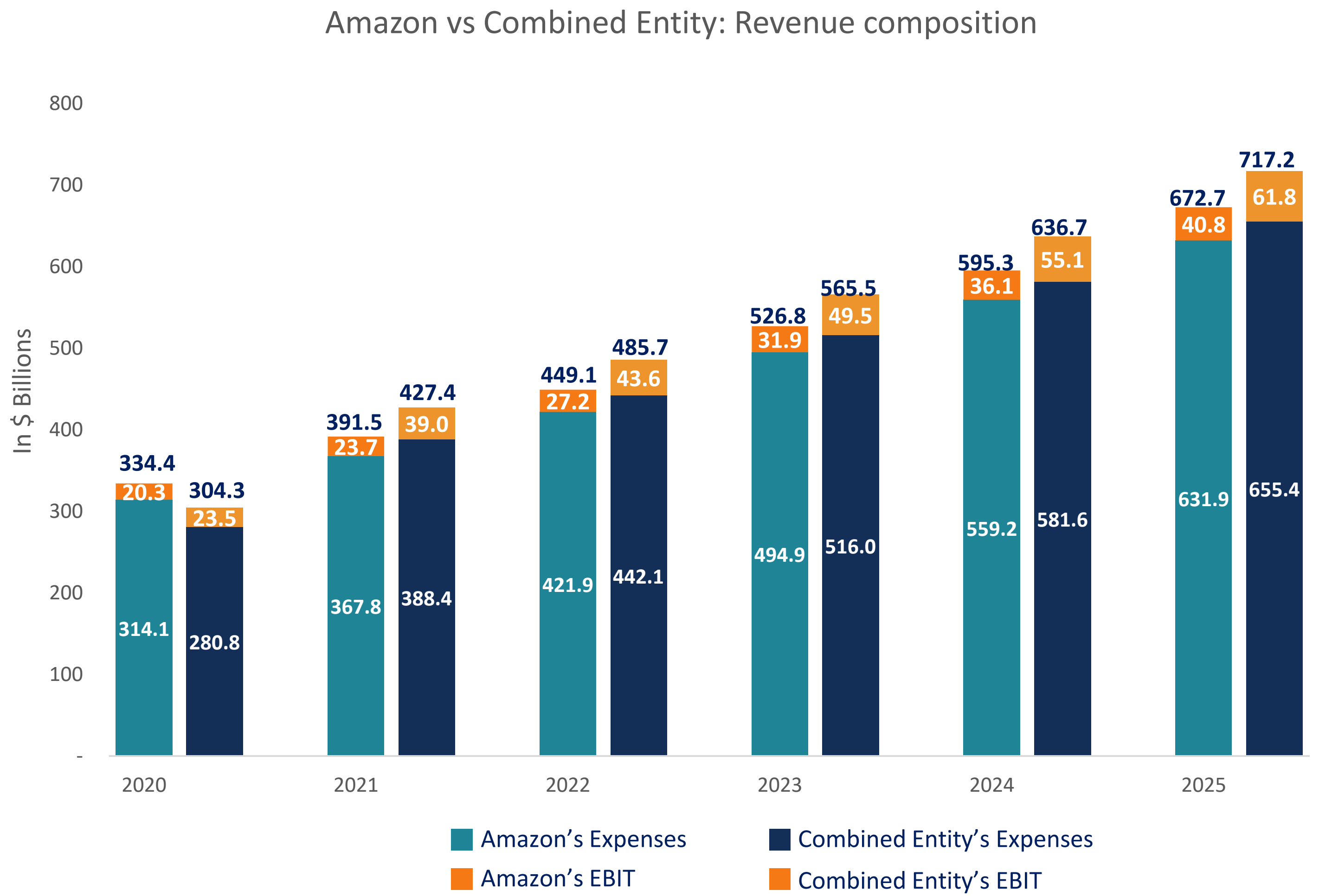




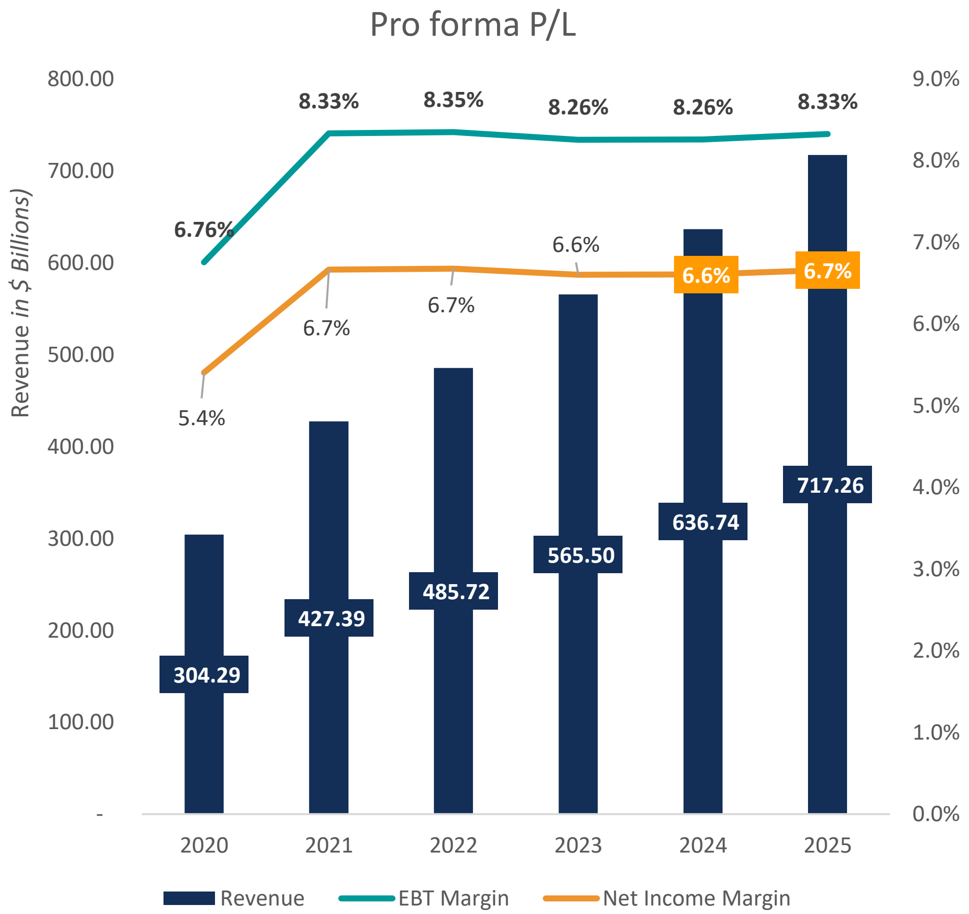
ViacomCBS is currently undervalued by over 80% as per the discounted cash flow analysis

Pro Forma Financial Scenario

Boosting Amazon's Top-line & Bottom-line



Performance Statement



Unleashing Value Creation upon Shareholders

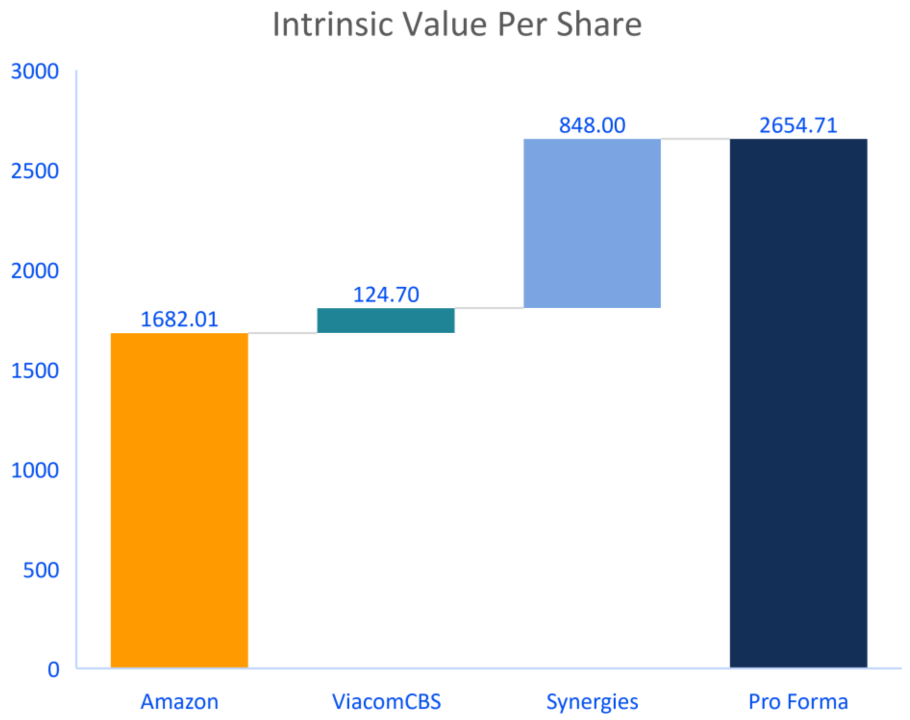
Accretion/Dilution Analysis

In $ Millions	2021	2022	2023	2024	2025
Earnings Per Share					
Acquirer Net Earnings	18,554	21,402	25,242	28,629	32,506
Target Net Earnings	2,662	2,425	2,452	2,106	1,657
Pro Forma Net Earnings	28,492	32,439	37,349	42,074	47,776
Acquirer Shares O/S	498	498	498	498	498
Target Share O/S	614	614	614	614	614
Pro Forma Shares O/S	498	498	498	498	498
Acquirer EPS	37.27	42.99	50.71	57.51	65.30
Target EPS	4.34	3.95	4.00	3.43	2.70
Pro Forma EPS	57.23	65.16	75.03	84.52	95.97
Accretion/Dilution	**54%**	**52%**	**48%**	**47%**	**47%**

Capital Structure

	Current	Pro Forma	Change
Equity	**8,37,322**	**13,21,543**	**58%**
Cash	58,348	59,637	2%
Debt	23,244	62,246	168%
Enterprise Value	8,02,218	13,24,152	65%

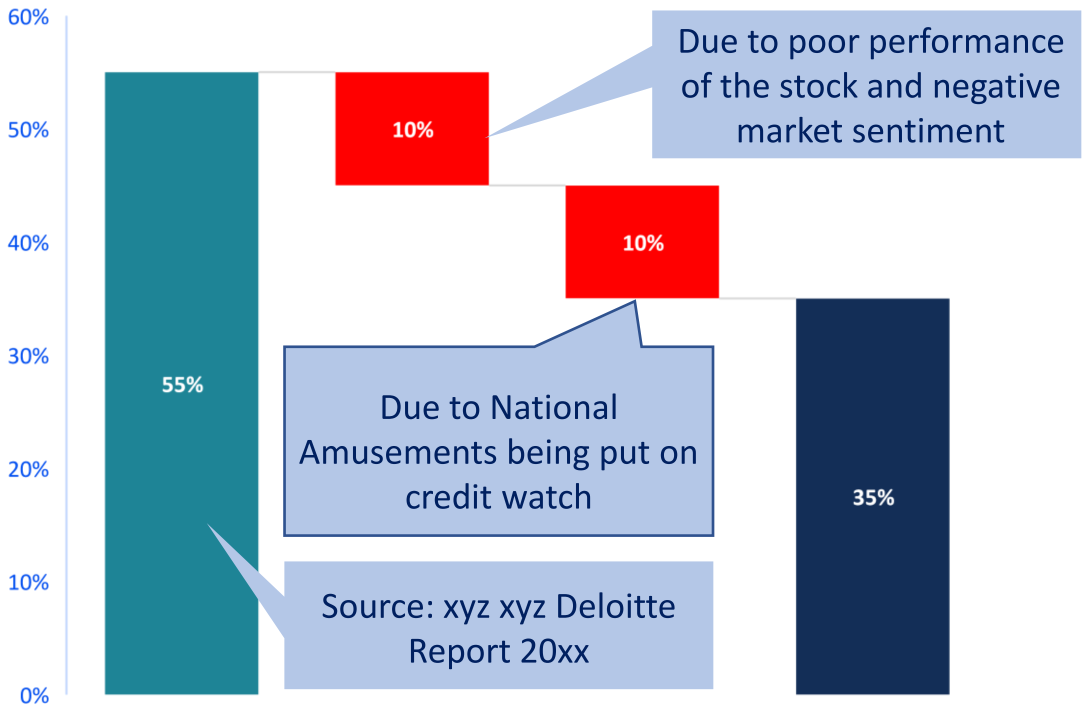
The additional $848 value per share is attributable to the operational as well as financial synergies. There's a positive accretion in the EPS to the tune of 47-54%, thereby maximizing the return to shareholders by trading on equity. The calculated IRR is way below the cost of debt allowing Amazon to acquire ViacomCBS by raising debt just like it's previous acquisition of Wholefoods.



Share Price Impact

	Offer Price	Market Price	DCF Model
Target Price per Share	$33.22	$24.61	$124.70
Acquirer			
Acquirer Price per Share		$1,883.75	$1,682.01
Pro Forma Price per Share			$2,654.71
Change in Acquirer NPV per Share			**$972.70**

Alterantive Solution – Purchase Price

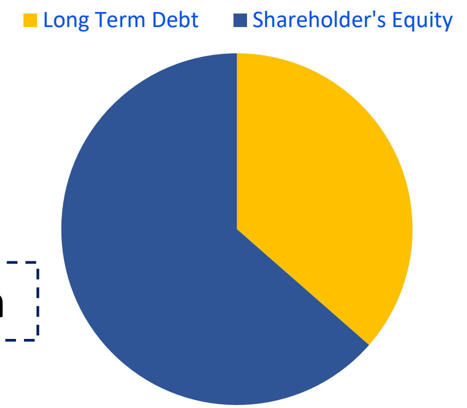


Purchase Price	
Target Share Price	$24.61
Takeover Premium	35%
Offer Price	$33.22

Target Shares Outstanding	614
Offer Price	$33.22
Purchase Price	**USD 20391 million**

Amazon can easily take on more debt

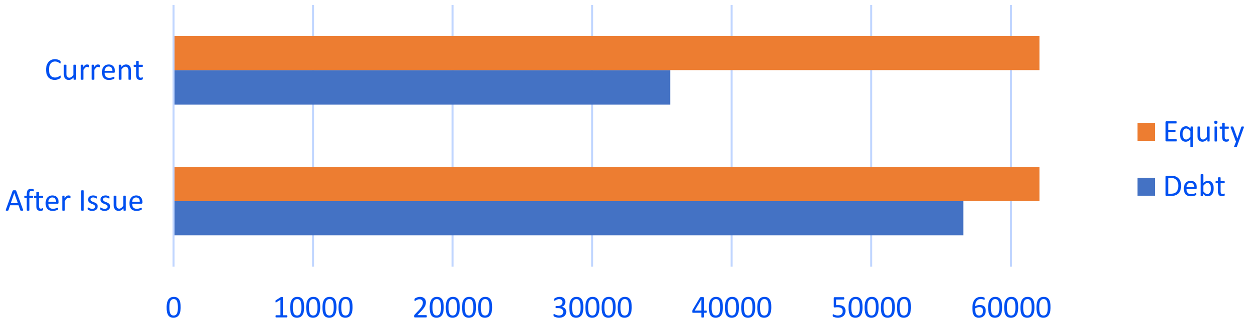
It has an extremely healthy debt-to-equity ratio



We recommend an all-debt acquisition

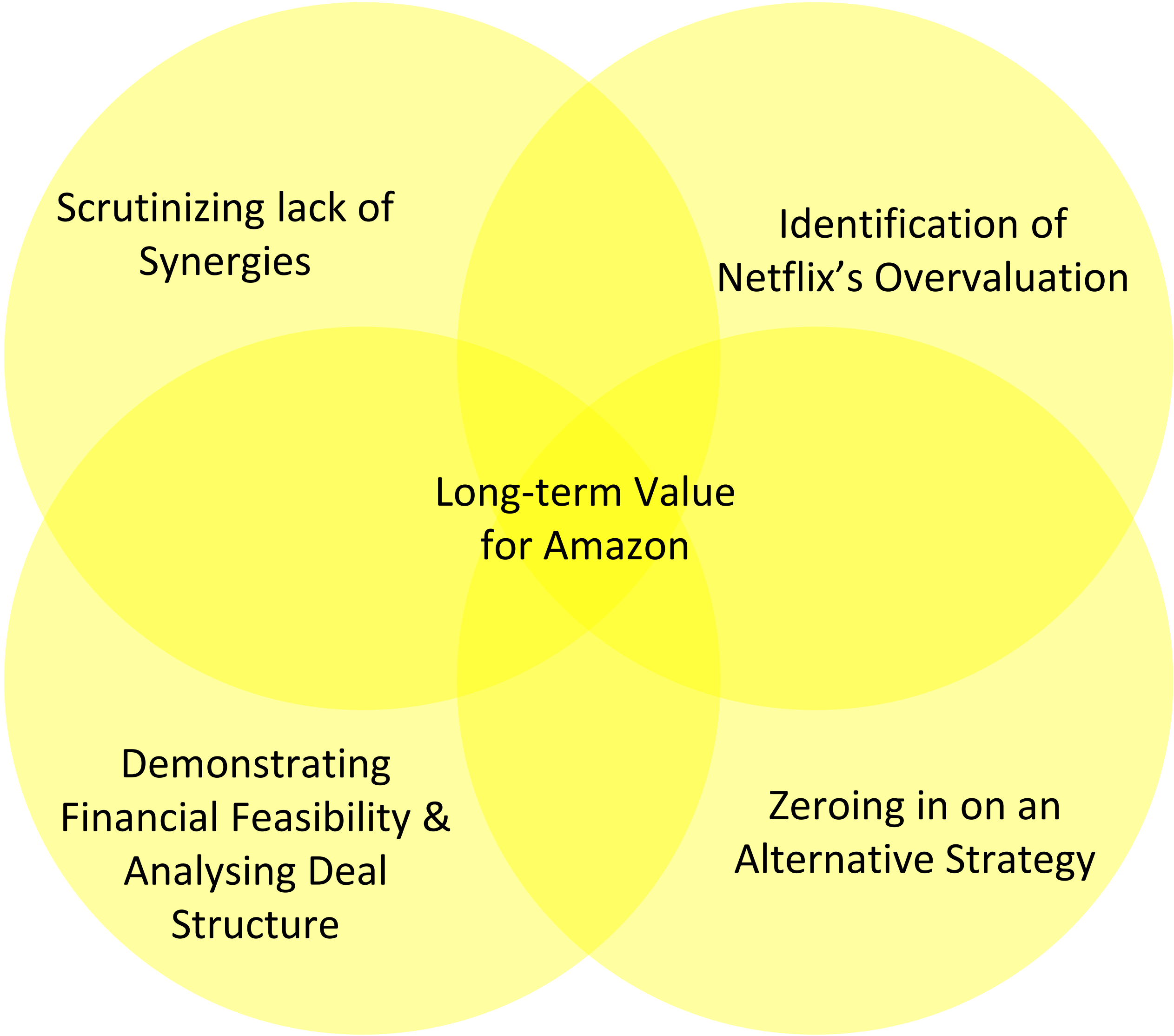
Debt Amortization Schedule

Tranche	2020	2021	2022	2023	2024	2025
4.2% Senior Debt A ($ 7 Billion)	20%	20%	20%	20%	20%	0%
4.8% Senior Debt B ($ Billion)	0%	20%	20%	20%	20%	20%
5.0% Senior Debt C ($7 Billion	0%	0%	0%	0%	0%	100%



VIII. Conclusion

Summarising our Solution



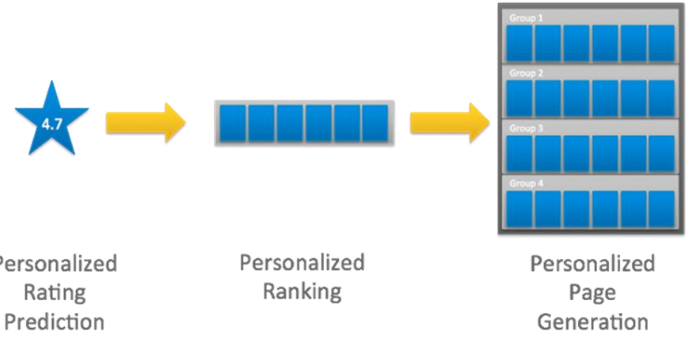
Appendix


NETFLIX
AGENT.45
TAXI
only in Rome
KALIBER
hotel social
ZEN&ZACK
MADEMOISELLE
UNIVERSE
SILENT NINJA

Strategic Fit: Technology and Development

Netflix's Algorithm- Need and importance

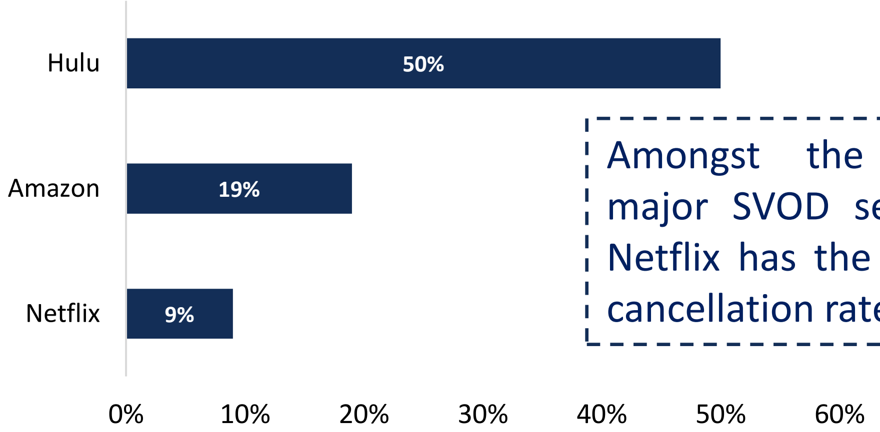
- According to Netflix, users look at between 20 and 50 titles before they give up, so Netflix has a 60-90 second window to recommend something before users switch to a different platform
- They constantly offer incentives for external teams to come in improve or review the algo. Even ran Netflix Prize – Gave 1 million to a team that came up with an algo that was 10% better than Netflix's old one
- To better identify users' preferences, content is categorized into tens of thousands of micro-genres. Together, the data points are combined to create clusters of people who have the same content preferences.



An illustration of the personalisation aspect of Netflix's Algorithm, its most distinguishable feature

Amazon's algorithm- needs improvement

- The amazon algorithm and recommendation system does exist but isn't as effective as the Netflix Algorithm.
- Initially, Amazon had inadvertently trained its algorithms to recommend safe bets. In the case of Prime Video, these were classic movies that were well-regarded. But while these movies had high ratings with audiences and critics alike, they weren't exactly what consumers wanted to watch.
- A sign of discontent with the existing content might be visible in the statistic that almost 35% of Prime video users cancel their subscription within a year as compared to Netflix's 9%



Amongst the three major SVOD services, Netflix has the lowest cancellation rate

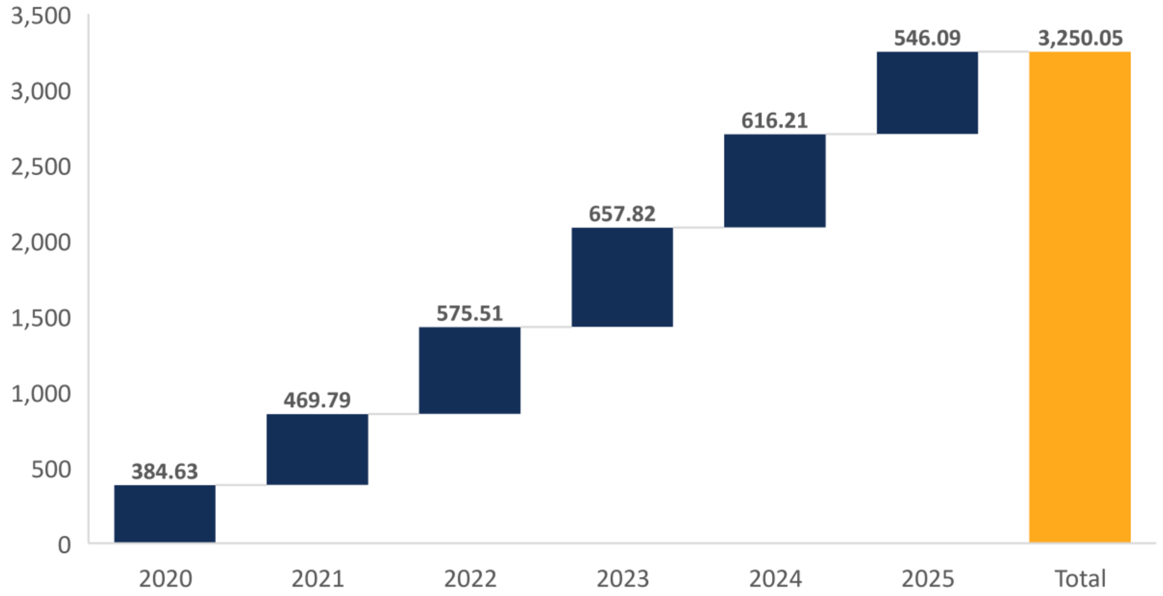
Source – Parks Associate (graph)

Appendix

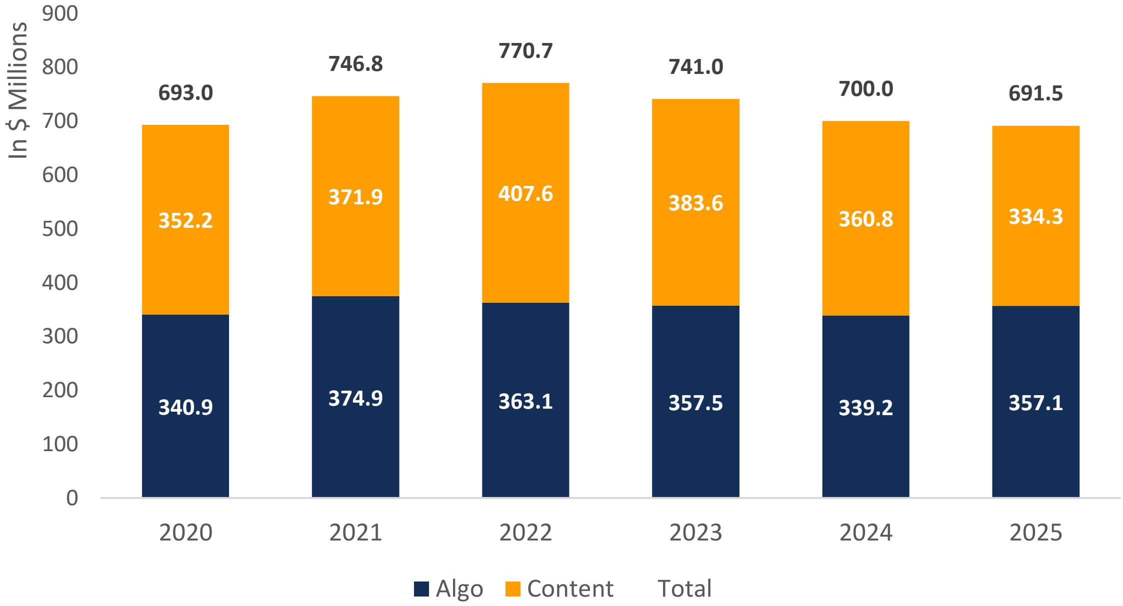
Bibliography

Strategic Fit: Technology and Development

Total technology and development numbers forecasted on DCF. Savings on infrastructure division of tech. and dev. given below.



Amazon's Savings on R&D Spending



Netflix's Infrastructure Research Savings

- Division of the Tech and Development Expenses taken from the Netflix tech blog.
- Division of expenditure done according to our own analysis
- Savings worth 65% of expenditure in 2020, 75% in 2021, 85% in 2022, and 100% after that point till 2025

Amazon Saves on Algorithm and Content valuation

- Savings on algorithm are worth 75% of expenditure in 2020, 85% in 2021, 100% after that point till 2025
- Savings on content valuation and market research are worth 15% of expenditure in 2020, 25% in 2021, 30% in 2022 and 35% after that point till 2025

Appendix

Bibliography

Strategic Fit: CDN

Amazon's infrastructure

- Since 2006, Amazon has been offering IT infrastructure services to business through Amazon Web Services, and the company has now transitioned to offering most of their solutions through cloud computing under the same brand.

- In 2018, AWS brought in $25.7 billion in revenue, a near 50% jump from 2017, and in fact contributed more to Amazon's operating income in 2018 than any of their e-commerce division.

- Amazon Web Services offers a wide range of different business purpose global cloud-based products. The products include storage, databases, analytics, networking, mobile, development tools, enterprise applications, with a pay-as-you-go pricing model.

Netflix Already Uses AWS's services

- Netflix stopped using their own data centers in 2008, as they realized they had such a huge requirement for them that they would essentially have to transform into a data center company if they didn't switch to a public cloud
- Switching to Amazon's cloud allowed them to focus on their core business, and means they don't have a huge amount of their capital tied up in computing assets.
- Today, all of Netflix's computing infrastructure, with the exception of their CDN, runs through various AWS products.

- Content
  - Video Masters
  - EC2
  - S3
  - CDN
- Logs
  - S3
  - EMR Hadoop
  - Hive
  - Business Intelligence
- Play
  - DRM
  - CDN Routing
  - Bookmarks
  - Logging
- WWW
  - Search
  - Movie Choosing
  - Ratings
  - Similars
- API
  - Metadata
  - Device Configuration
  - TV Mobile Choosing
  - Mobile iPhone

A comprehensive list of AWS services used by Netflix and the function they serve.

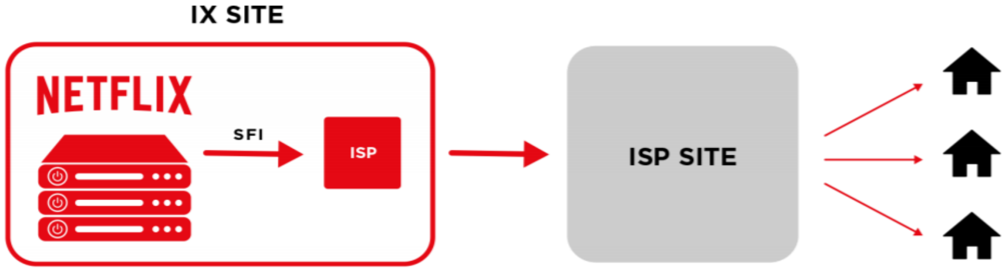
Appendix

Bibliography

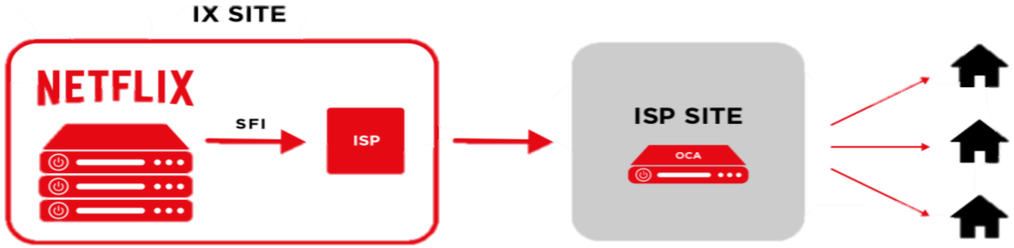
Strategic Fit: CDN

Netflix OpenConnect works In 2 ways

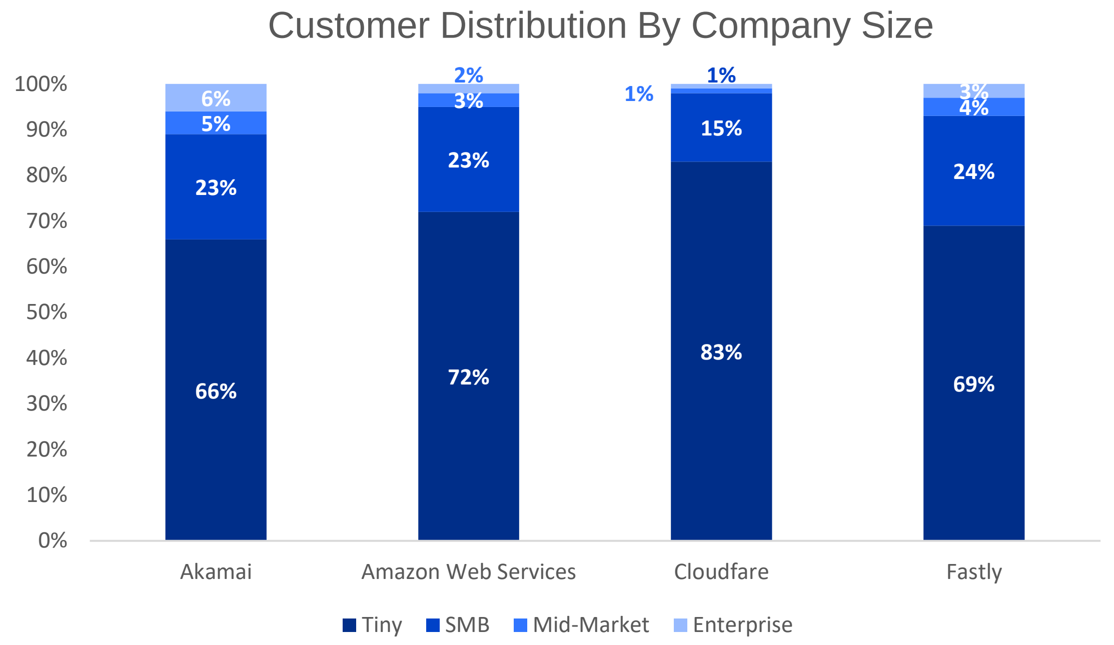
- Netflix installs OCAs within internet exchange points (referred to as IXs or IXPs) in significant Netflix markets throughout the world. These OCAs are interconnected with mutually-present ISPs via settlement-free public or private peering (SFI). Peering alone can be very beneficial to our ISP partners.



- Provide OCAs free of charge to qualifying ISPs. These OCAs, with the same capabilities as the OCAs that are in the IXPs, are deployed directly inside ISP networks. We provide the server hardware and the ISPs provide power, space, and connectivity. ISPs directly control which of their customers are routed to their embedded OCAs



Amazon CloudFront customer breakup



- Although Amazon CloudFront has more customers, Amazon serves only 2% of Enterprise level customers as compared to the industry leading Akamai that serves 6%
- While Amazon's CDN strategy is focused on customer adoption, Akamai has been far more effective at targeting the higher profit CDN use cases.

Appendix

Bibliography

Source: Netflix tech. blog, Intricately market report

Strategic Fit: Leasing

Need for licensing content

- Netflix has been trying to end it's reliance on licensed content by investing heavily in original content and trying to come up with new originals
- Licensed TV shows accounted for 3 of the top 4 streaming series on Netflix for 2018.
- Netflix reportedly paid $100 million to keep Friends on its service for 2019, more than triple its previous licensing fee of $30 million, which shows how important licensed shows are to Netflix.

RANK	TITLE	STUDIO
1	THE OFFICE (U.S.)	NBC
2	CHILLING ADVENTURES OF SABRINA	NETFLIX
3	FRIENDS	WARNER
4	GREY'S ANATOMY	ABC
5	HOUSE OF CARDS	NETFLIX

Source: Forbes

Effects of bidding wars.

- HBO directors Benioff and Weiss made a deal to leave the studio. All major studios pursued them and they selected Netflix. The deal, and will see Benioff and Weiss leaving HBO to create and develop new film and TV projects exclusively for Netflix. According to The Hollywood Reporter, the deal was worth $200 million.

- In Nov 2018 Netflix and amazon engaged in bidding wars again to acquire rights to Lord Of The Rings, which became the most expensive acquired series when it finally got acquired by Amazon prime

- For Netflix, it is imperative to invest the money in licensed shows that are popular with the audience, because Netflix's revenue growth has been lower than its expenditure growth.

Appendix

Bibliography

Financial Analysis: Precedents Overview

By virtue of precedent transactions in the media and entertainment industry, we arrive at an EV/Revenue multiple of 3.4x and an EV/EBITDA multiple of 12.4x.

Precedent M&A transactions, 2009-19.

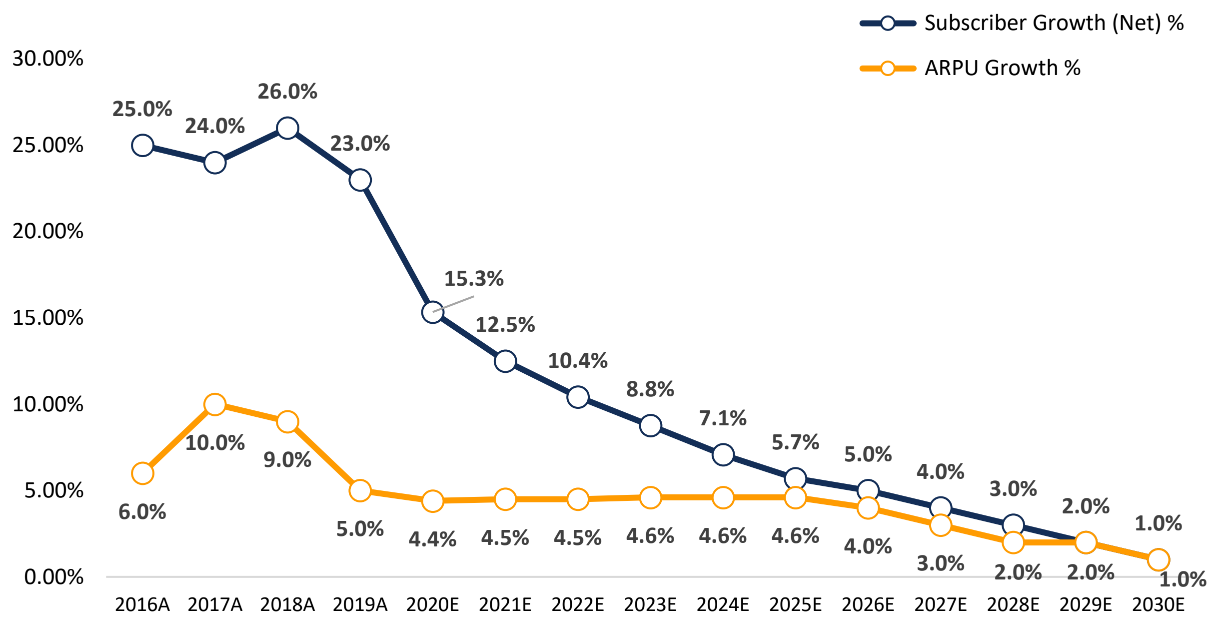
S.No.	Date	Target	Acquirer	Deal Value ($bn)	Implied EV ($bn)	EV/LTM Revenue	EV/LTM EBITDA	Rationale/Relevance to Netflix
1	13-08-2019	Viacom	CBS	11.70	19931	1.5x	6.6x	Target is engaged in the motion pictures and video services business.
2	31-07-2019	FUNimation Entertainment Ltd	Sony Pictures Television Inc	0.13095*	137.84*	7.1x	xx	Target is into content distribution and streaming.
3	20-03-2019	21st Century Fox	Disney	90.575	83203	2.8x	12.9x	Target is a traditional content and distribution company.
4	04-10-2018	Sky	Comcast	49.687	47566	2.7x	17.7x	Target is a traditional media company.
5	31-07-2017	Scripps	Discovery		11515	3.3x	7.2x	Target is traditional content & distribution company.
6	30-06-2016	Starz Inc.	Lionsgate		3815	2.3x	9.7x	Target produces and distributes modern content.
7	22-10-2016	Time Warner Inc.	AT&T Inc.	85	84036	2.9x	12.6x	Target is a full-service content and distribution company.
8	28-04-2016	DreamWorks Animation SKG Inc.	NBCUniversal Media, LLC	4.239	4147	4.4x	34.3x	Target is an animated content creator and television company.
9	28-09-2015	Media General	Nexstar Group, Inc.		3651	2.8x	11.0x	Target is a traditional programmer and distributor.
10	18-05-2014	DirecTV	AT&T Inc.		62979	2.0x	7.7x	Target is a traditional distribution company
11	31-03-2014	LIN Media	Media General		1487	2.1x	8.5x	Target is a traditional programmer and distributor.
12	13-06-2013	Belo Corp.	Gannett Co.		2170	3.0x	8.3x	Target is a traditional programmer and distributor.
13	12-02-2013	NBCUniversal Media	Comcast		39300	1.7x	9.2x	Target is traditional content company.
14	08-08-2012	Starz Inc.	Liberty Media		10830	6.6x	24.7x	Both target and acquirer are content and distribution companies.
15	27-06-2012	Twenty-First Century Fox	New News Corporation		51301	5.9x	57.7x	Target is into content production and distribution.
16	31-08-2009	Marvel Entertainment	Walt Disney		3709	5.2x	11.6x	Target is a original content producer and owner of franchises.

	EV/LTM Revenue	EV/LTM EBITDA
Average	3.5x	12.4x
Median	2.8x	12.9x
Min	1.5x	6.6x
Max	7.1x	17.7x

Source: CapitalIQ, Bloomberg, MergerMarkets, Google Finance
Note: AT&T's deal to acquire Time Warner Inc. was announced in 2016, but was delayed till 2018 (the Justice Department did an 18 month evaluation of the deal).
*: Converted to USD from GBP. xx: Data for the particular transaction not available

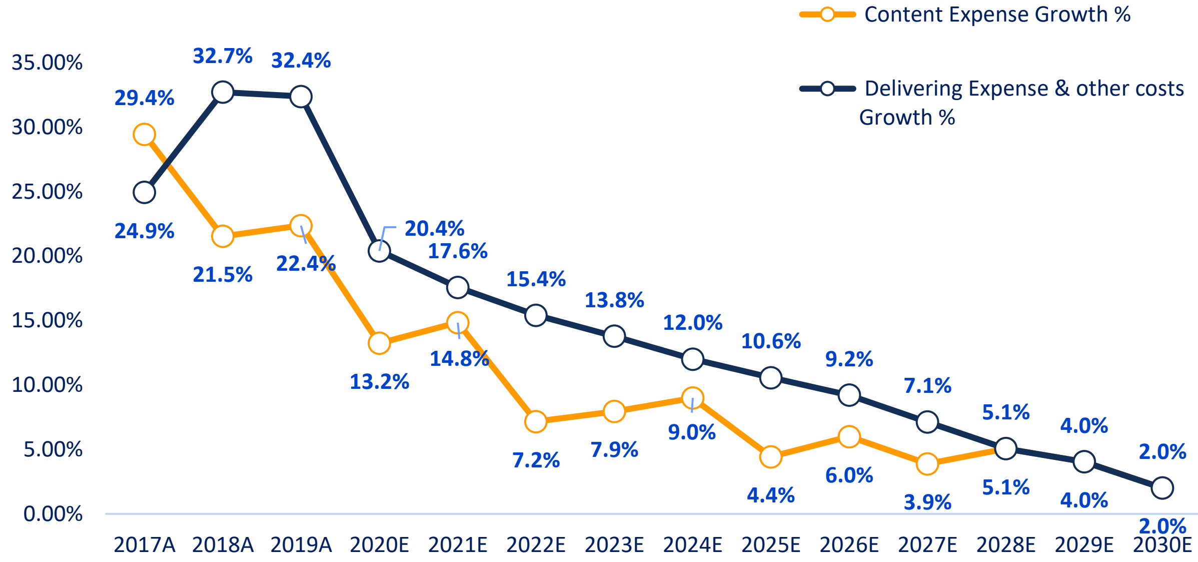
Financial Analysis

Revenue Drivers



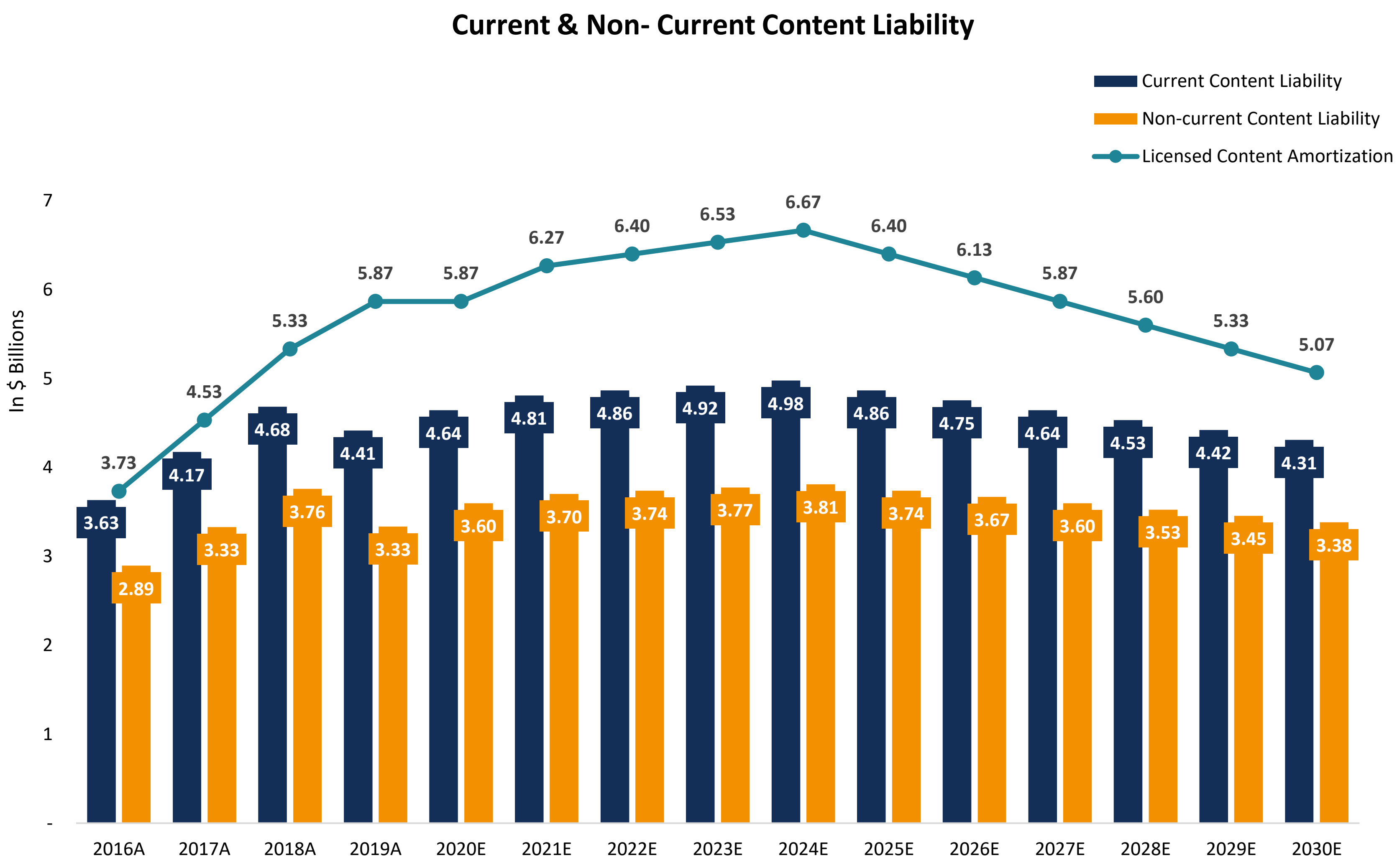
Range Of Values	Source of assumptions	Key Assumptions
1-15.33%	***Deutsche Bank** Estimates 2020-25*	*Assumed to be diminishing thereafter*

Cost Drivers



Range Of Values	Source of assumptions	Key Assumptions
2-20.40%	***Deutsche Bank** Estimates 2020-25*	*Assumed to be diminishing thereafter*

Financial Analysis



Current Content Liability	Non-Current Content Liability
Range Of Values	*Range Of Values*
$4.31-4.98 Bn	*$4.31-4.98 Bn*

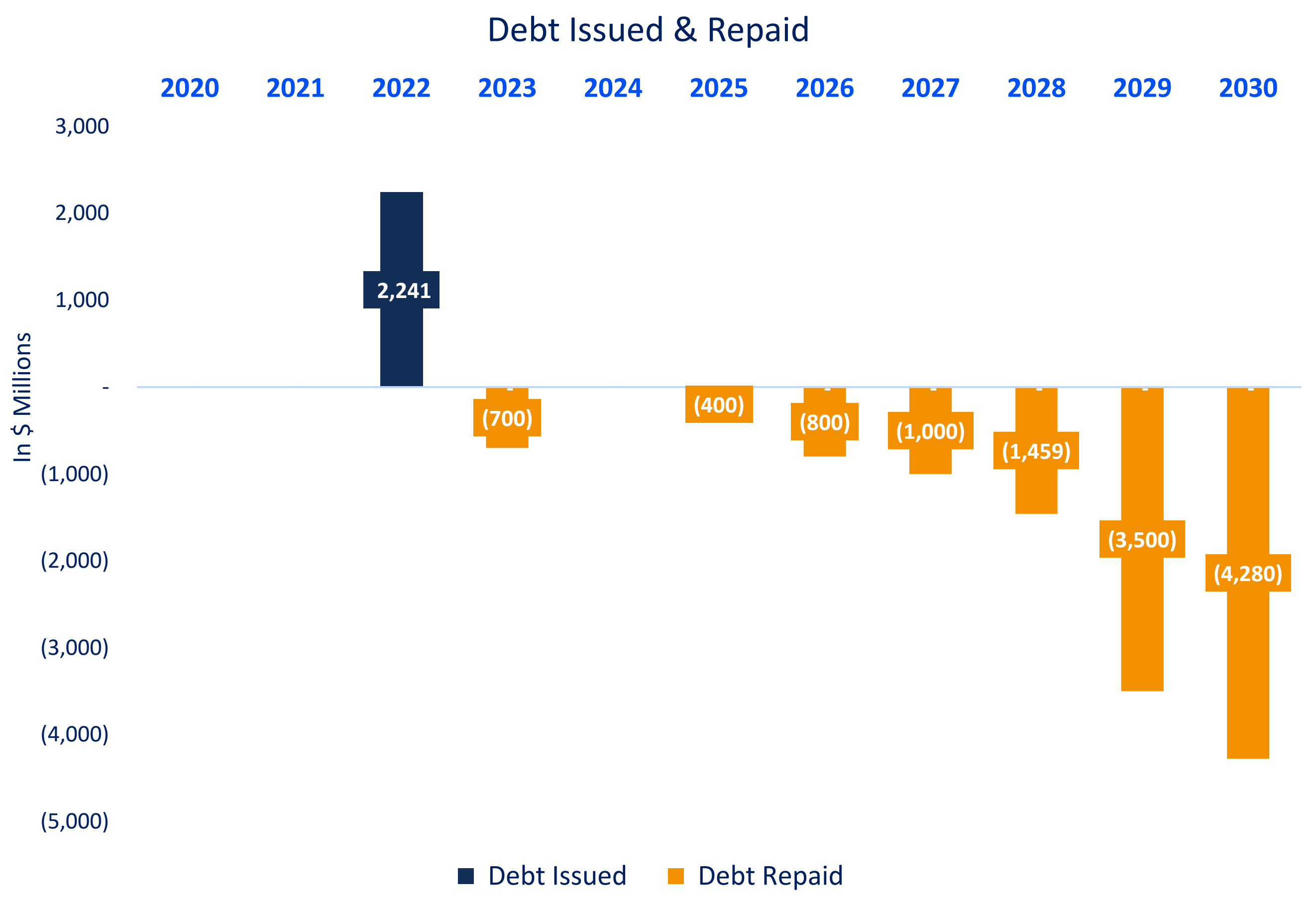
Source of assumptions

***Deutsche Bank** Estimates 2020-25*

Other Sources

Own Analysis

Financial Analysis

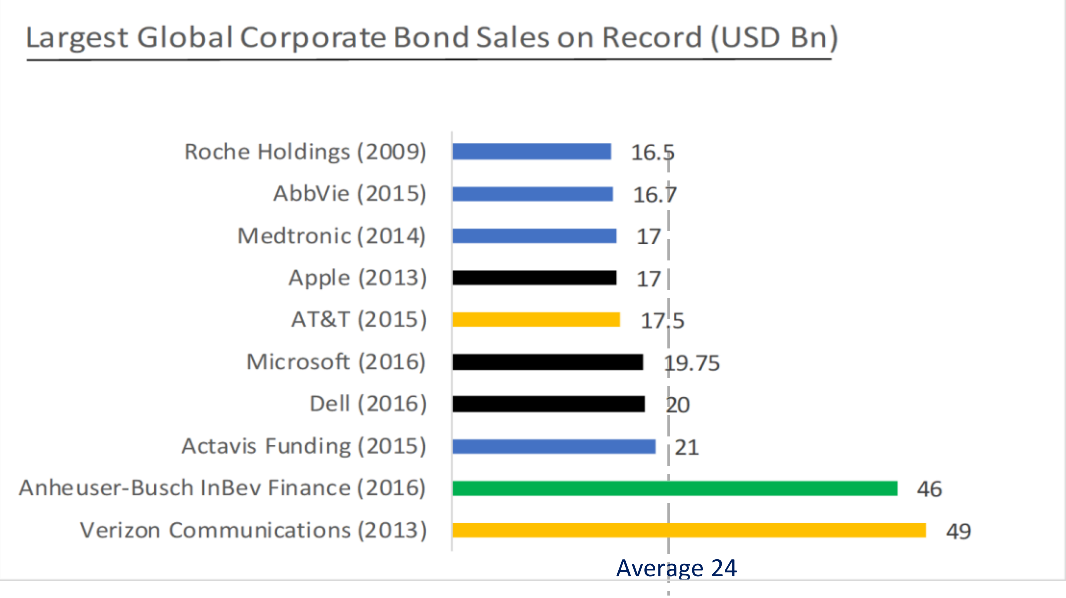


Assumptions

- Own analysis based on Consensus Estimates that suggest Cashflow from Operations to turn positive 2023 onwards.
- Netflix has a cash balance ~ $5 bn as against an all time high Cash deficit of $3.2 bn.
- Until 2023, Netflix will refinance it's debt due, the management guidance points towards the preference of debt finance.
- Due dates of issued Notes have been taken into consideration.

Acquisition Feasibility: Cash, Debt & Equity

Data about the biggest debt issuances in the USA



Amazon's liquidity

Statement Data	2019	2018	2017	2016	2015
Current Ratio	1.10	1.10	1.04	1.04	1.05
Quick Ratio	0.86	0.85	0.76	0.78	0.75

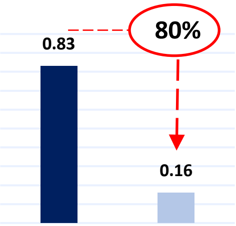
Amazon can't use its cash balance to fund the acquisition because:

- Amazon has to pay off its current liabilities as well, which are almost equal to the current assets.
- The quick ratio has been less than 1, i.e., the cash isn't sufficient to pay the current liabilities.

Hence, Amazon would have to fund the entire purchase price through debt.

Equity issuance

Amazon's current Debt to Equity ratio is 0.83. Issuing new equity results in a sharp decline in this ratio. .83 to .16
Since the company is already very unlevered, raising more equity will only dilute earnings.



This will result in a massive equity dilution for Amazon's shareholders, and a sharp fall in EPS as well.

Acquisition Feasibility: New Cost of Debt

Cost of Debt Computation:

Company	EBIT 2020e ('000s)	Interest 2020e ('000s)
Netflix	4,156,980	540,189
Amazon	18,398,366	1,405,441
Add: Additional interest expense for raising debt		5,958,318
Total	22,555,346	7,903,948

Based on the new EBIT and the new interest, we concluded the interest coverage ratio and determined the following metrics:

Ratio	Post Acquisition Value	Current Value
Interest Coverage Ratio	2.85	6.34
New credit rating	Baa2	A2
New default spread	1.56%	0.71%
Risk free rate	1.52%	1.52%
New cost of debt	3.08%	2.23%

Source: Aswath Damodaran

Process

We estimated the new cost of debt for Amazon post acquisition. The process is as follows:

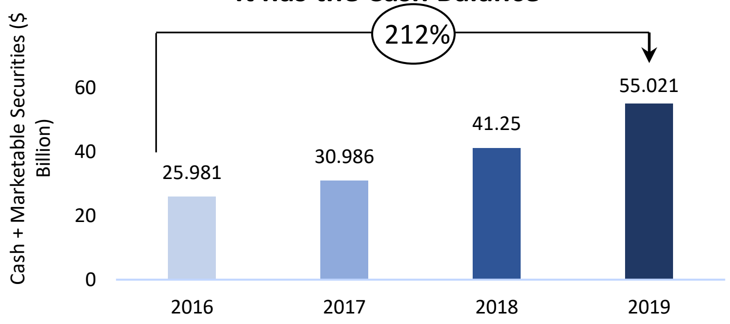
- The forecasted EBIT and Interest expenses of the combined entity were used to get a new Interest Coverage Ratio (ICR).
- The new ICR was used to develop a synthetic credit rating for the company, which came out to be Baa2.
- The new credit rating has a default spread of 1.56%, as compared to the earlier one of 0.71% for standalone Amazon.
- Adding this new default rate to the risk free rate, we get the new cost of debt as 3.08%, as compared to 2.23% pre acquisition.

Alternate Solution: Solving Amazon's Problems

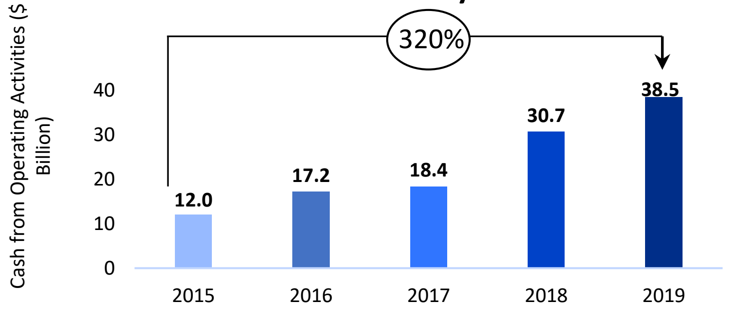
Content

Amazon can afford to out-spend the competition

It has the Cash Balance



And Generates a Healthy Cash Flow



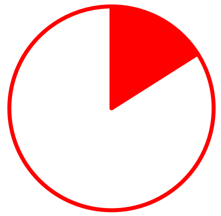
Source: SEC Filings

Big Data in Content Creation

Before producing House of Cards, Netflix examined millions of data points and made the following observations

- The British version of House of Cards was extremely popular, and most people watched the episodes all the way through
- People who watched the British version tended to watch more films directed by David Fincher, and also films starring Kevin Spacey

So, Netflix spend $100 million to produce two seasons starring Kevin Spacey, with David Fincher acting as director and executive producer



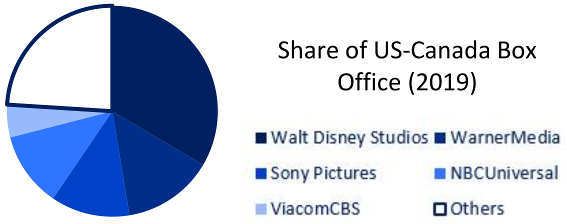
At peak popularity, 16% of US Netflix subscribers surveyed watched at least one episode of House of Cards on just a single particular date

Source: Insider Pro, Sandvine.com

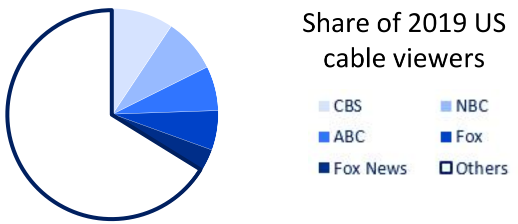
Media Companies Own the Content

Most content is produced by Movie and TV studios, but the rights to that content usually lie with a distributor or network

The Film Industry is Dominated by a Few Players



The Television Industry is More Segmented



Source: boxofficemojo.com, Nielsen Media Research

Fixing the Algorithm The Quick and Easy Way

- For a period of 3 years from 2006, Netflix ran an annual competition where teams competed to come up with an algorithm that could beat Netflix's own for a $1 million cash prize. None of the new solutions were actually used due to the cost of implementation, but teams from AT&T labs managed to beat Netflix's own algorithm by up to 10%.
- While Netflix's algorithm would developed significantly since then, the Netflix Prize example shows that effective algorithms can be developed at relatively low cost by 3rd parties. A company like DataRobot, which is a Boston-based AI company that specializes in providing machine learning solutions to solve enterprise level problems, may provide a fresh take on the algorithm and help Amazon catch up to Netflix in this regard

Appendix

Bibliography

Alternate Solution: Finding the Right Creator – Deeper Analysis

Company	Overview	Verdict
hulu	• A streaming service that is a direct competitor to Netflix and Prime Video • Smaller library than both, but hosts a few favorites such as Black-ish, Seinfeld, and most notably, The Handmaid's Tale. It is able to launch content much faster than most of its competitors, with many shows becoming available just 24 hours after their release on TV • Initially established as a joint venture between News Corporation and NBC Universal but is now fully controlled and majority-owned by The Walt Disney Group, who have been slowly integrating it into their other services by bundling it with Disney Plus and ESPN • Offers two main services, Hulu, which operates on a model similar to Netflix and Prime Video, and Hulu Plus Live TV, which also gives access to live feeds from over 50 cable broadcast channels	Hulu is used more as a way to stream content from Disney's vast media empire than as a content creator. Further, its valuable strategic position in Disney's portfolio makes an acquisition unrealistic. Overall, even if acquired, Hulu would not solve Amazon's problem
abc	• Owned by the Walt Disney company, ABC is one of the 'Big 3' television networks of the US alongside NBC and CBS • Has an impressive lineup of shows such as Grey's Anatomy, Modern Family, The Good Doctor, Shark Tank, and more • ABC's flagship shows such as Grey's Anatomy and Modern Family are already available on popular OTT platforms, and it is questionable whether their content library has the depth to actually win the streaming wars • Content sharing tie ups with Disney owned HULU, which indicates Disney's plans to use it produce OTT content for itself	In 2010, Disney was actually looking for a buyer for ABC, as it was not adding much value to Disney's portfolio, but Disney's domestic broadcasting division now brings in a sizeable chunk of their revenue, and they are unlikely to let a valuable assets like ABC be acquired cheaply. Even if ABC is acquired, their content library may be not be sufficient for Amazon's purposes
NBCUniversal	• Comcast-owned mass media conglomerate with multiple divisions, primarily the television network NBC and the Hollywood studio Universal Pictures, set to launch their own OTT service called Peacock in 2020 • NBC has a healthy lineup of TV shows, especially in the reality TV segment, with shows like The Voice, This is Us, Project Runway, Law and Order, etc., and Universal Studios boasts an impressive catalogue of movies. • NBC Universal may be too large a firm to be acquired in its entirety, and would include assets Amazon isn't really interested in, such as its theme park division, and so only certain divisions of NBCUniversal would have to be bought	NBCUniversal would not be willing to sell any one significant division of its business as it would leave the rest of the firm strategically compromised. Further, the company is wholly owned by the telecommunications conglomerate Comcast, and forms a valuable part of their portfolio, which greatly reduces the chances of a successful acquisition of any part of NBCUniversal
HBO	• Currently owned by WarnerMedia, which is owned by AT&T • Known for great original content like Game of Thrones, The Wire, and Westworld • WarnerMedia is currently under threat from OTT services, and HBO performs consistently on their catalogue. • AT&T has already invested over $1 billion into HBO Max, a streaming service set to launch in 2020, and management has said they intend to commit between $3.5 and $4 billion in investments into HBO Max over the next few years	As HBO and HBO Max are WarnerMedia's hedge against being totally replaced by services such as Prime Video, it is unlikely to sell to a major competitor like Amazon. The only viable route would be for Amazon to acquire WarnerMedia as a whole, which would be excessive and prohibitively expensive, and the ultimate ownership lying with AT&T may cause further problems

Continued

Appendix

Bibliography

Alternate Solution: Finding the Right Creator – Deeper Analysis

Continued

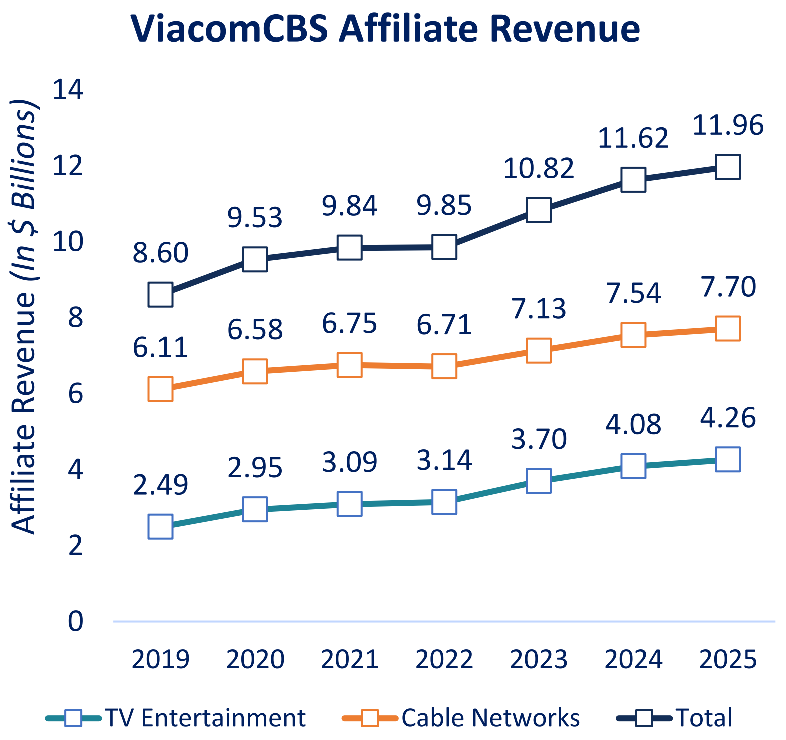
Company	Overview	Verdict
MGM	• Known for producing high quality films, it has also recently found success in co-producing TV shows such as the Apprentice, Are you smarter than a 5th grader, the Voice, etc.. MGM was the producer behind The Handmaid's Tale, which was a huge hit for Hulu • Has a few extremely valuable assets, most notably distribution rights to the James Bond Films. However, as MGM has traditionally relied on other companies to distribute their films, they actually own the rights to relatively few titles themselves • It faced bankruptcy in 2010 and is currently owned by former creditors, who are already rumored to have entered into talks with companies such as Netflix and Apple to sell MGM	MGM's track record of producing high quality content is excellent, and they would undoubtedly contribute to Amazon's library in the long run, however, Amazon may already be too far behind their competitors by then, and MGM brings very little in terms of pre-owned content assets that can immediately be used to bridge the gap
SONY PICTURES	• Ultimately owned by the Sony Corporation, it has two main divisions: Sony Pictures Motion Picture Group and Sony Pictures television • The Motion Picture Group owns multiple studios including Columbia Studios, and has more than 3500 titles as part of its library. It has produced some of the most commercially successful films and franchises in history, such as Spider Man, Men in Black, Jumanji etc. • The TV division has an equally impressive set of titles under its belt, including hit shows produced for Amazon and Netflix, however, as most of the networks owned by Sony are centered around Asia, the distribution rights to most of the shows do not lie with them • While Sony's entertainment business has often played second fiddle to their electronics business, Sony's newest CEO has categorically stated that they are not planning on exiting these businesses, and wish to expand them by integrating them with the PlayStation network	Acquiring Sony Pictures Entertainment would certainly add huge value to Amazon's film library, but would do little for their TV library. Moreover, senior management at Sony seem quite unwilling to sell the division
LIONSGATE	• Has television and interactive divisions, but is most well known for its film division • Content library and scale of operations is relatively limited, it was only the 7th largest studio in America by revenue in 2015, thus available at a cheaper valuation, currently trading at a market cap of around $1.2 billion • Has entered into an agreement with NBC through its subsidiary Starz, which will allow Starz productions to stream through NBC's Peacock service. This content may not be contractually available to stream through a rival OTT service, further limiting the library	While Lionsgate may seem like an attractive option due its relatively low price, the content that would come with it would not be a sufficient addition to Amazon's current library
VIACOMCBS	• Formed in December of last year by the merger of Viacom and CBS, both of whom are owned by National Amusement, in order to consolidate the business and be better equipped to fight the competition from tech giants entering the media sphere, including Amazon and Netflix • The combined entity has a huge asset base, including Paramount Pictures, CBS News, CBS Television Studios, Comedy Central, Nickelodeon, etc. • It would bring hundreds of successful TV shows and Movies to the Amazon content library, including rights to assets like Star Trek, Mission Impossible, CSI, The Late Show, and more. CBS also has the partial rights to many sporting events, including the NFL, WNBA, PGA Tour, etc. • Shari Redstone, the president of National Amusements, has been trying to merge CBS and Viacom for years now. In a complaint she filed against CBS executives in Delaware Chancery Court in 2018, it was clearly implied that her objective behind merging the two entities was to sell them together Since the merger has finally been successful, National Amusements might soon begin to look for a prospective buyer for ViacomCBS • ViacomCBS currently trades at a Market Cap of about $12.4 billion, but as most of the shares are owned by National Amusements, the actual price of the acquisition may be significantly different	ViacomCBS has the content library Amazon needs, and the prowess to continue to add to that library. The management also appears to be ready to sell in the long run. The timing of the acquisition is also not ideal, considering the company has just formed out of a difficult merger, but CBSViacom seems like Amazon's best bet of winning the streaming wars.

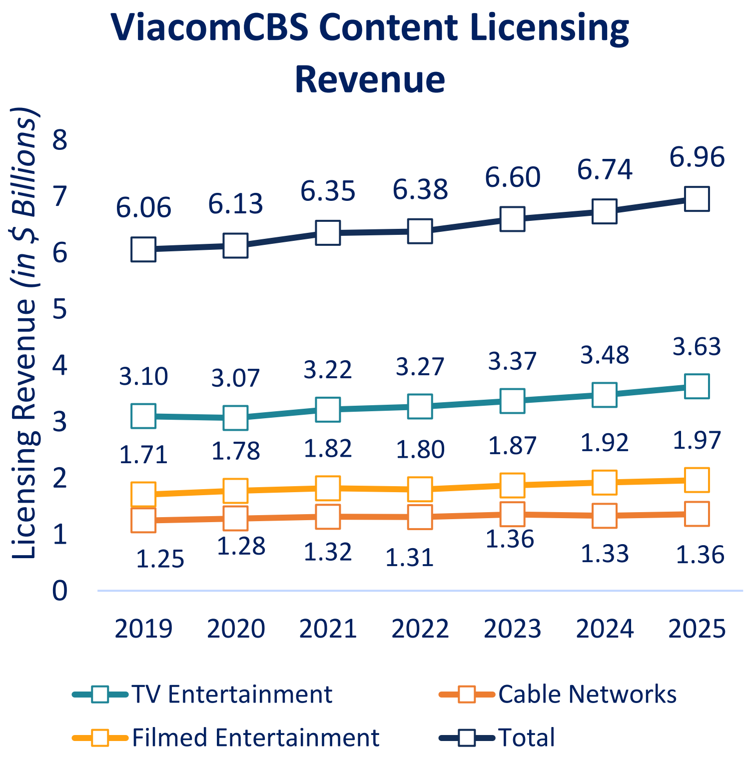
Appendix

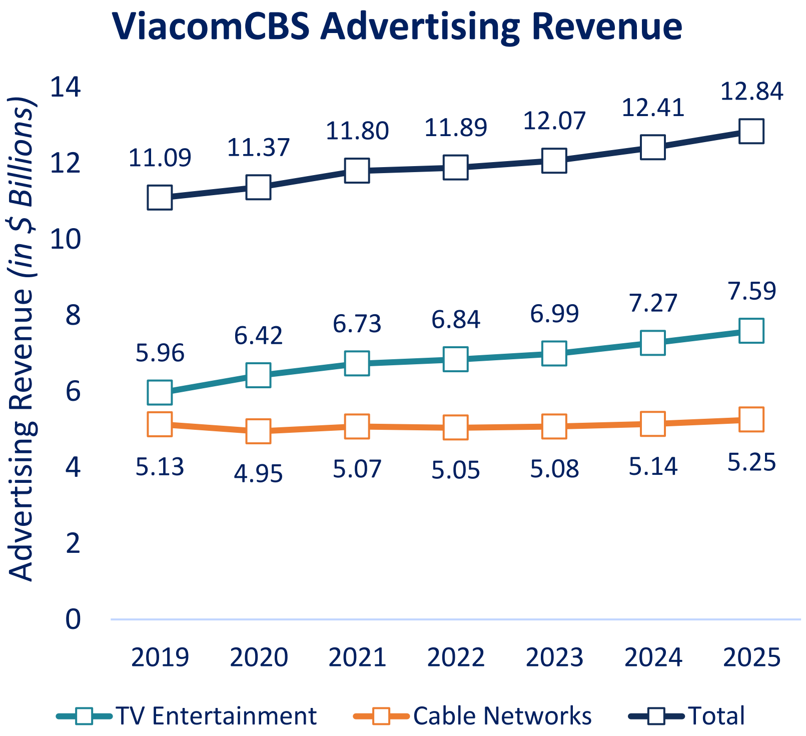
Bibliography

Alternative Solution: Post Acquisition Strategy – Financial Analysis

ViacomCBS Revenue Forecasts







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